Implementation of State Auditor's Recommendations

Audits Released in January 2002 Through December 2003

Special Report to

Senate Budget and Fiscal Review Subcommittee #4—Legislative, Executive, Judiciary, Transportation, and General Government

February 2004
Report No. 2004-406 S4

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CALIFORNIA STATE AUDITOR

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February 25, 2004 2004-406 S4

The Governor of California
Members of the Legislature
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

The Bureau of State Audits presents its special report for the Senate Budget and Fiscal Review Subcommittee No. 4—Legislative, Executive, Judiciary, Transportation, and General Government. This report summarizes the audits and investigations we issued during the previous two years that are within this subcommittee's purview. This report includes the major findings and recommendations, along with the corrective actions auditees reportedly have taken to implement our recommendations.

This information is also available in a special report that is organized by policy areas that generally correspond to the Assembly and Senate standing committees. This special policy area report includes appendices that summarize recommendations that warrant legislative consideration and monetary benefits that auditees could realize if they implemented our recommendations. This special policy area report is available on our Web site at www.bsa.ca.gov/bsa/reports/subcom2004-policy.html. Finally, we notify auditees of the release of these special reports.

Our audit efforts bring the greatest returns when the auditee acts upon our findings and recommendations. This report is one vehicle to ensure that the State's policy makers and managers are aware of the status of corrective action agencies and departments report they have taken. Further, we believe the State's budget process is a good opportunity for the Legislature to explore these issues and, to the extent necessary, reinforce the need for corrective action.

Respectfully Submitted,

Elaine M. Howle

ELAINE M. HOWLE
State Auditor

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INTRODUCTION

This report summarizes the major findings and recommendations from audit and investigative reports we issued from January 2002 through December 2003, that relate to agencies and departments under the purview of the Senate Budget and Fiscal Review Subcommittee No. 4—Legislative, Executive, Judiciary, Transportation, and General Governement. The purpose of this report is to identify what actions, if any, these auditees have taken in response to our findings and recommendations. We have placed this symbol ➲ in the left-hand margin of the auditee action to identify areas of concern or issues that we believe an auditee has not adequately addressed.

For this report, we have relied upon periodic written responses prepared by auditees to determine whether corrective action has been taken. The Bureau of State Audits' (bureau) policy requests that auditees provide a written response to the audit findings and recommendations before the audit report is initially issued publicly. As a follow-up, we request the auditee to respond at least three times subsequently: at 60 days, six months, and one year after the public release of the audit report. However, we may request an auditee provide a response beyond one year or initiate a follow-up audit if deemed necessary.

We report all instances of substantiated improper governmental activities resulting from our investigative activities to the cognizant state department for corrective action. These departments are required to report the status of their corrective actions every 30 days until all such actions are complete.

Unless otherwise noted, we have not performed any type of review or validation of the corrective actions reported by the auditees. All corrective actions noted in this report were based on responses received by our office as of February 2, 2004.

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STATE BAR OF CALIFORNIA

Although It Reasonably Sets and Manages Mandatory Fees, It Faces Potential Deficits in the Future and Needs to More Strictly Enforce Disciplinary Policies and Procedures

REPORT NUMBER 2002-030, APRIL 2003

The State Bar of California response as of October 2003

Audit Highlights . . .

The State Bar of California (State Bar) continues to make some improvements since our audit in 2001. For example, it:

- ☑ *Made further changes to reduce its backlog of disciplinary cases.*
- ☑ *Continued to ensure that mandatory fees are reasonable and do not support voluntary programs.*

However, the State Bar needs to do the following:

- ☑ *Ensure that policies and procedures for processing disciplinary cases are being followed.*
- ☑ *Monitor its need for an increase in membership fees to avoid a potential deficit in its general fund in the future.*

Chapter 342, Statutes of 1999, directed the State Bar of California (State Bar) to contract with the Bureau of State Audits to conduct a performance audit of the State Bar's operations from January 1, 2002, through December 31, 2002. We found that the State Bar continues to reduce its backlog of disciplinary cases that resulted from its virtual shutdown in 1998. Overall, the State Bar's efforts have significantly decreased the number of cases in its backlog from 1,340 at the end of 2000 to 401 at the end of 2002. In addition, the State Bar continues to ensure that dues for members are reasonable and are not used to support voluntary functions. However, deficiencies similar to those identified by the State Bar's staff in its 2000 internal random review of disciplinary cases continue to be an issue. Moreover, the State Bar's financial forecast indicates that if fees remain at its current level, the State Bar could face a deficit in its general fund at the end of 2005.

Finding #1: The State Bar has made significant progress in decreasing its backlog of disciplinary cases.

Since our 2001 audit, the State Bar has continued its efforts to decrease its backlog of disciplinary cases. For example, it created a backlog team in its enforcement unit. The backlog team, composed generally of the most experienced investigators, focused exclusively on the backlog cases. The overall goal for 2002 was to have a backlog of no more than 400 cases. The State Bar's efforts significantly decreased the number of cases in its backlog from 1,340 at the end of 2000 to 401 at the end of 2002. According to a backlog reduction report prepared by its staff, the State Bar is currently focusing on not allowing the backlog to increase beyond 400 in 2003. Further, it maintains an "aspirational goal" of reducing the backlog to 250 by the end of

2003, but the report stated that the State Bar's ability to achieve that goal has been negatively impacted by budget constraints and other external factors.

We recommended that the State Bar continue its efforts to reduce its current backlog.

State Bar Action: Partial corrective action taken.

The State Bar reported that it is continuing its efforts to reduce the backlog. In June 2003, it reported that the backlog had risen to 756. However, as of October 2003 the State Bar reduced it to 566 cases. The State Bar stated it maintains its goal of bringing the backlog back down to 400 by the end of 2003.

Finding #2: The State Bar needs to strictly enforce its policies and procedures when processing complaints.

The State Bar's internal random review process indicates that staff do not always follow policies and procedures when processing complaints. Specifically, in 2002, the State Bar identified some of the same type of deficiencies as reported in its random review in 2000. Its two reviews in 2002 identified staff's failure to enter information into the computer database, poor record keeping and file maintenance, and not sending closing letters to complainants or respondents. Because State Bar staff did not always provide proper record keeping and file maintenance, the reviewers sometimes found it difficult to determine if a case had been appropriately handled. However, the reviewers found that the areas of concern were not generally significant enough to have an adverse effect on the overall disposition of a case. To address some of these issues, the State Bar conducted group and individual training, and it issued a training bulletin to remind staff of the policies and procedures.

We recommended that the State Bar require that each file contain a checklist of important steps in the process and potential documents to ensure that employees follow policies and procedures for processing cases. Each applicable item should be checked off as it is performed or received. An employee's supervisor should be responsible for reviewing the checklists to ensure their use. In addition, the State Bar should conduct spot checks of current cases that are being closed. Responsible staff should be required to resolve any issues concerning files determined to be noncompliant.

State Bar Action: Partial corrective action taken.

The State Bar reported that it has implemented the use of checklists to ensure important steps are taken and necessary documents are contained in the files. It also has begun implementation of a computer verification system. This system does not allow a matter to be closed or forwarded unless the file is properly updated. In addition, the State Bar reported that it has postponed until November 2003 the implementation of having supervising attorneys in the Office of the Chief Trial Counsel spot-check closures every month to verify that files include closing letters and detailed closing memos. Instead, the State Bar performed a one-time, large-scale audit of cases closed in 2002. A full analysis of the results was to have been completed by the end of October 2003.

Finding #3: Cost recoveries for the State Bar's client security fund and disciplinary activities continue to be low.

Since our 2001 audit, the State Bar's cost recovery rates improved slightly, although the rates remain low. Specifically, the Client Security Fund cost recovery rates increased from 2.5 percent in 2000 to 10.9 percent in 2002. A similar increase occurred in the cost recovery rates from the disciplinary process. In 2002, these amounts increased from 28.8 percent to 36.4 percent. Because cost recoveries are still low, the State Bar used more of its membership fees to subsidize support for its Client Security Fund and disciplinary process than it might otherwise need to.

The State Bar believes that other recovery methods, such as the State's offset program, may not be feasible. One cost recovery method that may be available is the collection of money debts under the California Enforcement of Judgments Law. However, according to the executive director, the State Bar's position is that state statutes explicitly define the specific circumstances and methods by which it is to impose and collect its disciplinary costs, and thus the Legislature has implicitly excluded other methods more generally provided in the law.

When our audit report was issued in April 2003, the executive director told us that the State Bar was seeking a legislative amendment, similar to statutory language applicable to costs imposed in disciplinary proceedings of the Department of Consumer Affairs, to help it strengthen its collection enforcement authority. Because existing state law does not

explicitly state that the State Bar can use the methods provided in the Enforcement of Judgments Law, the State Bar believes it needs statutory language that states it can do so. This language would provide the State Bar independent authority to pursue legal action for these costs.

We recommended that the State Bar pursue a legislative amendment that would help it strengthen its enforcement authority over collections related to client security and disciplinary costs.

State Bar and Legislative Action: Corrective action taken.

The State Bar reported that on September 6, 2003, the governor approved Assembly Bill 1708 (AB 1708). Effective January 1, 2004, sections 6086.10(a) and 6140.5(d) of the Business and Professions Code will provide that court orders, which impose disciplinary costs or require the reimbursement of the Client Security Fund by attorneys who have been suspended, disbarred, or the subject of a public reproval, will be enforceable as a money judgment. The remedy will apply retroactively to all court orders imposing disciplinary costs or Client Security Fund reimbursements. The State Bar reported that these changes would permit it to obtain writs and abstracts of judgments and seek orders of examinations in the superior courts. In addition, the recording of abstract judgments would then typically be reflected in the reports of credit agencies. Further, the State Bar reported that it created a working group of staff to establish the processes and procedures necessary to implement these new statutes on the effective date of January 1, 2004.

Finding #4: Although it continues to ensure that mandatory fees are reasonable and do not support voluntary programs, the State Bar faces potential deficits in the future.

For the year 2002, the State Bar's financial records for the general fund indicate that it charged a reasonable level of fees. The general fund's revenues of $46.4 million exceeded its expenses by $2.5 million. However, because the board of governors approved transfers to other funds of $5.9 million, its general fund balance declined from $6.6 million in 2001 to $3.3 million in 2002. A financial forecast prepared by the State Bar predicts that in 2003 through 2007, if membership fees remain at $390 a year, general fund expenses will exceed its revenues. Although the State Bar's general fund balance is

expected to decrease as a result of its expenses increasing faster than its revenues, a deficit is not expected to occur until the end of 2005 because of the newly created Public Protection Reserve Fund. As of January 1, 2001, the State Bar established this fund to provide a hedge against the unexpected and to assure continuity of its disciplinary system and other essential public protection programs. However, if State Bar expenses continue to exceed its revenues, a deficit in the combined available balance for the general fund and Public Protection Reserve Fund is anticipated by the end of 2005 that will continue to grow through 2007.

We recommended that the State Bar continue to monitor for the necessity of a fee increase to ensure that mandatory fees are set at a reasonable level to meet its operational needs.

State Bar Action: Partial corrective action taken.

In June 2003, the State Bar reported that because of the State's current fiscal situation it was seeking a one-year fee bill that would maintain mandatory dues at $390 for the 2004 billing year. The State Bar expected to rely on existing reserves to balance the general fund budget for 2004 and anticipated proposing a multi-year fee bill with a tiered fee increase that would support ongoing operations without relying on reserves. In October 2003, the State Bar reported that the 2004 general fund budget was balanced by transferring the revenue allocated to the Lawyer Assistance Program back to the general fund; enhancing member revenue by restricting eligibility for reduced fees for certain categories of members (member fee scaling); eliminating the general fund contribution to the Public Protection Reserve Fund; eliminating 16 positions; and reducing proposed non-personnel expenditures. The State Bar also reported that AB 1708 was signed in September 2003, authorizing it to collect up to $390 per member in annual membership fees for 2004. This authorization maintains the same fee level in effect since 2001. AB 1708 also amends existing statute to restrict eligibility for member fee scaling and allows the State Bar to enforce the collection of disciplinary costs incurred in the general fund and reimbursements to the Client Security Fund as money judgments to be included in an individual's membership fee. The State Bar is hopeful this legislation will provide additional funding and ease pressure to increase member fees. Finally, the State Bar reported that it would continue to review its operations for improvements in efficiency, with staff reductions, as appropriate.

DISABLED VETERAN BUSINESS ENTERPRISE PROGRAM

Few Departments That Award Contracts Have Met the Potentially Unreasonable Participation Goal, and Weak Implementation of the Program Further Hampers Success

Audit Highlights . . .

Our review of the Disabled Veteran Business Enterprise (DVBE) program found that:

- ☑ *Many awarding departments do not report their DVBE participation levels; of those that do report, most do not meet the 3 percent participation goal.*
- ☑ *The reasonableness of the 3 percent goal itself is not clear.*
- ☑ *Outreach to potential DVBEs should be more aggressive.*

Other factors that contribute to the State's failure to meet the DVBE goal are:

- ☑ *The program's overly flexible legal structure and limited clarifying regulations.*
- ☑ *The frequency with which certain departments exercise their discretion to exempt contracts from DVBE participation.*
- ☑ *Lack of effective evaluation of bidders' good-faith efforts and monitoring of contractors' compliance with contract DVBE requirements.*

REPORT NUMBER 2001-127, JULY 2002

Audit responses as of July 2003 and October 2003[1]

The Joint Legislative Audit Committee requested that we determine the extent to which departments that award contracts (awarding departments) are meeting the 3 percent Disabled Veteran Business Enterprise Program (DVBE) participation goal and to identify statutory and procedural mechanisms that could assist in overcoming any barriers to fulfilling this goal. We found that many awarding departments do not report DVBE participation as required under law, and even fewer departments actually meet the goal. Specifically, we found:

Finding #1: Awarding departments' DVBE participation statistics are not always accurate, and the methodologies they employ are at times flawed.

State law requires each awarding department to report to the governor, Legislature, the Department of General Services (General Services), and the Department of Veterans Affairs (Veterans Affairs) by January 1 each year on the level of participation by DVBEs in state contracting. General Services then issues a summary report.

Our own review showed that some awarding departments did not report DVBE statistics and others could not always provide supporting documentation for the DVBE statistics they reported. For example, for fiscal year 2000–01, the Department

[1] Business, Transportation and Housing; State and Consumer Services; and Youth and Adult Correctional agencies and Departments of General Services, Transportation, and Veterans Affairs responses as of July 2003. Departments of Fish and Game and Health Services and Health and Human Services Agency responses as of October 2003.

of Fish and Game (Fish and Game) reported $12.1 million in DVBE participation but could identify only $431,000 in specific contracts, or less than 3.6 percent of the total. In addition, the Department of Health Services (Health Services) could not provide any summarized documentation for the numbers it reported. Health Services asserted that it had documentation in individual contract files to support its figures, but indicated it would be too time intensive to tally the information for our review.

Additional problems with the accuracy of DVBE participation information exist. The reporting methodology General Services established is contrary to statutory requirements. According to statute, the 3 percent DVBE participation goal applies to the overall dollar amount expended each year by the awarding department. However, under current reporting regulations issued by General Services, awarding departments must report the amount winning bidders "claim" they will pay to DVBEs under the contract. In its clarifying instructions, General Services has asked awarding departments to report the amounts "awarded" in contracts, rather than amounts actually paid to DVBEs.

To ensure DVBE statistics are accurate and meaningful, we recommended General Services require awarding departments to report actual participation and maintain appropriate documentation of statistics, continue its periodic audits of these figures for accuracy, and, if the audits reveal a pattern of inconsistencies or inaccuracies, address the causes in its reporting instructions.

General Services' Action: Partial corrective action taken.

General Services has interpreted the statutes governing DVBE reporting to provide participation statistics to be reported based on the value of contracts awarded instead of dollars actually expended. According to General Services, this is the same methodology used in the small business participation report (California Government Code, Section 14840). General Services believes it is important to use consistent reporting standards to allow for program comparisons. Since its six-month response, based on the concerns raised by our office, General Services has revisited the issue and concluded that its own interpretation of the DVBE reporting requirements is reasonable and appropriate. We disagree with General Services' interpretation of the DVBE reporting requirements. As we state on page 18 of the audit report, departmental reporting of actual payments [to DVBEs] provides more useful information because it focuses on the realized benefit to DVBEs.

As to the issue of requiring departments to maintain documentation of participation statistics, to reemphasize this administrative control procedure, General Services indicates it has added an instruction to the new participation report form that addresses the necessity of maintaining supporting documentation. Departments used this new form in reporting fiscal year 2001–02 cumulative participation statistics. General Services is also continuing to include the audit of the DVBE reporting process within its comprehensive external compliance audit program performed of other state agencies. It indicates it uses the results of these audits to identify areas for possible improvement within the reporting process.

Finding #2: Not all state agencies have finalized and implemented their plans to monitor their departments' reporting of DVBE statistics and, for those failing to meet the 3 percent goal, require a DVBE improvement plan.

In June 2001, the governor issued executive order D-43-01, which requires all state agency secretaries to review the DVBE participation levels achieved by the awarding departments within their agencies. Further, the executive order requires each secretary to require awarding departments to develop an improvement plan if the 3 percent goal is not achieved or the data is not reported. Three of five state agencies responding to our survey indicated that they were still developing procedures to monitor the DVBE participation levels of their subordinate awarding departments.

We recommended those state agencies that have not already done so should finalize and implement their plans to monitor awarding departments' reporting of DVBE statistics and, for those failing to meet the 3 percent goal, monitor their efforts to improve DVBE participation.

Agency Action: Partial corrective action taken.

On June 28, 2002, the governor directed that all state departments and agencies submit monthly reports to the State and Consumer Services Agency regarding DVBE participation. Based on the reporting forms developed by the State and Consumer Services Agency, state departments and agencies are required to report total contracting dollars,

dollars paid to DVBEs, and DVBE participation percentages. In addition, departments that have not met the 3 percent DVBE participation goal are required to explain why.

Each of the following state agencies indicates the development of plans to monitor awarding departments' reporting of DVBE statistics: State and Consumer Services Agency; Business, Transportation and Housing Agency; Health and Human Services Agency; and the Youth and Adult Correctional Agency. The Resources Agency did not provide a one-year update on its efforts to implement this recommendation. Some agencies reported increases in DVBE participation during the fiscal year 2001–02. In particular, the State and Consumer Services Agency reported a DVBE participation rate of 3.3 percent in 2002, which is an increase from 1.5 percent in the prior year. Further, the Business, Transportation and Housing Agency similarly reported an increase in DVBE participation, indicating 3.7 percent participation during the fiscal year 2001–02.

Finding #3: The State does not know how many DVBEs can be certified and the extent to which they can provide needed goods and services to the State. As a result, the reasonableness of the 3 percent goal is uncertain.

Even though the law establishes a 3 percent participation goal for every awarding department, our review did not find sufficient evidence to support the assumption that this is an equitable share of contracts for DVBEs. When the DVBE legislation was being drafted in 1989, several awarding departments opposed the bill on the grounds that the 3 percent goal was unrealistic.

The awarding departments' concern about enough DVBEs to justify the 3 percent goal seems to have been valid. As of May 2002, General Services had only 797 DVBEs certified and available for contracting. The services these DVBEs offered and their geographical distribution did not always match the State's needs. All five agencies responding to our survey and many awarding departments' improvement plans identified a limited pool of DVBEs as one of the impediments to meeting the 3 percent DVBE participation goal.

To determine if the 3 percent DVBE goal is reasonable, the Legislature may wish to consider requiring either General Services or Veterans Affairs to commission a study on the

potential number of DVBE-eligible firms in the State, the services they provide, and their geographic distribution, and compare this information to the State's contracting needs.

Based on the results of this study, the Legislature may wish to consider doing the following:

- Modify the current DVBE participation goal.
- Allow General Services to negotiate department-specific goals based on individual contracting needs and the ability of the current or potential DVBE pool to satisfy those needs.

Legislative Action: None.

We have found no indication that any study on DVBE-eligible firms has been commissioned. Further, the statutory requirement for the DVBE participation rate remains at 3 percent, while the reasonableness of this goal remains unclear.

Veterans Affairs' Action: None.

According to Veterans Affairs' September 2002 response to this recommendation, it appears that the department was intending to commission a study on the number of potentially DVBE-eligible firms in the State. However, the department's July 2003 update does not specifically address this recommendation.

Finding #4: General Services is not sufficiently aggressive or focused in its outreach and promotional efforts for the DVBE program.

As the administering agency for the DVBE program, General Services has been responsible for certifying eligible businesses as DVBEs and conducting promotional and outreach efforts to increase the number of certified DVBE firms.

It is unclear to what extent General Services' outreach activities target disabled veterans' groups. General Services was also unable to readily quantify its outreach activities. The information it ultimately provided was based on old personal calendars and planners. We also could not evaluate the effectiveness of these outreach activities since General Services only selectively monitors the results.

To ensure the DVBE program is promoted to the fullest extent possible, we recommended General Services aggressively explore outreach opportunities with the U.S. Department of Veterans Affairs and organizations such as the American Legion, Disabled American Veterans, and Veterans of Foreign Wars. In particular, General Services should cultivate a clear working relationship with county veteran service officers. It should also maintain complete records of its outreach and set up a system to track effectiveness. For example, General Services could consistently survey newly certified DVBEs to determine how they heard about the program and what convinced them to apply for certification. Finally, General Services and Veterans Affairs should continue to work to develop their joint plan for improving the DVBE program, finalizing and implementing it as soon as possible.

General Services' and Veterans Affairs' Action: Partial corrective action taken.

On June 28, 2002, the governor directed the implementation of a more intensive DVBE outreach effort, with the staff dedicated to that effort moved from General Services to Veterans Affairs. According to General Services, on August 1, 2002, the two DGS staff members performing the outreach function physically transferred to Veterans Affairs.

According to the July 2003 response from Veterans Affairs, it has completed the CDVA Disabled Veterans Business Enterprise Outreach Program Plan, which became effective April 1, 2003. The plan indicates that Veterans Affairs will introduce General Services "outreach team members" to veteran organizations' leadership and local county veteran services officers. However, Veterans Affairs also indicated that in May 2003, the two employees working on DVBE outreach, formerly from General Services, returned to that department. The plan also indicates that Veterans Affairs will establish working relationships with veteran service representatives and local county veteran service organizations.

Finding #5: Some awarding departments exempt a significant number of contracts, potentially limiting their ability to maximize DVBE participation rates.

Under statute, the DVBE participation goal applies to an awarding departments' overall expenditures in a given year. Therefore, awarding departments have the discretion to apply DVBE participation requirements on a contract-by-contract basis.

The frequency with which certain awarding departments exempt contracts from DVBE requirements is significant. Further, some of these awarding departments are not tracking the value of the contracts they exempt or the required compensating increase in participation goals for their remaining non-exempt contracts. For fiscal year 2000–01, two of the five awarding departments we reviewed, Health Services and Caltrans, did not compensate for these exemptions with increased participation on other contracts, and subsequently reported they did not meet the participation goal. According to our calculations, Health Services exempted 48 percent of DVBE-eligible contract dollars it reported in fiscal year 2000–01, which means it would have had to average almost 6 percent on all remaining eligible contracts to meet the goal. Similarly, General Services' procurement division estimated that it exempted over 50 percent of its contracts during fiscal year 2000–01.

Awarding departments offer varying reasons for their exemption decisions. Some departments we reviewed exempt all contracts with certain characteristics, and the reasonableness of these blanket decisions may not be clear. For example, at least one unit within four of the five departments we reviewed has indicated it exempts all contracts it believes do not offer a subcontracting opportunity for DVBEs. However, this practice may significantly reduce a department's chances for obtaining more DVBE participation.

To maximize DVBE participation, we recommended awarding departments attempt to use DVBEs as prime contractors instead of viewing them only as subcontractors. Further, the awarding departments should periodically examine the basis for their assumptions behind blanket exemptions for whole categories of contracts to ensure the exemptions are justified.

General Services', Caltrans', Health Services', and Fish and Game's Action: Partial corrective action taken.

General Services indicates it has policies and practices that actively encourage the use of DVBEs as prime contractors. Further, General Services has asserted that its chief deputy director stressed to General Services staff that all contracts include DVBE participation unless specifically exempted. Caltrans indicates that its DVBE exemption requests are researched to verify that no certified DVBEs are available in the particular geographic area specified to perform the work. Caltrans also indicates that it mails DVBE solicitation

materials to contractors who are on a special list of DVBEs and who provide services in the geographical area. Health Services similarly reported that it now reviews each DVBE exemption request by requiring its programs to explain why DVBE participation is not viable or possible. Health Services also requires that General Services' Web site be verified to ensure no DVBEs are available to perform likely subcontract services in the service location. Fish and Game asserts it does not have a blanket exemption by category type. However, it indicates that it does exempt contracts under $10,000 from DVBE participation requirements. Fish and Game has determined that requiring bidders to undergo a good-faith effort to find and use a DVBE under these circumstances is not cost-effective. Fish and Game also indicates that if the lowest bidder on a contract is a DVBE, it awards the contract to the DVBE acting as a prime contractor.

Finding #6: Awarding departments do not consistently scrutinize and evaluate good-faith effort documentation or ensure that DVBEs are actually being used as called for in contracts.

The effectiveness of the implementation of the good-faith effort may be diminished by the lack of consistent or meaningful standards for awarding departments to follow when evaluating bidders' documentation of such efforts. Although statute requires General Services to adopt standards, it has not issued much direction to awarding departments on how to evaluate a bidder's good-faith effort. The State Contracting Manual offers appropriate suggestions for procedures in assessing good-faith effort, but the suggestions are not binding. There is also no clear requirement in statute requiring awarding departments to monitor actual DVBE participation to ensure the contractor is complying with the contract's DVBE requirements.

A common result of this lack of direction is the cursory evaluation of a bidder's good-faith effort documentation and inconsistent monitoring of actual DVBE usage. For example, Health Services does not instruct staff to independently verify bidders' statements that they solicited DVBEs to participate as subcontractors. Before February 2002, Health Services also lacked policy to monitor actual DVBE participation. Caltrans also does not follow up to ensure the DVBEs that the bidder claimed to have solicited were actually contacted. Although

Caltrans' procurement unit did have a policy to monitor actual DVBE participation to ensure contract compliance, we saw no monitoring consistent with this policy in a sample of their contract files.

To ensure that prime contractors make a genuine good-faith effort to find a DVBE, we recommended the Legislature consider requiring awarding departments to follow General Services' policies. General Services should issue regulations on what documentation the awarding departments should require and how they should evaluate that documentation. These standards should include steps that ensure the documentation submitted is accurate. Similarly, General Services should issue regulations on what steps departments should take to ensure contractors meet DVBE program requirements. These steps might include requiring awarding departments to monitor vendor invoices that detail DVBE participation or requiring the vendor and DVBE to submit a joint DVBE utilization report.

Legislative Action: None.

We found no indication that the Legislature has required awarding departments to follow General Services' policies regarding the evaluation of bidders' good-faith effort documentation.

General Services' Action: Partial corrective action taken.

Effective April 1, 2003, the procurement division of General Services revised its solicitation instructions and forms to require bidders to provide additional information and documentation on their compliance with DVBE program requirements. These new bidder instructions are available on General Services' Web site and are available for use by other state agencies. Further, General Services states that it has begun the process of reviewing DVBE program regulations to identify areas of improvement.

Finding #7: The efficiency and effectiveness of the DVBE program could be improved with legislation aimed at providing incentives for DVBE participation and penalties for bidders who do not comply with program requirements.

Legislation establishing the DVBE program does not have adequate provisions to ensure compliance with program goals.

To increase the efficiency and effectiveness of the DVBE program, we recommended the Legislature consider doing the following:

- Replace the current good-faith effort step requiring bidders to contact the federal government with a step directing bidders to contact General Services for a list of certified DVBEs.
- Enact a contracting preference for DVBEs similar to the one for the small business program—that is, allow an artificial downward adjustment to the bids from contractors that plan to use a DVBE to make the bids more competitive.
- Require awarding departments to go through their own good-faith effort in seeking DVBE contractors.
- Provide awarding departments with the authority to withhold a portion of the payments due to contractors when they fail to use DVBEs to the extent specified in their contracts.

➲ ***Legislative Action: None.***

We found no indication that the Legislature has passed legislation addressing the recommendations presented above.

SCHOOL BUS SAFETY II

State Law Intended to Make School Bus Transportation Safer Is Costing More Than Expected

REPORT NUMBER 2001-120, MARCH 2002

The Commission on State Mandates response, State Controller's Office response, and most school district responses as of March 2003[1]

Audit Highlights . . .

Our review of the School Bus Safety II mandate found that:

- ☑ *The costs for the mandate are substantially higher than what was initially expected.*
- ☑ *The costs claimed by seven school districts varied significantly depending upon the approach taken by their consultants.*
- ☑ *The different approaches appear to result from the lack of clarity in the guidelines adopted by the Commission on State Mandates (commission).*
- ☑ *Most of the school districts we reviewed lacked sufficient support for the amounts they claimed.*
- ☑ *The commission could have avoided delays totaling more than 14 months when determining whether a state mandate existed and in developing a cost estimate.*

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits examine the claims under the School Bus Safety II mandate. Specifically, we were asked to review the Commission on State Mandates' (commission) guidelines to determine if they adequately define the mandate's reimbursable activities and provide sufficient guidance for claiming reimbursable costs. In addition to examining any prior reviews of the claims, we were asked to examine a sample of claims to determine if the costs met the criteria for reimbursement. Finally, the audit committee asked us to evaluate the commission's methodology for estimating the future costs of this mandate.

Finding #1: The commission's guidance regarding claims reimbursement lacks clarity.

The guidance issued by the commission does not provide sufficient clarity to ensure that school districts claim reimbursement for mandated activities in an accurate and consistent manner. Instead, the guidance established a broad standard that has allowed a variety of interpretations by school districts as to what costs to claim. The lack of clarity in the guidance appears to be the result of several factors, including the broad language in the statutes from which the guidelines were developed. In addition, the test claim process does not require the claimant to be specific when identifying activities to be reimbursed. Further, the commission's executive director states that the commission, as a quasi-judicial body, is limited in making changes to the guidelines. Finally,

[1] School districts responding to the audit were Ceres Unified School District, Dinuba Unified School District, Elk Grove Unified School District (Elk Grove), Fresno Unified School District, and San Dieguito Union High School District. Elk Grove's response was as of October 2002.

the fact that the school districts' interests appear to have been better represented in the process than the State's also may have contributed to the ambiguity on this issue.

We recommended the Legislature amend the parameters and guidelines through legislation to more clearly define activities that are reimbursable and to ensure that those activities reflect what the Legislature intended. The guidelines should clearly delineate between activities that are required under prior law and those that are required under the mandate. To ensure that the State's interests are fully represented in the future, we recommended the commission ensure that all relevant state departments and legislative fiscal committees be provided with the opportunity to provide input on test claims and parameters and guidelines. Further, we recommended the commission follow up with entities that have indicated they would comment, but did not. Finally, we recommended that the commission notify all relevant parties, including legislative fiscal committees, of the decisions made at critical points in the process, such as the test claim statement of decision, the adoption of the parameters and guidelines, and the adoption of the statewide cost estimate.

Legislative Action: Legislation passed.

On September 30, 2002, the governor approved Assembly Bill 2781 (Chapter 1167, Statutes of 2002). This new law requires the commission to specify that costs associated with implementation of transportation plans are not reimbursable claims and requires the amended parameters and guidelines to be applied retroactively as well as prospectively.

Commission Action: Corrective action taken.

In January 2003, the commission amended the parameters and guidelines as outlined in Chapter 1167, Statutes of 2002. Additionally, commission staff implemented new procedures to increase the opportunity for state agencies and legislative staff to participate in the mandates process; notify relevant parties of proposed statements of decision, parameters and guidelines, and statewide cost estimates; and follow up with entities that are late in commenting on claims. For example, in addition to a letter initially inviting state agency participation, commission staff now send a letter notifying all parties of the tentative hearing dates for each test claim. Additionally, they send e-mail notices of release of analyses of test claims, proposed parameters and guidelines, statewide

cost estimates, and proposed statements of decision to fiscal and policy committee staff. Further, commission staff contact state agencies, claimants, and other relevant parties when comments are late.

Finding #2: Most school districts we reviewed lacked sufficient documentation for their costs.

We found that many school districts did not maintain sufficient documentation to support their claims. In fact, of the more than $2.3 million total direct costs the seven districts we reviewed submitted for reimbursement in fiscal year 1999–2000, only $606,000 (26 percent) was traceable to documents that sufficiently quantified the costs. To support the remaining $1.7 million (74 percent), these school districts relied substantially upon incomplete supporting data. School districts are to follow the parameters and guidelines issued by the State Controller's Office (Controller) when claiming reimbursement under the mandate. The districts asserted they had sufficient support, yet the documentation we reviewed lacked crucial elements, such as corroborating data, and failed to substantiate the amounts claimed for reimbursement in many instances. In addition, some school districts claimed amounts for time increases to complete school bus routes, yet they failed to maintain corroborating evidence to support these increases. Further, one district based much of the costs it claimed on questionable assumptions and even claimed for activities that appear to be beyond the scope of the mandate. Only San Diego City Unified School District had support for all the $5,171 in direct costs it claimed. Additionally, San Jose Unified School District had sufficient documentation to support nearly all the $590,000 in direct costs that it claimed.

School districts should ensure that they have sufficient support for the costs they have claimed. In addition, the commission should work with the Controller, other affected state agencies, and interested parties to make sure the language in the guidelines and the claiming instructions reflects the commission's intentions as well as the Controller's expectations regarding supporting documentation.

School District Action: Partial corrective action taken.

Ceres Unified School District, Dinuba Unified School District, and Fresno Unified School District conducted time studies to support costs associated with the mandate. San Dieguito Union High School District has taken steps to ensure that its claimed activities are supported by sufficient documentation, including ensuring that it properly maintains training records in its computer system. Elk Grove Unified School District previously stated that when the commission came out with new rules, regulations, and guidelines regarding the mandate, it would follow them.

Commission Action: Corrective action taken.

Commission staff worked with the Controller and others to amend existing parameters and guidelines and adopt new parameters and guidelines that reflected its intention and the Controller's expectations regarding supporting documentation. In January 2003, the commission adopted the Controller's proposed language, as modified by commission staff, that requires claimants to maintain documentation developed at or near the time actual costs were incurred in order to support their reimbursement claims. The commission intends to address the language in all future parameters and guidelines, and in existing parameters and guidelines as they are amended.

Finding #3: The commission did not identify the true fiscal impact of the mandate until three years after the law was passed.

The Legislature was not aware of the magnitude of the fiscal impact of its action when it passed the 1997 law that comprises the majority of the School Bus Safety II mandate. Three different entities that analyzed the 1997 law before its passage believed that it would not be a state mandate and thus the State would not have to reimburse the districts' costs. Further, these entities advised the Legislature that annual costs would be no more than $1 million, considerably less than the $67 million in annual costs that the commission is now estimating. This misperception of the likely costs prevailed until January 2001, when the commission finally released a statewide cost estimate. Although the commission is required to follow a deliberate and often time-consuming process when determining whether a test claim is a

state mandate and adopting a statewide cost estimate, it appears that it could have avoided a delay of more than 14 months. Consequently, the Legislature did not have the information necessary to act promptly to resolve the issues of possible concern previously discussed in this report. Finally, commission staff believe that waiting for actual reimbursement claims reported to the Controller and using this data to estimate statewide costs for the mandate results in more accurate estimates. However, commission staff have not sought changes to the regulations to include sufficient time for waiting for the claim data.

We recommended the commission ensure that it carries out its process for deciding test claims, approving parameters and guidelines, and developing the statewide cost estimate for mandates in as timely a manner as possible. If the commission believes it necessary to use actual claims data when developing the statewide cost estimate, it should consider seeking regulatory changes to the timeline to include the time necessary to obtain the data from the Controller.

Commission Action: Corrective action taken.

Commission staff implemented new procedures to ensure that it carries out its process in as timely a manner as possible. Specifically, they now propose statewide cost estimates for adoption approximately one month after they receive initial reimbursement claims data from the Controller. They also close the record of the claim and start their staff analysis if claimant responses are not submitted timely. Claimants who choose to rebut state agency positions at a later time may provide rebuttal comments to the draft staff analysis. Further, the commission initiated a rulemaking package in February 2003 to incorporate the current methodology for developing statewide cost estimates into the commission's regulations.

STATE MANDATES

The High Level of Questionable Costs Claimed Highlights the Need for Structural Reforms of the Process

Audit Highlights . . .

Our review of the Peace Officers Procedural Bill of Rights (peace officer rights) and the animal adoption mandates found that:

- ☑ *The costs for both mandates are significantly higher than what the Legislature expected.*
- ☑ *The local entities we reviewed claimed costs under the peace officer rights mandate for activities that far exceed the Commission on State Mandates' (Commission) intent.*
- ☑ *The local entities we reviewed lacked adequate supporting documentation for most of the costs claimed under the peace officer rights mandate and some of the costs claimed under the animal adoption mandate.*
- ☑ *Structural reforms are needed to afford the State Controller's Office an opportunity to perform a field review of initial claims for new mandates early enough to identify potential problems.*
- ☑ *Commission staff have indicated that the Commission will not be able to meet the statutory deadlines related to the mandate process for the foreseeable future due to an increase in caseload and a decrease in staffing.*

REPORT NUMBER 2003-106, OCTOBER 2003

Commission on State Mandates' and State Controller's Office's responses as of December 2003[1]

The Joint Legislative Audit Committee asked the Bureau of State Audits to review California's state mandate process and local entity claims submitted under the Peace Officers Procedural Bill of Rights (peace officer rights) and animal adoption mandates. Our review found that the costs for both mandates are significantly higher than what the Legislature initially expected. In addition, we found that the local entities we reviewed claimed costs under the peace officer rights mandate for activities that far exceeded the Commission on State Mandates' (Commission) intent. Further, claimants under both mandates lacked adequate supporting documentation and made errors in calculating costs claimed.

The problems we identified highlight the need for some structural reforms of the mandate process. Specifically, the mandate process does not afford the State Controller's Office (Controller) the opportunity to perform a field review of the first set of claims for new mandates early enough to identify potential claiming problems. In addition, the Commission could improve its reporting of statewide cost estimates to the Legislature by disclosing limitations and assumptions related to the claims data it uses to develop the estimates. Finally, Commission staff have indicated that the Commission will not be able to meet the statutory deadlines related to the mandate process for the foreseeable future due to an increase in caseload and cutbacks in staffing. Specifically, we found:

Finding #1: Local entities claimed reimbursement for questionable activities under the peace officer rights mandate.

We question a large portion of the costs claimed by four local entities that received $31 million of the $50 million paid under the peace officer rights mandate, and we are concerned that

[1] City of Los Angeles, San Francisco, San Jose, Los Angeles County, and San Diego County responses as of January 2004.

the State already may have paid more than some local entities are entitled to receive. In particular, we question $16.2 million of the $19.1 million in direct costs that four local entities claimed under the peace officer rights mandate for fiscal year 2001–02 because they included activities that far exceed the Commission's intent. Although we noted limited circumstances in which the Commission's guidance could have been enhanced, the primary factor contributing to this condition was that local entities and their consultants broadly interpreted the Commission's guidance to claim reimbursement for large portions of their disciplinary processes, which the Commission clearly did not intend. We also noted that the local entities we reviewed did not appear to look at the statement of decision or the formal administrative record surrounding the adoption of the statement of decision for guidance when they developed their claims.

We recommended that, to ensure local entities have prepared reimbursement claims for the peace officer rights mandate that are consistent with the Commission's intent, the Controller audit the claims already paid, paying particular attention to the types of problems described in our report. If deemed appropriate based on the results of its audit, the Controller should request that the Commission amend the parameters and guidelines to address any concerns identified, amend its claiming instructions, and require local entities to adjust claims already filed. The Controller should seek any statutory changes needed to accomplish the identified amendments and to ensure that such amendments can be applied retroactively.

We also recommended that, to assist local entities in preparing mandate reimbursement claims, the Commission include language in its parameters and guidelines to notify claimants and the relevant state entities that the statement of decision is legally binding on all parties and provides the legal and factual basis for the parameters and guidelines; it also should point out that the support for such legal and factual findings is found in the administrative record of the test claim.

Further, we recommended that all local entities that have filed, or plan to file, claims for reimbursement under the peace officer rights mandate consider carefully the issues raised in our report to ensure that they submit claims that are for reimbursable activities. Additionally, they should refile claims when appropriate. Finally, if local entities identify activities

they believe are reimbursable but are not in the parameters and guidelines, they should request that the Commission consider amending the parameters and guidelines to include them.

Controller Action: Partial corrective action taken.

The Controller reports that it has developed an audit program and initiated audits of the peace officer rights claims. In addition, the Controller indicates that it has met with Commission staff regarding a legislative proposal to allow retroactive claiming when amendments are made to reduce existing parameters and guidelines.

Commission Action: Corrective action taken.

Commission staff report that they have developed language to implement our recommendation for inclusion in all new parameters and guidelines adopted on or after December 3, 2003.

Local Entities Action: Pending.

The city of Los Angeles reports that it is working with its consultant and the Controller to clarify what activities are subject to reimbursement. It will then take appropriate action based on that information. Los Angeles County reports that it is revising its fiscal year 2002–03 peace officer rights claim in light of our audit findings and the Controller's draft claiming instructions for conducting time studies. However, its 60-day response did not address revisions to claims it submitted for earlier years. The city and county of San Francisco (San Francisco) disagrees with our findings related to the peace officer rights mandate and believes that the activities it claimed are allowable because it considers them to be an integral part of investigation activities related to the peace officer rights process and reasonable and necessary to protect its peace officers' rights in these cases. Finally, although the city of Stockton (Stockton) indicated in its initial response to our report that it generally agrees with our recommendations and plans to file amended claims, it did not provide us a 60-day response to update its status.

Finding #2: In varying degrees, claimants under the peace officer rights and animal adoption mandates lacked adequate support for their costs and inaccurately calculated claimed costs.

We question $18.5 million of the $19.1 million in direct costs that four local entities claimed under the peace officer rights mandate because of inadequate supporting documentation.

The local entities based the amount of time they claimed on interviews and informal estimates developed after the related activities were performed instead of recording the actual staff time spent on reimbursable activities or developing an estimate based on an acceptable time study.

Additionally, we noted several errors in calculations of costs claimed under the peace officer rights mandate. Although we generally focused on fiscal year 2001–02 claims, the largest error we noted was in the fiscal year 2000–01 claim of one local entity. It overstated indirect costs by about $3.7 million because it used an inflated rate and applied the rate to the wrong set of costs in determining the amount it claimed. We noted two other errors related to fiscal year 2001–02 claims involving employee salary calculations and claiming costs for processing cases that included those of civilian employees, resulting in a total overstatement of $377,000.

We also found problems with the animal adoption claims. The four local entities we reviewed could not adequately support $979,000 of the $5.4 million they claimed for fiscal year 2001–02. In some instances, this lack of support related to the amount of staff time spent on activities. In another instance, a local entity could not adequately separate the reimbursable and nonreimbursable costs it incurred under a contract with a nonprofit organization that provided shelter and medical services for the city's animals.

In addition, we noted numerous errors in calculations the four local entities performed to determine the costs they claimed under the animal adoption mandate for fiscal year 2001–02. Although these errors caused both understatements and overstatements, the four claims were overstated by a net total of about $675,000. Several errors resulted from using the wrong numbers in various calculations involving animal census data.

We recommended that the Controller issue guidance on what constitutes an acceptable time study for estimating the amount of time employees spend on reimbursable activities and under what circumstances local entities can use time studies.

We also recommended that all local entities that have filed, or plan to file, claims for reimbursement under the peace officer rights or animal adoption mandate consider carefully the issues raised in our report to ensure that they submit claims that are supported properly. Additionally, they should refile claims when appropriate.

Controller Action: Partial corrective action taken.

The Controller indicates that it has been meeting with representatives of local governments and local government organizations to review proposed time study guidelines.

Local Entities Action: Partial corrective action taken.

Five of the six local entities we reviewed provided us a 60-day response generally indicating that they had taken some action to correct errors and develop better documentation to support their claims. In particular, the cities of Los Angeles and San Jose and San Diego County indicated that they either have or plan to submit revised animal adoption claims for fiscal year 2001–02. In addition, the city of Los Angeles indicates that it corrected some errors in its peace officer rights claiming process, and San Francisco reports that it is working on developing and enhancing support for its peace officer rights claim. Further, Los Angeles County reports that it is revising its fiscal year 2002–03 peace officer rights claim in light of our audit findings and the Controller's draft claiming instructions for conducting time studies. However, none of the 60-day responses mentioned whether or not the entities plan to submit revised peace officer rights claims for fiscal year 2001–02. Finally, although Stockton indicated in its initial response to our report that it generally agrees with our recommendations and plans to file amended claims, it did not provide us a 60-day response to update its status.

Finding #3: The Commission's animal adoption guidance does not adequately require claimants to isolate reimbursable costs for acquiring space and its definition of average daily census could be clearer.

Although the guidance related to the animal adoption mandate generally is adequate, the Commission's formula for determining the reimbursable amount of the costs of new facilities does not isolate how much of a claimant's construction costs relate to holding animals for a longer period of time. The two local entities we audited that claimed costs for acquiring space in fiscal year 2001–02 used the current formula appropriately to prorate their construction costs. However, one of them needed space beyond that created by the mandate; as a result, the costs it claimed probably are higher than needed to comply with the mandate.

In addition, we found that one local entity understated its annual census of dogs and cats by including only strays in the figure, instead of including *all* dogs and cats. The entity made

this mistake because it used a definition from an earlier section of the parameters and guidelines that limited the census number to strays. Although the parameters and guidelines could have been clearer by including a separate definition in the care of dogs and cats section of the guidance, we believe the context makes it clear that the total costs for *all* dogs and cats must be divided by a census figure including *all* dogs and cats to compute an accurate daily cost per dog or cat.

We recommended that the Legislature direct the Commission to amend the parameters and guidelines of the animal adoption mandate to correct the formula for determining the reimbursable portion of acquiring additional shelter space. If the Commission amends these parameters and guidelines, the Controller should amend its claiming instructions accordingly and require local entities to amend claims already filed.

In addition, we recommended that the Controller amend the claiming instructions or seek an amendment to the parameters and guidelines to emphasize that average daily census must be based on all animals housed to calculate reimbursable costs properly under the care and maintenance section of the parameters and guidelines.

Legislative Action: Legislation proposed.

The Legislature has introduced Assembly Bill 533, which would direct the Commission to amend the parameters and guidelines of the animal adoption mandate to correct the problem we identified. As of January 2004, the bill was being discussed in assembly committees.

Controller Action: Pending.

Although the Controller indicates in its 60-day response that it has met with Commission staff and Joint Legislative Audit Committee (JLAC) staff regarding legislative proposals to address our recommendations, the response did not specifically address our recommendation related to care and maintenance costs under the animal adoption mandate.

Finding #4: Structural reforms are needed to identify mandate costs more accurately and to ensure that claims reimbursement guidance is consistent with legislative and commission intent.

The problems we identified related to claims filed under the peace officer rights and animal adoption mandates highlight the need for some structural reforms of the mandate process. For example, it is difficult to gauge the clarity of the Commission's guidance and the accuracy of costs claimed for new mandates until claims are subjected to some level of field review. However, the mandate process does not afford the Controller an opportunity to perform a field review of the claims for new mandates early enough to identify potential claiming problems.

Also, inherent limitations in the process the Commission uses to develop statewide cost estimates for new mandates result in underestimates of mandate costs. Even though Commission staff base statewide cost estimates for mandates on the initial claims local entities submit to the Controller, these entities are allowed to submit late or amended claims long after the Commission adopts its estimate. The Commission could disclose this limitation in the statewide cost estimates it reports to the Legislature by stating what assumptions were made regarding the claims data. In addition, Commission staff did not adjust for some anomalies in the claims data they used to develop the cost estimate for the animal adoption mandate that resulted in an even lower estimate.

We recommended that the Controller perform a field review of initial reimbursement claims for selected new mandates to identify potential claiming errors and to ensure that costs claimed are consistent with legislative and Commission intent. In addition, the Commission should work with the Controller, other affected state agencies, and interested parties to implement appropriate changes to the regulations governing the mandate process, allowing the Controller sufficient time to perform these field reviews and identify any inappropriate claiming as well as to suggest any needed changes to the parameters and guidelines before the development of the statewide cost estimate and the payment of claims. If the Commission and the Controller find they cannot accomplish these changes through the regulatory process, they should seek appropriate statutory changes.

We also recommended that Commission staff analyze more carefully the completeness of the initial claims data used to develop statewide cost estimates and adjust the estimates accordingly. Additionally, the Commission should disclose the incomplete nature of the initial claims data when reporting to the Legislature.

Controller Action: Pending.

The Controller reports that it has met with Commission staff regarding a legislative proposal to change the statewide cost estimate process and make other structural reforms. The Controller also indicates that it has met with JLAC staff on proposed legislation for implementing several of our recommendations.

Commission Action: Partial corrective action taken.

Commission staff indicate that they have met with the Controller and plan to meet with other state agencies and interested parties to discuss implementation of our recommendations. In addition, staff report that they will seek regulatory or statutory changes as necessary based on these discussions. Further, Commission staff indicate that they have developed additional assumptions and revised the method for projecting future-year costs and for reporting statewide cost estimates to the Legislature.

Finding #5: Commission staff assert that lack of staffing will continue to affect the Commission's ability to meet statutory deadlines related to the mandate process.

Commission staff indicated that the Commission has developed a significant caseload and has experienced cutbacks in staffing because of the State's fiscal problems. As a result, staff state that the Commission will not be able to meet the statutory deadlines related to the mandate process for the foreseeable future. This will cause further delays in the mandate process in general, including determination of the potential cost of new mandates.

We recommended that the Commission continue to assess its caseload and work with the Department of Finance and the Legislature to obtain sufficient staffing to ensure that it is able to meet its statutory deadlines in the future.

Commission Action: Corrective action taken.

Commission staff report that, on an ongoing basis, they will submit budget change proposals to the Department of Finance for additional resources that support the Commission's caseload. In addition, staff will report caseload status to the Commission at each hearing and to relevant legislative committees upon request.

VACANT POSITIONS

Departments Have Circumvented the Abolishment of Vacant Positions, and the State Needs to Continue Its Efforts to Control Vacancies

REPORT NUMBER 2001-110, MARCH 2002

Department of Finance's response as of May 2003, State Controller's Office response as of March 2003, and Department of Mental Health's response as of November 2002

Audit Highlights . . .

Our review of vacant positions in the State disclosed that:

- ☑ *Although the Legislature amended state law to shorten the period a position can be vacant before it is to be abolished, the law's effectiveness is hindered by departments' efforts to preserve positions.*
- ☑ *The five departments we visited misused certain personnel transactions to circumvent the abolishment of vacant positions.*
- ☑ *Changes in state law have not completely addressed the reasons departments have lengthy vacancy periods in some positions.*
- ☑ *The Department of Finance performed two reviews and plans to continue monitoring vacant positions during the next two years, but has not established an ongoing monitoring program.*
- ☑ *A method to provide the Legislature with an up-to-date yet reliable count of vacancies still does not exist.*

The Joint Legislative Audit Committee requested the Bureau of State Audits review vacant positions in the State and the uses of funding associated with the positions. Our review found that, although the Legislature amended state law to shorten the period a position can be vacant before it is abolished, the law's effectiveness is hindered by the efforts of state departments to preserve positions. Additionally, the departments we reviewed used the funding from vacant positions to carry out their programs, in part, because certain costs have not been fully funded. Finally, the Department of Finance (Finance) performed two reviews and plans to continue monitoring vacant positions during the next two years, but has not established an ongoing monitoring program. Specifically, we found that:

Finding #1: The five departments we visited misused certain personnel transactions to circumvent the abolishment of vacant positions.

The policies and procedures related to "120" transactions, which are intended to legitimately move existing employees between positions, allow flexibility, require little documentation substantiating the need for the transactions, and are not closely monitored. Although the State's policies do not specifically preclude departments from performing these transactions to avoid having positions abolished, circumventing state law is not a reasonable use of this form of transaction. Nevertheless, our review of transactions at the five departments for a two-year period revealed that they initiated at least 440 (89 percent) of 495 transactions to avoid the abolishment of vacant positions. However, our findings should not be interpreted to mean that departments throughout the State performed 89 percent

of "120" transactions to preserve vacant positions, as we selected some transactions to review because the patterns of use appeared questionable.

Our analysis of "607" transactions at these same five departments revealed that they are also sometimes being misused, though not nearly as often as "120" transactions. Properly used, "607" transactions propose new positions, delete positions, or reclassify positions. However, the departments performed, on average, at least 22 percent of the transactions we analyzed to preserve positions. More controls exist for "607" transactions than for "120" transactions, but the State requires little external accountability for "607" transactions. As we found with "120" transactions, state policies do not specifically preclude the use of "607" transactions to preserve existing positions. However, circumventing state law is not a reasonable use for the transactions.

We recommended that Finance issue an explicit policy to prohibit the use of "120" and "607" transactions to preserve vacant positions from abolishment. Additionally, we recommended that the State Controller's Office (SCO) issue guidance to departments on processing these transactions consistent with the policy issued by Finance. Further, the SCO should periodically provide to Finance reports of such transactions. Finance should analyze the reports to identify potential misuses of the transactions and follow up with departments as appropriate. Departments should discontinue their practice of using "120" and "607" transactions to circumvent the abolishment of vacant positions.

Legislative, Finance, and SCO Action: Legislation passed and corrective action taken.

In September 2002 the governor approved Chapter 1124, Statutes of 2002, which amended Government Code, Section 12439, to prohibit departments from performing personnel transactions to circumvent the abolishment of vacant positions. As a result, Finance did not issue an explicit policy to prohibit the use of "120" and "607" transactions to preserve vacant positions from abolishment. In December 2002 the SCO issued guidance to departments on processing the transactions consistent with the amended statute. Further, the SCO provided reports of "120" transactions to Finance in November 2002 and March 2003, respectively, for Finance's analysis and review. The SCO plans to provide reports of "607" transactions to Finance in fiscal year 2003–04.

Finally, the five departments we visited reported to us they have taken actions to discontinue or minimize the use of "120" and "607" transactions to circumvent state law and, thus, ensure that the transactions are used for appropriate reasons.

Finding #2: Despite changes, state law allows some positions to remain vacant almost a year.

After the Legislature became concerned about the number of vacant positions in state government, it amended Government Code, Section 12439, in July 2000 to reduce to six months the period of vacancy before the SCO abolishes vacant positions. However, the amended law stipulates that the six months must occur in the same fiscal year. This allows positions that become vacant after January 1 to stay vacant for almost a year before being abolished. Based on current law, the SCO's system tracks the vacancies until June 30 and then starts recounting the six consecutive monthly pay periods on July 1. Thus, some positions could be preserved from abolishment as long as the SCO issued a payment for only two days, January 2 and December 31. Finance reported in January 2002 it plans to examine the feasibility of amending state law to allow the vacancy period to cross fiscal years. However, as Finance also reported, the SCO's 30-year-old position control system requires significant changes to track vacancies without regard to fiscal year. Finance plans to evaluate the potential cost to modify the SCO's system. Finance stated that if the cost is feasible, it will address the funding in spring 2002.

We recommended that Finance, in conjunction with the SCO, continue with its current plans to examine the costs associated with modifying the SCO's position control system to track vacancies across fiscal years. If Finance determines that the necessary system changes are feasible, it should seek to amend Government Code, Section 12439, to require that the six consecutive monthly pay periods for which a position is vacant before abolishment be considered without regard to fiscal year.

Legislative and SCO Action: Legislation passed and corrective action taken.

Chapter 1124, Statutes of 2002, amended state law to allow the six consecutive monthly pay periods to occur within one fiscal year or between two consecutive fiscal years. As a result, the SCO has made the necessary changes to its position control system and planned to implement the changes no later than June 2003.

Finding #3: The amended law has not resolved some of the underlying causes of vacancies.

Changes in state law have not resolved some of the reasons departments have positions with lengthy periods of vacancy. The law currently provides departments with only one circumstance to retain vacant positions and two circumstances to reestablish vacant positions. In particular, the hard-to-fill designation has not entirely solved the problem of departments' inability to fill some vacant positions. Additionally, departments stated that lengthy examination and hiring processes hinder their ability to fill positions within six months. Further, departments may maintain some vacant positions to absorb other costs not fully funded.

We recommended that Finance continue to work with departments and other oversight agencies to fully identify and address the issues that lead to positions being vacant for lengthy periods. Finance should then consider seeking statutory changes that provide it with the authority to approve the reestablishment of vacant positions in additional circumstances, including when delays in hiring and examination processes extend the time it takes to fill positions.

Legislative Action: Legislation passed and corrective action taken.

Chapter 1124, Statutes of 2002, amended Government Code, Section 12439, to provide Finance with the authority to approve the reestablishment of vacant positions when certain conditions existed during all or part of the six consecutive monthly pay periods. The conditions include when a hiring freeze is in effect, when a department has been unable to fill positions despite its diligent attempts, and when positions are determined to be hard-to-fill. Additionally, the amended statute authorizes the SCO to reestablish vacant positions when department directors certify that specific circumstances existed in the six consecutive months.

Finding #4: The SCO's system for identifying positions to be abolished cannot track a position reclassified more than once during the fiscal year and does not have the capability to account for "120" transactions performed to circumvent abolishment.

The tracking system the SCO uses is supposed to follow a position through subsequent reclassifications. Thus, if the combined vacancy period before and after the reclassification

is more than six consecutive pay periods, the SCO flags the reclassified position for potential abolishment. However, the SCO's system for identifying positions to be abolished has two significant limitations. First, it cannot track a position that is reclassified more than once during the fiscal year. This causes the SCO to have to manually research transactions, which increases the risk that transactions may be missed. Second, the system does not have the capability to account for the use of "120" transactions performed to circumvent the abolishment of vacant positions. Our review found that departments use "120" transactions extensively to preserve vacant positions, thus increasing the likelihood of the tracking system missing vacant positions that should be abolished.

We recommended that the SCO consider the feasibility of modifying its system for identifying positions to be abolished so it can track them through more than one reclassification. Additionally, as we discussed in Finding #1, we recommended that the SCO periodically provide to Finance reports of "120" transactions so that Finance can identify potential misuses of the transactions and follow up with departments as appropriate.

SCO Action: Corrective action taken.

The SCO stated it has completed modifications to its system to track five different position changes. In addition, it has twice provided to Finance reports of "120" transactions for Finance's analysis of potential misuses of the transactions.

Finding #5: The Department of Mental Health did not adhere to the established controls requiring it to seek external approval for certain "607" transactions.

The Department of Mental Health (Mental Health) did not submit two transactions to Finance, even though they involved reclassifications to positions above the minimum salary level required for Finance's approval. Mental Health believed one of these transactions did not need Finance's approval because it downgraded a position and the related salary. Nonetheless, Finance staff stated that both transactions needed its approval.

We recommended that Mental Health ensure that it submits for Finance's required approval all "607" transactions that involve a reclassification to positions above the specified minimum salary level.

Mental Health Action: Corrective action taken.

Mental Health stated it has submitted for Finance's review and approval the reclassifications involving positions above the specified minimum salary level.

Finding #6: Despite Finance's recent scrutiny of vacant positions, ongoing monitoring is needed.

Finance performed two reviews to address the Legislature's concerns about the number of vacant positions. The reviews recommended that certain departments eliminate or redirect 4,236 positions beginning in fiscal year 2000–01. Additionally, Finance recommended in its first report that the funding from the positions be reallocated to the departments for other program uses. In its second report, Finance did not identify the total amount of funding to be eliminated or reallocated. In January 2002, Finance stated that it plans to conduct further reviews in 2002 and 2003. However, no ongoing monitoring program has been established. Without a regular process to monitor vacant positions, data may not be available to enable the State's decision makers, including the Legislature, to make informed decisions.

To ensure that the State continues to monitor vacant positions and the associated funding, we recommended that Finance direct departments to track and annually report the uses of such funding. Additionally, Finance should continue to analyze the departments' vacant positions and uses of funds, recommend to what extent departments should eliminate vacant positions, and either eliminate or redirect the funding for the positions. Further, it should periodically report its findings to the Legislature to ensure that the information is available for informed decision making.

Finance Action: Corrective action taken.

Finance stated that the Budget Act of 2002, Section 31.60, directed it to abolish at least 6,000 positions from all positions in state government that were vacant on June 30, 2002. The section also authorized Finance to eliminate at least $300 million related to the abolished positions. The section further required Finance to report to the Legislature on the specific positions abolished. Finance reported in November 2002 that it abolished 6,129 positions and $300.4 million. However, our review of Finance's report

revealed that it included 560 public safety positions, representing $23.5 million in cost savings, that Section 31.60 excluded from abolishment. Additionally, we found errors that understated the abolished positions by 39 and cost savings by $6.7 million. Moreover, we could not determine whether the positions Finance abolished included any that had been eliminated by other provisions of law. Chapter 1023, Statutes of 2002, also directs Finance to abolish at least 1,000 vacant positions by June 30, 2004, and to report to the Legislature on the specific positions abolished.

Finding #7: Actual funding needs may be obscured because departments use funding from excess vacant positions to carry out their programs, in part, because certain costs have not been fully funded.

Our review at five departments found that they spent the funds budgeted from excess vacant positions for the higher costs of their filled positions, overtime, personal services contracts, and operating expenses. For example, the five departments in total spent the majority of their funding from excess vacant positions on the higher cost of filled positions, in part because of their efforts to hire in hard-to-fill classifications included such expenses as hiring above the minimum salary level and pay differentials. The departments told us, and Finance acknowledges, that the State typically has not augmented department budgets for increases in the cost of filled positions. Because certain program costs have not been fully funded, departments sometimes use funding from excess vacant positions to bridge the gap between their actual costs and their present funding levels.

To ensure that budgets represent a true picture of how departments manage their programs, we recommended that Finance continue to assess if common uses of funds resulting from vacant positions represent unfunded costs that should be reevaluated and specifically funded.

Finance Action: Corrective action taken.

Finance stated that the Budget Act of 2002, Section 31.70, authorized it to reinstate up to one-half the funding reduced by Section 31.60 for fiscal year 2002–03 appropriations to ensure that departments have sufficient levels of funding. As of April 1, 2003, Finance approved the reinstatement of $37.4 million in funding.

Finding #8: A method to provide reliable, up-to-date information about the number of vacant positions does not exist.

Legislators have expressed concerns because current point-in-time information on vacant positions from the SCO appears to show a substantially higher number of vacancies than those presented by Finance. The vacancy number that Finance presented is derived from past year actual information from other SCO reports. However, this number is generally not available until about five to six months after the end of the fiscal year. The SCO and Finance worked together to calculate a reliable, up-to-date number of vacancies as of June 30, 2001. Their efforts were beneficial as they provided a better understanding of the differences in the various data used by the entities. However, the efforts resulted in an estimate of vacancies that proved to be inaccurate.

To ensure that the State's decision makers have an accurate picture of the number of vacancies during the fiscal year, we recommended that Finance and the SCO, in consultation with the Legislature, work together on a method to calculate an up-to-date and reliable number of vacant positions statewide.

➲ ***Finance Action: None.***

Finance stated that, because of the state hiring freeze and the reductions of positions over the next several months, it would not be possible for it and the SCO to develop a method to provide up-to-date and reliable calculations of vacant positions.

STATE CONTROLLER'S OFFICE

Does Not Always Ensure the Safekeeping, Prompt Distribution, and Collection of Unclaimed Property

Audit Highlights . . .

Our review of the State Controller's Office (controller), Bureau of Unclaimed Property (bureau), revealed the following:

- ☑ *The bureau's computerized Unclaimed Property System lacks sufficient controls to prevent unauthorized changes, and the duplication of account data, potentially resulting in the payment of fraudulent or duplicate claims.*
- ☑ *The bureau's manual tracking of securities is unreliable and the bureau is inconsistent in how quickly it sells securities.*
- ☑ *The bureau excludes more than $7.1 million in unclaimed property from its Web site.*
- ☑ *The bureau does not consistently review and distribute claims in a reasonable amount of time.*
- ☑ *The bureau does not ensure that it receives all of the reported contents of safe deposit boxes.*
- ☑ *The controller's Financial-related Audits Bureau did not pursue an estimated $6.7 million in unclaimed property from one holder.*

REPORT NUMBER 2002-122, JUNE 2003

State Controller's Office response as of December 2003

The Joint Legislative Audit Committee (audit committee) requested that we evaluate the process used by the State Controller's Office (controller) Bureau of Unclaimed Property (bureau) for identifying unclaimed property from corporations, business associations, financial institutions, insurance companies, and other holders. Further, the audit committee asked us to determine whether the bureau distributes unclaimed property to eligible recipients accurately and in a timely manner. We were also asked to evaluate the bureau's process of safeguarding unclaimed property in its custody. Lastly, we were to determine whether the bureau evaluates claimant satisfaction, is responsive to complaints, and has a process in place to identify and implement corrective action.

Finding #1: Inaccurate data contained in the bureau's property system has resulted in the payment of fraudulent and duplicate claims.

The bureau relies on its computerized Unclaimed Property System (property system) to track unclaimed property escheated to the State by persons and businesses holding unclaimed property (holders) and to disclose that the controller has the unclaimed property. However, the property system is not sufficiently reliable. Our primary concern is that the controller has not implemented controls to prevent bureau employees from making unauthorized changes to the system, despite knowing about this problem for eight months. Further, the property system does not generate reports that would reveal when unauthorized changes are made and by whom. These flaws allowed two student assistants to conspire to modify owner names in the data and allowed their accomplices to fraudulently claim some of the property.

Prior to 2002, the property system lacked effective controls to prevent duplicate data from being loaded into the property system. Although the controller took action to correct this weakness, as of May 6, 2003, the bureau had not yet removed all of the duplicate data from its property system. While the Information Systems Division reports it has taken action to prevent payments on properties listed on the duplicate reports, some of the properties are still on the bureau's Web site. Individuals using the Web site to determine whether the controller has their property may inadvertently conclude that they are owed more than the actual amount.

The bureau does not reconcile the total amount remitted for each holder report to the total of all the individual accounts loaded into the property system by that report. This may result in claimants not receiving funds to which they are legally entitled. In addition, the bureau's staff manually entered nearly 6,700 holder reports directly into the property system due to problems with a holder's electronically submitted reports. In doing so, the bureau bypassed most of the automatic system checks that could have identified errors in the data, such as checking for duplicate information. The bureau has established a procedure to verify the data in these records as claims come in, but it does not intend to verify all of the data entered directly into the property system.

To increase the reliability of the data in the property system, the bureau should do the following:

- Implement the programming changes necessary to ensure that employees cannot make unauthorized and unmonitored changes to the property system.

- Remove all duplicate account data from the property system.

- Ensure that both current and newly hired staff review unclaimed property accounts entered manually when claims are filed against the property to determine the accuracy of the data.

To ensure the accuracy of the data loaded into the property system, the bureau should require its staff to reconcile the total amount remitted by each holder to the total of all the individual records in the property system for that report.

Controller's Action: Corrective action taken.

The controller modified its property system to limit on-line property updates and to generate audit reports that allow supervisory review of any such on-line transactions. Additionally, the controller developed a plan to delete all the duplicate reports from the system, including modifying the property system to prevent the duplicate properties from appearing on the bureau's Web site.

Furthermore, the controller conducted training classes to ensure that all staff continues to adhere to current procedures for verification of claims filed for properties on the reports entered manually. The controller retrained staff on proper procedures for holder overpayments. Additionally, the controller made the necessary programming changes to fix system problems, including the development of a periodic report to identify any out of balance reports.

Finding #2: The bureau may incorrectly bill holders for interest penalties.

Inaccuracies in the property system may result in the incorrect billing of holders for interest penalties from which they should be exempt under the controller's amnesty program. Beginning in 2000, holders were allowed amnesty for their past failures to report unclaimed property on or before November 1, 1999, and were exempted from paying an interest penalty. However, the bureau did not include an amnesty indicator in the property system for all qualifying holder reports, and the controller has not modified its program that calculates interest penalties to exclude holder reports that were granted amnesty. The controller will have to correct both problems to avoid inappropriately billing the holders that it granted amnesty.

To prevent the billing of penalties for late reporting to holders granted amnesty, the controller should do the following:

- Identify reports covered by the amnesty program that do not currently have an amnesty indicator and add it.

- Modify its program that generates bills for interest penalties to exclude those reports with an amnesty indicator.

Controller's Action: Corrective action taken.

The controller reconciled all amnesty reports in the tracking system and the unclaimed property system. Further, the controller reviewed interest billings previously issued to verify that no erroneous billings were issued for approved amnesty reports. Additionally, the controller modified its procedures to ensure that all interest billings are reviewed and that no amnesty reports are incorrectly billed for interest. Lastly, the controller developed a plan for programming changes to prevent generating interest billings for approved amnesty reports.

Finding #3: Although holder reports must be processed in order to account for property escheated to the State, thousands of holder reports await processing.

To allow for the tracking and eventual disbursement of unclaimed property, the bureau must process the holder reports by loading the detailed owner data into the property system. Although the bureau must complete this process to be able to disclose on its Web site that it has the owner's property, to pay claims, to bill holders for interest due on late filings, and to reconcile the amounts reported by the holders to the amounts actually remitted by the holders, it told us that, as of June 5, 2003, it had not uploaded more than 8,500 holder reports, some as far back as 1996. More than 4,500 of these reports are less than one year old and are not considered a backlog.

During discussions with the bureau, we learned that two conditions contributed to its backlog of holder reports:

- Electronic reports in unreadable formats.
- Large increases in the number of holder reports submitted.

To enable the bureau to upload data reported in formats that it cannot access, it should do the following:

- Continue its efforts to contact the holders and request that they resubmit the owner data in the current reporting format.
- Consider contracting with an outside entity to read the remaining reports or to convert them into a usable format.

To allow for the timely notification to owners that the State has their property and the prompt billing of interest penalties, the bureau should ensure that it uploads holder reports within 12 months of receipt.

Controller's Action: Corrective action taken.

The controller completed its analysis of the backlogged reports and contacted the holders as necessary for any replacement media needed. Further, the controller developed alternatives for reading or converting any remaining reports, including options to contract with an outside firm, if necessary, to read or convert the data. Lastly, the controller developed a plan to process reports within a year of receipt.

Finding #4: The bureau's tracking of securities in its custody needs improvement.

Because the bureau cannot use the computerized property system to track changes in securities, it tracks these manually, increasing the probability of error and the number of staff needed to accommodate the workload. We found that the bureau's manual tracking of securities is unreliable and that the bureau is inconsistent in how quickly it sells securities. Moreover, because the bureau tracks securities by company name rather than by individual owner, when corporate actions such as stock splits result in the issuance of additional securities, the bureau does not consistently associate the new securities with the original securities. This results in securities for the same owner being sold on different dates for different prices, further complicating the bureau's reconciliation process, increasing both the potential for errors and the risk of allegations that the bureau has mismanaged owners' assets.

To eliminate the bureau's manual tracking of securities and dispel any impressions that it exercises judgment in deciding when is the best time to sell securities, thereby reducing the potential for errors, eliminating unnecessary work, and reducing the potential for litigation against the State, the controller should seek legislation to require it to sell securities immediately upon receipt. To ensure that the holders remit all of the reported securities, the bureau should compare the shares received to the shares reported by the holders, using the holder report summary sheets.

Alternatively, the controller should consider having holders deliver duplicates of the securities they have transferred into the controller's name to a specified broker authorized to accept them on the State's behalf. The controller should instruct and give the broker authorization to sell the securities immediately upon receipt. This may also require legislation. Additionally, the bureau should immediately sell all securities already in its custody.

If the bureau is unable to sell securities immediately upon receipt, it should do the following:

- Reconcile the securities remitted to the securities reported within one month of the receipt of the securities, for securities not already in its custody.

- Modify the property system to allow it to track all changes to securities, including the effective dates, receipts, sales, disbursements, and corporate actions, on an owner-by-owner basis. The bureau should ensure that it updates the property system to account for securities currently tracked in its manual ledgers. This process should be automated to allocate changes in the number of securities to the affected accounts with minimal human intervention.

- Sell all securities related to a particular account within two years of the initial receipt, regardless of corporate actions. Additionally, the property system should be modified to generate a monthly report to alert the bureau to securities approaching the two-year deadline for sale, regardless of the timing of corporate actions.

In either case, the bureau should do the following:

- Review all of its manual ledgers to ensure that it has accurately recorded all corporate actions, receipts, sales, and disbursements of securities. Once this review is complete, the bureau should discontinue the use of its manual ledgers.

- Complete its reconciliation of the securities remitted to the securities reported for all securities not previously reconciled.

Legislative Action: None.

Although the controller did not seek legislation to require it to sell securities immediately upon receipt, as discussed in the following paragraph it did address the issue internally.

Controller's Action: Corrective action taken.

The controller directed staff to immediately sell securities received with holder reports. Further, the controller developed a plan to accelerate the sale of securities currently in house. Additionally, the controller reviewed options to streamline the process of escheating securities to facilitate the more immediate sale of securities. Future contracts with third-party contractors include a requirement that securities be delivered to the controller-contracted broker for immediate sale. The controller created standardized procedures for making entries into the security ledgers to improve consistency of entries in the ledgers, including a quality review of the entries. Additionally, the controller developed a plan to improve the timeliness of reconciling the remitted securities to reported securities.

Finding #5: Property belonging to governmental agencies and some private entities are excluded from the bureau's Web site.

We also found that the bureau excludes a large amount of unclaimed property reported to it for federal and state departments, local governments, schools and school districts, other states, and some private entities from its Web site. As of April 30, 2003, the bureau held more than $7.1 million in unclaimed property for various entities that it has not posted on its Web site. Even if the entities check the Web site to see if the State has some of their property, they would erroneously conclude that it does not.

To fully inform all entities that it has their unclaimed property in its possession, the bureau should do the following:

- Discontinue excluding any properties from its Web site.
- When it receives unclaimed property belonging to any governmental entity, notify that entity. If it does not receive sufficient information to determine which governmental entity the property belongs to, it should seek additional information from the holder.

Controller's Action: Corrective action taken.

The controller issued instructions to holders in writing and through the Web site of their responsibilities to notify owners prior to the escheatment of accounts. Additionally,

the controller discontinued its practice of excluding government properties from its Web site. Further, the controller developed a plan to notify government agencies of potential unclaimed properties in excess of $1,000 on an annual basis and simplified the process for transferring property to them.

Finding #6: The bureau does not approve and distribute claims in a timely manner.

The Unclaimed Property Law (law) requires the bureau to consider each claim for the return of property within 90 days after it is filed and to provide written notice to the person claiming the property (claimant) if the claim is denied. Although the law does not specifically require the bureau to approve or deny claims within 90 days, we believe that once the claimant has provided all required documentation, 90 days is a reasonable amount of time for the bureau to either approve or deny the claim. However, the bureau does not consistently do so. Claims for securities generally take longer to review and to distribute to the claimant than claims for most other types of property. Lastly, although the bureau has received numerous complaints regarding the timely distribution of claims, it has not streamlined the claim distribution process.

To ensure that it distributes assets to bona fide claimants in a timely manner, the bureau should do the following:

- Review all claims and either approve or deny them within 90 days of receipt.
- Distribute assets on approved claims within 30 days of approval.

Controller's Action: Corrective action taken.

The controller identified means of streamlining the approval of claims by increasing the threshold for applying its streamlined claim approval process from $1,000 to $5,000. Additionally, the controller created a new unit to process unclaimed property claims from heirfinders and investigators.

Finding #7: The bureau does not compare the contents of safe deposit boxes it receives to the holder-prepared inventories.

To determine the adequacy of the bureau's safekeeping of the contents of safe deposit boxes, we reviewed a sample of 32 safe deposit boxes. We expected that the bureau's inventories would conform materially to the holders' inventories; however, we found that the bureau does not reconcile the holders' inventories to its own inventories or to the boxes' contents to ensure that it has received all of the property listed. Instead, the bureau creates its own inventories from the contents actually received and usually disregards the holder inventories. The bureau's process of creating its own inventories results in unnecessary work and does not ensure that it has received all of the reported contents of the safe deposit boxes. If the bureau compared the contents received to the contents reported by the holder, it would be able to identify any missing property and take prompt action to request that the holder either explain the difference or remit the missing property. Doing so would reduce its liability for items that were not remitted by the holder.

To ensure that it has properly accounted for all of the owners' properties, the bureau should develop a standard inventory form for holders to use to report the contents of safe deposit boxes and for the bureau to use to verify that it has received all of the reported contents from the holders. This standard form should include a section for the bureau to indicate its receipt of all of the reported contents, the date of review, and any follow-up required for contents that were reported but not remitted by the holder.

Controller's Action: Pending.

The controller will develop and implement the necessary forms, instructions, and procedures.

Finding #8: Although state law allows the bureau to auction the contents of safe deposit boxes, it did not auction property for almost two years.

The law allows the bureau to sell the contents of safe deposit boxes in its custody to the highest bidder at public sale, including sales via the Internet. Although the bureau is not required to sell the contents of safe deposit boxes, failure to do so results in higher costs to the State to store and safeguard those contents. The floor of the bureau's vault is crowded with the safe deposit box contents it has received from holders but has not sent to

storage, and its shelves are overflowing with binders and the bagged contents of safe deposit boxes. We found that the bureau had not conducted an auction for almost two years, resulting in the overcrowding of its safe deposit box vault with the contents of safe deposit boxes that it has received from holders.

To reduce the overcrowding in its safe deposit box vault, the bureau should conduct an auction of the contents of safe deposit boxes at least monthly.

Controller's Action: Partial corrective action taken.

The controller completed a pilot project for conducting on-line Internet auctions of safe deposit box contents. Further, the controller implemented an ongoing on-line auction using new procedures and system updates to verify that sale proceeds are received for all items sold. The controller explored the need for additional space for secured storage of the safe deposit contents to reduce the overcrowding.

The controller completed its Request for Proposal with a private auctioneer to conduct a large public auction of unclaimed property. Additionally, the controller created new procedures to verify and reconcile public auction proceeds to the actual hammer price from the auction. The controller developed a plan to implement programming changes to post auction proceeds to the related owner's account.

Finding #9: The controller does not ensure the collection of all unclaimed property.

The controller's Financial-related Audits Bureau (audit bureau) does not always fully pursue unclaimed property that its auditors have a reasonable basis for believing should be remitted to the State. Specifically, we found that even though its auditors estimated in January 2002 that one holder failed to remit $6.7 million beginning as far back as 1978, the audit bureau did not move forward to substantiate or invalidate the estimated findings. After we brought this to the controller's attention, the audit bureau reopened the examination of the holder. Assuming that the audit bureau substantiates the $6.7 million and the holder remits the funds on June 30, 2003, the estimated interest penalty would be nearly $8.2 million, resulting in the potential collection of more than $14.9 million. By not exercising due diligence in pursuing the collection of unclaimed property that there is a reasonable basis to believe should have been remitted,

the controller is not fulfilling its responsibility to reunite owners with their lost or forgotten property.

To ensure that it collects all unclaimed property, the controller should complete its examination of estimated unclaimed property that its auditors have a reasonable basis for believing should be remitted to the State. Further, the bureau should ensure that it bills and collects the applicable interest penalties based upon the results of the audit bureau's examination.

Controller's Action: Pending.

The controller plans to complete its follow-up examination to substantiate or invalidate the estimated unclaimed property referred to in the examination of this holder by January 31, 2004. Further, the controller plans to bill the holder for any additional audit findings by February 27, 2004.

STATE OF CALIFORNIA

Its Containment of Drug Costs and Management of Medications for Adult Inmates Continue to Require Significant Improvements

Audit Highlights . . .

Our review of the State's drug and medical supply procurement practices reveals:

- ☑ *Annual expenditures for the five agencies most frequently purchasing drugs increased by an average of 34 percent per year between fiscal years 1996–97 and 2000–01.*
- ☑ *The Department of General Services has explored a variety of options, but it has not gone far enough in improving the State's drug procurement process. Moreover, the State needs a statewide process for contracting for medical supplies.*
- ☑ *The Department of Corrections' (Corrections) Health Care Services Division continues to have significant weaknesses that prevent it from effectively monitoring its pharmacies' purchases of drugs, such as:*
  - *As of November 2001 it had not updated its formulary nor monitored compliance with the existing one.*
  - *It lacks a utilization management program that can assist in reducing costs.*

REPORT NUMBER 2001-012, JANUARY 2002

Department of General Services' response as of January 2003 and Department of Corrections' response as of December 2002

Chapter 127, Statutes of 2000, required the Bureau of State Audits (bureau) to report to the Legislature on the trends in state costs for the procurement of drugs and medical supplies for offenders in state custody and to assess the major factors affecting those trends. The statutes also required the bureau to summarize the steps that the Department of Corrections (Corrections), the Department of General Services (General Services), and other appropriate state agencies have taken to improve drug and medical supply procurement and to comply with prior bureau recommendations relating to necessary reforms to improve the procurement of drugs.

In fiscal year 1996–97 state agencies purchased $41.6 million in drugs, but in fiscal year 2000–01 their purchases rose to $135.1 million, which represents an annual average increase of 34.3 percent for this five-year period. During the same period state agencies' expenditures for medical supplies rose from $11.1 million to $14.2 million, which represents roughly a 27 percent increase.

Restrictions in state and federal law prevent human immunodeficiency virus-positive inmates in federal and state prisons, such as Corrections', from benefiting from the State's AIDS Drug Assistance Program. Further, Corrections may not use the federal supply schedule, which by federal law places limits on the prices of drugs that the federal Department of Veterans Affairs, the Department of Defense, the Public Health Service, and the Coast Guard purchase because it is not affiliated with one of these eligible federal agencies.

However, we found that General Services and other state agencies such as Corrections could do more to control the State's drug and medical supply expenditures. Specifically, we found:

- Its pharmacy staff do not regularly review monthly reports to understand if purchases are cost-effective.

- Its pharmacy prescription tracking system cannot support monitoring, cost-containment efforts, or day-to-day management of pharmacy services.

- Corrections does not plan to replace this system until November 2006, and development of the new system is already behind schedule.

- Finally, we found that Corrections is not eligible for some options, such as the AIDS Drug Assistance Program and the federal supply schedule.

Finding #1: General Services needs to do more to identify the best option for reducing drug costs.

General Services has not been successful in securing more individual contracts with drug manufacturers for more drugs at less-than-wholesale acquisition cost, the standard price a wholesaler pays a manufacturer for drug products not including special deals, such as rebates or discounts. Further, General Services recently contracted with the Massachusetts Alliance for State Pharmaceutical Buying but failed to fully analyze other options, such as contracting with Minnesota Multistate Contracting Alliance for Pharmacy (MMCAP) or directly with a group-purchasing organization, before doing so. This action may have prevented the State from achieving greater future savings.

General Services should increase efforts to solicit bids from drug manufacturers so that it can obtain more drug prices on contract. Further, General Services should fully analyze measures to improve its procurement process, such as joining MMCAP or contracting directly with a group-purchasing organization.

General Services' Action: Partial corrective action taken.

General Services reported that it has awarded two-year contracts covering 321 line items, primarily generic drugs, which went into effect on November 1, 2002. Further, based on analysis of the bids it received, General Services identified an additional 140 drug line items for inclusion in its contract with the Massachusetts Alliance for State Pharmaceutical Buying (Massachusetts Alliance). In January 2003 General Services received statutory authority to enter into contracts

in a bid or negotiated basis with manufacturers and suppliers of single-source or multi-source drugs, which it believes allows it to explore additional strategies for managing drug costs.

General Services also reported that it was conducting a detailed review of the effectiveness of using the Massachusetts Alliance. General Services stated that as part of its review it surveyed a number of group-purchasing organizations and compared the advantages of using other group-purchasing organizations with its current relationship with the Massachusetts Alliance. General Services told us that its current agreement produced the greatest savings, which it estimated at roughly $5.9 million annually. General Services stated that it is committed to continually evaluating other approaches and is working with MMCAP to analyze drug procurement data.

Finding #2: Although General Services is spearheading efforts to develop a statewide drug formulary, it has not ensured that state agencies will be able to enforce the formulary.

A drug formulary is a listing of drugs and other information representing the clinical judgment of physicians, pharmacists, and other experts in the diagnosis and treatment of specific conditions. One of the main purposes of a formulary is to create competition among manufacturers of similar drugs when the clinical uses are roughly equal. The success of a statewide formulary and the State's ability to create enough competition to negotiate lower drug prices for certain products depend on how well state agencies adhere to the statewide formulary when they prescribe drugs. Currently, Corrections, which was responsible for roughly 68 percent of the State's drug purchases in fiscal year 2000–01, has an outdated formulary and lacks sufficient data to perform reviews that can identify prescribing patterns. Agencies that help develop but do not adhere to strict guidelines for enforcing the formulary would negate the State's effort.

Therefore, General Services should fully consider, and attempt to mitigate, all obstacles that could prevent the successful development of a statewide formulary.

General Services' Action: Partial corrective action taken.

General Services has formed a Pharmacy Advisory Board (board) to assist in its implementation and administration of a statewide pharmaceutical and medical supply program. The board held one meeting in September 2002 and plans to hold its next meeting in early 2003. General Services' Common Drug Formulary Committee, which is a subcommittee of the board, has received approval to begin contract negotiations for a number of proprietary drugs that were recommended for inclusion on the State's common drug formulary listing.

Finding #3: The State lacks statewide agreements for purchasing medical supplies.

Often state agencies are not aware of what their institutions are purchasing and how much they are paying for medical supplies. Typically, each state agency or individual institution generally procures its own medical supplies. Currently, General Services has only two medical supply contracts and is unaware of what medical supplies the agencies use and what they pay for them. However, it believes that having a medical supply catalog would aid state agencies in obtaining these supplies.

General Services should ask state agencies to determine their needs and then consider contracting for a medical supply catalog to maximize the State's buying power.

General Services' Action: Partial corrective action taken.

General Services has formed a Medical and Surgical Supply subcommittee to focus on the needs of state and local government entities. General Services reported that it is developing a request for proposal for the medical and surgical supply program, which it expects to release in early 2003.

Finding #4: Corrections' Health Care Services Division (Health Care Services) lacks an effective system for controlling drug purchases.

Despite the recommendation in our January 2000 report to update its departmental formulary and use it to control which drugs medical professionals can prescribe routinely, as of November 2001, Corrections' Health Care Services still had not done so. Further, Health Care Services does not monitor its pharmacies' noncontract purchases from the

State's prime vendor and cannot substantiate the reasons they are choosing to purchase potentially more expensive noncontract drugs. Until Health Care Services addresses significant deficiencies, neither an external or internal pharmacy benefits manager can accomplish the task of improving its contracting and procurement for drugs.

As we previously recommended, Health Care Services should update its formulary and ensure that headquarters and prison staff monitor compliance with the formulary. Further, Corrections should ensure that prisons receive monthly contract compliance reports from the prime vendor and use them to monitor noncontract purchases. Finally, Corrections should await the results of its consultant's report and identify those recommendations that will be beneficial to the program. Only then should it decide whether to hire an internal or external pharmacy manager to assist in resolving its pharmacy operations deficiencies.

Corrections' Action: Partial corrective action taken.

Corrections reported that it had revised its formulary and planned to distribute it in early 2003. It also plans to hold trainings on this formulary and on the use of reports it receives from the prime vendor to monitor noncontract purchases. Corrections also reported that it received its consultant's report and identified the recommendations beneficial to the pharmacy program, such as the creation of a Pharmacy Services Unit at its headquarters. However, although it has identified the resources necessary to implement the recommendations, Corrections reported that it is still in the process of filling the position of pharmacy services manager for that unit.

Finding #5: Health Care Services did not always meet criteria for using mail-order pharmacy services.

Although Corrections obtained approval from General Services to use mail-order pharmacy services in prisons when pharmacist vacancy rates rise to more than 50 percent, it did not demonstrate that the use of mail-order pharmacy services was necessary. Specifically, we cannot substantiate Corrections' shortage of pharmacists and thus its need for mail-order pharmacy services because Health Care Services lacks sufficient information about its use of registry employees. A registry service provides

pharmacists who can fill in for long- or short-term staffing needs resulting from vacancies, illnesses, or exceptional workload conditions.

Further, Corrections still has not addressed our previous recommendation that it consider whether it has appropriately divided responsibilities between its pharmacists and pharmacy technicians. This analysis could indicate that Corrections may be able to allow pharmacy technicians to assume more responsibilities so that it can lower the number of pharmacists necessary to run its pharmacies.

Corrections should take the necessary steps to substantiate its position that a shortage of pharmacists exists. Additionally, it should analyze whether it has the appropriate division of responsibilities between its pharmacists and pharmacy technicians. If it is able to substantiate that a pharmacy shortage exists and General Services approves another contract for mail-order pharmacy services, Health Care Services should ensure that prisons meet the contract conditions before beginning to use these services and monthly thereafter.

Corrections' Action: Partial corrective action taken.

Corrections reported that it has gathered and reviewed data related to pharmacists, pharmacy technicians, the number of satellite pharmacies, and its use of registry pharmacists to evaluate the extent of a pharmacist shortage. However, Corrections told us that it is unable to determine the appropriateness of the staffing ratios until it decides on which consultant recommendations it will implement.

Finding #6: Although its prescription tracking system is inadequate, Corrections has made little progress in implementing a new system.

Corrections has been trying to replace its prescription tracking system and other health care information technology systems since 1991 without significant progress. Currently, it is behind schedule on its plans to implement a new health care management system by November 2006 as part of its Strategic Offender Management System and is not considering an automated pharmacy system in the interim.

Corrections should accelerate the acquisition and implementation of the Strategic Offender Management System and its new health care management component.

Corrections' Action: Partial corrective action taken.

Corrections reported that its implementation of the new system depends on infrastructure and resources. However, Corrections also reported that it has completed a feasibility study report, as an interim solution, to procure an existing pharmacy management software package for its local institutions and headquarters. Corrections told us that the report is being reviewed by the Department of Finance.

Finding #7: Corrections made significant errors in attempting to streamline its drug dispensing process.

Corrections neither sought the necessary approvals to contract with the vendor of an automated drug delivery system nor ensured that it uses the system in accordance with state law. The California State Prison, Sacramento's, entering a limited-time agreement to obtain two machines for $4,999.99 appears to be a circumvention of the State's requirement of securing at least three competitive bids for each contract of $5,000 or more.

Corrections also failed to consider thoroughly the legal ramifications of using an automated drug delivery system. To control misuse, state law allows the removal of drugs from these machines in only one of three circumstances: (1) to provide drugs for a new prescription order, (2) to provide drugs in an emergency, or (3) to provide drugs that the medical practitioner has prescribed for an inmate to take as the need arises. Corrections contends that it is using the system appropriately, since the law pertains only to skilled nursing or intermediate care facilities. However, our attorney's analysis of the law is that Corrections' authority to use these machines in health care facilities in its prisons is unclear. Specifically, although the legislative history of Senate Bill 1606 indicates that the Legislature had skilled nursing and intermediate care facilities in mind when drafting it, the state law setting forth the circumstances in which automated drug delivery machines may be used refers to "facilities" in a generic sense and not merely skilled nursing and intermediate care facilities.

Corrections should cease using its automated drug delivery system until it secures a contract in accordance with the State's public contracting laws. Further, Corrections should seek an opinion from the attorney general to support its current use of the machines.

Corrections' Action: Partial corrective action taken.

Corrections reported that it received approval on a contract for the automated drug delivery machines on December 24, 2001. However, Corrections has chosen not to seek an opinion from the attorney general because it does not believe that Health and Safety Code, sections 1261.5 and 1261.6, apply to its pharmacies.

CALIFORNIA DEPARTMENT OF CORRECTIONS

A Shortage of Correctional Officers, Along With Costly Labor Agreement Provisions, Raises Both Fiscal and Safety Concerns and Limits Management's Control

REPORT NUMBER 2002-101, JULY 2002

California Department of Corrections' response as of August 2003

Audit Highlights . . .

Our review of the California Department of Corrections' (department) ongoing fiscal problems revealed:

- ☑ *A shortage of correctional officers continues to drive overtime costs higher.*
- ☑ *At its current pace of hiring, it may take the department until 2009 to meet its need for additional correctional officers.*
- ☑ *Some officers work excessive amounts of overtime while others at the same prison work very little overtime.*
- ☑ *Certain provisions in the labor agreement between the State and the California Correctional Peace Officers Association, related primarily to correctional officers, will eventually add about $518 million to the department's annual costs.*

The Joint Legislative Audit Committee requested that the Bureau of State Audits conduct an audit of various Department of Corrections' (department) fiscal problems. The audit committee expressed particular interest in the collective bargaining process that governs the department's relationship with its correctional officers, the assignment of new cadets from the academy to prisons, the impact of statewide mandated salary savings on correctional officers' use of overtime and sick leave, and the impact of medical transportation costs on the cost of medical care.

Finding #1: The department pays large overtime costs to cover for unmet correctional officer need.

The department has been unable to attract and train enough correctional officers to meet its needs. Specifically, as of September 2001, its full-time and intermittent officers numbered only 19,910 while its budget and labor agreement allow for a maximum of 23,160 officers. As a result, the department has an unmet need of about 3,250 officers. To fill this unmet need, the department has resorted to assigning overtime. During the first half of fiscal year 2001–02, the department spent more than $110 million on custody staff overtime—already $36 million more than its overtime budget of $74 million for the entire fiscal year. We estimate that the department will not fill its unmet officer need until sometime between the end of 2005 and the beginning of 2009, depending on the number of future academy graduates and the officer attrition rate.

To reduce its use of overtime, the department should consider the feasibility of further increasing the number of correctional officer applicants and, if warranted, the physical capacity for training them. Additionally, the department should pursue additional funding from the Legislature to operate its academy at full capacity. Once it can attract more cadets to its academy, the department should pursue funding for additional correctional officer positions that it will need to reduce its reliance on overtime. Until such time, as the department has enough correctional officers to meet its needs and incurs only unavoidable overtime, the department should be realistic in its budget and plan for the overtime it will need to cover its unmet need. Finally, the department should maximize its use of intermittent officers by either converting them to full-time or ensuring that they work as close to the 2,000-hour-a-year maximum as possible.

Department Action: Partial corrective action taken.

The department states that as part of the fiscal year 2003–04 governor's 20 percent reduction plan, it submitted a proposal to restructure the academy so that 12 weeks of training will be provided at the academy and the remaining four weeks of training will be provided at the cadets' assigned institution. The department asserts that the authority for this change was contained in Senate Bill 19X and was signed into law by the governor in March 2003. However, implementation of the restructured academy is contingent upon the State and the union representing correctional officers reaching agreement on the implementation of the on-the-job training requirement. The department indicates that it is in negotiations with the union regarding this issue. The department believes that the reduced length of the academy will allow it to schedule an additional two classes per year, potentially graduating several hundred additional officers per year.

The department also states that it is pursuing authority and funding for additional correctional officer positions, and indicated that the use of sick leave by correctional officers continues to be a major contributor to overtime. In addition, the department stated that as part of its analysis of correctional officer needs through June 2005, it has developed procedures to project the overtime necessary to cover vacancies, and has incorporated this information into its fiscal year 2003–04 budget request. Further, the department indicated that its institutions maximize their use of intermittent officers by converting them to full-time when positions become vacant and if, or when, intermittent officers are eligible for and accept

permanent positions. Finally, the department reports that 193 intermittent officers were appointed to full-time positions during the period from January 1, 2003, to June 30, 2003.

Finding #2: Savings from vacant budgeted positions are insufficient to finance shortfalls in the overall funding for correctional officers and overtime.

The savings the department realizes by intentionally leaving more than 1,000 of its authorized correctional officer positions vacant under the Institutional Vacancy Plan do not result in net salary savings because the budget for each officer is not sufficient to meet the actual costs when an officer works full time. Specifically, we estimated that the department would experience a net deficit of about $193 million related to its funding of correctional officers and overtime in fiscal year 2001–02.

To reduce its use of overtime, the department should fill vacant relief officer positions currently in its Institutional Vacancy Plan once it has filled its positions currently vacant because of insufficient staff.

Department Action: Partial corrective action taken.

The department states it is making every effort to fill vacant positions. The department reports that it has reduced its vacant permanent full-time positions to 429 as of June 30, 2003, compared to 1,040 at June 30, 2002. It also indicates that 160 additional cadets were scheduled to graduate in August 2003, and another 504 in October 2003. Finally, the department notes that it continues to work with the administration related to its long-term staffing needs, including developing a strategy related to the remaining vacant relief officer positions in its Institutional Vacancy Plan.

Finding #3: A more strategic assignment of new cadets and better monitoring of overtime worked at each prison would be beneficial.

The department does not consider the varying amounts of overtime that correctional officers work at its prisons when assigning cadets from its academy. In particular, based on our review of the November 2001 academy, we found that there was no strong correlation between the assignments of new cadets and the amount of overtime at each prison. In addition, we found that a total of 235 officers at 26 different prisons averaged more

than 80 hours of overtime each work period between July and December 2001. The department could also better protect the health and safety of everyone in the prison setting by more evenly distributing the total overtime among individual officers within each prison.

To reduce health and safety risks for its employees, the department should reassess the number of budgeted full-time positions at each prison and determine whether reallocations are warranted because of excessive overtime at specific prisons. Additionally, the department should pursue options to limit overtime that individuals work so that individuals do not exceed the 80-hour cap considered relevant for health and safety risks.

To better match the supply of correctional officers with the demand for correctional officers that use of overtime hours indicates, the department should consider assigning its academy graduates to those prisons that experience the highest levels of overtime. For example, if it has too many qualified candidates to fill a class, the department could give preference to candidates willing to go to the 10 prisons with the most overtime.

Department Action: Partial corrective action taken.

The department states that it is conducting a standardized staffing study that will assess staffing needs and establish standardized staffing patterns for each prison based on mission and location. In addition, the department reports that the number of correctional officers averaging more than 80 hours of overtime has decreased from the 235 we reported for July through December 2001, to 159 for January through June 2003. Further, the department states that until the pool of candidates on its correctional officer certification list increases significantly, competition is inadequate to make high vacancy institutions attractive to correctional officer candidates. Nevertheless, the department will continue efforts to increase the pool of candidates willing to work at high vacancy institutions.

Finding #4: Certain provisions of the new labor agreement increase the department's fiscal burden and limit management's control.

The new labor agreement between the State and the California Correctional Peace Officers Association includes many provisions that either increase personnel costs or create challenges for the department to effectively manage its staff. Ranging from salary

increases and enhanced retirement benefits to seniority-based overtime, some of these provisions were included in the prior labor agreement, but many are new to the labor agreement that was ratified in February 2002. The department estimates that the annual cost of new provisions in the agreement will be as high as $300 million a year by fiscal year 2005–06, the latest year for which it has estimated costs. In developing these estimates, the department included classes of employees who are covered by the agreement, such as medical technical assistants and correctional counselors, as well as correctional officers. Focusing mainly on costs related to correctional officers and including the entire term of the labor agreement, we analyzed five new and three continuing provisions of the labor agreement and estimate that the department's annual costs for these provisions will eventually amount to about $518 million. Further, several changes in the provisions related to sick leave have likely resulted in additional overtime to cover for the increased use of sick leave. Finally, a continuing provision related to how post assignments are made limits the department's ability to assign particular individuals to posts of its choosing.

SUPERIOR COURTS

The Courts Are Moving Toward a More Unified Administration; However, Diverse Service, Collection, and Accounting Systems Impede the Accurate Estimation and Equitable Distribution of Undesignated Fee Revenue

REPORT NUMBER 2001-117, FEBRUARY 2002

Administrative Office of the Court's response as of March 2003

Audit Highlights . . .

Our review of certain court-related fees and the fiscal and administrative oversight of superior court operations found that:

- ☑ *The Lockyer-Isenberg Trial Court Funding Act of 1997 addressed the disposition of some fees, but did not specify who would receive others, referred to as undesignated fees.*
- ☑ *Due to the decentralized nature of the superior courts' accounting and collection processes, it is prohibitively complex to determine the precise amount of revenue generated by undesignated fees.*
- ☑ *We estimated that the largest division in each of the three largest superior courts together generated $17.4 million in undesignated fee revenue during fiscal year 2000–01, most of which was distributed to the counties in accordance with locally negotiated agreements.*

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The Joint Legislative Audit Committee requested that the Bureau of State Audits review a sample of superior courts to determine how much revenue is generated by fees not designated by the Lockyer-Isenberg Trial Court Funding Act of 1997 (funding act), which entities collect these revenues, and how the courts distribute them.

Finding #1: The working group inappropriately categorized certain fees as undesignated.

Although the funding act addressed the disposition of many court-related fees, it did not specify who should receive others, referred to as undesignated fees. To address this issue, a working group, comprised of representatives from selected courts and counties, was formed to recommend to the Legislature how to distribute these fees. The working group identified many fees and placed them in one of four categories. The first three categories recommended a particular distribution; however, the fourth category represented all those fees for which a recommendation could not be made. Our review of these fees found that some were in fact designated.

To ensure that all undesignated fees are properly identified and distributed, we recommended that the Administrative Office of the Courts (AOC) review and correct the working group's list of these fees.

☑ *Several issues must be resolved before the State can implement a consistent and equitable distribution of undesignated fee revenue.*

☑ *The Administrative Office of the Courts has initiated a wide-reaching management system for superior court resources; however, such actions will not ease efforts to determine how much revenue undesignated fees generate.*

AOC Action: Corrective action taken.

According to the AOC, the working group's listing of undesignated fees has been reviewed and corrected.

Finding #2: The California Constitution mandates that the entity incurring the cost in providing a service must retain the fees.

The California Constitution imposes the restriction that any revenue generated by certain undesignated fees must be distributed to the entity that incurs the cost of providing the service. This restriction does not apply to all governmental charges, including fines or penalties; however, it does apply to fees. Before a statewide designation could be assigned for any given fee, all 58 counties would have to fund the delivery of services in the same way. Therefore, when the State considers imposing a statewide designation for a particular fee it must first consider whether it is a court or county that provides the service, which we found varies from one jurisdiction to another. Currently, the superior courts and counties have made stipulations in their local agreements for the distribution of undesignated fee revenue.

Once the working group's listing of undesignated fees has been reviewed and corrected, we recommended that the AOC:

- Direct each superior court to identify the entity in its jurisdiction that incurs the cost of providing the service related to each undesignated fee on the list.
- Direct the superior courts to ensure that, in their agreements with their respective counties, the courts distribute each of these fees to the entity incurring the cost.
- Seek legislation designating the distribution of charges other than fees, such as penalties and fines.

AOC Action: Partial corrective action taken.

According to the AOC, it has surveyed each superior court regarding who incurs the cost, provides the service, and retains each undesignated fee. The AOC also stated that it has proposed language concerning the appropriate distribution of undesignated fees to be included in the local agreement between each superior court and its respective

county when the agreement is renewed. The AOC also stated that it has proposed legislation to clarify the disposition of undesignated fees, fines, and penalties where currently no statutory reference provides for their distribution and use.

OFFICE OF CRIMINAL JUSTICE PLANNING

Experiences Problems in Program Administration, and Alternative Administrative Structures for the Domestic Violence Program Might Improve Program Delivery

Audit Highlights . . .

The Office of Criminal Justice Planning (OCJP) has not fulfilled all of its responsibilities in administering state and federal grants, including the domestic violence program. Specifically, OCJP:

- ☑ *Has not adopted guidelines to determine the extent it weighs grant recipients past performance when awarding funds.*
- ☑ *Does not always provide grant applicants the necessary information or time to challenge its award decisions.*
- ☑ *Missed opportunities to seek guidance an advisory committee could provide regarding program administration.*
- ☑ *Has not consistently monitored grant recipients.*
- ☑ *Spent $2.1 million during the last three years on program evaluations of uneven quality, content and usefulness.*

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REPORT NUMBER 2002-107, OCTOBER 2002

Office of Criminal Justice Planning and Department of Health Services' responses as of November 2003

The Joint Legislative Audit Committee (audit committee) requested an audit of Office of Criminal Justice Planning's (OCJP) administration of its grant programs in general and of its and the Department of Health Services' (DHS) administration of their respective domestic violence programs in particular. The audit committee also asked us to identify alternatives to the current administrative structures for the domestic violence programs. We reported the following findings:

Finding #1: Weaknesses in OCJP's process for awarding grants may result in the appearance that its awards are arbitrary or unfair.

OCJP has not adopted guidelines weighing grant recipients' past performance when awarding funds, nor is its review process systematic enough to identify grant recipients with poor past performance. Moreover, OCJP does not always provide unsuccessful grant applicants the necessary information or time to challenge its award decisions, and it has missed opportunities to seek the guidance an advisory committee could provide regarding certain decisions that affect program administration.

To ensure its application process is perceived as fair and impartial, we recommended that OCJP take the following steps:

- Create guidelines and criteria to determine when an applicant's past performance issues rise to the level that OCJP will consider those issues when deciding whether or not to continue the applicant's funding.

Our review of the domestic violence programs administered by OCJP and the Department of Health Services (DHS) revealed that:

- ☑ *OCJP decided not to correct an inconsistency in its 2001 request for proposals, which resulted in fewer shelters receiving funding.*
- ☑ *DHS has not established guidelines as to how past performance will be considered when awarding grants.*
- ☑ *OCJP and DHS award the majority of their domestic violence funds to shelters for the provision of similar services.*
- ☑ *OCJP's and DHS's activities for awarding grants and providing oversight of recipients sometimes overlap.*

- Conduct a periodic uniform review of all applicants with regard to past performance issues that includes applying weighting factors that indicate the relative importance of each such issue as it relates to future funding.
- Promptly inform grant recipients when their past performances are jeopardizing their chances for future funding.
- Properly document the rationale not to fund grant recipients and clearly state in the rejection letters sent to the applicants the reasons that they were denied funding.
- Change the process for the filing of appeals so that an applicant has 10 to 14 calendar days, depending on the type of grant award, from the registered receipt of the notification letter in which to justify and file an appeal.

To improve outreach to its grant recipients and comply with legislation that is soon to take effect, we recommended that OCJP create an advisory committee for the domestic violence program that could provide guidance on key program decisions.

OCJP Action: Partial corrective action taken.

According to the 2003–04 Budget Act, OCJP will be eliminated effective January 1, 2004, and its grant programs will be transferred to other state agencies. Prior to its closure, OCJP stated that it had created a formal written policy to use when considering the past performance of an applicant as a factor in its funding decisions and that the new policy will be used for those applying for competitive funding under OCJP's next request for proposal. However, we reviewed the new policy and, while we believe it is a good first step, it is still too vague and subject to varying interpretation.

In order to address the possible view that the current appeals guidelines are overly strict in terms of the time allowed to file an appeal and that the denial notice is too limited concerning the reasons for the denial, OCJP has revised its appeals guidelines. The guidelines were reviewed and approved by an independent council that hears such appeals at the end of July 2003. The new guidelines, which were implemented August 1, 2003, permit more time to appeal and provide more information to those applicants that are denied.

Finally, OCJP stated it would work with the agency that will be administering the domestic violence program beginning in 2004—the Office of Emergency Services—to establish a Domestic Violence Advisory Committee that will provide insight and guidance in administering the domestic violence program.

Finding #2: OCJP does not provide consistent and prompt oversight of grant recipients.

Although OCJP conducts a variety of oversight activities, its efforts lack consistency and timeliness. It has not visited grant recipients as planned and has not considered prioritizing its visits to first monitor recipients with the highest risk of problems. It has also been inconsistent in following up on its grant recipients' submission of required reports, and it has not always reviewed required reports promptly and consistently. In addition, it has spent nearly $23,000 per year to review audit reports that another state agency also reviews. Finally, it has not always conducted sufficient follow-up on reports once it notified grant recipients of performance problems.

We recommended that OCJP take several actions to improve its oversight of grant recipients, including:

- Ensure prompt site visits of newly funded grant recipients.
- Establish a risk-based process for identifying the grant recipients it should visit first when it conducts monitoring visits.
- Develop written guidelines to determine when and how staff should follow up on late progress reports and ensure that existing guidelines are followed regarding the prompt follow up on late audit reports.
- Ensure that it reviews audit reports within six months of receipt in order to comply with federal guidelines and promptly follow up on audit findings until they are resolved.
- Revise its process for reviewing the audit reports for municipalities to eliminate duplicating the State Controller's Office's (SCO) efforts.
- Establish written guidelines to address how staff should follow up on problems identified in progress reports or during site visits to ensure they are resolved.

- Require that its monitors review grant recipients' corrective action plans to ensure problems identified during monitoring visits have been appropriately addressed through problem-specific narratives.

OCJP Action: Partial corrective action taken.

According to the 2003–04 Budget Act, OCJP will be eliminated effective January 1, 2004, and its grant programs will be transferred to other state agencies. Prior to its closure, OCJP stated that it has a goal of conducting one technical site visit for a new grant recipient within the first six months of the grant period and one monitoring visit within the three-year grant period. Therefore, at a minimum, every grant recipient should receive a visit at least once every three years. OCJP also stated it was continuing to implement its plan to prioritize monitoring visits based on identified problems, the length of time since the last visit, and the dollar value of the project. Once its grant programs are transferred to other agencies, OCJP stated it would work with the receiving agencies to ensure a smooth transition of the monitoring function.

OCJP stated that it has made significant progress in reducing its backlog of pending reviews of grantee audit reports. For example, OCJP reports it has reviewed 235 audit reports as of October 2003, and anticipates it will complete reviews of 269 more before it ceases operations at the end of the year, and will work with the agencies taking over its grant programs so that work continues on reducing the backlog. Finally, OCJP stated it intends to provide the written guidelines for its grant programs to those agencies slated to administer them once they are transitioned and will also help those agencies develop procedures for following up on problems identified in grantee progress reports, technical or monitoring site visits, or other sources such as audit reports.

Finding #3: OCJP has not properly planned its evaluations or managed its evaluation contracts.

During the last three years, OCJP's evaluation branch spent $2.1 million on activities that culminated in evaluations of uneven quality, content, and usefulness. The branch lacks a process that would help it determine what programs would profit most from evaluations, how detailed evaluations should be, what criteria evaluations must satisfy, and, until recently, how to ensure they contain workable recommendations. The branch has been lax in management of its contracts; as a result,

it did not include measurable deliverables in one contract and failed to ensure that it received the deliverables contained in others. It also circumvented competitive bidding rules in entering an agreement with a University of California extension school.

To improve its evaluations branch, we recommended that OCJP:

- Develop a planning process to determine what programs would profit most from evaluations, how rigorous evaluations should be, and that it follow its new process for discussing the relevance and feasibility of proposed recommendations to improve their chances for implementation.
- Develop general criteria establishing what evaluations should accomplish.
- Include measurable deliverables and timelines in its contracts with evaluators and hold evaluators to their contracts.
- Withhold payments to contractors whenever they do not provide established deliverables or when the deliverables are not of the quality expected.
- Ensure that interagency agreements with university campuses comply with state guidelines regarding competitive bidding.

OCJP Action: Partial corrective action taken.

According to the 2003–04 Budget Act, OCJP will be eliminated effective January 1, 2004, and its grant programs will be transferred to other state agencies. Prior to its closure, OCJP stated that significant efforts have been make to identify and prioritize those evaluations that are mandated, and it is working to ensure that evaluation criteria and requirements are met. A new interim chief was assigned to oversee evaluation activities and has since issued five evaluation reports with plans to issue one more before OCJP ceases operations at the end of the year.

Finding #4: OCJP's allocation of indirect and personnel costs may have resulted in some programs paying for the administration of others.

OCJP's method for assigning indirect and personnel costs to the various programs it administers may result in some programs paying the administrative costs for others. Its allocation of indirect costs has been inconsistent, and it has not kept adequate records of

its allocation decisions to demonstrate that they were appropriate. OCJP has also failed to require its employees to record their activities when working on multiple programs as required by federal grant guidelines.

We recommended that OCJP ensure that it equitably allocates all indirect costs to the appropriate units and maintains sufficient documentation to support the basis for its cost allocation. OCJP also should establish an adequate time-reporting system that uses activity reports or certifications, as appropriate, to document the total activity for each employee and then use such reports or certifications as the basis for allocating personnel costs.

OCJP Action: Corrective action taken.

According to the 2003–04 Budget Act, OCJP will be eliminated effective January 1, 2004, and its grant programs will be transferred to other state agencies. Prior to its closure, OCJP stated that it had designed a functional timesheet modeled after those used by other state agencies, trained its staff on its use, and fully implemented the timekeeping system as of May 2003. The timesheets better ensure that costs are accurately recorded in the accounting system.

Finding #5: OCJP's decision not to correct an inconsistency in its request for proposals resulted in fewer domestic violence shelters receiving funding.

OCJP funded almost three fewer domestic violence shelters than it could have in fiscal year 2001–02 because it chose not to correct an inconsistency in the 2001 request for proposals for its domestic violence grant. This decision resulted in a reduction of nearly $450,000 a year of funds available for shelters. The error occurred during the development of its request for proposals, when program staff set the minimum amount that a small shelter would receive at $185,000 a year, even though an adjoining table within the proposal stated that $185,000 was the maximum amount that a small shelter could receive. The minimum amount was over $30,000 more for some small shelters than the minimum OCJP had previously awarded.

OCJP could provide no documentation of the decision-making process it used to arrive at the $185,000 funding minimum, such as written input from the shelters stating that the previous minimum amount was insufficient. Furthermore, OCJP provided

no indication that it had considered the consequences that raising the minimum funding amount of some shelters by as much as $30,000 would produce.

So that it can support and defend future funding decisions affecting the domestic violence program, we recommended that OCJP document and retain the reasons for changing funding levels.

OCJP Action: Pending.

According to the 2003–04 Budget Act, OCJP will be eliminated effective January 1, 2004, and its grant programs will be transferred to other state agencies. Prior to its closure, OCJP stated that Senate Bill 1895 provided the authority to create an advisory council effective January 1, 2003, that could recommend specific future funding levels for all shelters in OCJP's domestic violence program. Further, OCJP stated it would work with the agency that will be administering the domestic violence program beginning in 2004—the Office of Emergency Services—to establish a Domestic Violence Advisory Committee that can provide such insight and guidance.

Finding #6: DHS has not considered past performance or been able to use its advisory committee when awarding grants.

DHS has not adopted guidelines or criteria to establish when a grant recipient's past performance has been sufficiently poor to prevent it from being awarded funds during the next grant cycle, nor has it established a systematic review process to identify grant recipients with poor past performance. Further, forces outside of its control precluded DHS from seeking counsel from a domestic violence advisory committee as required by state law.

We recommended that DHS develop guidelines and criteria to determine when a grantee's past performance warrants denying it funding in the next grant cycle, which would include performing a periodic uniform review of all grant recipients' past performance. Also, now that enough appointments have been made to the advisory council to create a quorum, DHS should meet frequently with the council to seek its input as required by law.

DHS Action: Partial corrective action taken.

DHS stated that it has begun to meet regularly with the domestic violence advisory council and will request that the council consider whether it should use the past performance of grant recipients in preparation for awarding funds in future Request for Applications (RFA). If past performance is to be used in determining grant awards, DHS will develop specific criteria.

Finding #7: DHS has not fully met its responsibility to oversee grant recipients.

DHS does not have a process to conduct state-mandated site visits of its grant recipients. Moreover, it has not considered prioritizing its visits to first monitor those with the highest risk of problems. It has also been inconsistent in following up on its grant recipients' late submission of required reports, and it has not always reviewed required reports promptly and consistently.

To ensure better oversight of its shelters, we recommended that DHS:

- More efficiently use its resources when complying with state law mandating technical site visits to all its shelters by establishing a risk-based process for identifying which shelters it should visit first.
- Develop a structured process for staff to use to follow up on late progress reports. This process should include documenting follow-up efforts.
- Ensure that staff follow existing guidelines regarding the prompt follow-up of late audit reports.
- Ensure that it reviews all submitted progress reports promptly.

DHS Action: Corrective action taken.

DHS stated that it has put a system in place to ensure that timely review and follow up of progress reports occurs and that the system includes a status log that lists all the deliverables required from the shelters, including progress reports. The status log contains a "notes" column to record staff follow-up efforts regarding late reports, and all written communication or e-mail contacts with the shelters will be maintained in the working file.

In addition, DHS stated that it had developed and maintains an audit-tracking log to monitor the receipt of audit reports, and has developed guidelines to ensure that audit reports are received on time. Finally, DHS stated that it is on schedule to complete at least one site visit to each shelter within the current grant cycle as required by law.

Finding #8: OCJP and DHS require separate grant applications for similar activities.

OCJP and DHS conduct separate grant application processes. As a result, shelters must submit separate applications describing how they will use each program's funds, although the applications and the services themselves are similar.

To reduce the administrative burden for the shelters, we recommended that OCJP and DHS coordinate the development of the application processes for their shelter-based programs and identify areas common to both where they could share information or agree to request the information in a similar format.

OCJP's and DHS's Actions: Pending.

According to the 2003–04 Budget Act, OCJP will be eliminated effective January 1, 2004, and its domestic violence programs will be transferred to the Office of Emergency Services. DHS stated it would continue its efforts to coordinate the application process for the shelter-based program with this new administering agency.

Finding #9: OCJP and DHS perform some of the same oversight activities.

OCJP and DHS require shelters to submit periodic progress reports containing similar information, except that each requires the information for a different time period. Furthermore, as a result of a new legislative requirement, DHS will perform site visits to shelters to assess their activities and provide technical assistance, even though OCJP already conducts such visits.

To avoid duplicate oversight activities, we recommended that OCJP and DHS consider the following changes to their administrative activities and requirements:

- Align the reporting periods for their progress reports so that shelters do not have to recalculate and summarize the same data for different periods.

- Coordinate technical site visits, monitoring site visits, and audits that they schedule for the same shelters.

- Establish procedures for formally communicating on a regular basis with each other their ideas, concerns, or challenges regarding the shelters.

OCJP's and DHS's Actions: Pending.

According to the 2003–04 Budget Act, OCJP will be eliminated effective January 1, 2004, and its domestic violence programs will be transferred to the Office of Emergency Services. DHS stated it would continue its efforts to coordinate the oversight process for the shelter-based program with this new administering agency to avoid duplication.

Finding #10: Greater cooperation or consolidation between OCJP's and DHS's programs could increase efficiency.

Because of the similarity of OCJP's and DHS's programs and the overlap between their application and oversight activities, adopting an alternative administrative structure could improve the efficiency of the State's approach to funding domestic violence services.

To improve the efficiency of the State's domestic violence programs and reduce overlap of OCJP's and DHS's administrative activities, we recommended OCJP and DHS, along with the Legislature, should consider implementing one of the following alternatives:

- Increase coordination between the departments.

- Develop a joint grant application for the two departments' shelter-based programs.

- Combine the two shelter-based programs at one department.

- Completely consolidate all OCJP's and DHS's domestic violence programs.

OCJP's and DHS's Actions: Pending.

According to the 2003–04 Budget Act, OCJP will be eliminated effective January 1, 2004, and its domestic violence programs will be transferred to the Office of Emergency Services. DHS stated it would continue its efforts to coordinate the process for administering the shelter-based program with this new agency to avoid duplication.

Legislative Action: Unknown.

We are not aware of any legislative action with regard to this recommendation.

ENTERPRISE LICENSING AGREEMENT

The State Failed to Exercise Due Diligence When Contracting With Oracle, Potentially Costing Taxpayers Millions of Dollars

Audit Highlights . . .

On May 31, 2001, the State entered into a six-year enterprise licensing agreement (ELA), a contract worth almost $95 million, to authorize up to 270,000 state employees to use Oracle database software and to provide maintenance support.

Our audit of this acquisition revealed the following:

- ☑ *By broadly licensing software, a buyer that has many users, such as the State, can achieve significant volume discounts.*
- ☑ *The State proceeded with the ELA even though a survey of departments disclosed limited demand for Oracle products.*
- ☑ *The departments of General Services, Information Technology, and Finance approved the ELA without validating Logicon's cost savings projections; unfortunately, these projections proved to be significantly overstated.*
- ☑ *Logicon apparently stands to receive more than $28 million as a result of the ELA.*

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REPORT NUMBER 2001-128, APRIL 2002

Department of General Services and Department of Finance's responses as of April 2003[1]

The Joint Legislative Audit Committee (audit committee) requested the Bureau of State Audits (bureau) to examine the State's contracting practices in entering into the enterprise licensing agreement (ELA) with Oracle. Specifically, the bureau was asked to review the sole-source justification for the ELA and the roles of the Department of General Services (General Services), the Department of Information Technology (DOIT), and the Department of Finance (Finance) in developing and executing the ELA. We were also asked to review the terms of the agreement and determine whether they were in the best interests of the State and assess the methods used to justify the technical and business need for the ELA.

Further, we were asked to identify the fixed and variable costs of the ELA, the funding sources that will pay for it, and the reasonableness of the projected savings from the ELA. Lastly, the audit committee requested we obtain a legal opinion on whether the contract is null and void if it was executed in violation of state law.

Finding #1: Surveys conducted by DOIT and Finance indicated a limited need for Oracle database licenses.

The three departments involved in the ELA—DOIT, General Services, and Finance failed to conduct a comprehensive analysis to gauge or confirm the level of statewide interest in the ELA. However, at least two months before the ELA was executed, DOIT ignored preliminary survey data that strongly suggested most departments had no immediate need for Oracle database licenses. Specifically, of the 127 surveys it sent to state entities,

[1] The Department of Information Technology was sunset on July 1, 2002.

- ☑ *Nearly 10 months after the ELA was approved, no state departments had acquired the new licenses, which may be due to the fact that General Services had not issued instructions to departments on how to do so.*
- ☑ *General Services used an inexperienced negotiating team and limited the involvement of legal counsel in the ELA contract. As a result, many contract terms and conditions necessary to protect the State are vague or missing.*
- ☑ *Our legal consultant has advised us that a court might conclude that the ELA contract with Oracle is not enforceable as a valid state contract because it may not fall within an exception to the State's competitive bidding requirements.*

DOIT received only 21 responses, five of which indicated a possible interest in purchasing any additional Oracle products under a consolidated agreement in the near future.

In November 2001, five months after the ELA was approved, Finance sent out another survey to assess the need for Oracle database licensure and to establish a basis for allocating the cost of the ELA. This survey explicitly required all departments to respond. Preliminary survey results indicated that for the 12 state departments with the largest number of authorized positions, 11 use Oracle database products to some extent. However, while the ELA will cover up to 270,000 users—more than the total number of state employees—according to the survey, 113,000 of the authorized positions at just these 11 state departments will not use the Oracle database software.

Finance administered the survey as a preliminary step to appropriately allocate the ELA's cost among the various departments, and the information obtained on current and planned use of the Oracle enterprise database licensure was to be used to develop a cost allocation model. However, as of April 2002, 10 months after the ELA was approved, the analysis of the survey was incomplete. Furthermore, state departments have not been informed of how to acquire the database licenses using the ELA. Thus, it is not surprising that no state department had acquired new licenses under the ELA as of the end of March 2002.

Finance's survey was to provide necessary information about whether state departments have purchased any Oracle database licenses or entered into any maintenance contracts since the ELA was signed. The absence of an allocation model along with the lack of any specific pricing information or ordering instructions informing departments how to purchase the database licenses through the agreement may further reduce any cost savings or utility from the ELA. In reviewing the preliminary results of the November 2001 survey, we identified 12 state departments that have entered into their own maintenance contracts with Oracle—totaling $1.1 million for products covered by the ELA—since it was signed on May 31, 2001.

In order to take full advantage of the Oracle ELA, we recommended that Finance complete its survey and develop a method to allocate the ELA's cost to departments.

Finance Action: None.

Finance has elected not to complete its survey since the ELA was rescinded in July 2002.

Finding #2: DOIT and Finance did not adequately evaluate the ELA proposal's merits.

The State negotiated and ultimately approved the ELA proposal without sufficient technical guidance, assessment of need, or verification of projected benefits. According to officials at DOIT, General Services, and Finance, the State had never before considered a statewide software purchase, nor did it have any specific guidance in identifying the extent of the need for the software and in negotiating the key provisions to include in the contract. In fact, DOIT had looked at the concept of statewide software licensing as early as June 2000, when it hired Logicon Inc. (Logicon) to research and present information on enterprise licensing. Nevertheless, DOIT and Finance routinely evaluate IT proposals, including those involving software purchases. Although both possessed the expertise needed to evaluate aspects of the ELA proposal—DOIT the need to license 270,000 users and Finance the cost projections—neither did so, citing a lack of suitable procedures and inadequate time. To its credit, Finance's Technology Investment Review Unit (TIRU) identified specific concerns with the ELA proposal, and on May 10, 2001, communicated these concerns to the directors of Finance and DOIT. It also recommended that the proposal be postponed until the following year, giving the State a chance to develop appropriate policy. However, TIRU's concerns and recommendation were not heeded. As a result, the State committed almost $95 million without knowing whether the costs and benefits of the ELA were justified.

Before pursuing any future enterprise agreements, we recommended the State take the following actions:

- DOIT, Finance, and General Services should seek legislation establishing the authority to enter into an ELA that protects the State's interests and clarifies each department's respective role and responsibility in the process.

- Finance should notify the Legislature at least 30 days in advance of any state department executing any future ELA.

- DOIT should continue its efforts to create a statewide IT inventory, including software.

Finance, General Services, and DOIT Action: Partial corrective action taken.

Finance, General Services, and DOIT developed a draft process for statewide software licenses that defined specific roles and responsibilities for the three departments and addressed analytical and approval procedures. However, because of the closing of DOIT and the adoption of Section 11.10 of the Budget Act of 2002, the process was not formally approved.

As proposed by the governor, Section 11.10 of the Budget Act of 2002 was adopted and will fulfill some of the recommendations. Specifically, Section 11.10 requires a 30-day legislative notification before any department can enter into a statewide software license agreement of $1 million or more, regardless of future costs or savings. Additionally, the agreement must be reviewed by Finance. This section also states that any department considering entering into such an agreement is required to submit to Finance a business plan with specific components, including an analysis of base and current usage of the license, rationale for statewide license versus an alternative type of agreement, cost-benefit analysis, and funding plan.

DOIT ceased to exist on July 1, 2002, thereby ending its efforts to create a statewide IT inventory. Currently, no other state department has been assigned the responsibility to continue these efforts.

Finding #3: The Oracle ELA could cost the State added millions in taxpayer resources.

The Oracle ELA could cost the State $41 million more in database license and maintenance support than what the two would have cost in the absence of the contract. This is because the State did not validate the projections of costs and savings prepared by Logicon, who, acting in an undisclosed capacity as an Oracle reseller or licensing agent, would benefit significantly from the contract. Logicon, whose only role according to the contract was as the designated lender, and who apparently stood to make more than $28 million as a result of the ELA, developed the business case analysis General Services used to justify the State's decision to contract with Oracle. However, Logicon's analysis, which projected a savings to the State of $111 million over

10 years, was seriously flawed. Specifically, it was based on costs that should have been excluded because they were outside the ELA's coverage or did not follow the analysis' stated methodology. Further, Logicon's calculations contained numerous errors and many of its assumptions were questionable.

To ensure that future enterprise agreements meet the State's best interests, we recommended DOIT and Finance develop policies and procedures on how to evaluate future ELAs. To be effective, one state department needs to take responsibility for developing and justifying the ELA proposal.

Finance, General Services, and DOIT Action: Corrective action taken.

Finance, General Services, and DOIT developed a draft process for statewide software licenses that defined specific roles and responsibilities for the three departments and addressed analytical and approval procedures. However, because of the closing of DOIT and the adoption of Section 11.10 of the Budget Act of 2002, the process was not formally approved. Further, information technology experts have informed Finance and General Services that ELAs are not generally considered a best practice, especially with state governments. These experts state that such an environment is better suited to a volume purchase agreement (VPA). According to Finance, in the event that a VPA is being considered, General Services has agreed to take lead responsibility.

Finding #4: The State did little to protect itself against risks associated with the contract.

The State rushed into the Oracle ELA without negotiating strong provisions to guard against the risks inherent in long-term software contracts. The term of these types of contracts generally ranges between three to five years, partly because of the rapidly changing nature of the software industry. However, the State's contract with Oracle was for six years with a maintenance option for four more years. Our technical consultant observed that by entering into such a large long-term contract, the State increased risks such as the following:

- The vendor going out of business, being purchased, or otherwise becoming unable to perform.
- Technology changes that leave the State with a prepaid, long-term contract for a product that has diminishing value.

- Future software upgrades that are not supported under the contract.

- Lack of funding to make all future payments required under the contract.

- Demand for the software licenses not meeting expectations.

To protect against such risks, buyers normally try to negotiate mitigating safeguards as part of the terms and conditions of a contract. For example, a buyer would normally want to ensure that contract terms clearly define the support level the vendor will provide, including how upgrades and subsequent versions of the software will be furnished at no additional cost. Unfortunately, the State's hastily negotiated contract with Oracle lacked adequate provisions to minimize these risks.

The increased risks associated with this long-term contract largely occurred because General Services failed to properly prepare for contract negotiations with Oracle. For example, General Services did not include on its negotiating team anyone with expertise in the area of software licensing agreements or anyone with an in-depth knowledge of Oracle's past business practices. Moreover, General Services' legal counsel's role in the negotiations was limited to a few hours review of the contract's terms and conditions occurring the day before and the day it was signed. Consequently, the contract does not adequately protect the State's interests.

We recommended that, before negotiating any future enterprise licensing agreements, General Services should assemble a negotiating team that possesses all the types of expertise necessary to protect the State's interests. Further, if deemed enforceable, General Services should renegotiate the contract to ensure it includes adequate protections for the State. We also recommended that the Legislature should consider requiring all IT contracts over a specified dollar amount to receive a legal review by General Services.

General Services' Action: Partial corrective action taken.

On July 23, 2002, the ELA for Oracle database licenses and maintenance support was rescinded. However, General Services stated that it would ensure sufficient resources and expertise are assigned to any future ELA proposals. If deemed necessary, this will include the use of an independent third party to review each proposed agreement. Additionally,

General Services is working on developing and delivering a comprehensive training and certification program for state contracting and purchasing officials.

In support of recommendations made on August 30, 2002, by the Governor's Task Force (task force) on Contracting and Procurement Review, an assessment was performed to determine the knowledge, skills, and abilities needed by acquisition professionals. This information was used to determine course content for a comprehensive training and certification program for state contracting and purchasing officials. General Services specifically identified the urgency for targeting training in the complex area of IT contracting.

General Services has developed a new contract and procurement review process whereby state departments doing high-risk procurements undergo an assessment review during the early stages of the contracting process. At that time, General Services determines if a contract needs developmental support, technical support, and/or legal support. General Services ensures that the type of review received is appropriate for the risk involved.

Legislative Action: None.

We are unaware of any legislative action implementing this recommendation.

Finding #5: The State's contract with Oracle may not be enforceable.

Our legal consultant has advised us that a court might find the ELA is not enforceable as a valid state contract because it may not fall within an exception to competitive bidding requirements. However, further analysis is required to understand the impact of a finding that the Oracle contract is unenforceable. For example, our legal consultant cautioned that even if a court found that the ELA contract is void for failure to comply with competitive bidding requirements, additional questions are raised by the financing arrangements for the $52.3 million dollar loan under which Logicon assigned its rights to Koch Financial Corporation (Koch Financial). Because Koch Financial apparently acted in good faith and the State has received the full consideration for the loan—the enterprise license and one year of maintenance support—under the financing provisions, Koch Financial is likely to assert that the

State is obligated to repay the loan. Also, the State has agreed to stop using the ELA's enterprise database licensure if the Legislature does not appropriate funds for the loan payments or the State does not otherwise make payment and the ELA contract is terminated. More importantly, under the ELA contract the State also agreed not to replace the Oracle license with substantially similar database licenses for one year from the termination date.

Logicon's role, actions, and compensation from the ELA also raise troubling questions about the validity of the ELA contract. Specifically, the amount of compensation Logicon has or will continue to receive—more than $28 million—for its undisclosed role in the ELA is too much to be merely compensation for being a lender and for the limited support services it will provide.

Finally, Logicon's erroneous savings projections may make the contract voidable. We arrived at vastly different numbers in reviewing the data that supports the costs and projections that Logicon presented to the State. For example, although Logicon projected that the State would save as much as $16 million during the first six years of the contract, using Logicon's data and assumptions, we project that the State could spend as much as $41 million more than it would have without the ELA.

For these reasons, we recommended that General Services should continue to study the ELA contract's validity in light of the wide disparities we identified in Logicon's projections of costs and savings and consult with the Office of the Attorney General (attorney general) on how to protect the State's best interests. General Services should also work with the attorney general in further analyzing the ELA contract; all amendments, including any and all documents pertaining to side agreements between Oracle and Logicon; and the laws and policies relating to the ELA, including the potential legal issues that this audit has identified.

General Services' Action: Corrective action taken.

As previously discussed, on July 23, 2002, the ELA with Oracle for database licenses and maintenance services was rescinded. General Services notified state departments of the rescission through the issuance of a management memo.

FEDERAL FUNDS

The State of California Takes Advantage of Available Federal Grants, but Budget Constraints and Other Issues Keep It From Maximizing This Resource

REPORT NUMBER 2002-123.2, AUGUST 2003

Departments of Finance and Health Services responses as of October 2003

Audit Highlights . . .

Our review of federal grant funding received by California found that:

- ☑ *California's share of nationwide grant funding, at 11.8 percent, was only slightly below its 12 percent share of the U.S. population.*
- ☑ *Factors beyond the State's control, such as demographics, explain much of California's relatively low share of 10 large grants.*
- ☑ *Grant formulas using out-of-date statistics reduced California's award share for another six grants.*
- ☑ *In a few cases, California policies limit federal funding, but the effect on program participants may outweigh funding considerations.*
- ☑ *California could increase its federal funding in some cases, but would have to spend more state funds to do so.*

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The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits determine whether California is maximizing the amount of federal funds it is entitled to receive for appropriation through the Budget Act. Specifically, we were asked to examine the policies, procedures, and practices state agencies use to identify and apply for federal funds. We also were asked to determine if the State is applying for and receiving the federal program funds for which it is eligible, and to identify programmatic changes to state-administered programs that could result in the receipt of additional federal funds. Finally, the audit committee asked us to examine whether the State is collecting all applicable federal funds or is forgoing or forfeiting federal funds for which it is eligible. Specifically, we found:

Finding #1: California's share of federal grants falls short of its population share, due in part to the State's demographics and federal grant formulas.

California's share of total federal grants awarded during fiscal year 2001–02 was 11.8 percent, or $42.7 billion. This share is slightly below California's 12 percent share of the nation's population (population share). For 36 of 86 grants accounting for 90 percent of total nationwide federal grant awards in fiscal year 2001–02, California's share was $5.3 billion less than an allocation based on population share alone. Grants for which California's share falls below its population share include ones in which demographics work against California, and formula grants that provide minimum funding levels to states or use out-of-date statistics. With regard to state efforts to gain federal funding, we found that state

- ☑ *In some instances, California has lost federal funds because of its noncompliance with program guidelines or by not using funds while they are available.*
- ☑ *The statewide hiring freeze and a pending 10 percent cut in personnel costs may further limit federal funds for staff.*

departments appear to use reasonable processes to identify new or expanded funding from federal grants and do not miss grant opportunities because of a lack of awareness.

Of the 36 grants for which the State's share fell below its total population share, 10 are due to California's low share of a particular demographic group. For example, California received relatively little of the federal funds awarded to rural communities for water and waste disposal systems in fiscal year 2001–02 because its rural population is low in relation to the rest of the nation. In addition, California is the country's sixth youngest state, so it received less than its total population share of grants to serve the elderly.

Funding formulas that do not allocate funds based on populations in need result in a lower percentage of grant funding for populous states such as California. Some grants are awarded based on old statistical data that no longer reflect the distribution of populations in need. For example, much of a grant for maternal and child health services is distributed according to states' 1983 share for earlier programs, for which California's share was 5.8 percent. If the entire grant were based on more current statistics, California's award for fiscal year 2001–02 would be $23.6 million higher. Other grants provide minimum funding to states without regard to need; the State Homeland Security grant, for example, distributes more than 40 percent of its funds to states on an equal basis, with the rest matching population share. For this grant, the average per resident share for California will be $4.75, far less than the $7.14 average per U.S. resident.

We recommended that as federal grants are brought up for reauthorization, the Legislature, in conjunction with the California congressional delegation, may wish to petition Congress to revise grant formulas that use out-of-date statistics to determine the share of grants awarded to the states.

Legislative Action: Legislation passed.

In September 2003, the Legislature passed an Assembly Joint Resolution requesting that the California congressional delegation use the opportunities provided by this year's reauthorization of several federal formula grant programs to attempt to relieve the disparity between the amount of taxes California pays to the federal government and the amount the State receives in return in the form of federal formula grants and other federal expenditures.

Finding #2: State and local policies have limited California's share of federal funds in a few cases.

State and local policies limit California's share of federal funds for three programs. For the Special Education–Grants to States (Special Education) grant, California's share is less than would be expected based on its number of children because of the local approach to deeming children eligible for special education services. California's federal funding for the In-Home Supportive Services program is also low because of a state program that pays legally responsible relatives to be caregivers, a type of activity that is ineligible for federal reimbursement. Another agency has proposed changing the Access for Infants and Mothers and State Children's Health Insurance (Children's Insurance) programs to increase federal grant funding. These policies have affected the State's ability to maximize the receipt of federal funds. However, we did not review the effects on stakeholders that a change in government policies for these programs would entail, effects that may outweigh funding considerations.

The State's Residual In-Home Supportive Services program, funded solely from state and county sources, has likely reduced the participation of some eligible recipients in the federally supported Personal Care Services program. Both programs provide various services to eligible aged, blind, and disabled persons who are unable to remain safely at home without this type of assistance. The Residual In-Home Supportive Services program provides additional services and serves recipients who are not eligible for the federal program. In addition, the State's program allows legally responsible relatives to be caregivers to recipients. Legally responsible relatives include spouses and parents who have a legal obligation to meet the personal care needs of their family members. The federal program, in contrast, does not allow payments to such caregivers.

The Department of Health Services (Health Services), in conjunction with the Department of Social Services, may be able to apply for a waiver under the Medical Assistance program, called Medi-Cal in California. This recently developed waiver program, called Independence Plus, may allow states to claim federal reimbursement for a portion of the expenditures for caregiver services provided by family members. The departments estimate that the State may be able to save $133 million of costs currently borne by the State's Residual In-Home Supportive Services program if this waiver is pursued. They indicated that they are jointly exploring the feasibility of this waiver.

We recommended that Health Services continue to work with the Department of Social Services to determine the feasibility of pursuing an Independence Plus waiver that may allow the State to claim federal reimbursement for a portion of the expenditures for caregiver services provided by legally responsible family members to participants in the In-Home Supportive Services program.

➲ ***Health Services' Action: Pending.***

Health Services says that due to the state budget crisis and lack of available staff to develop the new Independence Plus waiver, it has suspended efforts in this area. When it obtains additional resources to work on the waiver, it says it will resume working with the Department of Social Services to obtain federal approval.

Finding #3: California is not obtaining the maximum funding available from some federal grants, but to do so generally would require more state spending.

The State has lost some federal dollars because departments were unable to obtain the matching state dollars required by federal programs. For example, a Health Services program to recognize high-quality skilled nursing facilities would have received more federal grant money had state matching funds been available. For fiscal years 2001–02 and 2002–03, the federal government agreed to provide as much as $16 million for the program. In fact, however, Health Services received only $4 million in state funding for this program during fiscal year 2001–02, and it received no state funding for the program in fiscal year 2002–03 because of cuts in General Fund spending. Consequently, the State received $12 million less in federal funding than it would have if it had spent the originally planned state match.

In addition, a reduction in state funding for several transportation-related funds may lead to the loss of federal funding for local projects. For example, the Los Angeles County Metropolitan Transportation Authority reported that if it could not replace traffic fund contributions, it risked losing $490 million in federal funds for one project. In April 2003, it requested that this project replace other projects already earmarked for funding by another state transportation fund in order to secure the federal funding. The use of state matching dollars to maximize federal funds must, however, be balanced against the State's other priorities.

We recommended that the Legislature may wish to ask departments to provide information related to the impact of federal program funding when it considers cuts in General Fund appropriations.

Legislative Action: Unknown.

Finding #4: The State has lost and may continue to lose some federal funds because of an inability to obligate funds, federal sanctions, and budget constraints.

Over the last three fiscal years, agencies sometimes lost federal funds by failing to obligate funds within the grants' period of availability. In addition, noncompliance with program guidelines in four instances resulted in funding losses of more than $758 million, mostly related to the lack of a statewide child support automation system. Finally, the statewide hiring freeze sometimes keeps agencies from spending available federal funding on grants staff, and a pending budget cut of 10 percent in personnel costs may further limit spending of federal funds.

Period of Availability

The most significant loss of federal funds resulting from a failure to obligate funds within a grant's period of availability relates to the Children's Insurance program grant, which is administered by the Managed Risk Medical Insurance Board (board). According to the board, over the last three years the State has forgone as much as $1.45 billion in available federal funding because of a slow start-up and limited state matching funds. As a state initiating a new program, California's need to enroll clients led to a slow start-up of the Children's Insurance program and a resulting loss of federal funds, which primarily match a state's spending on insurance coverage for enrollees. According to a report by San Diego State University, administrative start-up costs made up a high proportion of total costs for states with new Children's Insurance programs, but the federal Children's Insurance program limits federal funding for these costs to 10 percent of total program costs. Thus, states with new programs had to bear most of the costs for outreach and other administrative expenditures during this phase.

California has not had enough qualified program expenditures to use its total annual allocations each year, but expenditures have been rising steadily. According to estimates by the board, reimbursable program expenditures will approximate its annual

allocations in the next few years. Thus, the board estimates that unspent grant funds that carry over from year to year, though still large, will decline, and reversions to the federal government will stop after October 2003.

Program Noncompliance

Noncompliance with program guidelines in four instances resulted in funding losses of more than $758 million, mostly related to the lack of a statewide child support automation system. Since 1999, California has paid federal penalties for failing to implement a statewide child support automation system. Through July 2003, the total amount of federal penalties paid by the State amounted to nearly $562 million. The estimated penalty payment for fiscal year 2003–04 is $207 million.

As a step toward eliminating the penalties, the Legislature enacted Chapter 479, Statutes of 1999, providing guidelines for procuring, developing, implementing, and maintaining a single, statewide system to support all 58 counties and comply with all federal certification requirements. In June 2003, the Department of Child Support Services and the Franchise Tax Board, which is managing the project, submitted a proposal to the Legislature to enter into a contract with an information technology company to begin the first phase of project development in July 2003, with implementation in the 58 counties completed by September 2008. The total 10-year project cost is $1.3 billion, of which $801 million is for the contract. The federal government has conditionally approved the project, which is estimated to be eligible for 66 percent federal funding.

Hiring Freeze and Proposed 10 Percent Staff Reduction

In order to address the State's significant decline in revenues, Governor Gray Davis has undertaken several initiatives to reduce spending on personnel. These include a hiring freeze in effect since October 2001 and a 10 percent reduction in staffing proposed in April 2003. The hiring freeze already has had a negative effect on some federal programs, and the 10 percent reduction may affect them as well. After the October 2001 executive order, the Department of Finance (Finance) directed agencies, departments, and other state entities to enforce the hiring freeze. It also established a process for exempting some positions. The process includes explaining why a particular

position should be exempted and what the effect of not granting an exemption would be. Departments and their oversight agencies must approve the exemptions and then forward them to Finance for approval.

In response to our audit survey, staff at two departments said the hiring freeze and an inability to obtain exemptions had affected their federal programs negatively. In September 2002, the U.S. Centers for Disease Control and Prevention (CDC) wrote to Health Services noting vacant positions within the State's National Cancer Prevention and Control program and difficulties in filling vacancies due to the state-imposed hiring freeze as a major weakness. In a December 2002 letter of response to the CDC, Health Services indicated that it had filled some vacant positions, and in March 2003 Health Services sent exception requests for five federally funded positions to Finance, four of which Finance denied. As of June 2003, Health Services said that the CDC planned to reduce its grant for the 12 months ending June 30, 2004, to $8.4 million from the $10.6 million awarded for the nine months ending June 30, 2003. Health Services said an important element in the CDC's reduction was Health Services' inability to fill vacant federally funded positions.

Similarly, the U.S. Department of Agriculture (USDA) informed the Department of Education's (Education) Nutrition Services Division in September 2002 that through a management evaluation it had identified corrective actions in several areas where a lack or shortage of staff contributed to findings. It was concerned about staffing shortages in a unit responsible for conducting reviews and providing technical assistance to sponsoring institutions participating in the child nutrition programs. It warned that the USDA may withhold some or all of the federal funds allocated to Education if it determines that Education is seriously deficient in the administration of any program for which state administrative funds are provided. In May 2003, the State Superintendent of Public Instruction wrote to the Governor's Office asking for approval of a blanket freeze exemption allowing Education to fill all division vacancies, reestablish 12 division positions eliminated during the fiscal year 2002–03 reduction of positions, and exempt the division from a proposed 10 percent reduction in staff.

We recommended that Finance ensure that it considers the loss of federal funding before implementing personnel reductions related to departments' 10 percent reduction plans.

Finance Action: Partial corrective action taken.

Control Section 4.10 of the 2003 Budget Act, approved by Governor Gray Davis in August 2003, requires the Director of Finance to reduce departments' budgets by almost $1.1 billion and abolish 16,000 positions. Finance states that it specifically omitted any federal funds from its August 2003 notice to the Legislature identifying the appropriations to be reduced in accordance with this section. It did this so that departments would not be required to reduce federal fund appropriations without full consideration of the effects.

FRANCHISE TAX BOARD

Its Performance Measures Are Insufficient to Justify Requests for New Audit or Collection Program Staff

REPORT NUMBER 2002-124, MAY 2003

Audit Highlights . . .

Our review of the Franchise Tax Board's (board) audit and collection activities revealed the following:

- ☑ *The board does not always describe the differing cost components of its various performance measures, potentially leading to confusion about program results.*
- ☑ *Between fiscal years 1998–99 and 2001–02, recently acquired audit staff returned $2.71 in assessments for each $1 of cost.*
- ☑ *Because of limitations in board data, we could not isolate the return on 175 new collection program positions.*
- ☑ *The board's process for assessing the incremental benefit of recently acquired audit and collection program positions is flawed.*
- ☑ *The board allows some collection program positions to remain unfilled in order to pay for other expenses.*

Franchise Tax Board Response from State and Consumer Services Agency as of November 2003

A primary revenue-generating agency for the State, the Franchise Tax Board (board) processes individual and corporation tax returns, audits certain tax returns for errors, and collects delinquent taxes. Between fiscal years 1990–91 and 2001–02, the board provided an average of $31 billion in annual tax revenues to the State, over 60 percent of the State's General Fund. Although many taxes are self-assessed by individuals and companies, the board's audit program reviews the accuracy of tax returns, assessing additional taxes when appropriate. In turn, the collection program pursues delinquent taxpayers identified through the board's various assessment activities.

The Joint Legislative Audit Committee requested that we review the board's audit and collection programs, identifying recently acquired audit and collection program positions, assessing the board's calculation of the costs and benefits of these positions, and determining whether the board uses these positions as the Legislature intended. We were also asked to review the board's methodology for calculating the costs and benefits of its audit and collection programs. Finally, we were asked to determine whether a point of diminishing returns exists where additional audit and collection program positions do not generate a $1 to $5 cost-benefit ratio (CBR) and, if so, to determine the board's actions to shift those positions to other activities. We found that:

Finding #1: The board uses a variety of performance measures and does not always describe their differences in public documents.

The board uses a variety of measurements to gauge audit and collection program performance and to assign workloads to staff. Most of these measurements take into account some of the costs and related benefits for program activities, but the various measurements may include differing calculations of costs, which the board does not always fully describe in public documents. As a result, misunderstandings of the board's performance may arise. Ideally, a performance measure should compare all the benefits of a program with all the costs of producing them. However, when the board's budget documents project a return of at least $5 in benefits, whether assessments or revenues, for each $1 of cost for new positions, the projected return does not reflect allocated costs for departmental overhead, such as rent and utilities, and the understated costs are not disclosed. In contrast, the historical measures reported in the board's annual operations reports are calculated using full costs.

The board's performance measures for its audit and collection programs also suffer from a partial overlap in claimed benefits, another potential source of confusion about returns on costs. After 120 days, tax assessments the audit program claims as benefits become the collection program's accounts receivable, which, if collected, are also counted as benefits of the collection program.

To more completely and clearly reveal its programs' costs and benefits, the board should consider using the complete measurement of the audit program's performance that we have described in our report. This measurement compares all the benefits—the total revenues that result over time from the auditors' assessments of additional taxes—with the total costs to produce them, including the costs of collection. If it determines that its current information system cannot produce the data necessary for such a measurement, the board should consider the needs of a complete measurement when it upgrades or changes its current information system.

If the board decides not to use the complete measurement and continues to use separate performance measurements for the audit and collection programs, in budget change documents and other reports given to external decision makers, it should:

- Explicitly disclose the elements not included in the cost components of various performance measures used to assess the audit and collection programs and the effect of their absence.

- Disclose the overlap in benefits claimed by its audit and collection programs.

Board Action: Partial corrective action taken.

The board reports that it has developed and deployed an enterprise Activity Based Costing (ABC) tool, which provides information on the costs to perform various processes and business activities. The ABC model includes both direct and indirect processes and activities, which contribute toward the board's programs, including programs that provide revenue to the state. The ABC model enables the board to calculate the "cost" element of the CBR, but additional work is required to link the cost of the work to the revenue generated.

The board reports that its Activity Based Revenue (ABR) effort will link the cost of work to the revenue generated by adding "revenue streams" as work products. By adding the revenue stream costs to ABC, the board will be able to more completely measure program performance—that is, total cost and total benefit for programs such as audit and filing enforcement.

The board states that its ABR effort will initially use existing fiscal year 2002–03 cost and revenue stream data, and will produce test performance measures by Spring 2004. The board will evaluate the test performance measures and make recommendations for improvements for fiscal year 2003–04 data collection. Additionally, through its ABR effort, the board is evaluating the ability of its current information systems to produce the data required for a complete measurement, and will make recommendations for future consideration. The board states that the test performance measures and recommendations will be complete by June 2004.

Finally, the board reports that it has begun to provide clarification to performance measures reported to external decision makers. It states that recent documents provided to the Department of Finance (Finance) and the Legislative Analyst's Office (LAO) have both footnoted the measurement type and clarified its discount status. The board plans to continue this practice in future communications.

Finding #2: Prospective cost-benefit ratios for individual audit types do not reflect historical performance.

The board's historical performance measure of returns on its audit program includes the full effect of indirect costs, including departmental overhead, but the prospective CBRs for individual audit types do not. Thus, when full departmental overhead costs are taken into account, certain prospective CBRs drop below the anticipated return of $5 in assessments generated for every $1 of cost.

When we deflated the board's projected returns by actual departmental overhead costs, we found that had the board included full departmental overhead costs, the total actual return in assessments would closely resemble the board's projections. However, when we examined individual audit types, the variance was much greater, and the workplan projections failed to mirror historical returns. For example, the average assessment per $1 invested in personal income tax desk audits over the period was $3.87, whereas the board estimated that they would return $6.36. Even after deflating the workplan projections by departmental overhead costs, actual assessments per dollar of cost were still $1.75 less than originally projected.

The board believes that these differences generally arise from adjustments the audit program makes to historical data ultimately reported in operations reports. According to the board, the adjustments are made to correct misallocated charges and miscoded revenue and to better match costs to benefits. If the audit program corrects errors in the financial reporting system when it recalculates the basis for projections, we would expect that the board would use the corrected data in the operations reports, which it publishes after it prepares the workplans.

If the board believes that information it publishes in its operations reports is not accurate, even though it is based on the board's financial accounting system, the board should:

- Ensure that its financial accounting system reports accurate information, and

- Correct data it believes to be inaccurate before it publishes the information in its operations reports.

To track the accuracy over time of its calculations of the prospective CBRs for individual audit workload types, the board should compare these prospective CBRs against actual returns annually. The board should make the results available to Finance and the LAO and should also include them in the board's annual report to the Legislature on the results of its audit and collection activities. If the board believes this information is confidential, it can cloak the identity of the individual audit workloads in its annual report to the Legislature. Moreover, the board should use the results of the comparison in future calculations of prospective CBRs.

Board Action: Corrective action taken.

The board states that it is reviewing its methods of gathering data used in its operations reports and is reviewing actual costs and revenue reported. According to the board, progress has been made in changing the methods of assigning support costs for many sections beginning with fiscal year 2003–04. The board states that it is also continuing to look at the methods used to compile the operations reports.

The board further reports that it is compiling the information necessary to compare prospective CBRs against actual returns for its current workplan process and will include this information in its annual report to the Legislature. The board plans to use this information as one of several factors in its calculations of projected CBRs.

Finding #3: The board's budget change documents do not show how new audit positions have met projected results.

Although the board's current resource request format for new audit positions provides decision makers with more detail regarding audit workloads than the board typically provided prior to our 1999 report titled *Franchise Tax Board: Its Revenue From Audits Has Increased, but the Increase Did Not Result From Additional Time Spent Performing Audits,* its current format is still insufficient to demonstrate both the workload types to which the board intends to assign new staff and the historical return on those workloads. In addition, historical actual returns on the specific workloads are not measured against the projections used to justify the staff increases.

While the board's resource request format does include many of the features we previously recommended, it does not detail historical and projected hours and assessments by audit type as

we had suggested. Rather, the board summarizes all desk, field, and Internal Revenue Service follow-up audit activity into a single category, which obscures the very different returns on each of the personal income tax and corporation tax audit types. Without this information, decision makers are left without an accurate tool against which to measure whether the board's staffing increases return their projected assessments.

To provide useful information to decision makers when requesting additional audit positions, the board should use a format, shown in our 2003 report, that details the types of activities new auditors will perform as well as the projected assessments and historical assessments resulting from these activities. Additionally, the board should revise its supporting audit workplan to include the actual returns of each of the specific workload types for the most recently completed fiscal year.

Board Action: Pending.

The board states that before making any changes to its resource request format and supporting audit workplan it must first discuss them with the users of these documents. The board reports that due to the recent budget situation and the change in administration, discussions with the users of these reports have been delayed. According to the board, its budget director is scheduled to meet with Finance in November 2003 to discuss our suggested changes to these documents.

Finding #4: The incremental benefit of new audit positions was originally negative but has increased recently and measuring the incremental benefit of additional collection program staff proves elusive.

Although sufficiently demonstrating the overall cost-effectiveness of its audit and collection programs, the board's process for assessing the incremental benefit of recently acquired audit and collection program positions is flawed. The board uses an inadequate methodology to determine whether increases in audit assessments or collection program revenues resulted from additional positions. Rather than using an incremental approach to isolate assessment or revenue pools likely to have been affected by additional audit or collection program positions, the board compares its total projected audit assessments against its total actual audit assessments and its total projected collection program revenue against its total actual collection program revenue.

To determine the incremental benefit of the 340 net new audit positions between fiscal years 1992–93 and 2001–02, we isolated their budgeted costs and the actual assessments associated with the audits to which the board would have likely assigned the new staff. We found that the new audit positions generated average assessments of only $0.79 for every $1 of cost. It is important to note that the return on the additional positions shows improvement over more recent fiscal years. Between fiscal years 1998–99 and 2001–02, the new positions produced average assessments of $2.71 for every $1 of cost. Changes in the economy probably affected the return on these audit positions, but a significant cause of the low return is that despite having additional staff, the board did not increase the number of hours staff spent performing audits. The collection program received 175 positions between fiscal years 1998–99 and 2001–02, promising increased revenue of $179 million over that period. However, because of limitations in board data, we could not determine the return on the collection program positions.

See the recommendation under finding #3 above for addressing the measurement of the effectiveness of additional audit positions. To better measure the effectiveness of its additional collection positions, the board should develop a methodology for determining the incremental return of new collection program positions received in any given year. This type of analysis should isolate changes over a base year in revenue pools that are affected by the new positions and compare the resulting revenue against all costs resulting from the new positions.

Board Action: Partial corrective action taken.

The board reports that it is well on its way towards completing the design of a more refined methodology for measuring the effectiveness of manual collection efforts. The board states that it has established a consensus across the collection program as to the definition of "proactive," "reactive," and "automated" collection activities. The board reports that it has also created a conceptual framework for measuring inputs in terms of time expended by direct collection and support staff and matching the results in terms of dollars collected. This new framework will allow the establishment of a base year and comparison of results from year to year. The board reports that it has populated this model, run preliminary tests, and is currently evaluating the

results of those tests. Although the board plans to implement the new methodology in January 2004, it concedes that this target date may slip partially because of budget cuts.

Finding #5: The board's justification for new collection program positions does not reflect its current process for assigning work.

Unlike the audit program, which both justifies new positions and assigns work based on a workplan process that prioritizes work according to a CBR, the collection program currently uses a similar workplan process only to justify its increases in collection program positions. In actually assigning work, the board relies on the recently implemented Accounts Receivable Collection System (ARCS) to rank accounts according to various risk and yield factors that predict the likelihood of collection as well as the ultimate amount the system expects to collect. According to the director of the board's special programs bureau, now that the collection program has nearly two years of collecting experience using ARCS, analysis is under way to use data from the system to justify future staffing needs.

To more accurately represent how it actually allocates resources, the collection program should continue to develop a methodology based on ARCS for justifying future collection program positions. The revised process should include all relevant costs, including an allocation for departmental overhead, in addition to the ARCS' risk and yield factors. The estimated expenditures and projected revenues related to each new staffing request should be easy to compare against actual results.

Board Action: Partial corrective action taken.

The board reports that the workload tracking and revenue assignment methodology discussed above will complement the process used to project potential revenue from new collection positions that may be added in the future. The board expects to have this new reporting methodology in place by January 2004.

Finding #6: The board leaves some approved collection program positions unfilled.

The board is not using all of its funding for collection program salaries to actually fill authorized positions, but is instead using some funding for other costs. Periodically, the board rewards employees for meritorious performance through pay increases, or merit salary adjustments (MSA), above the initial salary funding for their positions. Before fiscal year 1999–2000, the board received budget augmentations to fund its MSAs, but beginning in fiscal year 1999–2000, the board's MSA funding ended. The difference between the total hours collection program staff worked and the total budgeted hours for the collection program increased by 5 percent shortly after the board lost its separate funding for MSAs.

Since the loss of separate MSA funding, the board has required each branch to achieve savings to pay for the branch employees' MSAs, allowing them to realize the savings from unfilled positions. The board believes state departments must leave positions vacant or they will overspend their salaries and wage budgets. However, Government Code Section 12439 requires that positions that are continuously vacant for six months be eliminated and Finance recently began eliminating those positions in state departments.

For the board to be consistent with the intent of budget control language and Finance, it should not, as a long-term strategy, leave collection program positions unfilled beyond the normal time it takes to fill a position.

Board Action: Corrective action taken.

The board reports that Finance removed all vacancies in existence on June 30, 2003, but has since returned some of the positions. According to the board, a small number of vacancies currently exist, but it states that virtually every vacancy in the collection program will be filled by the end of December 2003. The board also states that it will fill any future vacancies at the earliest opportunity. Finally, the board states that any future funding requests for additional positions will be based on a realistic estimate of appointment dates for the new employees.

DEPARTMENT OF GENERAL SERVICES

Certain Units Can Do More to Ensure That Client Fees Are Reasonable and Fair

REPORT NUMBER 2002-108, DECEMBER 2002

Department of General Services' response as of December 2003

Audit Highlights . . .

We found that certain units within the Department of General Services (General Services) often missed their estimates of project fees charged to client departments by more than 20 percent. These units, which are within General Services' Real Estate Services and Telecommunications divisions, could improve the accuracy of their estimates by more consistently employing the following best practices:

- ☑ *Document how estimates are calculated.*
- ☑ *Ensure the review and approval of estimates.*
- ☑ *Use multiple estimating approaches—along with historical data—to validate estimates.*
- ☑ *Evaluate estimates on completed projects.*

Further, we found that certain units could more accurately prepare and report cost data that General Services' management uses to decide on hourly rates. Finally, the Office of Public Safety Radio Services needs to improve its billing practices.

The Joint Legislative Audit Committee (audit committee) requested the audit after hearing concerns from the Legislative Analyst's Office (LAO) regarding the appropriateness of the Department of General Services' (General Services) capital outlay project management fees. We evaluated General Services' estimates of fees it charges departments for capital outlay and telecommunications projects—which generated three-quarters of General Services' project management fees during fiscal year 2001–02—and concluded that improvements can be made. Specifically, we found:

Finding #1: Some units do not always follow best practices or their own procedures when estimating project costs and fees.

Although units within General Services' Real Estate Services Division (Real Estate Services) and Office of Public Safety Radio Services (Radio Services) do well with certain aspects of estimating costs and fees for capital outlay and radio equipment installation projects, they do not always follow the best practices we identified or their own procedures. Specifically, staff were unable to provide us with documentation to demonstrate how the estimators derived the estimated cost for all line items for eight of the 10 projects we reviewed. In addition, Radio Services could not always demonstrate that its project estimates received either client or supervisory approval. The lack of client approval for two projects may lead to Radio Services absorbing $93,000 of the projects' costs. Moreover, these units are not consistently using multiple cost estimating approaches—along with historical data—when preparing estimates and are not conducting end-of-project reviews to evaluate the success of their estimates. We also found that Radio Services had not compared actual results to the estimates it generated using an estimating tool. As a result of these deficiencies, General Services cannot ensure that fees charged to client departments for these services are reasonable and fair. Further, the significant variances we found in project

estimates and line item estimates—many exceeding actual costs by more than 20 percent—further support the need to follow best practices when estimating fees.

To ensure that its estimates of project costs and fees are accurate and defensible and to improve the reliability of its process for estimating project costs, we recommended that General Services employ the following best practices:

- Adopt and follow a procedure to thoroughly document assumptions used in creating project estimates.
- Document evidence of supervisory and client review and approval and, if needed, develop a process for expedited client approval when clients of Radio Services insist that projects start immediately.
- Conduct evaluations at the end of each major project.
- Develop a historical database of completed projects and use the database to provide support for future estimated project costs for all major projects.
- Use multiple cost-estimating approaches for all significant line item estimates of major projects.
- Periodically review the performance of its cost-estimating tools against actual results and update the tools when necessary.

General Services' Action: Partial corrective action taken.

General Services agrees with the elements of best practices identified in our report and is striving to implement processes that include those practices. Specifically, General Services states that both Real Estate Services and Radio Services now require staff to document assumptions used to prepare fee and project estimates, along with the supervisory approval of these estimates. However, Radio Services continues to begin work on telecommunications projects before clients approve the costs, but does require that clients put their requests to start work on projects without approved costs in writing. While Real Estate Services indicates it has taken steps to better evaluate the estimates for completion projects, Radio Services believes that it is unable to perform in-depth post-evaluations of all major telecommunications

projects until it implements a new system known as the Automated Enterprise Support and Oversight Product system. This system will integrate Radio Services' existing automated and manual systems to allow for better management of its business practices. Because Radio Services does not expect to award a contract to develop this system until January 2004, it modified existing systems to include more relevant budget and cost information for staff to use when making estimates. Finally, General Services states that as more historical cost information becomes available, both Real Estate Services and Radio Services will be able to use additional cost estimating approaches.

Finding #2: Reports used to determine client hourly rates do not always reflect actual costs and Fiscal Services does not always allocate its overhead fairly.

Although General Services' process for developing the hourly rates of staff—which are the basis of many fee estimates—appears reasonable, it can improve the accuracy of a report that management uses to decide on the hourly rates. Units that provide services—with the assistance of General Services' Office of Fiscal Services (Fiscal Services)—provide management a report to allow it to make the decisions on hourly rates. The report recommends hourly rates for each type of service and is designed to include the at-cost rate for each service, which is calculated by dividing projected costs by the projected billable hours. However, we found that Radio Services' staff made $10.2 million in arbitrary or unsupported adjustments, such as shifting costs between units when calculating its at-cost rate. In addition, Fiscal Services allocated its overhead—which amounted to $7.6 million for fiscal year 2001–02—to units based partly on the units' ability to absorb the costs rather than on actual services provided. Although some of these adjustments may be justified, staff told us that some of the adjustments were made to achieve hourly rates similar to the prior-year rates. This preliminary "leveling" process distorts the picture that management sees when making rate decisions, and may lead to setting rates inappropriate to recover actual unit costs. In addition, some adjustments cause other units within General Services to shoulder more than their fair share of costs.

To ensure that the reports General Services uses in setting hourly rates reflect the true projected cost for each unit, we recommended that it require units to include in their

cost-recovery proposals the actual, unadjusted, at-cost hourly rate and clearly document the existence of and retain support for any adjustments designed to achieve a desired or recommended hourly rate. Also, to improve its method of allocating overhead and to make the process more objective, Fiscal Services should consider using another method to allocate its overhead costs to other units, such as using an average of two or three years' actual costs per unit.

General Services' Action: Corrective action taken.

General Services stated that as a part of its annual financial plan process, its executive management team will be provided at-cost rates as well as various other rate scenarios that will impact an operating unit's ability to be financially solvent and avoid rate volatility. In addition, Radio Services now requires that staff retain all documents and data to support adjustments to hourly rate calculations. Finally, Fiscal Services has revised its method of allocating its overheard costs to other General Services' units to be based on the average actual cost of services provided to each unit from the most recent three fiscal years.

Finding #3: Radio Services can improve its methods for assessing consulting fees related to system services and can improve its billing practices.

In addition to installing and maintaining telecommunications equipment, Radio Services provides consulting services such as preparing cost studies, developing reports, attending client meetings, and common services such as Federal Communication Commission (FCC) license renewals, representing the State before the FCC, and developing equipment specifications. However, we could not determine whether the consulting fees that Radio Services charges to client departments were reasonable and fair because of weaknesses in its cost accounting system. Further, we also found that Radio Services does not review for errors in invoices before they are sent to departments but instead it relies upon departments to detect billing errors. In one instance, the lack of review resulted in an under billing of $126,000 to a department. Compounding the problem is that Radio Services' invoices generally contain insufficient detail to allow departments to detect billing errors.

To improve the reliability and accuracy of its client fees, we recommended that Radio Services improve its cost accounting system so that it can ensure billings to client departments are reasonable and fair. In addition, we recommended that Radio Services review the accuracy of all invoices and continue its efforts to provide its clients with an adequate amount of invoice detail for them to review the accuracy of charges.

Radio Services' Action: Partial corrective action taken.

Radio Services reports that it has improved the controls over how staff charges time to client departments and strengthened the procedures for reviewing client invoices. In addition, for departments that request to be billed an annual fixed amount for services, Radio Services now bases these invoices on a three-year average of past costs to provide these services. However, Radio Services believes that it cannot provide client departments additional invoice detail to review the accuracy of charges until after it implements the Automated Enterprise Support and Oversight Product system. As mentioned previously, Radio Services does not expect to award a contract to develop this system until January 2004.

STATEWIDE PROCUREMENT PRACTICES

Proposed Reforms Should Help Safeguard State Resources, but the Potential for Misuse Remains

Audit Highlights . . .

Our review of the State's procurement practices revealed the following:

- ☑ *Until the governor's May 2002 Executive Order, departments did not compare prices among California Multiple Award Schedule vendors.*
- ☑ *Inadequate oversight by the Department of General Services (General Services) contributed to the problems we identified with departments' purchasing practices.*
- ☑ *Without comparing prices, the State purchased millions in goods and services for the Web portal from vendors that played a role in defining the approach and architecture for the project.*
- ☑ *Estimated Web portal project costs given to administrative control agencies and the Legislative Analyst's Office were sometimes inaccurate.*
- ☑ *Before the Executive Order, departments frequently misused alternative procurement practices—sole-source contracts and emergency purchases.*

REPORT NUMBER 2002-112, MARCH 2003

Department of General Services and the Stephen P. Teale Data Center responses as of September 2003

The Joint Legislative Audit Committee (audit committee) asked the Bureau of State Audits to audit the California Multiple Award Schedule (CMAS) program and the State's sole-source contracting procedures. Specifically, the audit committee asked that we review the process used by General Services when establishing the CMAS vendors list and the procedures and practices used to identify qualified contractors and consultants when using noncompetitively bid and CMAS contracts to procure goods and services. The audit committee also asked us to include in our review procurements related to the state Web portal.

Finding #1: Departments largely ignored recommended procedures for purchasing from CMAS vendors.

Our review of CMAS purchases made by nine state departments revealed that, before May 2002, when an Executive Order called for wholesale changes in the State's procurement practices, few departments took prudent steps, such as comparing prices, to ensure that they obtained the best value when acquiring goods and services from CMAS vendors. For example, largely at the request of two former officials of the Governor's Office, the Department of General Services (General Services), the Stephen P. Teale Data Center (Teale Data Center), and the Health and Human Services Data Center purchased more than $3.1 million in goods and services for the state Web portal from one CMAS vendor without comparing prices or using some other means to determine that the selected vendor provided the best value to the State. Additionally, General Services and the Teale Data Center purchased items for the Web portal totaling $690,000 that were not included in the vendors' CMAS contract.

Recent changes to the CMAS requirements have slowed but not halted departments' misuse of the CMAS program. Specifically, departments did not obtain at least three price quotes, as required, for two of the 25 CMAS purchases made after the date of the Executive Order.

In order to ensure that the State receives the best value when acquiring goods and services, we recommended that departments stress adherence to all CMAS requirements and reject requested purchases if these requirements are not met. Additionally, departments should review the appropriate CMAS contract to ensure that the requested good or service is included in the contract.

General Services' Action: Corrective action taken.

According to General Services, former Governor Gray Davis' Cabinet Secretary and Deputy Chief of Staff and the former Director of the Department of Finance jointly issued a memorandum to all departments notifying them that General Services' comprehensive training program for state contracting and procurement professionals is mandatory. The memorandum also encouraged all departments to review their procurement and contracting operations to ensure that all activities within these programs are conducted in compliance with requirements. These requirements are discussed most recently in a management memo issued by General Services on May 28, 2003, that establishes strict requirements for procuring goods and services through the use of CMAS and non-competitively bid acquisition methods.

Finding #2: The State's failure to compare prices created the appearance that some companies may have had an unfair advantage in selling Web portal components to the State.

The Web portal was developed with guidance from a group of executives from several private businesses, some of which later sold products for the project. Members of this group, called the Web Council, gave their "unanimous blessing to the portal's conceptual approach and its specific architecture." According to the minutes and agendas from Web Council meetings, representatives of several companies participating in the council made presentations to discuss their companies' products. Three of these companies ultimately sold hardware

and software components to the State for the Web portal totaling $2.5 million. These companies sold their products to the State, either directly or indirectly through resellers with CMAS contracts. The concept of obtaining guidance from industry experts is meritorious if, after obtaining the guidance, the State engages in an open, competitive procurement process. However, if obtaining advice from industry experts is followed by procurement of their goods or services without comparing prices to those offered by others, as was the case with numerous CMAS purchases for the Web portal, an appearance of unfairness is created.

In September 2002, the Teale Data Center assumed responsibility for providing management, maintenance, and support for the Web portal project. To ensure that the State's investment in the Web portal is a prudent use of taxpayer resource, it should use the competitive bidding process for purchasing goods and services for the project.

Teale Data Center Action: Corrective action taken.

Teale Data Center regularly utilizes General Services' contract registry to seek competition. Further, it is standard Teale Data Center practice to exceed the minimum number of bids required for informal bids as this practice ensures diverse vendor participation. Finally, as the existing Web portal services and maintenance contracts required renewal, Teale Data Center has competitively bid all subsequent new contracts.

Finding #3: General Services and former officials of the Governor's Office did not follow state policy governing information technology projects.

General Services—the administrator of the Web portal project—failed to obtain the necessary approvals from the former Department of Information Technology (DOIT) and the Department of Finance (Finance) before significant changes were made to the Web portal project. The changes, which increase previously approved project costs by 94 percent, were made at the direction of the former director of eGovernment. Among the changes, estimated to cost $9.2 million, were significant enhancements related to the energy crisis and terrorist threats and ongoing maintenance provided by consultants rather than state personnel, as was originally planned. General Services submitted a special project report to DOIT and Finance explaining the reasons

for the increased cost and seeking approval for the enhancements. However, the enhancements were completed four to six months before General Services submitted the report.

Additionally, General Services did not adequately coordinate and monitor Web portal purchasing and reporting activities. As a result, the special project reports submitted to DOIT, Finance, and the Legislative Analyst's Office (LAO) did not accurately account for all Web portal purchases. Specifically, at least one special project report that General Services submitted was inaccurate because it did not include more than $1.3 million in Web portal costs incurred by its Telecommunications Division and the Health and Human Services Data Center. According to the former chief of General Services' Enterprise Business Office, only costs that were under her control were reported to the individual preparing the special project reports.

Finally, it appears that responsible officials at General Services were unaware that a revised Web portal project report, which nearly doubled the estimated cost of the project, had been submitted to DOIT, Finance, and the LAO reflecting a significant increase in total project costs. According to officials at Finance, they met with former officials of the Governor's Office and representatives from General Services to discuss the proposed cost increases. The officials at Finance stated that it is not uncommon for minor modifications to be made to a special project report after it has been submitted for approval. However, we believe that changes to a project that effectively double the estimated cost of the project do not constitute minor modifications. Moreover, Finance could not provide any documentation of its analysis of the proposed project changes and resulting cost increase. Nevertheless, it approved submitting the revised estimates to the Legislature based on available information, given the high priority of the project.

To ensure that Web portal costs are properly accounted for, the Teale Data Center should monitor project expenses by recording estimated costs when contracts and purchase orders are initiated and actual costs when paid. The Teale Data Center should also submit special project reports to Finance and the LAO when required and ensure that reported costs accurately reflect actual expenditures and commitments to date. Finally, the data center should make certain that special project reports contain estimates for at least the same number of years that earlier reports cover so that reviewers can easily identify changes in the overall projected costs.

Teale Data Center Action: Corrective action taken.

The Teale Data Center's administrative processes require an internal analysis and approval of estimated costs prior to the initiation of the bidding process. If the resulting procurement activity results in costs that exceed the original estimate, approval is required before acquisition can be completed. Teale Data Center's Finance Division has developed a spreadsheet used to monitor projected versus actual expenditures. Should requests for acquisitions vary from the original plan, they are analyzed to determine the reason for the change and if it is within budget authorization prior to the expenditure being made. The spreadsheet is updated monthly and is shared with the manager of the Web portal and the assistant director of the Enterprise Division.

Furthermore, the Teale Data Center will continue to submit special project reports to the Department of Finance and the Legislative Analyst's Office, when required, which will accurately reflect all costs for the Web portal. Finally, the Teale Data Center will ensure that any future special project report and feasibility study report have consistent reporting periods.

Finding #4: The use of multiple departments to make purchases for the Web portal resulted in payments for services that were required under earlier agreements.

Several departments made Web portal purchases rather than one office coordinating and making all purchases. Consequently, no one office carefully tracked existing purchases and compared them to newly requested purchases, and the State contracted for some services even though the same services had already been required under earlier agreements. For example, General Services' Telecommunications Division issued a $173,000 purchase order to a consulting firm for project management of ongoing operations and maintenance of the Web portal. However, the terms and services of this contract duplicated some of the terms and services of another purchase order that General Services' Enterprise Business Office had previously issued to the consulting firm.

Similarly, the Health and Human Services Data Center entered into a $246,000 agreement with a consulting firm to create a plan to develop a Web portal mirror site. In reviewing the three reports that the consulting firm submitted in fulfillment of its

agreement with the Health and Human Services Data Center, we found that the content of the reports was information the consulting firm was already obligated to provide under an earlier contract with General Services.

General Services should review past payments to the consulting firm and another vendor by General Services, the Health and Human Services Data Center, and the Teale Data Center to ensure that the State has not paid for goods or services twice. If duplicate payments were made, General Services should recover them.

General Services' Action: Corrective action taken.

General Services reviewed the transactions in question and concluded that duplicate payments did not occur.

Finding #5: Recent actions by General Services and the Teale Data Center have reduced Web portal costs.

According to the most recent special project report, jointly submitted by General Services and the Teale Data Center, total estimated costs of the Web portal were nearly $6 million less than previously reported. The reduced costs were largely due to cutbacks in Web portal maintenance that included a major reduction in the number of hours for the consulting firm to maintain the portal.

In June 2002, the interim director of DOIT stated that the consulting firm's Web portal agreements were expensive and little had been done to transfer the consulting firm's expertise to state employees so that a state department could ultimately operate the portal. He recommended that General Services extend the consulting firm's contract until a competitively selected contractor became available. He also recommended reducing the size of the contract by restricting the consulting firm's role to limited maintenance and knowledge transfer functions, ultimately turning over the maintenance of the Web portal to state employees.

In January 2003, the Teale Data Center entered into a six-month contract with the same consulting firm for $350,000 in Web portal maintenance. Unlike the manner in which previous maintenance contracts had been established, however, the Teale Data Center solicited proposals from 20 different companies and six firms responded. The Teale Data Center evaluated the responses and eventually chose the consulting firm, achieving

a 39 percent average reduction in the hourly rate over previous noncompetitively bid agreements with the firm. Therefore, the Teale Data Center should continue to use the competitive bidding process for purchases of goods and services for the project.

Teale Data Center Action: Corrective action taken.

The Teale Data Center strongly supports the competitive bid process and has competitively bid all new contracts for the Web portal.

Finding #6: State departments improperly used sole-source contracts and emergency purchase orders.

Before the May 2002 Executive Order, state departments often did not adequately justify the need for sole-source contracts. Requests for sole-source contracts were often ambiguous or failed to demonstrate that the contracted good or service was the only one that could meet the State's needs. In addition, because they failed to make sufficient plans for certain purchases, departments often used sole-source contracts inappropriately. We reviewed 23 requests for sole-source contract approval submitted by various departments and found eight examples of departmental misuse of this type of exemption. General Services, however, approved all 23 requests. In four requests that General Services approved, the departments failed to provide the kind or degree of justification we expected to see. We could not determine whether the circumstances warranted a sole-source contract for one of the 23 requests because the department's justification was ambiguous. Finally, in three of the 23 sole-source requests, the departments sought the contracts because they failed to properly plan for the acquisition and, as a result, did not have time to acquire the goods or services through the normal competitive bidding process.

Similarly, departments frequently misused the State's emergency purchasing process by failing to meet the legal requirements for this type of procurement. For 17 of the 25 purchase requests we reviewed, the departments were requesting emergency purchases. In the remaining eight cases, the departments were requesting approval for reasons other than meeting emergency needs, such as seeking the purchase of items to meet special needs. Although General Services did not have the proper authority to grant exceptions for these purchases, it approved all eight.

Of the 17 emergency purchase requests totaling $21.3 million, nine totaling $2.3 million completely failed to identify the existence of an emergency situation that fell within the statutory definition or to explain how the proposed purchase was related to addressing the threat posed by an emergency.

State departments should require their legal counsel to review all sole-source contracts and emergency purchases to ensure they comply with statutes governing the use of noncompetitively bid contracts. Departments should also ensure that adequate time exists to properly plan for the acquisition of goods and services.

Moreover, General Services should require its Office of Legal Services to review all sole-source contract requests above a certain price threshold. General Services should also implement review procedures for sole-source contracts and emergency purchase orders to ensure that departments comply with applicable laws and regulations and require departments to submit documentation that demonstrates compliance. General Services should reject all sole-source and emergency purchase requests that fail to meet statutory requirements. Finally, General Services should seek a change in the current contracting and procurement laws if it wants to continue to exempt purchases from competitive bidding requirements because of special or unique circumstances.

General Services' Action: Partial corrective action taken.

General Services has implemented policies and procedures that provide for its Office of Legal Services to review all non-competitively bid contract requests that exceed $250,000. Additionally, General Services has developed a form that requires detailed information be provided to justify non-competitively bid procurements. Specifically, the form requires departments to provide detailed responses for various issues, including (1) why the acquisition is restricted to one supplier, (2) background events that led to the acquisition, (3) the consequences of not purchasing the good or service, and (4) what market research was conducted to substantiate the lack of competition. Finally, General Services is working to enhance the form to provide additional assurance that non-competitive procurements are properly justified.

Legislative Action: None.

General Services is reviewing the need for additional exemption authority related to competitive bidding. At this time, a final decision has not been made on the need to pursue additional authority in this area.

Finding #7: General Services needs to strengthen its oversight of state purchasing activities.

General Services has provided weak oversight and administration of the CMAS program. We found that General Services, which is responsible for auditing state departments for compliance with contracting and procurement requirements, is not performing the audits required by state law. Specifically, between July 1999 and January 2003, General Services had completed only 105 of 174 required reviews. Moreover, less than one-half of the 105 reviews were completed on time.

Additionally, General Services does not sufficiently review CMAS vendors to ensure that they comply with the terms of their contracts with the State. For instance, from July 1998 through September 2002, General Services had only reviewed 29 of 2,300 active CMAS vendors. Perhaps more importantly, General Services does not always make sure that other state and local government contracts on which CMAS contracts are based are, in fact, awarded and amended on a competitive basis. As a result, the State may be paying more than it should for the goods and services it purchases. Finally, General Services does not consistently obtain and maintain accurate data on departments' CMAS purchases. Consequently, it is sometimes charging other state departments more than it should for administrative fees. For example, we reviewed 90 CMAS purchases at nine departments and found 24 instances in which General Services had either entered the incorrect amount in its accounting system or had no record of the transaction. We further reviewed 10 of the 24 transactions and determined that General Services had overcharged departments more than $219,000.

We recommended that General Services implement the recommendations made by the Governor's Task Force on Contracting and Procurement Review (task force), which include increasing the frequency of audits and reviews of state departments. General Services should consider reducing or eliminating the delegated purchasing authority of departments that fail to comply with contracting and procurement

requirements. Additionally, General Services should increase the frequency of its reviews of CMAS vendors and ensure that processes established by other governmental entities for awarding and amending contracts are in accordance with CMAS goals. Finally, General Services should consult with departments to determine what can be done to facilitate monthly reconciliation of CMAS purchasing and billing activities.

General Services' Action: Partial corrective action taken.

General Services is committed to fully addressing the recommendations contained in the task force's report and is continuing to assign significant resources to that activity. For instance, General Services has initiated a cornerstone of the procurement reform effort—the training of state procurement officials. General Services has also implemented a system to track the volume and type of state procurement contracts. As a result, the State is now able to capture, through an internet-based system, data on all significant purchases on a near-real time basis. General Services has also facilitated meetings with the Department of Finance and departmental internal auditors to revise existing audit procedures to include CMAS and non-competitively bid contracts. Further, General Services is considering limiting its audits and reviews of some departments to an evaluation of the adequacy of the departments' most recent internal reviews. General Services noted that compliance with purchasing and contracting requirements is a major part of maintaining approved purchasing authority. If these requirements are not met, purchasing authority will be reduced or eliminated.

Although implementing a program that results in an increase in the frequency of vendor reviews is a priority, the State's current budget situation limits General Services' ability to obtain and assign additional resources to this activity. In the interim, General Services is focusing its limited resources on the review of the most frequently used CMAS suppliers. Finally, General Services believes that the implementation of a mandatory statewide electronic procurement system that would enable them to capture actual department purchasing activity in real time is the ultimate solution to its billing challenges. While General Services recognizes the importance of such a system, it is not feasible in the current fiscal environment. As an interim corrective action, General Services issued a memorandum to its customer departments advising them of the importance of regularly reconciling their purchasing information with invoices.

Finding #8: Although task force recommendations address most weaknesses, some cannot be immediately implemented and others are needed.

In August 2002, the task force recommended 20 purchasing reforms, completing its directive from the governor's Executive Order issued on May 20, 2002. The recommendations, which focus on the use of the CMAS program and noncompetitive bid contracts, call for comprehensive changes in the State's contracting and procurement procedures. Prompted by the controversy surrounding the Oracle enterprise licensing agreement, the governor asked the task force to review the State's contracting and procurement procedures and recommend the necessary statutory, regulatory, or administrative changes to "ensure that open and competitive bidding is utilized to the greatest extent possible." The task force's recommendations include the following:

- Departments must compare prices among CMAS vendors.
- Acquisitions of large information technology projects using CMAS contracts and master agreements should be prohibited unless approved in advance.
- General Services needs to establish specific criteria to qualify piggybacking vendors.[1]
- General Services should increase the frequency of its compliance reviews of purchasing activities of state departments.
- General Services should implement a new data integration system to address deficiencies in its ability to capture data and report on contracting and procurement transactions.

In general, we believe the task force's recommended changes, if properly implemented, should address many of the weaknesses in the CMAS program and noncompetitive bidding procedures we identified in our report. However, we believe that additional steps should be implemented based on the results of our audit. For example, General Services should revise its procedures for awarding contracts to vendors based on contracts they hold with other government entities because it often awards CMAS contracts without adequately evaluating the competitive-pricing processes that other state and local governments use to award base contracts.

[1] Vendors that do not have an existing federal multiple-award schedules contract but obtain a CMAS contract by agreeing to provide goods and services on the same terms as vendors that do have a multiple-award contract through the federal or some other government entity, are commonly referred to as piggyback contracts.

General Services also needs to develop classes that provide comprehensive coverage of sole-source contracts, emergency purchases, and CMAS contracts, and departments need to ensure that affected personnel attend the classes periodically. Also, because most of the departments we surveyed indicated they had experienced problems working with CMAS vendors, General Services should also consider holding periodic information sessions with the vendors. Further, in addition to implementing a new data integration system, which both General Services and the task force acknowledge is a long-term solution, we believe General Services should work with departments to establish a process to reconcile their purchasing information with invoices and reports prepared by General Services. Such reconciliation would allow departments to report and correct errors to General Services, thereby preventing incorrect billings and increasing the reliability of purchasing data. Finally, to increase departments' ability to access online information about the CMAS program, General Services should explore the possibility of including copies of vendor contracts on its Web site.

General Services' Action: Partial corrective action taken.

General Services is continuing to focus additional efforts on obtaining further assurance that processes used by other government entities to execute contracts are in accordance with CMAS goals. As part of this process, General Services has developed and implemented written policies and procedures that more clearly address this activity. Specifically, the CMAS analyst, through a review of documents and conversation with the awarding entity, must ensure that the process used by the awarding entity meets the State's standards for solicitation assessment.

As previously discussed, General Services has begun training of state procurement officials. In conjunction with the California State University at Northridge's Center for Management and Organization Development, General Services conducted an extensive survey of individuals involved in state purchasing activities. Based on this data, General Services is phasing in a series of new state acquisition courses. The first classes within General Services' comprehensive training and certification program were held on April 30, 2003. Additionally, the first classes within General Services' 64-hour Basic Certificate Program began on October 7, 2003.

Finally, according to General Services, while its Web site does provide a search tool by which departments can identify CMAS contracts by the categories of goods and services provided, departments are not able to access line-item detail on-line. Implementing a detailed catalog containing CMAS goods and services requires implementation of a comprehensive electronic procurement system. A dynamic software and hardware solution will be required to support the CMAS program, which has over 2,300 active contracts and more than 1,600 suppliers. At this time, the State's budget situation prevents the pursuit of this complicated and costly project.

RED LIGHT CAMERA PROGRAMS

Although They Have Contributed to a Reduction in Accidents, Operational Weaknesses Exist at the Local Level

REPORT NUMBER 2001-125, JULY 2002

Audit responses as of July 2003 to September 2003[1]

Audit Highlights . . .

Red light cameras have contributed to a reduction of accidents; however, our review of seven local governments found weaknesses in the way they are operating their programs that make them vulnerable to legal challenge. Specifically, we found that the local governments:

- ☑ *Need to more rigorously supervise vendors to maintain control of their programs.*
- ☑ *All but one would use photographs as evidence in criminal proceedings even though it would appear to conflict with the law governing the program.*
- ☑ *Generally follow required time intervals for yellow lights.*

Of the local governments we visited, only San Diego and Oxnard have generated significant revenue from their red light camera programs.

Our review of available data shows that red light accident rates decreased between 3 percent and 21 percent after red light cameras were installed by five of the local governments in our sample.

The Joint Legislative Audit Committee (audit committee) asked us to review the implementation, application, and efficacy of red light camera programs statewide. We found that accidents related to motorists running red lights have generally decreased where local governments have employed cameras. However, the seven local governments we reviewed—Fremont, Oxnard, Los Angeles County (Los Angeles), Long Beach, the city of San Diego (San Diego), the city of Sacramento (Sacramento), and the city and county of San Francisco (San Francisco)—need to make operational improvements to maintain effective control of their programs, comply with state law, and avoid legal challenges.

Finding #1: Local governments have been challenged on their control of red light camera programs.

Several local governments have been taken to court by alleged red light violators who claim that the local governments are not operating their red light camera programs as required under the law. Although the law stipulates that only a government agency, in cooperation with a law enforcement agency, can operate a program, it offers no further explanation or definition of what operate means, leaving the term open to interpretation. Because local governments contract out the bulk of services for these programs, private sector vendors inevitably play an important role. However, if municipalities delegate too much responsibility, they run the risk of their program being perceived as vendor controlled. For example, a court found that San Diego failed to satisfy the plain meaning of the word operate and that it had no

[1] Each of the seven auditee's responses were received on the following dates: Los Angeles, Long Beach, San Diego, and Sacramento, July 2003; San Francisco and Fremont, August 2003; and Oxnard, September 2003.

involvement with or supervision over, the ongoing operation of the program and concluded that San Diego exhibited a lack of oversight. San Francisco is in the early stages of defending itself against a similar lawsuit. However, a court ruled in favor of Beverly Hills, which was also the subject of a lawsuit alleging concerns over program operations like those in San Diego.

We recommended that to ensure local governments maintain control and operate their red light camera programs and avoid legal challenge, the Legislature should consider clarifying the law to define the tasks that a local government must perform to operate a red light camera program and the tasks that can be delegated to a vendor.

Legislative Action: None.

No legislative action found.

Finding #2: Local governments must more rigorously supervise vendors to retain program control.

We found that the local governments we visited do not exercise enough oversight of their vendors to avoid the risk of legal challenge over who operates their red light camera programs. Best practices for oversight consists of several elements to monitor and control vendor activities. Such oversight includes strong provisions in local governments' contracts with vendors to protect the confidentiality of motorists' photographs and personal data, making periodic site visits to inspect the vendor's operations for compliance with the law and contract terms, establishing criteria for screening violations, having controls in place to ensure that the vendor only mails properly authorized and approved citations, making decisions as to how long certain confidential data should be retained, and conducting periodic technical inspections of red light camera intersections. However, at the outset of our review, we found that the seven local governments did not exhibit all of the oversight elements we believe are needed to avoid legal challenge. After our inquiries, Long Beach took steps to amend the contract with its vendor to address two elements of oversight that were absent.

To maintain control over their programs and minimize the risk of legal challenges, we recommended that local governments conduct more rigorous oversight of vendors by employing all of the oversight elements we identified.

Local Government Action: Partial corrective action taken.

The seven local governments for which this finding applied reported the following corrective actions:

Fremont: Fremont reports that it now performs weekly spot checks of intersections with red light cameras. Further, Fremont completed a vendor site visit in April 2003, and concluded that the vendor maintains its office facility in an organized manner and is conducting business to the city's satisfaction. During this visit, Fremont concluded that the security over data was appropriate and that the vendor was purging Department of Motor Vehicles' records every 90 days. Fremont did not report action on our finding that its contract lacks a specific provision that makes the misuse of the photographs a breach of the contract.

➲

Long Beach: Long Beach reports amending its vendor contract to specifically state that photographs are confidential and to include a provision on when to destroy confidential documents. Further, Long Beach reports implementing a procedure to reconcile citations it has approved against those that the vendor has mailed.

Los Angeles: In August 2002, Los Angeles conducted an oversight visit of the vendor and it plans to perform other visits periodically. From this initial oversight visit, Los Angeles concluded that the internal controls are sufficient to maintain the integrity of the evidence and to ensure that only authorized citations are mailed to offending drivers. However, it will reevaluate the need for additional controls over the citation process when it awards a new vendor contract in December 2003. Los Angeles has developed new business rules that require the vendor to comply with all confidentiality provisions of the California Vehicle Code. The business rules also require that information and pictures for unenforced violations be destroyed immediately. The business rules will take effect when the county awards a new contract for red light camera services in December 2003. Recently, Los Angeles has adopted new maintenance procedures to inspect intersections equipped with red light cameras. The new procedures provide that at least once per quarter, or when signal timing is changed, the county's department of public works, red light camera vendor, and the California Highway Patrol will conduct a joint on-site test and certification to ensure that camera settings and calibration are correct.

➲

Oxnard: Oxnard suspended its program in January 2003 and reports that it changed red light camera vendors, with the new vendor beginning to install cameras in September 2003. Under the new vendor contact, Oxnard reports that the vendor must adhere to the confidentiality provisions in law, with any violation constituting a breach of contract with the city. Although the new contract does not require that data and photographs relating to unenforced citations be destroyed immediately, the contract does require that the vendor adhere to the city's policy for records retention and destruction of confidential information. Oxnard also indicates that during an upcoming visit to the vendor's facility, police officers will review the vendor's procedures for compliance with the contract and the practices outlined in our report. Finally, Oxnard believes that the vendor's system allows for a remote confirmation of the calibration of red light cameras. However, Oxnard indicates that it will conduct periodic inspections of intersections to ensure systems are intact and report any problems to the vendor.

Sacramento: Sacramento reports restarting its program in October 2002 as a joint photo enforcement program with the Sacramento County Sheriff's Department (sheriff's department). In September 2003, the city plans to enter an agreement with the sheriff's department, which will essentially allow the county to operate the red light camera program in the city as a part of a countywide enforcement program. The city believes this agreement will standardize and centralize the program so that only one program, with one standard is in effect. The city will have input into camera locations, but the day-to-day operation, maintenance, inspections, and issuance of citations will become the responsibility of the sheriff's department. The city indicates that sheriff's department staff will perform the citation screening, processing, and mailing functions that the vendor previously performed. The vendor will continue to maintain the cameras, develop the film and convert it to digital images, and archive the film. However, Sacramento indicates that all photographs relating to unenforced citations will be retained for three years because the city attorney believes that such retention is necessary to comply with California Government Code, Section 34090, and a city council resolution. Also, although Sacramento County will operate the city's program, the city of Sacramento indicates that it does not intend to review the need for revising the

contract language to specifically protect the confidentiality of data and photographs obtained from the Department of Motor Vehicles until after the current vendor contract expires.

San Diego: San Diego indicates it has restarted the program using the same vendor and that it has made numerous changes that should significantly improve the city's oversight of the vendor. Specifically, the revised vendor contract adds provisions that specify the confidentiality of program data and increase the penalties for contract violations. In addition, the city has developed detailed business rules to guide the vendor's review process. The city's police department will also inspect the vendor's facility each week . These inspections will be documented and will review security and data handling, along with testing a sample of alleged violations for proper handling by the vendor. The city's police department and traffic engineering office will conduct periodic inspections of red light camera intersections to ensure that the system settings and original construction designs have not been altered or tampered with. Further, the city attorney's office developed issuing guidelines for the alleged violations that it deems are prosecutable and the police department has agreed to follow these guidelines. Although not directly related to vendor oversight, the city is now using dual cameras—one showing the front view and one showing the review view—to better show the vehicle approaching the intersection and continuing through it during the red light phase. Finally, San Diego has changed the payment structure to pay the vendor based on a fixed monthly fee for each intersection equipped with red light cameras.

San Francisco: San Francisco reports taking several actions to address our recommendations. It now conducts all team meetings at the vendor's facility and intends to inspect the vendor's facility to ensure that confidential information is being safeguarded. In addition, San Francisco has commenced inspections of red light camera intersections to ensure that camera settings are appropriate and to determine whether the system is functioning properly. Further, in June 2003, San Francisco indicates the police department reconciled authorized citations with those mailed to ensure that only authorized citations were mailed for the period between October 2002 and May 2003. This reconciliation found no errors or inconsistencies. Finally, it has amended the vendor contract to require the vendor to destroy all data related to unenforced violations.

Finding #3: Most local governments believe photographs can be used for other law enforcement purposes.

According to state law, photographs captured by red light cameras are to be used only for enforcing compliance with traffic signals. However, local governments have differing interpretations of the confidentiality of the photographs taken by red light cameras. Six of the seven local governments in our sample acknowledged that they have used or would use the photographs for purposes other than enforcing red light violations, such as investigating unrelated crimes. According to our legal counsel, a literal reading of the statute prohibits use of the photographs for purposes other than to prosecute motorists for running red lights. However, several jurisdictions believe that other laws, as well as the California Constitution, would permit the use of red light photographs as evidence in criminal proceedings. According to our legal counsel, in view of the conflicting interpretation of the law, the courts will ultimately decide whether local governments are violating the red light camera law when they use photographs in criminal investigations. The California Constitution also provides that with a two-thirds vote of its members, the Legislature can specifically exclude certain evidence from criminal proceedings, and according to our legal counsel, this would likely include photographs related to traffic signal enforcement.

Because a potential conflict exists between the confidentiality provision in the Vehicle Code and the California Constitution regarding the admissibility of evidence, we recommended that the Legislature consider clarifying the Vehicle Code to state whether photographs taken by red light cameras can be used for other law enforcement purposes.

Legislative Action: None.

No legislative action found.

Finding #4: Local governments may not have addressed engineering improvements before installing red light cameras.

Although we found that traffic safety was usually the reason for selecting intersections for red light camera enforcement, we could not always verify that local governments addressed engineering solutions before placing red light cameras at intersections. The Federal Highway Administration recommends that before installing a red light camera system, traffic engineers review the engineering aspects of the potential sites to determine

whether the problem of vehicles running red lights could be mitigated by engineering changes or improvements. San Francisco best demonstrated that it met this best practice, while the other local governments we visited conducted their engineering improvements on a more informal and ongoing basis.

We recommended that before installing red light cameras, local governments should first consider whether engineering measures, such as improving signal light visibility or using warning signs to alert motorists of an upcoming traffic signal, would improve traffic safety and be more effective in addressing red light violations.

Local Government Action: Partial corrective action taken.

The six local governments for which this finding applied reported the following corrective actions:

➲ **Fremont:** Fremont has not reported the action it plans to take on this recommendation.

Long Beach: Long Beach reports that should it decide to expand the program beyond the three-year pilot, it will perform engineering reviews at each location identified for red light enforcement.

➲ **Los Angeles:** Los Angeles has not reported the action it plans to take on this recommendation.

Oxnard: Oxnard indicates that its traffic engineer has considered all possible options prior to installing red light cameras, including using an all-red interval to clear intersections, adjusting yellow light time intervals, adding new roadway striping, installing light-emitting diodes in signal lamps, and adjusting the posted speed limits. However, as noted in our audit, we could not determine if Oxnard took these steps before installing red light cameras under its original program.

➲ **Sacramento:** Sacramento has not reported the action it plans to take on this recommendation.

San Diego: San Diego has developed selection criteria for intersections, and it indicates that a detailed list of engineering solutions will be first considered at intersections selected for enforcement before it restarts the red light camera program. Also, intersections selected for enforcement will have a one second all-red interval to allow vehicles in the intersection time to clear.

Finding #5: Some local governments bypassed state-owned intersections with high accident rates.

Caltrans allows red light cameras at state-owned intersections but requires an encroachment permit for construction. The time it takes to obtain an encroachment permit—which grants the local government access to a state right-of-way for construction—was viewed differently among the local governments we visited. Fremont and Long Beach avoided placing red light cameras at state-owned intersections because they anticipated that the Caltrans permitting process would be too cumbersome and would unnecessarily delay the start of their programs. San Diego stated that Caltrans was unwilling to allow red light cameras on state-owned intersections, but the city could not provide evidence of Caltrans' refusal. Also, Los Angeles did not consider state-owned intersections for its program. By avoiding state-owned intersections, these local governments failed to place cameras at some of the more dangerous intersections within their jurisdictions.

To focus on traffic safety and to avoid overlooking high-accident locations that are state owned when considering where to place red light cameras, we recommended that local governments diligently pursue the required Caltrans permitting process, even though it may cause some delays to their programs.

Local Government Action: Partial corrective action taken.

The four local governments for which this finding applied reported the following corrective actions:

Fremont: Fremont reports that it will be pursuing the installation of red light cameras at state-owned intersections in the near future and that it has begun discussions with Caltrans regarding these installations.

Long Beach: Long Beach reports that should it decide to expand the program beyond the three-year pilot, it will consider placing red light cameras at state-owned intersections.

Los Angeles: Los Angeles has not reported the action it plans to take on this recommendation.

San Diego: The city indicates that it will place red light cameras at state-owned intersections if those intersections meet the selection criteria, regardless of any potential delays.

Finding #6: Not all local governments require vendors to follow municipal permit and engineering standards when installing red light cameras.

Local standards may include issuing the proper permits to perform the work, reviewing engineering drawings and plans for the suitability of the work proposed, and inspecting the finished work for accuracy and adherence to the plans and local construction requirements. Six of the seven local governments we visited required vendors to follow local permit and engineering standards to ensure proper construction and inspection of red light camera systems. However, San Diego chose not to apply its local permitting and engineering standards to red light camera intersections. Specifically, San Diego did not ensure that plans were prepared by a registered civil or electrical engineer, nor was the construction subject to the city's formal plan check, permitting, and inspection procedures.

We recommended that to ensure that intersections are constructed and cameras are installed as planned, local governments should follow their own permit processes by reviewing the as-built plans and inspecting the intersection after construction.

Local Government Action: Corrective action taken.

The one local government for which this finding applied reported the following corrective action:

San Diego: San Diego indicates that it will follow its own permit process. Specifically, it will require that a registered engineer design and submit plans for each red light camera installation for review and approval. Further, a city inspector will inspect the construction of each site before it is placed in operation, and as-built plans will be prepared to illustrate the actual construction of each site.

Finding #7: Caltrans guidance to local governments related to yellow light time intervals could be more specific.

With few exceptions, the local governments we visited complied with a new law requiring that the minimum yellow light time interval at intersections with red light cameras meet the standards established by Caltrans. The law became effective January 1, 2002, and was prompted by the Legislature's concern that yellow light time intervals at such intersections may be shorter than Caltrans' standards. Caltrans' standards use the

speed of the approaching traffic to determine the appropriate time interval for a yellow light. However, the Caltrans traffic manual does not specify how traffic engineers are to determine the speed of the approaching traffic, which can be done in one of two ways: using the posted speed limit or surveying the traffic speed. Therefore, local governments that do not meet Caltrans' standards using both posted speeds and speed survey results run the risk that their yellow light time intervals may be legally challenged.

To avoid the risk of legal challenges, we recommended that local governments petition Caltrans to clarify its traffic manual to explain when local governments should use either posted speeds or the results from speed surveys to establish yellow light time intervals at intersections equipped with red light cameras.

Local Government Action: Partial corrective action taken.

The seven local governments for which this finding applied reported the following corrective actions:

- **Fremont:** Fremont has not reported the action it plans to take on this recommendation.

  Long Beach: Long Beach indicates that it sent a letter to Caltrans that specifically requested clarification on whether the yellow light time intervals at red light camera intersections should be based on engineering surveys. However, the city had not received a response as of July 2003.

- **Los Angeles:** Los Angeles has not reported the action it plans to take on this recommendation.

  Oxnard: Oxnard indicates that its yellow light time intervals comply with accepted standards, but does not indicate whether it petitioned Caltrans to clarify the guidance in the Caltrans traffic manual.

- **Sacramento:** Sacramento has not reported how it will address this recommendation.

  San Diego: The city indicates that it has increased minimum yellow light time intervals to 3.9 seconds and 3.4 seconds, for a straight through movement and a left turn, respectively. City engineers will also review the approach speeds at red light camera intersections to ensure that the yellow light time intervals meet or exceed Caltrans' standards.

San Francisco: San Francisco reports that it intends to seek confirmation from Caltrans regarding its current practices for yellow light time intervals.

Finding #8: Accounting for program revenues and expenditures is weak.

Although good internal control practices dictate that local governments properly account for the revenues and expenditures of their respective red light camera program, only Fremont did so. Because each local government pays their respective vendor based on the number of red light citations that motorists' pay, it would be prudent for them to properly account for program revenues. Additionally, we found that only Fremont and Long Beach conduct monthly reconciliations of their vendors' invoices with the courts' payment records to ensure that they are paying their vendors the appropriate amount. Also, San Diego, San Francisco, and Oxnard could only provide us with estimates for some of their program costs. Without a more precise method of accounting for program expenditures, these local governments cannot accurately determine the cost-effectiveness of their programs and ensure that local resources are used appropriately.

To allow for better accountability over red light camera programs and to ensure that vendors are paid appropriately, we recommended that local governments improve their methods of tracking revenues and expenditures related to their programs.

Local Government Action: Partial corrective action taken.

The five local governments for which this finding applied reported the following corrective actions:

➲ **Los Angeles:** Los Angeles has not reported the action it plans to take on this recommendation.

Oxnard: Oxnard indicates that the city's accounting system now allows for the tracking of expenditures related to the red light camera program.

Sacramento: Sacramento indicates that it hopes the partnership with the Sacramento County Sheriff's Department will improve accountability over the program, but it does not indicate specific actions that will occur to implement this recommendation.

San Diego: San Diego's police department and courts have changed their accounting processes to allow for the accurate accounting of red light camera ticket revenues and expenses.

San Francisco: To more accurately calculate expenditures, San Francisco reports that it is looking into setting up an accounting procedure to track police effort on the program.

CALIFORNIA NATIONAL GUARD

To Better Respond to State Emergencies and Disasters, It Can Improve Its Aviation Maintenance and Its Processes of Preparing for and Assessing State Missions

Audit Highlights . . .

The California National Guard (Guard) can improve its aviation maintenance and its process to prepare for and assess state missions:

- ☑ *The Army Guard's ability to perform state missions may be compromised by a shortage of qualified aircraft mechanics and delays in receiving helicopter parts.*
- ☑ *The Army Guard does not ensure that personnel readiness reports exclude ineligible troops; however, because the Office of Emergency Services typically does not request full troop strength, the Army Guard's personnel readiness has no bearing on its ability to assist the State.*
- ☑ *The Guard needs to make certain that personnel in its Joint Operations Center who coordinate the Guard's state mission response receive requisite training.*
- ☑ *The Guard does not annually review and update its various emergency plans nor ensure that it implements recommendations from past mission assessments.*

REPORT NUMBER 2001-111.2, FEBRUARY 2002

California National Guard's response as of February 2003

The Joint Legislative Audit Committee requested that the Bureau of State Audits review the California National Guard's (Guard) readiness to respond to a natural disaster, civil disturbance, armed conflict, or other emergency. However, many of the Unit Status Report (USR) records on federal readiness are not available, being classified by the U.S. Army. Similarly, the U.S. Air Force has determined that all its Status of Resources and Training System readiness data are classified. Consequently, we are unable to report on the Army Guard's or Air Guard's overall readiness ratings for their personnel, equipment on hand, equipment condition, and training. Therefore, we focused much of our audit on the missions the Guard performs at the State's request. We especially considered the three Army Guard units most frequently called up and how the percentages of grounded helicopters might affect their ability to assist in state emergencies. We also looked at how personnel readiness, as reported in the USRs, might affect use of the Army Guard for federal wartime duty.

Finding #1: A lack of staff formally trained in helicopter maintenance and delays in receiving helicopter parts may contribute to low numbers of operational aircraft.

U.S. Army regulations instruct the Army Guard commanders to attain aircraft readiness goals by effectively managing maintenance and part supplies. However, data reported in the monthly Bridge Commanders' Statements do not identify reasons for delays in the helicopters receiving either maintenance or parts—specifically, whether delays are caused by personnel levels or some other factor. In their USRs submitted between January 2000 and July 2001, two of the three units we studied reported shortages of qualified aircraft mechanics. Our review of the units' manning reports—which identify all the

units' personnel and their assigned duties and formal training—showed that 50 percent of two units' maintenance staff were not formally trained in maintenance of UH-60 helicopters. It seems reasonable to conclude that the low numbers of operational aircraft are influenced by a lack of trained aircraft mechanics.

Generally, the U.S. Army trains the Guard's aircraft maintenance mechanics but cannot accommodate all new Guard recruits in the training courses. Therefore, the Army Guard must recruit aircraft mechanics with maintenance training on other types of helicopters and provide transition training to do maintenance on its UH-60s or CH-47s. However, these mechanics may not be able to work without supervision or sign off on major maintenance items. Further, because of increased time spent training and supervising personnel without formal training, the Army Guard's qualified staff may have fewer hours to spend meeting maintenance demands.

In addition, the Army Guard indicated that a lack of replacement parts is a barrier to keeping its helicopters operational. The Army Guard attributes this to the U.S. Army's choice to not use its resources for the requisite amount of aircraft replacement parts. As a result, there are simply not enough parts in inventory to meet demand.

To help improve its percentage of operational aircraft, the Guard should improve its data tracking and collection to determine why helicopters are not operational, then take appropriate steps to correct the identified deficiencies. In addition, the Guard should reassess the feasibility of distance learning opportunities for its maintenance personnel, including those previously coordinated with the U.S. Army, until the U.S. Army makes more training slots available for new recruits.

Guard Action: Partial corrective action taken.

The Guard reports that it has taken certain actions such as forming an aviation readiness council; having its aviation directorate closely monitor monthly aircraft readiness reports to allocate resources to non-operational aircraft; and implementing a program for quick assessment of aircraft readiness, focusing on non-mission capable aircraft, their available date, and critical problems. In addition, the Guard told us that the U.S. Army is improving the availability of aircraft parts to help improve the Guard's readiness. With regard to distance learning, the Guard noted that the

necessary hardware is already available in various Guard locations and it will pursue the acquisition of distance courses when the National Guard Bureau develops them.

Finding #2: The Army Guard's use of full-time maintenance personnel to fight wildfires delays helicopter maintenance.

The Guard's practice of using its full-time helicopter maintenance staff as crew to drop water on California wildfires delays maintenance and contributes to the lack of operational helicopters. For example, in 2000, the Army Guard flew its helicopters on 13 separate fire-fighting missions between July 26 and September 5 and dropped at least 2.4 million gallons of water. We analyzed the Guard's pay records, and found that full-time maintenance facility staff from two units contributed about 65 percent of their unit's total man-days during the 2000 fire season.

The Guard should determine how frequently it uses its full-time flight facility personnel in fire-fighting missions and set a standard that will not negatively affect the Army Guard's ability to meet helicopter maintenance demands.

Guard Action: Corrective action taken.

The Guard reports that it completed an analysis of its 2000 fire fighting season payroll records for various flight personnel. The Guard stated that its data show that part-time guard personnel are engaged in its fire fighting efforts. The Guard said it has established a standard that will keep the percentage of full-time and part-time fire fighting personnel commensurate with the percentage of these same personnel at its aviation facilities.

Finding #3: Weaknesses in the Army Guard's process for reporting personnel could result in overstated personnel readiness.

Contrasted with the aviation capability for state missions, the Army Guard's personnel readiness affects only the federal need for troops. In a quarterly USR, each Army Guard unit reports its personnel status by comparing available strength levels, or staffing, against wartime requirements. However, the Army Guard lacks an effective process to ensure that a unit includes only eligible soldiers in its strength levels. For example, the three Army Guard units we reviewed erroneously included at least 21 soldiers in their

combined USRs. Therefore, these units may have overstated their personnel strength levels, or P-levels, making it appear as though they are more ready for war or other federal duties than they are.

To validate the accuracy of USR data, we expected the Army Guard's headquarters would have a process that includes at least a comparison of soldiers pending discharge and inactive soldiers to those reported in the units' USRs and a review of soldiers listed in the "nonvalidate pay report" it receives from the National Guard Bureau (NGB)—a report that identifies part-time soldiers who have not received pay for 90 consecutive days. Because the personnel office maintains such data, it could use these records to ensure that units accurately compute their P-levels. However, the personnel office does not validate the accuracy of USR personnel data for all units, so the Army Guard's headquarters cannot ensure that units are preparing their P-levels accurately.

According to the director of the personnel office, headquarters does not instruct the units, such as those in the 40th Infantry Division (40th ID) to work with the personnel office during the USR process. Consequently, the Army Guard's headquarters is relying solely on the 40th ID to accurately compute its P-levels. The 40th ID represents 52 percent of the total units the Army Guard reports to the U.S. Army and 74 percent of the Army Guard's personnel.

To strengthen its process for personnel reporting in the USR, the Army Guard should do the following:

- Instruct the 40th ID and the personnel office to work together during the USR process to ensure that units in the 40th ID report accurate personnel data.
- Train appropriate staff on how to complete the USR.
- Strengthen its USR validation procedures to ensure that units adhere to U.S. Army regulations when they report USR data.

Guard Action: Corrective action taken.

The Guard stated that is has, on two separate occasions, instructed both the 40th ID and 49th CSC, that the personnel office would validate key personnel data. In addition, in April and July 2002, the Guard trained its field command personnel on the proper procedures for completing the USR—emphasizing the problems and submission standards for non-deployable personnel. The

Guard also reported that during its April and July 2002 USR data collection and preparation, it reviewed the accuracy of personnel data using seven different personnel reports.

Finding #4: Flaws in the personnel office's database prevent the Guard from detecting all discharged soldiers units report on their USRs.

Even if the personnel office performed a more thorough review, its database contains flaws that prevent it from detecting all discharged soldiers on the USR. In our attempt to calculate the average time it takes the personnel office to process discharges, the Guard gave us two lists that we found to contain inaccurate data. First, the personnel office gave us a list of soldiers from our selected units processed for discharge in 2001. However, the Guard later informed us that six soldiers on the list were still active members of the Army Guard. Because of the errors we identified, we requested and the personnel office sent us another list. However, again we found incorrect information for some soldiers on the list, such as the Guard's officers and warrant officers. Until it corrects serious database deficiencies, the personnel office will not be able to detect all discharges that units report on their USRs.

The Army Guard should correct deficiencies in its discharge database and continually update this database to make sure that it reflects soldiers who have actually been discharged.

Guard Action: Corrective action taken.

The Guard told us that it is no longer using a secondary personnel database, which contained errors to generate its reports. It claims that the primary personnel database at its headquarters is free from deficiencies and inaccuracies and it uses this database to generate reports showing discharged soldiers.

Finding #5: Weaknesses in the Joint Operations Center's procedures may limit its ability to provide the most effective state mission response.

As part of Plans, Operations, and Security located at the Guard's state headquarters, the operations center manages the Guard's state missions. The operations center provides in-house staff training on its operating procedures and a brief overview

of the Response Information Management System, an Internet-based system used by local and state agencies to manage the State's response to disasters and emergencies. However, the operations center does not track who has attended its in-house training or require its staff to complete other disaster preparedness training. Further, the operations center's premission monitoring of potential and ongoing disasters, which allows the Guard to anticipate the general requirements of potential state missions, is not included in its Standard Operating Procedures manual (SOP manual). Because the operations center cannot ensure that all appropriate personnel have received training or are aware of standard premission activities, staff may work less efficiently and be less prepared to act during emergencies.

The Guard should do the following:

- Develop a system to continually identify requisite training for its operations center staff.
- Ensure that staff receive the requisite training in military support to civil authorities, thereby improving staff response to state missions.
- Establish and maintain a system to track the training activities that operations center staff attend.
- Include premission activities in the operations center's SOP manual.

Guard Action: Corrective action taken.

The Guard reported that Plans and Operations has developed a training chart, which is used to identify and track requisite training for staff. In addition, the director of Plans and Operations is producing a monthly newsletter to help keep staff abreast of current operations, including available training. Finally, the Guard noted that it added premission activities to its SOP manual in March 2002.

Finding #6: The Guard lacks a process to annually review and update its emergency plans.

The Guard's emergency plans guide its response to disasters such as fires, floods, and earthquakes. Although the NGB requires the Guard to review and update these plans annually by

September 30, the Guard does not have a process to ensure that this takes place. In fact, the Guard revised only 3 of its 13 plans in calendar year 2001. The director of Plans, Operations, and Security points to high staff turnover and vacancies as reasons for the delays. Without ensuring the revisions are completed, however, the Guard cannot guarantee that its plans contain up-to-date and effective responses to disasters.

The Guard should develop and implement a system to review and update its state emergency plans annually, as the NGB requires. In addition, the Guard should review all its state emergency plans by June 30, 2002.

Guard Action: Corrective action taken.

The Guard reported that it has developed a system showing the month and year it reviews and/or updates a plan and when it forwards the plan to the NGB. Moreover, the Guard told us that it reviewed all its state emergency plans and made any necessary changes as of July 2002. Further, the Guard states that it prepared and published a multi-hazard plan including annexes addressing specific hazards comparable to the plans used by the Governor's Office of Emergency Services.

Finding #7: The Guard does not have a process to implement recommendations from assessment reports.

We reviewed After Action Reports (AARs) relating to various types of large-scale state emergencies, such as the 1992 Los Angeles riots, the 1994 Northridge earthquake, and various flood and wildfire seasons. After completing each mission, the operations center performed a formal assessment of the Guard's performance and typically identified problems and made recommendations on how the Guard could improve its state mission response. Specifically, the AARs for three missions between 1996 and 1998 indicate that at the start of each mission, the Guard should work with the Office of Emergency Services to negotiate an exit strategy that includes clearly defined criteria for extracting the Guard from a mission. NGB regulations require the Guard to terminate its military support to civil authorities as soon as possible after civil authorities can handle the emergency. Without establishing an exit strategy at the start of each mission, the Guard's crews could remain active longer than necessary, performing tasks that other entities could be doing.

Also, in three AARs submitted between 1993 and 1997, we identified a recurring problem with the Guard's ability to easily track and update the status of critical equipment. However, the Guard did not implement corrective action until early 2001, nearly eight years after it first identified the problem, when the operations center developed a list of the equipment used in state missions and began tracking that equipment's availability through monthly reports other Guard directorates prepared.

Because the Guard has no formal process to address previous problems encountered during its missions, it cannot promptly implement corrective action on AAR recommendations. The Guard acknowledges it lacks an adequate system to benefit from the previous missions' lessons. It is currently conducting a study, expected to be ready by June 2002, to identify better tracking systems for all its actions and activities, including this area.

The Guard should update the operations center's SOP manual to ensure that staff establish an exit strategy at the start of each mission. In addition, the Guard should establish a process to track and implement corrective action as appropriate on AAR recommendations, ensuring quick action to correct previous mistakes. Finally, the Guard should make sure that it completes its study by June 2002 so that it can identify better tracking systems for all of its actions and activities.

Guard Action: Corrective action taken.

The Guard commented that it updated its SOP manual to include establishing an exit strategy at the start of each mission. The Guard stated that it plans to carry out its exit strategies by coordinating with the Office of Emergency Services and monitoring daily situation reports during state emergencies. The Guard stated that it also updated its SOP manual to require tracking of AAR recommendations. Finally, the Guard reported that it completed its management study in June 2002, and as of March 2003, it had purchased a computerized tracking system. The Guard expects the system to be in place and fully integrated by July 2003.

DEPARTMENT OF SOCIAL SERVICES

Continuing Weaknesses in the Department's Community Care Licensing Programs May Put the Health and Safety of Vulnerable Clients at Risk

REPORT NUMBER 2002-114, AUGUST 2003

Department of Social Services' response as of October 2003

Audit Highlights . . .

As the State's agency for licensing and monitoring community care facilities, the Department of Social Services:

- ☑ *Has been less prompt in communicating exemption decisions.*
- ☑ *Has not adequately managed or investigated subsequent criminal history reports.*
- ☑ *Did not always follow its complaint procedures or make certain that facilities fully corrected identified deficiencies.*
- ☑ *Has adequately reviewed the counties it contracts with to license foster family homes, but has not always corrected identified deficiencies.*
- ☑ *Was not always timely, consistent, and thorough in its enforcement of legal decisions.*

The Joint Legislative Audit Committee requested that we assess the Department of Social Services' (department) policies and practices for licensing and monitoring community care facilities. Since our last review in August 2000 (child care report), the department has more selectively granted criminal history exemptions and has prioritized and quickly processed legal actions against facility licensees. However, the department could improve in other areas.

Finding #1: The caregiver background check bureau granted exemptions without considering all available information.

The caregiver background check bureau (CBCB) did not sufficiently consider information other than convictions when reviewing five of the 45 approvals we examined. The department's evaluator manual instructs the CBCB staff to consider factors such as the age of a crime, a pattern of activity potentially harmful to clients, and compelling evidence to demonstrate rehabilitation. However, the CBCB did not always consider all these factors. For example, the CBCB ignored self-disclosed crimes not appearing on individuals' criminal history records (rap sheets) and accepted without question character references that appeared inadequate.

To ensure that criminal history exemptions are not granted to individuals who may pose a threat to the health and safety of clients in community care facilities, the department should:

- Make certain it has clear policies and procedures for granting criminal history exemptions.

- Ensure staff are trained on the types of information they should obtain and review when considering a criminal history exemption, such as clarifying self-disclosed crimes and vague character references.

Department Action: Partial corrective action taken.

The department reported that it agrees with these recommendations. It has drafted procedures related to exemption processing, trained its staff on these procedures in September 2003, and will release an updated procedures manual in November 2003. The department reported that rap sheet screening procedures, among others, have been finalized and it is training staff on this material.

Finding #2: The CBCB often did not perform criminal history checks within established time frames.

The CBCB's performance in promptly communicating to facilities and individuals the ultimate decisions on exemption requests worsened since we issued the child care report, despite the CBCB extending its time frames for decisions from 45 days to 60 days. In 20 of the 45 (44 percent) criminal history exemption approvals we examined, the CBCB did not meet its timeline in effect when the exemption decisions were made, even though there was nothing unusually complex about most of the cases. In July 2003, emergency regulations became effective that prohibit an individual from being in a licensed facility until the CBCB completes a criminal history review. This regulatory change addresses the concern that individuals with dangerous criminal backgrounds may begin work before the department has evaluated their criminal history. However, the CBCB's delays will also prevent individuals with less serious criminal histories from working until the CBCB completes its criminal history reviews. Thus, the CBCB's delays may impede a person's ability to work.

To process criminal history reviews as quickly as possible so that delays do not impede individuals' right to work or its licensed facilities' ability to operate efficiently, the department should work to make certain that staff meet established time frames for making exemption decisions as requested.

Department Action: Partial corrective action taken.

The department said that it was placing a higher priority on individuals with lesser crimes or infractions because this group represents the largest majority of workload and allows these individuals to be in a facility as quickly as possible. The department stated that individuals needing a standard exemption will take longer to process.

Finding #3: The CBCB's quality control review of exemption decisions was not always effective.

Although the CBCB performed quality control reviews of exemption analysts' processing of exemption requests, we had one or more concerns with six of 17 cases that were subject to the CBCB's quality control process, indicating further improvement is necessary. The CBCB's quality control process is designed to help ensure that the exemption analysts reached the proper decisions based on the available information, including, but not limited to, rap sheets. In addition, the CBCB requires the quality assurance reviewer to verify that exemption analysts properly complete departmental forms and correctly draft letters communicating the exemption decision to the appropriate people and entities. However, we found that the CBCB's quality assurance reviewers sometimes failed to question cases for which exemption analysts had recommended approval despite missing documents or vague disclosures.

The department should assess its quality control review process and ensure that these policies and procedures encompass a review of the key elements of the exemption decision process.

Department Action: Partial corrective action taken.

The department stated that it is modifying its quality control procedures and expects final procedures to be in place by the end of 2003.

Finding #4: The department could better track and assess arrest-only information and better review criminal history information before issuing clearances.

If the CBCB receives arrest-only information, which discloses arrests for crimes without convictions, the CBCB may refer the information to the department's Background Information Review Section (BIRS). The BIRS determines whether an investigation of the circumstances leading to the arrest is necessary.

We expected the BIRS to have a process in place that did the following:

- Recorded when a case was referred to the field for investigation.

- Tracked a case to ensure that an investigation took place.

However, when the BIRS initiated an investigation, it failed to effectively track cases to their conclusion and has no systematic follow-up on cases it referred to the field to ensure an investigation is completed. As a result, necessary investigations may not have been completed, potentially exposing clients in community care facilities to unfit caregivers.

In addition, the department's policies and procedures for processing and tracking arrest-only investigations are not always clear. For example, confusion exists about how field investigators are to report their recommendations on cases involving behavior that is considered "conduct inimical"—behavior so harmful or injurious, either in or out of a facility, that there may be a statutory basis to ban an individual from a licensed community care facility. It is clear that both the BIRS and licensing offices should be informed of the recommendation, but it is not clear if the field investigators are to inform the licensing offices directly, or indirectly, through the BIRS. Without clear communication to track the status of a case, it is possible that after determining that an individual is unfit to be a caregiver, the department would fail to take action to remove the individual.

If the arrest-only information reflects a crime the CBCB considers inconsequential, such as a vehicle code infraction, or if a field investigation initiated by the BIRS cannot develop sufficient information to legally exclude the individual, either unit will issue a criminal history clearance. In three of 25 cases

with arrest-only information we examined, the CBCB (two cases) and the BIRS (one case) inappropriately issued criminal history clearances to individuals who were actively involved in court-mandated diversion programs. In these three cases—two cases involving welfare fraud and perjury and one case involving possession of a controlled substance—the CBCB and the BIRS failed to follow department policy of seeking additional information to determine whether the individuals were satisfactorily meeting the court's requirements. By clearing individuals currently participating in diversion programs, we believe that the CBCB and the BIRS risk ignoring important information that could be used to better protect clients in community care facilities.

So that investigations of arrest-only information are properly tracked and communicated, we recommended that the department:

- Develop a process for the BIRS to record when it refers a case for investigation and track a case to make certain that an investigation takes place.

- Make certain that policies and procedures are consistent and clear on where the responsibility lies for ensuring that the necessary action occurs upon an investigation's completion.

We also recommended that the department review and enforce its arrest-only policies and procedures to ensure that it is issuing criminal history clearances only when appropriate to do so and properly train staff on these policies and procedures.

Department Action: Corrective action taken.

The department stated that it implemented a system that generates a listing of cases and the dates these cases are referred to the field for investigation. The department said the list will prompt its analysts to inquire about the status of case investigations. In addition, the department reported that it implemented procedures that clearly define the responsibilities for ensuring that an investigation has been completed and appropriate action taken. Finally, the department stated that it had implemented procedures that address clearance criteria for arrests and that all appropriate staff have been trained.

Finding #5: The CBCB's handling of subsequent criminal history information was weak.

The Department of Justice (Justice) sends the CBCB subsequent rap sheets (subraps) to notify the CBCB of crimes for which caregivers or others at a facility have been arrested or convicted after the CBCB conducts its initial criminal history review. However, significant problems exist in the way the CBCB processes subrap information it receives from Justice. For example, the CBCB did not have adequate procedures for tracking its handling of subraps and sometimes did not record when it had received them. By not tracking its process, the CBCB was unable to effectively monitor whether it promptly considered subraps to protect clients in community care facilities. Furthermore, the CBCB was slow to notify facilities when exemptions were needed based on conviction information in subraps and did not notify its licensing offices when individuals could no longer be present in facilities because they failed to respond to these notices. Because of these delays, the CBCB sometimes allowed individuals unfit to be caregivers to remain in that role.

To ensure the department can account for all subraps it receives and that it processes this information promptly, we recommended that the department develop and implement a policy for recording a subrap's receipt and train staff on this policy. In addition, upon receiving a subrap, the department should ensure that staff meet established timeframes for notifying individuals that they need an exemption.

So that the department's licensing staff have accurate information about who should or should not be in a facility, thereby helping to protect clients, the department should meet its established time frame for notifying licensing staff and facility owners/operators that an individual has not submitted a criminal history exemption request as necessary and may no longer be present in a facility.

Department Action: Partial corrective action taken.

The department said that it has modified its computer system to allow for better subrap tracking. In addition, the department reported that all policies, procedures, and training plans will be in place by January 2004. Moreover, the department stated that it has placed a higher priority on cases where individuals have received approval to work in a facility and are later arrested for certain crimes or are

convicted of a crime. Finally, the department reported that it is reassessing its work priorities in order to establish more realistic timeframes regarding exemption needed notices.

Finding #6: Under the CBCB's current criminal history review procedures, certain out-of-state crimes may go undetected.

If an individual leaves a community care facility and returns to work within two years, the CBCB may not be aware of that individual's complete criminal record for the two-year period. To meet the Health and Safety Code requirement that it maintain criminal record clearances for two years after a caregiver or adult nonclient resident is no longer in a facility, the CBCB receives subraps from Justice disclosing any in-state criminal activity over the two-year period. Department policy is to rely on these ongoing disclosures and not require a full criminal background check when these individuals return to work in a licensed facility. As a result, a caregiver or nonclient resident could leave a facility, be arrested or convicted of a crime outside of the State, which would not appear in Justice's subraps, and then return to a facility within two years without the CBCB knowing about the criminal activity. Unlike Justice, according to the operations branch chief of the Community Care Licensing Division, the Federal Bureau of Investigation does not offer a subrap service. However, he acknowledged that the problem we outlined exists, and stated that the department would continue to look at the issue.

We recommended that the department assess its Federal Bureau of Investigation background check practices to ensure that it is fully aware of an individual's criminal record should that individual have a two-year or less gap in employment in community care.

Department Action: Pending.

➲ The department assessed its practices as we recommended, but reported that limited resources will prohibit it from requiring additional Federal Bureau of Investigation background checks for individuals who become disassociated from a facility and then return to work within two years.

Finding #7: The department did not always follow required complaint procedures.

The department asserts that most of the corrective actions it undertakes are identified through its complaint process rather than other facility evaluations. However, we found when licensing analysts (analysts) identified facilities' deficiencies during complaint investigations, they did not always ensure that caregivers complied with the corrective action plans. For 11 of the 33 substantiated complaints we reviewed, the department could not demonstrate that the facilities completely corrected the problems that prompted the complaints. By not following through to see that corrections are made, the department negates its efforts in investigating and substantiating complaints.

To protect clients' welfare, laws and procedures mandate certain time frames within which the department must initiate and follow through on complaint investigations, but the department did not always meet these timeframes. For example, our review of 75 complaints the department received in calendar years 2001 and 2002 identified 19 complaints for which the department made its initial facility visits beyond the 10-day requirement set by law. The visits ranged from two to 175 days late. Whenever the department delays an initial facility visit following receipt of a complaint, the department runs the risk of perpetuating a client's exposure to the alleged harmful conditions.

Finally, the department's policies specify that abuse complaints are a top priority and require analysts and supervisors to handle these complaints differently from routine complaint investigations because these complaints represent a serious threat to the clients' well-being. However, the department did not consistently follow these special procedures for the top-priority allegations among the 75 complaints we reviewed. For instance, the department did not refer two of 22 abuse complaints to the field investigators as required and did not send another three within the required time frame of eight working hours after receiving the complaint. When analysts do not refer or are slow to refer serious complaints to the field investigators, the analysts risk jeopardizing the expeditious handling of complaints and may affect the immediate safety of vulnerable clients.

To address the department's weaknesses in following required complaint procedures, we recommended that the department:

- Continue to emphasize complaint investigations over other duties and require supervisors to review evidence that facilities took corrective action before signing off on a complaint.

- Require analysts to begin investigating complaints within 10 days of receiving complaints.

- Ensure that analysts follow policies requiring them to refer to the investigations unit any serious allegation within eight hours of receipt.

Department Action: Partial corrective action taken.

In August 2003, the department reminded its licensing staff of the importance of conducting and completing complaint investigations in a timely manner through a Workload Prioritization memorandum. The department reported that it will require all supervisors to wait to sign off on complaints until all plans of correction are complete. The department cited its increasing emphasis on complaints and the concern that all corrections be completed for making this change. The department indicated it plans to change its evaluator manual to reflect the requirement that licensing field staff issue a citation within 10 days of receipt of the investigative findings.

Finding #8: Certified family homes may have avoided correcting their deficiencies by changing certification from one foster family agency to another.

The department is responsible for licensing foster family agencies—private nonprofit corporations that in turn certify adults (certified parents) to operate foster family homes (certified family homes). However, because the department does not require foster family agencies to request information about applicants' compliance histories, the opportunity exists for certified parents to avoid correcting identified deficiencies.

We recommended that the department require foster family agencies to ask each applicant whether he or she had uncorrected, substantiated complaints at any other foster family agency and to verify the accuracy of an applicant's statements with the applicant's immediate prior foster family agency.

Department Action: Partial corrective action taken.

The department reported that it is developing a self-assessment Technical Assistance Guide for foster family agencies and plans to finalize it by February 2004. In addition, the department stated that this guide will serve as the foundation for regulations that it will develop within a year.

Finding #9: The department sometimes granted facility licenses based on incomplete applications and did not always perform required post-licensing visits.

When making its decision to license a new facility, the department did not always demonstrate that it collects and considers all required information and documents that help ensure the safety of vulnerable clients, such as evidence that the applicant obtained the necessary health screening and client care training. For example, of the 54 licenses we reviewed that the department granted during 2001 and 2002, the department granted 12 licenses before the applicants met one or more of the necessary requirements. In addition, the department did not consistently conduct all necessary post-licensing evaluations or ensure that the visits it did perform were made within statutory timelines. Specifically, of the 54 licenses we reviewed, 44 required post-licensing visits. For 13 of these facilities, the department could not provide documentation that it had conducted the necessary post-licensing visits. Moreover, the department conducted post-licensing visits late for an additional 21 facilities.

To ensure that it issues licenses only to qualified individuals, we recommended that the department ensure that analysts follow the department's checklist in collecting and considering all required licensing information, including, but not limited to, health screening reports, administrator's certification, and necessary background checks.

We also recommended that the department conduct the necessary post-licensing evaluations within the required time frame to make certain that newly licensed caregivers are operating according to regulations.

Department Action: Partial corrective action taken.

The department reported that it completed reviews of its licensing processes for its four program areas and is developing plans to better assure that all information necessary to approve licenses is received and reviewed. In September 2003, the department issued a memo outlining its program focus in response to the fiscal year 2003–04 budget. The memo lists post-licensing evaluations as an important activity and introduces annual and sample visit protocols that will provide additional time for post-licensing visits.

Finding #10: The department did not always evaluate staff performance or provide required staff training.

To periodically monitor the quality of the most important aspects of an analyst's work, the department created its quality enhancement process (QEP) reviews. Although supervisors in the foster care program prepared and documented the necessary QEPs for the analysts we selected to review, supervisors in the adult and senior care programs at the licensing offices we visited did not. In fact, adult and senior care program supervisors did not complete nine of the 11 QEP reviews of analysts we selected for examination. Although the supervisor recalls preparing QEPs for the remaining two analysts, she could not provide documentation to support her assertion. We believe ongoing assessment of the analysts' performance is essential to ensure the analysts are effectively applying program policies.

The Health and Safety code sets out staff development and training requirements for all analysts so they have the skills necessary to properly carry out their duties. Although these requirements are designed to provide information analysts need to stay current with the demands of their jobs, of the 22 analysts we selected who required this level of training during fiscal year 2001–02, 20 had training hours that fell short of statutory requirements. Without the necessary ongoing training, we question whether analysts are prepared to effectively perform their duties.

We recommended that the department make certain that all licensing office supervisors conduct QEP reviews of their assigned analysts. In addition, we recommended that the department make available to analysts the necessary training and develop a method to track whether analysts are meeting statutory training requirements.

Department Action: Partial corrective action taken.

➲ The department reported that it suspended its QEP evaluations in offices with severe staffing shortages and that it plans to reimplement these evaluations when staffing levels improve.

The department also stated that it had developed a new training database and instructed staff on its use. In addition, the department said it is developing a training need assessment tool to assist it in determining the specific needs of each licensing program.

Finding #11: The department has adequately monitored county licensing functions, but did not always ensure counties promptly corrected deficiencies.

As the department's agents for licensing and monitoring foster family homes within their geographical boundaries, contracted counties must follow related state law and department guidelines for implementing and enforcing rules and regulations pertaining to foster family homes. Although the department reviews the counties' licensing programs, it provides limited guidance regarding time frames to department staff performing the reviews, for preparing their reports, notifying counties about deficiencies, and to provide counties to correct deficiencies. Our analysis revealed that liaisons sometimes allowed a long time to elapse between the end of their reviews and the due date for the counties to submit their corrective action plans. Four counties we reviewed originally had between 120 days and 329 days after the end of the review to submit their plans, and the liaison granted extensions to the due dates for three of these. By not obtaining the counties' evidence of prompt corrective action, the department has limited the effectiveness of its county reviews and potentially allows counties to continue to operate improperly.

To help ensure that counties contracting with the department to license and monitor foster family homes adequately and promptly respond to complaints and enforce corrective actions, we recommended that the department establish reasonable time frames for liaisons to prepare reports resulting from reviews of the counties and to notify counties of the results of those reviews and for counties to submit and complete their corrective action plans.

Department Action: Corrective action taken.

The department said that it developed a formal policy with timeframes for liaisons to prepare reports and send notification of the review results to the affected county. In addition, the department developed standard timeframes for staff to utilize in developing corrective action plans. This policy went into effect October 1, 2003.

Finding #12: Despite recent efforts to improve, the department could do more to oversee county criminal history exemptions.

There are 42 counties that contract with the department to license foster family homes, and these counties perform background checks on potential caregivers and nonclient residents to ensure that people with serious criminal histories are not providing foster care or living in foster family homes. Contracted counties must submit exemption reports each quarter, but the department did not fully utilize the reports. The department has not provided its staff guidance on when to review the reports, what to look for when they perform their reviews, and when to follow up. We believe collecting and reviewing the exemption reports on a continuous basis allows the department to track criminal record information from all 42 counties and make certain it is aware of all their exemption processing.

We recommended that the department develop procedures to ensure that it promptly and consistently reviews quarterly reports on exemptions granted by each contracted county to help ensure that counties contracting with the department to license foster family homes are making reasonable decisions regarding criminal history exemptions.

Department Action: None.

➲ In its response, the department stated that it has continually reviewed its quarterly county exemption reporting process with the counties and licensing supervisors. However, the department has not addressed the need for it to establish internal procedures to ensure the information the counties submit is promptly and consistently reviewed.

Finding #13: By conducting follow-up visits, the department could have improved its enforcement of legal actions.

Once the department signs a decision revoking a caregiver's license, excluding a caregiver or adult nonclient resident, or putting a caregiver on probation, the legal division is responsible for sending a copy of the decision to the applicable licensing office. The licensing office is then responsible for enforcing the legal actions. We reviewed 26 legal actions which resulted in a caregiver's probation, exclusion, or license revocation. In 11 instances the department either did not adhere to its follow-up procedures to ensure the caregivers complied with the terms of the probation, revocation, or exclusion, or did not document its actions. Specifically, in five cases, the department failed to follow up with the caregiver promptly and in two cases did not visit the caregiver at all. In the remaining four cases, the department did not document the actions it took to follow up on the legal decision that was made.

To improve its enforcement of legal actions, we recommended that the department conduct follow-up visits to ensure that enforcement actions against facilities are carried out and that it document its follow-up for enforcement of revocation and exclusion cases.

Department Action: Corrective action taken.

The department stated that in August and September 2003 it issued memos reemphasizing the importance of conducting required visits to facilities to enforce legal actions.

CONTRACTORS STATE LICENSE BOARD

Investigations of Improper Activities by State Employees, July 2001 Through February 2002

ALLEGATION I2000-753 (REPORT I2002-1), JUNE 2002

State and Consumer Services Agency's response as of March 2002[1]

Investigative Highlights . . .

A Contractors State License Board (CSLB) executive engaged in the following improper governmental activities:

- ☑ *Accepted $4,000 from a non-state entity for performing duties related to his state function.*
- ☑ *Circumvented civil service hiring practices by directing a CSLB contractor to pay an employee to work for the CSLB.*

CSLB:

- ☑ *Made an emergency and subsequent permanent appointment of an employee that were illegal.*
- ☑ *Made other questionable or improper appointments of additional employees.*

Along with the Department of Consumer Affairs (Consumer Affairs), which oversees the Contractors State License Board (CSLB), we investigated and substantiated allegations that an executive at the CSLB engaged in activities that were incompatible with his state position when he accepted payment from a non-state entity for serving on an advisory panel as part of his state duties. The same executive circumvented civil service hiring policies, did not disclose pertinent facts about a collision he had in a state vehicle, and made inconsistent statements to internal affairs investigators. Specifically, we found:

Finding #1: The executive engaged in incompatible activities.

In violation of state law, the executive accepted $4,000 from a non-state entity for serving on an advisory panel that was related to his state duties. The non-state entity selected the executive to be a member of its consumer advisory panel (advisory panel). The CSLB members were aware of and condoned the executive's participation in the advisory panel.[2] In addition, the executive told us that both he and the board members believed his participation was congruent with his duties at the CSLB.

[1] Since we report the results of our investigative audits only twice a year, we may receive the status of an auditee's corrective action prior to a report being issued. However, the auditee should report to us monthly until its corrective action has been implemented. As of January 2003, this is the date of the auditee's latest response.

[2] The CSLB has a 15-member board, appointed by the governor and the Legislature. The board appoints the CSLB executive officer and directs administrative policy.

After the non-state entity selected the executive to be part of the advisory panel for a two-year term, the executive participated in 14 separate events—10 meetings, 2 facility tours, a breakfast social, and a reception. The non-state entity paid the executive a total stipend of $4,000, or $400 for each of the 10 meetings he attended. The executive's two-year term on the advisory panel ended in December 2000.[3] The executive violated state law by accepting payment from an entity other than the State for the performance of his state duties.

Finding #2: The executive intentionally circumvented civil service hiring practices.

Consumer Affairs concluded that the executive created a situation that would have allowed a CSLB contractor to "launder state contract funds." The executive did this by directing a contractor to pay an employee, employee A, to work for the CSLB during November and December 1997, rather than following standard civil service procedures for the position. However, although Consumer Affairs concluded that the executive created this situation, it appears the laundering of state contract funds did not occur, because the contractor told us the CSLB did not reimburse it for the amounts it paid employee A.

Finding #3: The CSLB made illegal emergency and permanent appointments of employee A.

Although the contractor paid employee A only for work during November and December 1997, employee A continued to perform work for the CSLB during 1998 and 1999 under emergency and permanent appointments that the State Personnel Board (personnel board) ultimately determined to be illegal.

On February 2, 1998, the CSLB sent a memorandum to Consumer Affairs requesting that it make an emergency appointment of employee A to a Career Executive Assignment (CEA) position, retroactive to January 1, 1998.[4] According to the personnel board,

[3] The executive left the CSLB and began working for another state agency effective August 14, 2000. According to a board member, since the last advisory panel meeting of the executive's two-year term would be in October, they wanted him to complete his service.

[4] State law defines a Career Executive Assignment as an appointment to a high administrative and policy-influencing position within the state civil service in which the incumbent's primary responsibility is the managing of a major function or the rendering of management advice to top-level administrative authority.

Consumer Affairs approved the appointment, though its reason for doing so is unclear. Clearly, the employee already had been working for the CSLB without any formal agreement or approval.

State law allows departments to make emergency appointments under certain circumstances, including preventing the stoppage of public business when an actual emergency arises. According to the personnel board, emergency appointments provide flexibility for responding to staffing needs that are so urgent, unusual, or short term that they cannot reasonably be met through other civil service appointment procedures. In March 1999, the personnel board concluded that there was nothing unusual or of an emergency nature that required the filling of a CEA position with an emergency appointment. In fact, it found that the record reflected that the CSLB was deliberately avoiding the competitive employment process.

On March 23, 1998, the CSLB announced an examination for the permanent CEA position. Nine candidates, including employee A, applied for the position. The CSLB reported that on April 1, 1998, a two-person evaluation panel that included the executive screened the applications based on detailed rating criteria. No interviews were held. The CSLB permanently appointed employee A to the position on the same day as the evaluation. The personnel board determined that the permanent appointment was illegal because the position never was established through the required process; preselection of employee A was evident; and the examination was a spurious process intended to give the appearance of a competitive examination.

The personnel board canceled employee A's illegal appointments, both the emergency and permanent appointment. Employee A, with the support of the CSLB, appealed the decision, and the personnel board ultimately overturned the cancellation of the emergency appointment because more than one year had passed between the appointment and the personnel board's attempt to cancel it. State law permits the personnel board to declare an appointment void from the beginning if such action is taken within one year after the appointment when an appointment was made and accepted in good faith but was unlawful. The cancellation of the permanent appointment was not overturned. Because it found no evidence that employee A had acted in other than good faith when he accepted the appointments, the personnel board allowed employee A to retain the $75,485 in compensation he earned from January 1998 through March 1999.

Finding #4: The CSLB made other questionable or improper appointments.

On April 13, 1999, the personnel board notified the CSLB that, in light of its recent findings regarding the processes the CSLB used to select and appoint individuals for CEA positions, it was revoking the CSLB's authority to conduct examinations for these assignments. State law gives the personnel board's executive officer the authority to delegate selection activities to an appointing power. When the personnel board has substantial concerns regarding a department's capability in this regard, it can require that it preapprove or be involved with all aspects of the examination process.

Agency Action: Pending.

The State and Consumer Services Agency (agency), which oversees Consumer Affairs, plans to provide briefings to key departmental managers on compliance with ethical standards and to determine other appropriate actions that could be taken to prevent a recurrence of this type of behavior. In addition, the agency secretary has asked for a review to determine whether further actions should be taken against the subject employee, even though the employee has retired from state service.

CALIFORNIA DEPARTMENT OF TRANSPORTATION

Low Cash Balances Threaten the Department's Ability to Promptly Deliver Planned Transportation Projects

REPORT NUMBER 2002-126, JULY 2003

California Department of Transportation's and the California Transportation Commission's responses as of January 2004

Audit Highlights . . .

Our review of the Department of Transportation's (department) delivery of projects in the State Transportation Improvement Program (STIP) and Traffic Congestion Relief Program (TCRP) revealed that:

- ☑ *A lack of cash in the State Highway Account will result in the California Transportation Commission (commission) allocating almost $3 billion less than it had originally planned for STIP projects scheduled in fiscal years 2002–03 and 2003–04.*
- ☑ *Funding uncertainties associated with the Traffic Congestion Relief Fund (TCRF) have resulted in the commission halting all TCRP allocations, including those to 15 projects that currently need $147 million in order to continue work.*
- ☑ *Delayed or cancelled transportation projects will affect the State's aging transportation infrastructure, resulting in deteriorated highways, more traffic congestion, and reduced air quality, as well as higher costs for California residents, in terms of wasted fuel and lost productivity.*

continued on next page

The Joint Legislative Audit Committee asked us to examine the Department of Transportation's (department) delivery of projects in the State Transportation Improvement Program (STIP) and Traffic Congestion Relief Program (TCRP). We found that the department's ability to promptly deliver transportation projects is affected by low cash balances in the State Highway Account (highway account) and Traffic Congestion Relief Fund (TCRF), and consequently, delayed and cancelled transportation projects will negatively affect the State's aging transportation system. The low cash balances in the highway account and TCRF were caused by several factors.

Loans from the highway account and TCRF to the State's General Fund drained cash reserves from these accounts at the same time that the department saw highway account revenues decrease from weight fees. Further, uncertainties related to the former governor's mid-year spending proposal have caused the California Transportation Commission (commission) to halt all allocations to TCRP projects until the budget uncertainties are resolved. Moreover, the department's cash forecast updates continue to be optimistic, and consequently the department could end fiscal year 2003–04 with a negative account balance in the highway account. The department and the commission have alternatives to fund projects in the short-term. However, most of these alternatives also have the potential to decrease the future flexibility of scheduling projects for the STIP and one could be perceived as unfair, so the commission needs to carefully consider and set guidelines for their use.

☑ *Many of the commission's and the department's alternatives to provide needed funding for projects on a short-term basis have the drawback of reducing the department's flexibility to fund future projects, and one potential option available to the commission may be perceived as unfair.*

Finding: The department has insufficient cash to allow it and regional agencies to deliver planned transportation projects in the STIP and TCRP at the levels originally planned.

Lacking sufficient cash in its major transportation funds and accounts, the department and regional transportation planning agencies are unable to deliver many of their planned transportation projects scheduled in the STIP and TCRP. Specific areas our audit identified include:

- Projected cash shortages identified by the department in its December 2002 cash forecast caused the department to temporarily halt allocations to STIP and TCRP projects. While the department's revised March 2003 cash forecast update prompted the commission to resume allocations to STIP (but not TCRP) projects, the department's estimates may be overly optimistic, and could result in the commission making allocations for which the department will lack available funds when later presented with reimbursement requests from implementing agencies.

- Although the commission resumed allocations to STIP projects in April 2003, the allocations are at dramatically lower levels than originally planned. Specifically, 194 projects needing $103 million in order to move forward with the next phase of project delivery will not receive allocations in fiscal year 2002–03. Moreover, the commission's actual and planned allocations for fiscal years 2002–03 and 2003–04 is almost $3 billion lower than the amounts originally planned.

- Minimal cash reserves in the TCRF will affect the department's ability to deliver at least 106 projects that require a minimum of $3.4 billion more in allocations to continue work. Since December 2002, 15 TCRP projects have submitted requests for allocations totaling $147 million, and work has ceased on 12 of these projects due to lack of spending authority.

- The former governor's May 2003 revision to the governor's budget threatens TCRF funds, calling for the Legislature to delay $938 million of the transfer of state gasoline sales tax revenues from the General Fund to the Transportation Investment Fund (TIF). Because state law provides for only a set number of annual transfers of specified amounts from the TIF to the TCRF, delays or reductions in amounts transferred to the TIF could result in a permanent annual loss of revenues to the TCRF of up to $678 million, unless the Legislature acts to obligate the General Fund to repay the TCRF in the future.

- Delayed or cancelled projects will affect the State's aging transportation system, resulting in deteriorated highways, increased traffic congestion, and reduced air quality. Additionally, delays in making improvements means that California residents will pay higher direct costs for wasted fuel and lost productivity. Also, consumers will pay increased indirect costs of the delays in the form of higher prices for goods and services, as well as compounding repair costs for fixing later what the department should fix now.

- The department and commission have alternatives that they could use to fund projects over the short term. However, many of these alternatives have the potential to make future project scheduling inflexible, and one option—pursuing the ability for the commission to rescind TCRP allocations—could be perceived as unfair.

We recommended that, considering the State's fiscal crisis, the Legislature may wish to allow the TIF to transfer the entire $678 million to the TCRF, and then authorize a loan of the money from the TCRF to the General Fund so that those funds would be repaid to the TCRF and therefore still be available in future years.

Further, we recommended that the department do the following to ensure that it can meet its short-term cash needs:

- Continue its efforts to become more precise in revising its revenue and expenditure estimates and ensure that these revisions are properly supported and presented in cash forecast updates to the commission.

- Continue to cautiously pursue other funding alternatives (GARVEE bonds, SIB loans, direct-cash reimbursement, and replacement projects) to meet short-term project funding needs, and continue to set limits on these alternatives to avoid making future project scheduling inflexible.

Finally, we recommended that should the commission be granted the authority to rescind unspent allocations, it should carefully consider statewide priorities and ensure that all counties are treated fairly before taking such actions.

Department and Commission Action: Partial corrective action taken.

The department states that its cash management team has expanded its cash forecasting activities to include a monthly analysis and projection of construction payments to contractors, which compose a large portion of the department's monthly cash disbursements. The department reports that its cash management team is also in the process of refining monthly projections of expenditures in the toll bridge seismic retrofit account, the TCRF, and the public transportation account to improve its projection of cash in the transportation revolving account. The department further reports that its cash management team has adopted a conservative approach to projecting anticipated federal collections due to uncertainty over passage of the new federal transportation act. Finally, the department reports that aside from monitoring and forecasting cash balances on a daily basis, its cash management team continues to update its internal project tracking database to monitor allocations and expenditures on capital outlay and local assistance projects. The department reports that it presented a quarterly cash update to the commission in September 2003 with recommendations on the amount of cash available for project allocations.

The department agrees with our recommendation that it should continue to cautiously pursue other funding alternatives. The department has implemented the Transportation Finance Bank Revolving Program (SIB loans) and is still developing GARVEE financing.

The commission stated that it has not been granted the authority to rescind unspent allocations, so no action has taken place.

Legislative Action: Unknown.

We are not aware of any action taken by the Legislature to allow the TIF to transfer $678 million to the TCRF and to authorize the loan of these funds to the General Fund.

CALIFORNIA DEPARTMENT OF TRANSPORTATION

It Manages the State Highway Operation and Protection Program Adequately, but It Can Make Improvements

Audit Highlights . . .

Our review of the California Department of Transportation's (Caltrans) management of its State Highway Operation and Protection Program (SHOPP) found that:

- ☑ *Most SHOPP projects do not exceed their original funding allocation. Also, although most of the 20 projects we reviewed experienced time delays, the causes for the delays appear reasonable.*
- ☑ *Resident engineers did not always maintain complete records of project events. Without these records, Caltrans is vulnerable to contractor claims for more money and cannot accurately assess contractors for liquidated damages.*
- ☑ *Caltrans does not evaluate the financial stability of the surety insurers that issue performance and payment bonds to its contractors.*
- ☑ *Caltrans lacks comprehensive policies and procedures instructing district staff on how to document and address complaints from the public regarding projects.*

REPORT NUMBER 2002-103, AUGUST 2002

California Department of Transportation's response as of August 2003

The Bureau of State Audits examined the California Department of Transportation's (Caltrans) process for managing State Highway Operation and Protection Program projects. Specifically, we were asked to determine whether Caltrans is managing projects to ensure minimal or no cost overruns and time delays, contractors have valid performance bonds from solvent companies, and staff follow Caltrans' public relations policies and procedures.

Finding #1: Some construction engineers do not adhere to Caltrans' policies for managing projects.

Some resident engineers, who manage the project construction costs and administer the contracts, are failing to keep adequate records of days with adverse weather conditions and days that contractors choose not to work on scheduled tasks. Thus, the State lacks necessary records of the causes for project delays and may not be able to assess and collect damages in disputes with contractors about days when they did not work. Also, some resident engineers do not get the required prior approval from the Division of Construction or the district director for construction change orders, which can lead to delays in processing the change orders and to interest charges for late payments to the contractors.

To ensure an adequate defense against contract disputes and to properly assess liquidated damages, Caltrans should ensure that resident engineers and assistant resident engineers maintain complete and accurate daily records of all relevant events occurring on working and nonworking days and that resident engineers complete the weekly statements accurately and in a timely manner. Further, Caltrans should ensure that

its staff obtain prior approval for construction change orders in a timely manner to avoid incurring any unnecessary costs, such as interest for late payments to the contractor, and to ensure that managers agree that proposed changes are necessary. Finally, to aid staff in properly managing construction projects, Caltrans should continue implementing its capital project skill development plan and ensure that staff continue to receive training after the plan expires.

Caltrans' Action: Corrective action taken.

Caltrans is developing an automated construction change order approval tracking system. According to Caltrans staff, this new system will improve the change order and approval process by documenting the required concurrence and prior approval for each construction change order. However, because of limited funding, this new system will not include the tracking of reported working days. Nevertheless, Caltrans has revised certain sections of its construction procedures and specifications manuals. Additionally, it has developed classes on contract administration, including a class specific to the tracking and reporting of working days.

Finding #2: Although somewhat limited by state law, Caltrans can reduce the risk of loss to the state from poor contractor performance.

Caltrans relies on state-required performance and payment bonds issued by a surety insurer (insurer) for loss protection when contractors fail to do the work as specified in the contract. However, although state law permits Caltrans to obtain financial statements from insurers, Caltrans believes it lacks authority to use those statements. Thus, it does not examine the insurer's financial statements, either at the beginning of or during a project, to evaluate its ability to cover possible project losses. However, because state law prevents Caltrans from knowing that the state's Department of Insurance is investigating an insurer that is on its list of approved insurers, it is important that Caltrans does its own checking of insurer's financial statements to reduce its risk of loss.

To ensure that Caltrans can collect on a performance bond if a contractor does not perform, we recommended that the Legislature consider expanding Caltrans' ability to use other financial indicators included within the financial statements and information available from rating companies such as A.M. Best Company and S&P as a basis for determining the

sufficiency of an insurer, before accepting performance bonds. Further, the Legislature should clarify Caltrans' authority to use the information it obtains from financial statements and other financial indicators to object to the sufficiency of an insurer throughout the bond term.

Legislative Action: Unknown.

We are not aware of any legislation that has passed to address this issue.

Finding #3: Caltrans can improve its public relations process to avert negative publicity.

Caltrans can better meet its goal of communicating effectively with the public about construction projects that inconvenience drivers. Caltrans provides guidance to the district offices, but it relies primarily on them to determine when and how to communicate with the public. Unfortunately, most district public information officers do not track the nature and resolution of the complaints they receive, so public dissatisfaction can grow unbeknown to either the public information officers or Caltrans' headquarters.

To ensure that districts handle complaints and inquiries consistently, Caltrans should develop comprehensive public relations policies and procedures that specify the process to use when responding to complaints, the documents that should be maintained, and the method that district offices should use to assess their public relations efforts. Further, Caltrans should monitor the district offices' public relations efforts periodically.

Caltrans' Action: Corrective action taken.

Caltrans has developed and fully implemented a new comprehensive process for addressing project complaints and requests for information, which includes ongoing monitoring of the districts' public affairs function by Caltrans' headquarters.

DEPARTMENT OF TRANSPORTATION

Investigations of Improper Activities by State Employees, February 2003 Through June 2003

ALLEGATION I2002-700 (REPORT I2003-2), SEPTEMBER 2003

Department of Transportation's response as of September 2003

Investigative Highlights . . .

A Caltrans' employee engaged in the following improper governmental activities:

- ☑ *Misappropriated $622,776 by requesting purchases and confirming the receipt of products that Caltrans did not receive.*
- ☑ *Directed a company to hold state funds outside the State Treasury and act as a fiscal agent without approval.*

We investigated and substantiated an allegation that an employee for the Department of Transportation (Caltrans) misappropriated $622,776 in state money. Our investigation showed that the employee submitted two purchase requests for products the department never received. The employee arranged for the company to hold these funds from these fictitious purchases and act as the State's fiscal agent.

Finding: An employee misappropriated state funds.

The employee misappropriated $622,776 by submitting two purchase requests. After submitting the purchase requests, the employee directed the company to cancel delivery of the items and hold the payments in a company maintained account. In addition to initiating the purchase, the employee also verified the receipt of the products even though the company never sent these items. According to the employee, she directed the company to hold these funds outside the State Treasury and act as a fiscal agent to correct clerical errors and purchase training and information technology (IT) products for her unit.

In addition, poor management contributed to the misappropriation of funds. The employee's manager did not verify the receipt of the products on the fictitious purchases. The employee's unit gave the employee the responsibility and authority to request products, ensure their receipt, and monitor the funds used, which created the opportunity to misappropriate the funds.

Although Caltrans cannot completely account for the misappropriated funds, it paid unauthorized taxes and fees to the company. The balances that the employee and the company

maintained did not reconcile partly because the company commingled state funds with its own. However, the State did pay unauthorized taxes and fees. The company retained $44,191, which represented sales taxes associated with the false purchase requests, and charged the State $68,505 to maintain the account. Although the company likely earned interest during the two-year period it retained these funds, it did not allocate this interest to the State. Nevertheless, the company remitted $75,698 to Caltrans, an amount it considered to be the balance the State paid for undelivered products.

Caltrans' Action: Partial corrective action taken.

Caltrans reported that it reinstated its prior policy of having all IT purchases shipped to, received, accepted, inventoried, and tagged by its Shipping and Receiving and Property Control units. Further, Caltrans reported that it initiated a practice of utilizing the Department of General Services' Technology and Acquisitions Support Branch for all IT procurements over $500,000. Caltrans transferred the employee to another branch where her duties do not include procurement-related duties and will take appropriate disciplinary action against the employee upon completion of its review of case documentation. Caltrans added that it has contacted the appropriate law enforcement agencies to investigate any criminal implications or activity relating to the misappropriation. Caltrans also reported that it will make appropriate changes to its procedures after completing a review of its internal controls related to approval authorizations and documentation.