

Report 2013-601

High Risk

The California State Auditor's Updated Assessment of High-Risk Issues the State and Select State Agencies Face

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September 26, 2013

2013-601

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As authorized by Chapter 251, Statutes of 2004, the California State Auditor presents this audit report assessing high-risk issues the State and selected state agencies face. Systematically identifying and addressing high-risk issues can contribute to enhanced efficiency and effectiveness by focusing the State's resources on improving the delivery of services related to important programs or functions.

We have added the 2011 realignment of funding and responsibility between the State and local governments to the high-risk list. Realignment shifts funding and responsibility for certain criminal justice and social services programs, totaling approximately \$6 billion, primarily to county governments. The State does not currently have access to robust data concerning the results of realignment. As a result, the impact of realignment cannot be fully evaluated at this time. Even so, initial data indicates that local jails may not have adequate capacity and services to handle the influx of inmates caused by realignment.

We believe the State continues to face eight other significant high-risk issues: the state budget, funding for the California State Teachers' Retirement System, funding retiree health benefits for state employees, funding for deteriorating infrastructure, ensuring a stable supply of electricity, workforce and succession planning, strengthening emergency preparedness, and providing effective oversight of the State's information technology. We further believe that three state agencies continue to meet our criteria for high risk as they face challenges in their day-to-day operations: the California Department of Corrections and Rehabilitation, the California Department of Health Care Services, and the California Department of Public Health.

We will continue to monitor the risks we have identified in this report and the actions the State takes to address them. When the State's actions result in significant progress toward resolving or mitigating these risks, we will remove the high-risk designation based on our professional judgment.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

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Summary

Results in Brief

Providing leadership, programs, and critical services to the people of California is a complex endeavor that encompasses the use of significant resources and is accompanied by inherent risks. A process for identifying and addressing the high-risk issues facing the State can help focus the State's resources on improving service delivery and contribute to enhanced efficiency and effectiveness. Legislation effective in January 2005 authorizes the California State Auditor to develop such a risk assessment process. We issued our initial assessment of high-risk issues in May 2007 (Report 2006-601), and we updated those issues and identified new issues in June 2009 (Report 2008-601) and August 2011 (Report 2011-601). Our current review found that most of the issues we identified in 2011 as posing a high risk to the State continue to be a high risk; we have also identified an additional issue as constituting a high risk.

Various fiscal issues continue to pose a high risk to the State. Although the budget condition has improved, it remains on the list of high-risk issues because of uncertainties concerning the size of the State's projected budget surplus and how the surplus should be spent. Specifically, in its analysis of the *Governor's Budget May Revision 2013-14*, the Legislative Analyst's Office projected that state revenues would be \$3.2 billion higher than those projected by the governor for fiscal year 2013-14. The governor and Legislature disagree about how to spend the surplus, making it difficult for the State to set budget priorities. The Legislature also faces constraints imposed by the state constitution and federal requirements that make adjusting budget priorities even more difficult.

The funding status of the Defined Benefit Program of the California State Teachers' Retirement System (CalSTRS) has not improved, and it remains on the high-risk list. One of the major risks to CalSTRS' funding is that its board does not have the authority to set contribution rates. The inability to adjust contributions, as well as poor investment returns due to economic recessions, have caused the funding ratio of the CalSTRS Defined Benefit Program to decrease from 98 percent in 2001 to 67 percent in 2012, well below the 80 percent considered fiscally sound. At the current contribution rate and actuarially estimated rate of return on investments, the Defined Benefit Program's funding ratio will continue to drop and assets will eventually be depleted. Similarly, the State's estimated accrued liability of \$63.85 billion related to retiree health benefits is almost completely unfunded and continues to increase. The State continues to cover only the current year's cost of these benefits, without setting aside funds to pay for future obligations. If the State

Report Highlights . . .

In our assessment of the high-risk issues facing the State, we identified the 2011 realignment of funding and responsibility for criminal justice and social services programs between the State and local governments as a new area of high risk.

We found the following in regards to issues we previously identified as posing a high risk to the State:

- » *Funding for the California State Teachers' Retirement System—the funding ratio has decreased well below what is fiscally sound.*
- » *Funding retiree health benefits for state employees—the estimated accrued liability of nearly \$64 billion continues to rise and is almost completely unfunded.*
- » *Managing and improving the State's deteriorating infrastructure—the State's investments in transportation, water supply, and flood management infrastructure have not kept up with demands.*
- » *Ensuring a stable supply of electricity—although much progress has been made, the supply of electricity is undergoing modification to better protect the environment.*
- » *Workforce and succession planning—challenges continue with many employees approaching retirement age and the recent reorganization of state personnel agencies.*
- » *The State's emergency preparedness—key agencies lack fully developed strategic plans and face challenges in meeting some objectives.*

» *The State's oversight of information technology projects—the high costs of certain projects and the failure of others makes oversight critical.*

The following three state agencies continue to meet our criteria for high risk as they face challenges in their day-to-day operations:

- *California Department of Corrections and Rehabilitation*
- *California Department of Health Care Services*
- *California Department of Public Health*

continues this current method of funding, its liability for retiree health benefits will continue to increase, presenting a risk to the State's ability to provide the level of health benefits promised to its retirees.

We have added the 2011 realignment of funding and responsibility between the State and local governments as a new high-risk issue. Realignment shifts the funding of and responsibility for many criminal justice and social services programs from the State primarily to county governments. The funding for these programs totals approximately \$6 billion. The State does not currently have access to reliable and meaningful data concerning the realignment. As a result, the impact of realignment cannot be fully evaluated at this time. Even so, initial data indicate that local jails may not have adequate capacity and services to handle the influx of inmates caused by realignment. Until enough time has passed to allow the effectiveness and efficiency of realignment to be evaluated, we will consider it a statewide high-risk issue.

Managing the State's prison population and quality of inmate health care in the prison system continues to be a challenge for the California Department of Corrections and Rehabilitation (Corrections). While Corrections has reduced inmate overcrowding in the prison system since our last report, it missed a population benchmark set in December 2012 and continues to face the risk that it will have to release inmates before they serve out their sentences or are paroled. In addition, the State's prison health care system has been taken over by a federal health care receiver (receiver) that has significant control over the system. Although the prison health care system has seen many improvements under the receiver, the process of improving inmate health care has been long and expensive. Until control of the system is returned to Corrections, the receiver can continue to order costly improvements to the prison health care system that the State must pay for. Finally, Corrections continues to struggle to permanently fill senior positions and lacks a formal succession plan, which can hamper its ability to ensure stability in leadership.

Maintaining and improving the State's infrastructure remains on our list of high-risk issues. The State's investments in transportation and water supply and flood management infrastructure have not kept up with demands. The California Transportation Commission estimated that the State faces a funding shortfall of more than \$290 billion to adequately maintain its transportation infrastructure for the 10-year period from 2011 through 2020. Similarly, the State's water supply and flood management infrastructure requires significant investments. Furthermore, although the State has made progress in updating its aging electricity infrastructure to better protect the environment and is currently on track to meet its

renewable energy target by 2020, the supply of electricity remains critical to the State's economy, and the shift in its production to sources and technologies that will have less impact on the environment is an important effort that we will continue to monitor as an area of high risk.

The State continues to face challenges related to its workforce and succession planning as the proportion of employees approaching retirement age increases. While state agencies we reviewed had generally developed workforce and succession plans to ensure continuity of critical services, we identified notable exceptions. Further, with the recent reorganization combining the State Personnel Board and the California Department of Personnel Administration into the California Department of Human Resources, the State faces the general risk associated with this type of structural change.

The State's emergency preparedness remains an area of high risk. Two key California agencies that oversee statewide emergency management—the California Department of Public Health (Public Health) and the California Governor's Office of Emergency Services (Cal OES)—lack fully developed strategic plans to guide their emergency preparedness efforts. Public Health's emergency preparedness office has the responsibility to coordinate planning and other efforts to prepare Californians for public health emergencies, including planning for the strategic stockpile of medical supplies, maintaining contact information for crisis response, and distributing funds to local health departments for disaster planning. Cal OES exists to enhance safety and preparedness in California and to protect lives and property by effectively preparing for, preventing, responding to, and assisting California in recovering from all threats, crimes, hazards, and emergencies. However, our review found that both agencies face challenges as they attempt to meet these objectives.

The high costs of certain projects and the failure of others continues to make the State's oversight of information technology (IT) projects an area of high risk. As of July 2013 the California Department of Technology (CalTech) reported that 46 IT projects with total costs of more than \$4.9 billion were under development. In our August 2011 high risk report, we discussed four large IT projects that would have a major impact on state operations—the State Controller's Office's 21st Century Project, the Judicial Branch's California Court Case Management System, the California Department of Finance's Financial Information System for California, and Corrections' Strategic Offender Management System. With this update, we examined the status of these projects, as well as the California Department of Motor Vehicles' IT Modernization Project. We found that three of the five IT projects

experienced major problems that require either part of the project or the entire project to be suspended or even terminated. Further, although CalTech is responsible for ensuring that state agencies comply with the general controls specified in Chapter 5300 of the *State Administrative Manual*, it does little to verify their compliance. Given the pervasive general control deficiencies at two agencies we reviewed—the Employment Development Department and Corrections—we believe CalTech’s limited oversight of the general controls state agencies have implemented over their information systems represents another area of high risk for the State.

Finally, Public Health and the California Department of Health Care Services (Health Care Services) remain on the list of agencies exhibiting high-risk characteristics. Public Health continues to face challenges and weaknesses in program administration and is slow to implement audit recommendations with a direct impact on public health. Its unresolved recommendations have increased from 20 to 23 in the past two years. Many of these recommendations have a direct impact on public health and safety and, if not implemented, could adversely affect the State. On the other hand, although Health Care Services has made significant progress in implementing unresolved audit recommendations, we continue to consider it a high-risk agency due to increased responsibilities resulting from enactment of the federal Patient Protection and Affordable Care Act and from the transfer of authority and responsibilities from the former California Department of Mental Health.

Introduction

Background

Legislation effective in January 2005 authorizes the California State Auditor (state auditor) to develop a risk assessment process for the State. In particular, Senate Bill 1437 of the 2003–04 Regular Session of the Legislature added Section 8546.5 to the California Government Code. It authorizes the state auditor to establish a high-risk audit program, to issue reports with recommendations for improving issues it identifies as high risk, and to require state agencies responsible for these identified programs or functions to report periodically to the state auditor on the status of their implementation of the recommendations. High-risk programs and functions include not only those particularly vulnerable to fraud, waste, abuse, and mismanagement, but also those of particular interest to the citizens of the State and those that have potentially significant effects on public health, safety, and economic well-being.

The State Auditor's Criteria for Determining Whether State Agencies and Major Issues the State Faces Merit High-Risk Designations

To determine whether a state agency's performance and accountability challenges pose a high risk to the State, we first consider the significance of an agency's mission or functions and the extent to which the agency's management and programs are key to the State's overall performance and accountability. We then determine whether risk is involved and if it constitutes one of the following:

- An issue that could be detrimental to the health and safety of Californians.
- A program that could be at risk of fraud, waste, and abuse. For example, a program involving payments to claimants for services provided to third parties involves risk due to the difficulty in verifying claims.
- A systemic problem that has created inefficiencies and ineffectiveness.

To identify a high-risk statewide issue, we consider the following:

- Whether it is evident in several state agencies.
- Whether it affects the State's total resources.
- Whether it stems from some deficiency or challenge that warrants monitoring and attention by the Legislature.

For both state agencies and statewide issues, we also consider a number of qualitative and quantitative factors, as well as whether or not an agency has taken measures to correct previously identified deficiencies or whether the State is taking measures to reduce the risk a statewide issue may pose. In all cases, the ultimate determination of high risk is based on the independent and objective judgment of the state auditor's professional staff. The Appendix further describes these factors. Additionally, the Appendix outlines the factors we consider in determining whether it is appropriate to remove a statewide issue or agency from our high-risk list.

Scope and Methodology

California Government Code, Section 8546.5, authorizes the state auditor to audit any state agency it identifies as high risk and to issue related audit reports at least once every two years. In May 2007 we issued a report¹ that provided an initial list of high-risk issues, and we issued update reports on the status of those issues and others that had been added in June 2009² and August 2011³.

Subsequent to our August 2011 report, the state auditor continued to evaluate issues faced by the State for inclusion on our high-risk list. As a result, in July 2013 we issued a report designating Covered California's establishment of a health insurance exchange as a high-risk issue in California. Because this issue is newly designated as a high risk, we have not updated it here. With this 2013 update, we are also adding to our list of high-risk issues the 2011 realignment of funding and responsibilities between the State and local governments. In addition, we highlight in this update water supply and flood management as high risks under the existing high-risk issue of the State's aging infrastructure. Finally, we are removing the administration of the American Recovery and Reinvestment Act of 2009 funds from our list of high-risk issues because state departments have made significant progress in spending most of these funds.

To update our analysis of high-risk issues and departments facing risks and challenges, we interviewed knowledgeable staff at each entity with significant related responsibilities to assess their

¹ *High Risk: The California State Auditor's Initial Assessment of High-Risk Issues the State and Select State Agencies Face* (Report 2006-601, May 2007).

² *High Risk: The California State Auditor's Updated Assessment of High-Risk Issues the State and Select State Agencies Face* (Report 2008-601, June 2009).

³ *High Risk: The California State Auditor's Updated Assessment of High-Risk Issues the State and Select State Agencies Face* (Report 2011-601, August 2011).

perspectives on the extent of risk the State faces and reviewed the efforts underway that they identified as mitigating the risks. We also reviewed reports and other documentation relevant to the issues.

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Chapter 1

PURSUING SOUND FISCAL POLICY

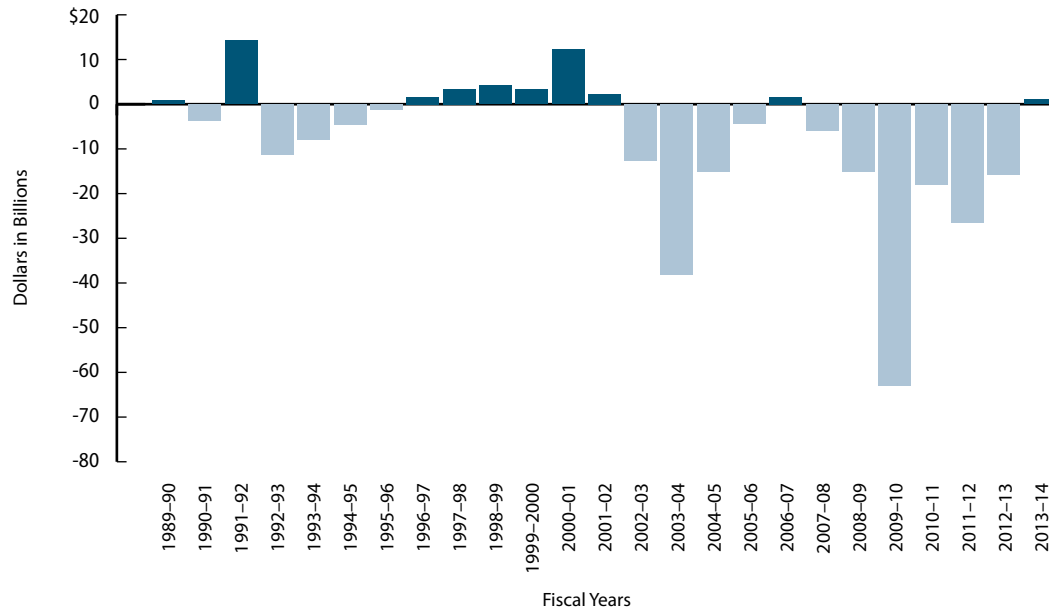
Various fiscal issues continue to pose a risk to the State. Although budget conditions have improved in the most recent fiscal year, the State has a history of budget shortfalls and of using short-term solutions that push budget problems into the future. The budget process and parameters have changed somewhat, but state decision makers still face difficulties in adjusting budget priorities due to limitations imposed by voter initiatives. In addition, the funding ratio of the teachers' retirement system has not improved—in fact, it has decreased to 67 percent. Similarly, the State's estimated liability of \$63.85 billion related to retiree health benefits is almost completely unfunded, jeopardizing the ability of the State to provide health benefits promised to its retirees. Finally, the State appears to have spent federal funds associated with recovery from the recent economic recession in a timely manner, and we no longer consider this a high-risk issue.

Adjusting Budget Priorities

In 2009 the California State Auditor designated the State's budget condition as a high-risk issue. Although the budget condition has since improved, it continues to be an area of high risk. The governor has projected a budget surplus for fiscal year 2013–14, but there is disagreement between the governor, the Legislature, and other agencies on the size of the surplus and how the surplus should be used. Further, the state constitution and federal limitations continue to make it difficult to adjust budget priorities, and certain segments of the population to which the State devotes considerable resources continue to grow faster than the general population.

As shown in Figure 1 on the following page, after a number of severe budget shortfalls, the State had a projected budget surplus of just over \$1 billion for fiscal year 2013–14. However, the size of this projected surplus is disputed. In its analysis of the *Governor's Budget May Revision 2013–14* (May revision), the Legislative Analyst's Office (LAO) projected that state revenues would be \$3.2 billion higher than those projected by the governor. Initial tax receipts seem to be bearing out the LAO's higher projections—by June 2013 revenue from the State's major income taxes was roughly \$1 billion above the revenue assumptions in the May revision of the budget.

Figure 1
Projected General Fund Budget Surpluses and Shortfalls as of the May Revision
Fiscal Years 1989–90 Through 2013–14



Sources: California Department of Finance's governor's budget summaries and the Governor's Budget May Revision for fiscal years 1989–90 through 2013–14 (May revisions); Legislative Analyst's Office's perspectives and issues, state spending plans, and overview of the May revisions.

The governor and Legislature disagree on how to use the surplus. According to an analysis by the LAO, both the Assembly and the Senate wanted to increase spending for health and human services programs; however, these priorities were not carried forward to the enacted budget. Instead, the governor saved the surplus in a special fund for economic uncertainties. Both the May revision and the enacted budget assume revenue levels of \$97 billion. If actual revenues continue to outpace projections, legislative leaders could seek a midyear increase in spending.

The State has a history of using short-term solutions to close budget gaps, as shown in Table 1. Over the last 12 fiscal years, only 59 percent of budget deficits have been directly addressed through increases in revenue or cuts in spending. The methods used to close the gap for the remaining 41 percent of the shortfalls have come from temporary fixes, such as increasing debt, shifting and transferring funds, and deferring expenditures, which can push the problem out to future years. For example, for fiscal year 2012–13, a combination of increased revenue and reduced expenditures was used to address 63 percent, or \$10.4 billion, of the \$16.5 billion budget deficit. However, the strategies used for the remaining 37 percent, or \$6.1 billion, of that year's deficit only delayed when the State would pay for expenditures in that fiscal year.

For instance, to address budget shortfalls, the governor deferred payments of \$2.1 billion in funding for K-12 education mandated by Proposition 98—a voter-approved constitutional amendment that guarantees minimum funding levels for K-12 schools and community colleges. These deferrals created a liability that must be paid back in the future.

Table 1
Types of Solutions Implemented to Reduce Budget Shortfalls
Fiscal Years 2002–03 Through 2012–13

	FISCAL YEARS										OVERALL
	2002-03	2003-04	2004-05	2005-06	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	
Total amount of budget solutions (in billions)*	\$23.64	\$39.40	\$16.10	\$5.85	\$4.93	\$23.97	\$59.60	\$19.30	\$24.20	\$16.51	\$233.50
Percentage by solution type											
Expenditure reductions	32%	21%	31%	71%	28%	36%	49%	63%	29%	27%	38%
Revenue increases	17	15	15	2	34	17	23	23	37	36	21
Increased debt†	13	41	39	15		17	4	6	12	4	16
Fund shifts or transfers	12	11	15	13	26	4	6	5	19	18	12
Accelerated revenues	19	5			12	11	4	0	0	0	4
Expenditure deferrals	7	5				8		3	1	15	4
Federal stimulus funds							14	0	0	0	4
Accounting changes		2				7	0	0	0	0	1
Other									2	0	0

Sources: California Department of Finance’s governor’s budget summaries and the Governor’s Budget May Revision (May revisions) for fiscal years 2002–03 through 2012–13; Legislative Analyst’s Office’s perspectives and issues, state spending plans, and overview of the May revisions.

Note: Fiscal years 2006–07 and 2013–14 are not shown in the table because there were projected budget surpluses for those years.

* The solutions in this table do not precisely link with the May shortfalls presented in Figure 1 because of timing differences and the differences between the shortfalls and the solutions to resolve them.

† Increased debt includes borrowing from internal sources.

The Legislature also faces constraints imposed by the state constitution and federal requirements that make it difficult to adjust budget priorities. As shown in Table 2 on the following page, the passage of several propositions in 2010 and 2012 has changed the State’s budgeting process, affecting the revenues available for General Fund expenditure and making it more difficult for the Legislature to generate revenues through fees and charges. For example, Proposition 26 increased the vote requirement for certain state and local fees and tax measures, making it more difficult for state and local governments to raise revenue. In addition, Proposition 30 temporarily increases taxes to support K-12 and community college expenditures while redirecting certain vehicle license fee and sales tax revenues to local governments (discussed in Chapter 2). Moreover, the California Constitution mandates many

General Fund expenditures, and certain federal programs, such as the Temporary Assistance for Needy Families program, require state matching funds, further limiting the Legislature's discretion on spending. For example, the state constitution mandates an expenditure level totaling 40 percent of the General Fund revenues for specific education uses. These various constraints limit the choices available to decision makers when attempting to address budget shortfalls.

Table 2
Ballot Measures Approved by Voters in November 2010 and 2012
General Elections That Impact the State Budget

INITIATIVE	SUMMARY
Proposition 25	Changed the legislative vote requirement to pass budget and budget-related legislation from two-thirds to a simple majority. Retained the two-thirds vote requirement for taxes. Required legislators to pass a budget bill by June 15 or forfeit salaries and expense reimbursement for every day a budget bill is not passed.
Proposition 26	Required that certain state and local fees be approved by a two-thirds vote. Broadened the definition of a state or local tax to include payments formerly considered to be fees or charges.
Proposition 30	Increased personal income taxes on high-income taxpayers for seven years and sales taxes for four years. Allocated temporary tax revenues to fund K-12 education and community colleges. Guaranteed that local governments receive certain tax revenues for public safety services realigned from the State to local governments in 2011.
Proposition 39	Prevents multistate businesses from choosing the method for determining their state taxable income that is most advantageous for them. Some multistate businesses have to pay more corporate income taxes due to this change. About half of the increased tax revenue over the next five years is to be used to support energy efficiency and alternative energy projects.

Sources: Voter guides for the November 2010 and 2012 elections, prepared by the California Office of the Attorney General.

As we reported in our 2011 high risk report, a change in federal law related to the estate tax has resulted in lost revenue for the General Fund. Prior to January 2005 the State generally received about \$1 billion of the federal estate taxes that would have otherwise been paid to the Internal Revenue Service. These revenues are commonly known as a state pick-up tax. However, the Economic Growth and Tax Relief Reconciliation Act of 2001 and subsequent amendments to it suspended the state pick-up tax so that, as of January 1, 2005, the State no longer receives this revenue. The American Taxpayer Relief Act of 2012 permanently extended the suspension of the pick-up tax. One way the State can make up for this lost revenue is by imposing a state estate tax. However, current state law, enacted through an initiative measure, prohibits California from doing so. Voter approval would be required to modify or repeal that prohibition.

Finally, growth in certain population segments to which the State devotes considerable resources continues to significantly affect the state budget. Specifically, as shown in Table 3, while the State’s population as a whole increased by 4 percent from fiscal years 2005–06 to 2011–12, the number of Medi-Cal recipients increased by roughly 17 percent. This disproportionate increase in Medi-Cal recipients is reflected in the funding the Medi-Cal program received from the General Fund, which increased from \$12.7 billion to \$14.3 billion over the same period. In addition, the governor plans to expand California’s Medi-Cal program under the federal Patient Protection and Affordable Care Act, increasing the number of eligible participants and likely the associated cost for care. According to the LAO, by fiscal year 2020–21, the State’s share of these expansion costs could range from \$300 million to \$1.3 billion annually.

Table 3
Growth Rates of California’s General Population Compared to the Growth Rates of Specific Groups

FISCAL YEAR	GENERAL POPULATION	INMATES	THOSE ELIGIBLE FOR MEDI-CAL	K-12 STUDENTS	HIGHER EDUCATION STUDENTS
2005–06	36,246,822	172,561	6,534,981	6,312,436	2,192,935
2006–07	36,552,529	173,312	6,553,257	6,286,943	2,246,098
2007–08	36,856,222	170,973	6,721,002	6,275,469	2,347,847
2008–09	37,077,204	167,832	7,094,877	6,252,031	2,456,556
2009–10	37,309,000	165,817	7,397,966	6,192,121	2,460,876
2010–11	37,570,000	162,368	7,594,872	6,217,002	2,394,074
2011–12	37,826,000	135,238	7,621,956	6,220,993	2,318,306
Percentage change fiscal years 2005–06 to 2011–12	4.36%	(21.63%)	16.63%	(1.45%)	5.72%

Sources: California Department of Finance population estimates prepared by the Demographic Research Unit; California Department of Corrections and Rehabilitation, *California Prisoners and Parolees 2012*; California Department of Education enrollment reports prepared by the Educational Demographics Office; California Department of Health Care Services, Medical Care Statistics Section; and California Postsecondary Education Commission higher education enrollment reports for the fall of each fiscal year.

In our 2009 update we identified California’s inmate population as a factor contributing to risk in the state budget. Although the population of state prison inmates decreased by more than 21 percent from fiscal years 2005–06 through 2011–12 much of this decrease is due to the State’s prison realignment plan, discussed further in Chapter 2. Under this plan, many low-level offenders are being housed in county-level facilities. To help pay for their increased inmate population, the counties are receiving increased levels of support from the State—\$400 million in fiscal year 2011–12, the

first partial year of realignment, growing to more than \$850 million in fiscal year 2012–13 and exceeding \$1 billion in fiscal year 2013–14. Chapters 15 and 39, Statutes of 2011, provide a dedicated and permanent revenue stream to counties, but they have done so by diverting portions of the revenue generated through vehicle license fees and the state sales tax that would otherwise have supported other programs paid for by the General Fund.

Funding the California State Teachers' Retirement System

The State continues to face the possibility of having to help further finance the pension liabilities of the California State Teachers' Retirement System (CalSTRS) Defined Benefit Program. The contributions required from CalSTRS members and their employers are currently not sufficient to ensure payment of all promised future benefits. Therefore, the funding of CalSTRS continues to be a high-risk issue for the State.

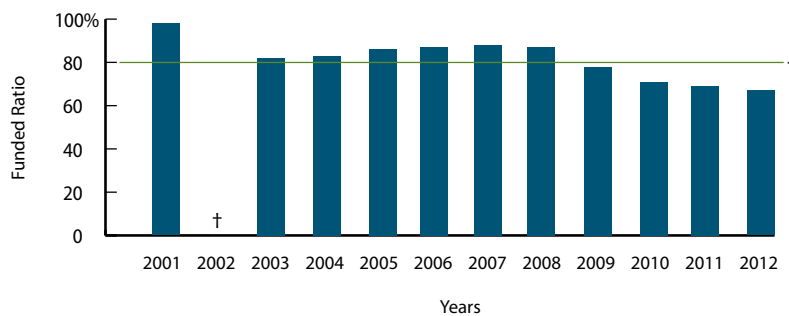
CalSTRS was created to provide California teachers with a secure financial future during their retirement years and to provide an incentive for them to stay in the teaching profession. With more than 860,000 members and benefit recipients, CalSTRS is the nation's largest public teachers' retirement system. CalSTRS is responsible for administering the State Teachers' Retirement Plan, the primary program of which is the Defined Benefit Program, which provides defined retirement benefits based on retirement age, years of service, and compensation totals. Membership in the Defined Benefit Program includes all employees in California public schools in positions requiring membership, such as certificated public school teachers, teaching superintendents, and educational administrators from kindergarten through community college. In addition to paying the current year's pension obligations, CalSTRS prefunds future pension benefits by setting aside funds each year. The members, their employers, and the State are each required to contribute a percentage of members' salaries to prefund pension benefits for CalSTRS members.

Pension systems have incredibly long-lived liabilities, paying promised benefits many decades after they are first offered.

Pension systems have incredibly long-lived liabilities, paying promised benefits many decades after they are first offered. To limit the risk of not having enough assets to cover retirement benefits, the U.S. Government Accountability Office recommends that retirement systems maintain a funding ratio of at least 80 percent of liabilities. This means a pension system should have enough assets on hand in any given year to cover at least 80 percent of its current-year and future pension liabilities. However, poor investment returns due to economic recessions, as well as the

inability to adjust contributions, have caused the funding ratio of the CalSTRS Defined Benefit Program to decrease from 98 percent in 2001 to 67 percent in 2012, as shown in Figure 2.

Figure 2
Value of Assets of the California State Teachers’ Retirement System Defined Benefit Program as a Percentage of Its Liabilities
June 30, 2001 Through June 30, 2012



Sources: California State Teachers’ Retirement System (CalSTRS) Defined Benefit Program Actuarial Valuation as of June 30, 2012.

* According to a study by the U.S. Government Accountability Office, a sound pension plan should have assets that are at least 80 percent of its current and future liabilities.

† Government Accounting Standards Board Statement No. 27 requires actuarial valuations to be performed biennially, or every other year. Although CalSTRS typically performs such valuations each year, it did not do so in 2002.

One of the major risks to CalSTRS’ funding is that its board does not have the authority to set contribution rates. Unlike the rates of the California Public Employees’ Retirement System (CalPERS), CalSTRS’ rates are established by state law. As a result, only the Legislature, not the CalSTRS board, has the authority to change the contribution rates. Members contribute 8 percent of their salary, employers contribute 8.25 percent, and the State contributes roughly 2 percent to the Defined Benefit Program. The member and employer contribution rates have remained largely unchanged by the Legislature since 1972 and 1990, respectively—a stark contrast to the adjustments to employer contribution rates that CalPERS makes each year.

California recently enacted the Public Employees’ Pension Reform Act of 2013. A significant impact of this legislation is that the normal retirement age for new CalSTRS members increases from age 60 to age 62. New CalSTRS members retiring earlier than age 62 generally must accept lower pension benefit rates. This legislation also requires new members to pay at least 50 percent of their pension costs. However, this legislation has not had a significant effect on CalSTRS’ funding ratio because employees hired before 2013 are not affected by the legislation’s significant provisions.

At the current contribution rate and actuarially estimated rate of return on investment, the Defined Benefit Program's funding ratio will continue to drop and assets will eventually be depleted. The actuaries who examined CalSTRS' Defined Benefit Program determined the current combined contribution rate of employees, employers, and the State to be about 19.47 percent of salaries in 2012. To reverse the funding ratio decline and reach 100 percent funding in 31 years, the actuaries concluded the combined contribution rate would need to increase by 14.62 percent of salaries for a combined contribution rate of 34.09 percent of current-year salaries.

As time passes, it will be harder to reverse the downward trend, and the required increase in contributions may grow too large for the State to take necessary action. According to a March 2013 actuarial valuation report, even assuming the expected return on CalSTRS' investments is achieved each year, the Defined Benefit Program is at risk of having its funding status continue to decrease to zero in 31 years if the Legislature does not increase contribution rates. Because the State may bear some responsibility for funding the benefits promised to CalSTRS members, unless the State takes steps to ensure that funding for the CalSTRS program is increased, it may have to make up for the deficit using revenue from taxes. Consequently, this remains a high-risk issue for the State that we will continue to monitor.

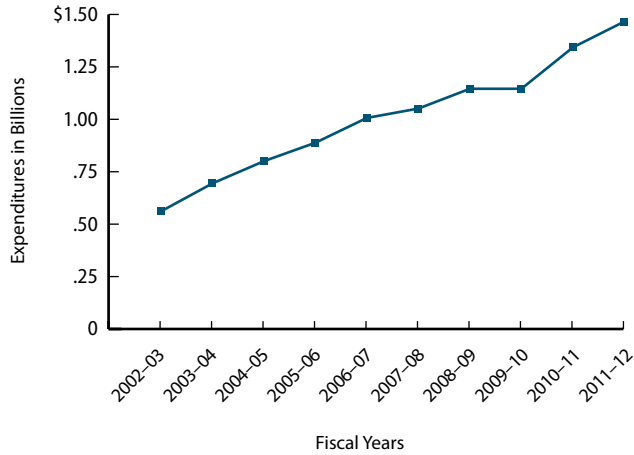
Funding Retiree Health Benefits

The State has experienced increasing costs for providing retirees and their family members benefits known as *other postemployment benefits* (OPEB), which are additional benefits beyond pensions and include, for example, medical and dental insurance premiums. The State's total accrued OPEB liability—the estimated total for all retiree health benefits that will be paid in the future—has grown from \$59.9 billion in 2010 to \$63.85 billion in 2012. If the State continues the current method of funding OPEB, the growth of the OPEB liability will continue to increase. The management of the State's OPEB liability continues to be a high-risk issue because the issues identified in our 2011 high risk update report have not been resolved.

The State's annual OPEB costs are rising due to a growing number of retirees and increases in health care premiums. The number of retirees has grown from approximately 134,000 in fiscal year 2009–10 to about 144,000 in fiscal year 2011–12—an increase of 7 percent. Over the same period, health care premiums have risen by approximately 15 percent. These two factors have resulted in an increase in OPEB expenditures from about \$1.1 billion in fiscal year 2009–10 to about \$1.5 billion in fiscal year 2011–12, as shown in Figure 3—an increase of 36 percent.

The State's total accrued OPEB liability—the estimated total for all retiree health benefits that will be paid in the future—has grown from \$59.9 billion in 2010 to \$63.85 billion in 2012.

Figure 3
Expenditures on Other Postemployment Benefits



Source: Data obtained from the California State Controller's Office.

Our 2011 high risk report concluded that the increased OPEB liability presents a risk to the State's ability to provide the level of health benefits promised to its retirees. The report described the risk the State is incurring by using the pay-as-you go method. Each year the State determines its annual required contribution, which is an actuarially determined level of funding that is projected to cover the current year's cost of benefits as well as a portion of the benefits earned in prior years. Since the State uses a pay-as-you-go method, which pays only for the current year's expenditures, the future OPEB liability that must be paid to state employees continues to grow. For example, the annual required contribution in fiscal year 2011-12 was \$4.8 billion, while actual contributions totaled only \$1.8 billion. This resulted in an increase in the OPEB obligation recognized in the State's financial statements from \$10.4 billion in fiscal year 2010-11 to \$13.4 billion in fiscal year 2011-12.

The State has the option to either partially or fully fund the total OPEB liability. If the State chose to prefund the OPEB liability by setting aside assets in advance to earn additional returns over time, the annual required OPEB contribution and unfunded OPEB liability would be reduced. As Table 4 on the following page shows, the State could have reduced its OPEB liability by almost \$22 billion if it had committed, as of June 30, 2012, to fully prefund its future retiree health benefits. Even partially prefunding its future retiree health benefits at 50 percent would have reduced the State's total OPEB liability by over \$12 billion.

Table 4
Comparison of Funding Method Valuations

	FUNDING METHOD (DOLLARS IN BILLIONS)		
	PAY AS-YOU-GO	PARTIAL FUNDING 50%	FULL FUNDING 100%
Assumed rate of return on investments	4.50%	6.06%	7.61%
Total estimated liability for retiree health benefits as of June 30, 2012	\$63.85	\$51.28	\$42.10
Savings over pay-as-you-go	–	12.57	21.75
Annual required contribution	4.92	4.07	3.51
Savings over pay-as-you-go	–	0.85	1.41
Expected employer cash payments	1.81	2.66	3.51
Projected liability for fiscal year 2012–13	16.09	14.49	13.17

Sources: State of California Retiree Health Benefits Program; Government Accounting Standards Board Statement Nos. 43 and 45; and Actuarial Valuation Report as of June 30, 2012.

There are some bargaining units that prefund OPEB. For example, the California Highway Patrol has an agreement with the State to prefund its OPEB obligations. However, this amount is too small to affect the State's overall OPEB liability. The State's OPEB 2012 Actuarial Valuation Report concluded that, given the low level of prefunding and the uncertainty of future contributions, the estimated liability for retiree health benefits will continue to grow in the future.

Other states are managing their OPEB liabilities better than California. According to a June 2012 report by the Pew Center on the States titled *The Widening Gap Update*, as of 2010, California has funded only 0.1 percent of its retiree health care liability, causing the State to be categorized as having "serious concerns." In contrast, seven states have funded at least 25 percent of their OPEB liabilities, including Alaska and Arizona, which have funded 50 percent and 69 percent, respectively. California has the largest OPEB liability and is one of the least funded states in the country. While the State has taken some steps to prefund OPEB for some employees, it remains unclear whether the State will begin prefunding OPEB for other employees and how the State will manage the risks associated with its large liability for retiree health benefits. Consequently, the State's growing OPEB liability remains a high-risk issue in need of continued monitoring.

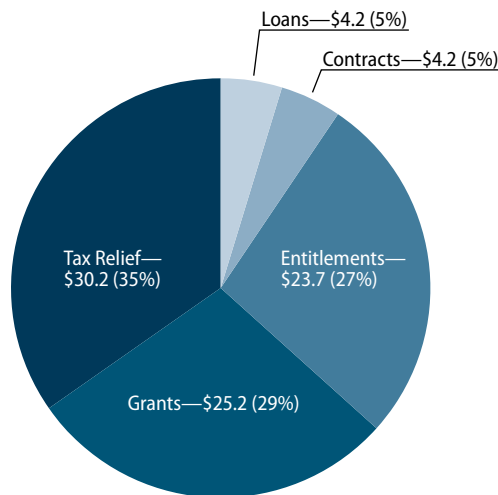
Ensuring Timely Expenditures of Recovery Act Funds

We no longer consider the timeliness of the State's expenditures of American Recovery and Reinvestment Act of 2009 (Recovery Act) funds a high-risk issue. In August 2011 we noted that various state

programs needed to ensure that these funds were spent before the respective deadlines to avoid having to forfeit them to the federal government. In addition, we noted that many state departments continued to have a significant number of internal control weaknesses related to their administration of the Recovery Act awards. Our current review, however, found that the State has done well in using its share of the Recovery Act money for its intended purposes in a timely manner.

The federal government enacted the Recovery Act to counter the negative effects of the United States' economic recession. With the distribution of more than \$800 billion in funds, the Recovery Act was expected to preserve and create jobs; promote economic recovery; invest in transportation, environmental protection, and other infrastructure; and stabilize state and local governmental budgets. Timelines for obligating Recovery Act funds were intentionally compressed by the Recovery Act to ensure that a significant amount of funds would be injected into the economy within a short time frame. Funds that were awarded and not obligated by mandated deadlines were to be reclaimed by the federal government in accordance with the Dodd-Frank Act of 2010. Figure 4 shows that California's total Recovery Act awards exceeded \$87 billion and consisted of tax relief, grants, entitlement payments, contracts and loans.

Figure 4
Breakdown of American Recovery and Reinvestment Act of 2009 Awards for California
(Dollars in Billions)



Sources: U.S. Government Recovery Act Web Site and California State Auditor's report High-Risk Update—California's System for Administering Federal Recovery Act Funds: State Departments Are Preparing to Administer Aspects of Recovery Act Funding, but Correction of Control Weaknesses and Prompt Federal and State Guidance Are Needed (Report 2009-611.1, June 2009).

The \$30.2 billion in tax relief for 2009 through 2012 included benefits such as education and first-time homebuyer credits and business tax incentives such as the five-year carry back of operating losses of small businesses. This component of the Recovery Act was not directly under the State's administration, although the influx in funds to California's economy was still significant. However, the State had at least some oversight of the grants, contracts, and loans, as well as the entitlement payments shown in Figure 4. These entitlement payments included assistance for needy families, foster care and adoption assistance, and a onetime \$250 payment to Social Security recipients, federal Railroad Retirement Board recipients, and veterans.

Because of the significant amount of funds involved, and because California had demonstrated weaknesses in administering programs for which federal funds were awarded in the past, in 2009 we determined that the administration of Recovery Act funds by state agencies was a high-risk issue. We noted that the then-existing internal controls may not provide sufficient assurance that Recovery Act funding would be properly administered. In addition, we found that although the California Recovery Task Force (task force) had provided general guidance for securing and administering Recovery Act funds, the task force should have provided a more detailed framework for administering and monitoring Recovery Act funds. In our most recent high risk report, in August 2011, we found that the State was at risk of losing up to \$8.6 billion in Recovery Act funds because these funds were not being allocated and spent in a timely manner.

Despite past challenges, our current review found that California was generally able to allocate and spend Recovery Act funds within the required time frames.

Despite these past challenges, our current review found that California was generally able to allocate and spend Recovery Act funds within the required time frames. As of April 2013 the State had received over 92 percent of its \$57 billion in Recovery Act awards for contracts, grants, loans, and entitlement programs. In addition, four of the six departments we reviewed—the Employment Development Department (Employment Development), California Department of Education (Education), California Energy Commission (Energy), and California Department of Transportation (Caltrans)—have indicated to us that they are planning to allocate and spend some or all of their remaining funds. This success is due in part to the executive branch's monitoring of the administration and use of Recovery Act funds. Specifically, a March 2009 executive order created the task force as the lead agency to ensure that California properly administered and accounted for the receipt of Recovery Act funds. The task force remained in operation until July 2011. Additionally, an April 2009 executive order created the Office of the Inspector General (inspector general) as an entity independent of the task force to protect the integrity and accountability of the expenditure of Recovery Act funds.

Our current review of selected state departments found significant progress in spending Recovery Act funds. We reviewed spending data for the four high-risk state departments discussed in our August 2011 report—Education, Employment Development, the California Department of Health Care Services, and the California Department of Social Services—and two other state departments—Caltrans and Energy. As shown in Table 5, these six departments collectively reported expenditures totaling \$34.7 billion (99 percent) of the \$35 billion in Recovery Act awards available to them.

Table 5
American Recovery and Reinvestment Act Awards and Expenditures at Six Departments We Reviewed as of Spring 2013

DEPARTMENT	TOTAL AWARD	TOTAL SPENT	REMAINING FUNDS	PERCENTAGE REMAINING
California Department of Health Care Services	\$13,223,817,558	\$13,193,467,722	\$30,349,836	0.23%
Employment Development Department	11,144,152,700	11,098,822,572	45,330,128	0.41
California Department of Social Services	1,490,627,600	1,455,767,020	34,860,580	2.34
California Department of Education	6,253,587,701	6,172,725,391	80,862,310	1.29
California Energy Commission	314,535,926	311,717,554	2,818,372	0.9
California Department of Transportation	2,618,537,817	2,467,934,338	150,603,479	5.75
Totals	\$35,045,259,302	\$34,700,434,597	\$344,824,705	0.98%

Sources: Expenditure reports provided to the California Department of Finance by the departments listed in the table.

While the remaining funds range from 0.23 percent to 5.75 percent, the deadlines to expend some of these funds are still in the future, allowing the State to continue to draw Recovery Act funds. The departments stated that they will spend most of their remaining funds, as indicated by the following:

- Before any applicable spending deadlines, Employment Development is planning to spend more than \$41 million for the unemployment compensation modernization incentive program, \$2.3 million for unemployment insurance special projects, and \$149,000 for competitive grants for worker training. As a result, the remaining unused balance of Employment Development’s Recovery Act awards will be roughly \$1.2 million.
- Caltrans is expecting to use its entire \$150.6 million in remaining Recovery Act funds by the September 2015 deadline.
- Education indicated that it expects to fully expend the remaining school improvement grants of over \$77 million by December 31, 2013, leaving only about \$3.1 million of its total Recovery Act awards unspent.

- Energy has commitments to spend (or has encumbered) \$2.7 million of its remaining \$2.8 million Recovery Act award.

Because most Recovery Act awards have been spent, and because four of the departments appear to have plans to spend any significant remaining amounts, we no longer consider the timeliness of the State's expenditure of the remaining awards to be a high-risk issue.

Chapter 2

MEETING REALIGNMENT CHALLENGES

The 2011 realignment of funding and responsibilities between the State and local governments is intended as a long-term solution to many challenges the State faces with respect to criminal justice, mental health, and social services programs. Although it appears that shifting certain criminal justice programs to the local level has reduced the State's prison overcrowding, the impact on jail overcrowding at the local level has become a potential concern. Further, the impact of realignment on other state programs, such as child welfare services, is unclear at this time. Until enough time has passed so that the effectiveness and efficiency of realignment can be evaluated, we designate realignment as a statewide high-risk issue.

Funding Realignment Programs

In 2011 California enacted legislation to undertake a major realignment of public safety, health, and human services programs. Realignment shifts the funding and responsibility for these programs, totaling over \$5.8 billion, primarily to county governments. In 2012 California voters approved Proposition 30, which contained provisions intended to ensure a stable funding source for the realigned programs. The new law transfers directly to counties a portion of the State's sales tax revenues that would otherwise have been collected in the State's General Fund, as well as certain motor vehicle license fee revenues that were previously allocated to the California Department of Motor Vehicles and some local governments. As shown in Table 6 on the following page, the programs affected by realignment span a wide range of services.

With realignment, the Legislature intended to provide local agencies with flexibility in administering the programs shown in Table 6. According to the *Governor's Budget May Revision for Fiscal Year 2012-13*, realignment funding is structured to provide counties with the flexibility to meet their highest priorities. For example, rather than going through the State's legislative process to reallocate funds between certain programs, a county's board of supervisors can redistribute some realignment funds to respond to the community's specific needs.

The legislation affected each program area differently, depending on which responsibilities shifted from the State to the local level. For criminal justice programs, the Legislature realigned responsibility for lower-level offenders, parolees, and parole violators from the State to the counties. As a result, individuals convicted of certain nonserious, nonviolent crimes, and who do not have a history of

serious, violent, or sex-related offenses, are being incarcerated in county jails or are under local supervision, rather than in the state prison system. In contrast, realignment did not change major functions of the child welfare system, according to the Legislative Analyst's Office (LAO). Instead, the Legislature transferred most nonfederal funding responsibility for child welfare programs to the counties; previously, the State and counties shared this responsibility. Before realignment, when child welfare system caseloads increased, the State and counties would share in these increased costs. According to the LAO, the counties now bear the primary financial responsibility for increased caseloads, thereby placing greater financial pressure on the counties to contain child welfare system costs.

Table 6
Estimated Program Allocations Covered Under Realignment
Fiscal Year 2012–13
(Dollars in Thousands)

PROGRAM	AMOUNT	PERCENT BUDGET
Criminal Justice		
Adult offenders and parolees	857,500	14.68%
Public safety programs	489,900	8.39
Court security	496,400	8.50
Juvenile justice	98,800	1.69
Subtotals	\$1,942,600	33.26%
Protective Services*		
Foster care and child welfare services	\$ 1,585,400	27.14%
Adult protective services	55,000	0.94
Subtotals	\$1,640,400	28.08%
Existing Community Mental Health Programs	\$1,120,600	19.19%
Behavioral Health†		
Early and periodic screening, diagnosis, and treatment	\$584,200	10.00%
Mental health managed care	196,700	3.37
Substance abuse treatment	183,600	3.14
Subtotals	\$964,500	16.51%
Total Before Growth Factor	\$5,668,100	97.04%
Program cost growth‡	172,900	2.96%
Total Allocated	\$5,841,000	100.00%
Sales tax revenue (1.0625 percent)	5,386,300	92.22%
Motor vehicle license fee transfer	454,600	7.78
Total Revenues	\$5,840,900	100.00%

Sources: California Department of Finance Governor's Budget May Revisions for fiscal years 2012–13 and 2013–14.

* Pursuant to Senate Bill 1020 (Statutes of 2012), the Legislature provides a single allocation for protective services.

† The Legislature provides a single allocation for behavioral health.

‡ Program cost growth represents sales and use tax revenues in excess of projections.

State oversight of child welfare programs remains largely intact, and the counties still have to comply with federal and state laws and the regulations that implement those laws. The chief of the Child Protection and Family Support Branch (branch chief) at the California Department of Social Services (Social Services) indicated that the oversight role of Social Services has largely remained the same. Social Services still regularly monitors counties' performance and must conduct a comprehensive review of county child welfare programs at least once every five years.

Assessing the Effects of Realignment

The 2011 realignment is intended to move program responsibility to the level of government that can best provide services, eliminate duplication of efforts, generate savings, and increase flexibility. To allow the State and key stakeholders to assess the effects of realignment, the State needs to begin gathering reliable and accessible data. According to a report issued by the LAO, the 2011 realignment included a broader array of programs than any other state-local realignment in modern California history. Beyond each county's involvement, multiple statewide stakeholders contribute to the implementation of realignment, as described in the text box. For example, the California Department of Finance, in consultation with appropriate state departments and the California State Association of Counties, provides the California State Controller's Office with distribution schedules for some realignment funds. In addition, because a change of this magnitude takes time, some aspects of realignment are being implemented before others. For example, the legislation shifted responsibility for adult offenders to counties in October 2011, whereas a parole revocation process was not transferred from the Board of Parole Hearings to the county superior courts until July 2013. Consequently, the success of many aspects of realignment cannot be assessed until more time has passed.

Key Stakeholders

State Departments

- California Department of Corrections and Rehabilitation
- California Department of Health Care Services
- California Department of Social Services
- California Department of Finance
- California State Controller's Office

Other Statewide Stakeholders

- Board of State and Community Corrections
- County Welfare Directors Association of California
- Chief Probation Officers of California
- California State Sheriffs' Association
- California State Association of Counties
- County Mental Health Directors Association

Sources: [Realignment legislation](#) and [entity Web sites](#).

The State does not currently have access to reliable and meaningful realignment data to ensure its ability to effectively monitor progress toward achieving intended realignment goals. Effective July 2012 the Legislature created the Board of State and Community Corrections (community corrections board) to collect and make publicly available up-to-date information reflecting the impact of state and community correctional, juvenile justice, and gang-related policies and practices enacted in the State, among other responsibilities.

Although the realignment legislation included a number of data reporting functions, some program areas cannot be fully evaluated due to their early stage of implementation.

The community corrections board is also responsible for collecting each county's public safety realignment plans and reporting on the data and outcome-based measures included in those plans. In its reports, the community corrections board provides a disclaimer on the limitations of the counties' data. These limitations occur because, for example, some of the data that counties provide to the community corrections board are voluntary, each county maintains its own data system for tracking offender populations, county personnel may have different interpretations of variable definitions, and county data may contain missing or overlapping information. In a report we issued in September 2012 we concluded that very limited data exist to measure whether the realignment, or shift in care, of thousands of juvenile offenders from the State to the counties has been successful.⁴

Although the realignment legislation included a number of data reporting functions, some program areas cannot be fully evaluated due to their early stage of implementation. Under Chapter 35, Statutes of 2012, Social Services must annually report to the appropriate fiscal and policy committees of the Legislature, and publicly post on its Web site, a summary of outcome and expenditure data that allow for monitoring of changes since the enactment of realignment. This report allows the Legislature to monitor the results of transferring the primary financial responsibility of nonfederal costs and increased caseloads to the counties. In April 2013 Social Services issued its first annual realignment report, which contained data on child welfare practices that affect child and family safety, permanency, and well-being. According to the branch chief, more time needs to elapse before Social Services can identify trends in performance measurements that may have occurred as a result of realignment. The branch chief indicated that Social Services measures some performance outcomes over a longer period of time, with some indicators taking as long as 12 months to measure.

Addressing Overcrowding in County Jails

The county jail system faces challenges in managing its inmate population. Realignment shifted responsibility for housing certain adult offenders from the State to the counties. By altering where certain offenders serve their sentences, the Legislature, in effect, transferred responsibility for these offenders to the counties. According to the LAO, offenders sentenced for certain nonserious, nonviolent crimes, who have no prior serious or violent criminal

⁴ *Juvenile Justice Realignment: Limited Information Prevents a Meaningful Assessment of Realignment's Effectiveness* (Report 2011-129, September 2012).

convictions and who are not required to register as sex offenders, will now serve their sentences in a county jail or under local community supervision rather than in state prison.

According to data collected by the community corrections board, the county jail population has steadily increased since realignment went into effect in October 2011. Specifically, the average daily population in the county jail system grew from 72,285 to 80,864 (12 percent) between October 2011 and September 2012.⁵ Not all counties are adequately prepared to properly handle an increased jail population. According to the chief deputy of the Sacramento County Sheriff's Department (chief deputy), managing inmate populations at the county level will be an ongoing challenge. The chief deputy explained that the county jail system across the State is not designed to house inmates for periods exceeding one year. Under realignment, however, county jails will need to house inmates with significantly longer sentences and often with more substantial needs, such as long-term medical and mental health care. The support services captain of the Santa Clara County Office of the Sheriff echoed this concern, stating that, in contrast to the infrastructure found in state prisons, county jails are not set up to effectively address the long-term physical and mental health issues of inmates.

Further, some county jails have been unable to incarcerate all offenders due to capacity constraints, presenting a potential risk to public safety. According to the Public Policy Institute of California (institute), as of September 2012, the statewide average daily jail population exceeded by nearly 4,000 inmates the community corrections board's target population of 76,910. The institute also reported that 21 counties had an average daily population greater than their rated capacity, and 18 counties were operating under court-ordered population caps for at least one jail in their county. Between October 2011 and September 2012, the community corrections board's data show that the number of nonsentenced offenders released each month by county jails due to capacity constraints increased from 6,212 to 7,050 (13.5 percent). In other words, these offenders were booked into jail facilities but released because of a lack of housing capacity. Moreover, the monthly number of sentenced offenders released early to supervision programs grew from 3,527 to 5,700 (62 percent) during the same time frame. Although the realignment legislation authorizes counties to use state facilities to house felons, the State is already struggling to meet a federal court order to reduce its inmate population, as we discuss in Chapter 3 of this report. Therefore, this

Offenders were booked into county jail facilities but released because of a lack of housing capacity.

⁵ The average daily population reflects the monthly average of inmates tallied during daily inmate counts.

option may not be practical in the short run. Until the State and local governments can demonstrate that they are able to adapt to their changed roles and responsibilities under realignment, we will consider realignment to be a high-risk issue.

Chapter 3

MANAGING THE STATE'S PRISON POPULATION AND CORRECTIONAL INSTITUTIONS

In 2006 we designated the California Department of Corrections and Rehabilitation (Corrections) as high risk due to issues related to overcrowding in state prisons, the quality of inmate health care in the prison system, and concerns about the consistency of leadership in its senior management. Although Corrections has reduced inmate overcrowding in the prison system since our last report in 2011, it missed a court-imposed population benchmark set for December 2012. New legislation enacted in September 2013 provides funding and new authority to Corrections to avoid early release of inmates; however, it is too early to conclude on the success of these efforts. Inmate health care has improved since our last report, but Corrections has not yet reached a sustainable, constitutionally adequate level, as required by the federal court. Finally, organizational instability in Corrections' management ranks and a lack of strategic and leadership succession plans continue to hamper Corrections' ability to provide consistent leadership. For these reasons, Corrections continues to represent a high risk to the State.

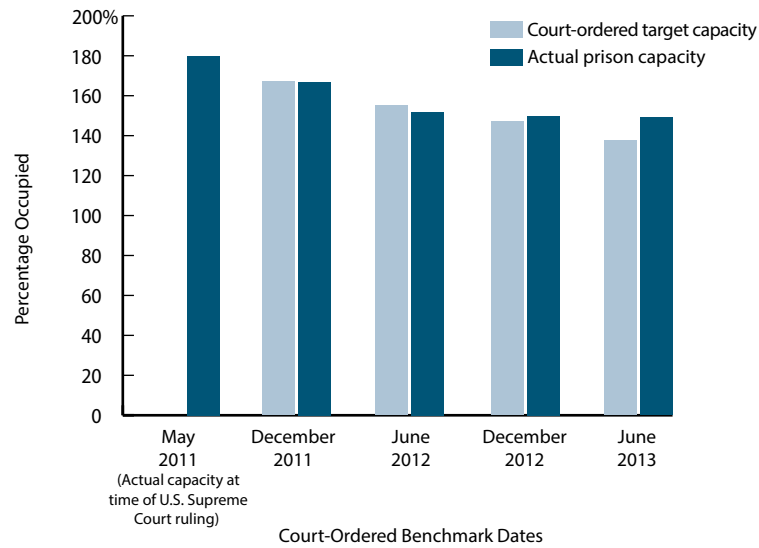
Reducing Overcrowding in State Prisons

California continues to face challenges to reduce overcrowding in the State's prisons to meet a maximum level of prisoners ordered by a federal court. Although, the State took recent actions to avoid the early release of inmates, until California meets court-ordered benchmarks, managing the prison population will remain a high-risk issue.

The State's correctional institutions continue to hold more inmates than their design capacity, which is defined by the federal court as essentially one inmate per cell. In 2009 the federal court ordered the State to reduce its prison population to no more than 137.5 percent of design capacity. When the U.S. Supreme Court (Supreme Court) upheld this prison population reduction order in May 2011, prison occupancy was at 180 percent of design capacity. To reduce prison overcrowding, the federal court ordered the State to meet four inmate population benchmarks at six-month intervals starting in December 2011 and ending in June 2013. Although the State met the first two benchmarks, it missed the December 2012 benchmark of 147 percent, having an actual capacity of 149.8 at that time. As indicated in Figure 5 on the following page, the State would have also missed the court-imposed benchmark for June 2013.

However, in January 2013 the State notified the federal court that it would not meet the June 2013 benchmark, and the federal court extended the final benchmark date to December 31, 2013.

Figure 5
Court-Ordered Targets and Actual Prison Capacity



Sources: Rulings by the U.S. District Court and inmate population reports from the California Department of Corrections and Rehabilitation.

The State introduced several new programs to comply with court rulings and reduce overcrowding in the state prison system. As stated in the previous chapter, the 2011 realignment shifted funding and responsibility for some inmates from the State to the counties. Although realignment has been a major factor in reducing state prison overcrowding, so far it has not been enough by itself to reduce the inmate population level to the final benchmark. An April 2013 fact sheet released by Corrections shows that the diversion of low-level offenders and parole violators to county jails instead of state prison has resulted in a decrease in the inmate population of about 28,000 (17 percent).

Needing further inmate population reductions to meet the court-ordered benchmark, Corrections has implemented other solutions in addition to realignment. These solutions, proposed in a plan Corrections refers to as the *blueprint*, include improving the State's inmate classification systems, improving access to rehabilitation programs, and standardizing staffing levels. In addition to the solutions proposed in the blueprint, the federal court ordered the State to create a list of proposed inmate population reduction measures. The State came up with a list of

17 options to reduce overcrowding but then explained that only two—expanding new construction projects and expanding fire camps—could be unilaterally implemented by the State’s executive branch. The State constructed the California Health Care Facility in Stockton, which opened in July 2013 and will apparently increase capacity by 1,818 beds by December 2013. The State also plans to maintain its fire camps at the level of roughly 3,900 inmates at these camps. In its response to the federal court, the State outlined some of the challenges with implementing the remaining 15 proposed solutions, including the lack of authority to implement some of the solutions without changes to state law. To avoid early release of inmates, in September 2013 the legislature enacted Senate Bill 105 that allows the state to comply with the federal court order. The new law appropriates \$315 million to Corrections with the authority to house inmates in various facilities and authorizes the state to take other actions that may, ultimately, reduce overcrowding.

New legislation allows the state to comply with the federal court order.

In May 2013 the State filed an appeal challenging the prison population benchmark to the Supreme Court. The State claimed that the primary reason that the court ordered a reduction in the prison population was due to the substandard prison health care system. The State claimed that inmate health care in the California prison system exceeds constitutional standards and that the 137.5 percent population benchmark is therefore no longer necessary. In August 2013 the Supreme Court denied California’s request for a stay of the court’s prison reduction order. Corrections anticipates that in October 2013 the Supreme Court will rule on whether it will hear the state’s appeal. Since the effectiveness of current efforts to reduce prison population by the end of 2013 is not known, overcrowding in California’s prisons remains a high-risk issue.

Improving the Prison Health Care System

Although California’s prison health care system has seen many improvements under the federal health care receiver (receiver) since its appointment by the U.S. District Court for the Northern District of California (district court) in 2006, the process of improving inmate health care has been long and expensive. The goal of the receiver is to bring California’s prison health care system up to a sustainable, constitutionally adequate level. Until the district court rules that this goal is met, California’s prison health care system will remain under the control of the receiver. The receiver has significant control over the health care system, including administrative, financial, accounting, legal, contractual, personnel, and other operational matters. Under this authority, the receiver can order costly improvements to the prison health care system,

which must be paid for by the State. Consequently, until control of the system reverts back to Corrections, this issue remains a high risk to the State.

When the receivership began in fiscal year 2005–06, the cost directly attributable to inmate medical care in California’s prisons was \$841 million. According to the governor’s budgets and information provided by the receiver’s office, the receiver’s cost of operating the prison health care system grew to \$1.7 billion in fiscal year 2011–12. For fiscal year 2013–14, a total of \$1.5 billion is budgeted.⁶

In 2008, at the request of the court and the receiver’s office, the Office of the Inspector General (inspector general) started an inspection program to provide an independent evaluation of the quality of inmate health care. As of April 2013 the inspector general had conducted three rounds of inspections at each institution and assigned an overall score of zero to 100 percent. Scores of 75 percent or below indicate a low adherence to standards, while scores of 85 percent or above indicate a high adherence to standards. As shown in Table 7, these inspections found that the overall quality of inmate health care has improved over time from 71.9 percent in 2008 through 2010 to 86.9 percent through January 2013.

Table 7
Results of Medical Program Inspections by the Office of the Inspector General

INSPECTION ROUND	HEALTH CARE QUALITY RATES		
	PERIOD COVERED	RANGE OF RATES	OVERALL RATE
First	September 2008 to June 2010	62.4 – 83.2%	71.9%
Second	September 2010 to December 2011	73.0 – 89.5	79.6
Third	February 2012 to January 2013	77.6 – 93.4	86.9

Source: Office of the Inspector General, Dashboard Monthly Comparison, May 2013.

However, the receiver has stated that the sustainability of these improvements is yet to be determined by the district court. To determine when a sustainable constitutional standard has been reached, the district court may consider several other factors in addition to the inspector general’s measurement. For example, the district court indicated that it would send out its own experts

⁶ These amounts do not include \$118 million budgeted for nursing services under the Corrections’ mental health program, which was not included in the receiver’s costs until fiscal year 2011–12.

to evaluate the quality of inmate health care. As of August 2013 seven reviews were complete with the results indicating additional improvements in medical care are needed.

The receiver is required to provide periodic progress reports to the district court. In May 2011, of the 48 required actions, the receiver identified 34 as complete and 14 as in process or ongoing. In its May 2013 report the receiver noted that of 48 required actions, 35 are complete and 13 are in process or ongoing. Even though the receiver has completed only one additional item since 2011, progress has continued to be made on the outstanding items. However, the receiver also noted that more work needs to be done to solve the challenge of providing timely access to health care and delivery of medications to all inmates who need them.

In May 2012 the district court ordered the receiver to work with Corrections to transfer, when appropriate, certain inmate health care functions back to State control under a revocable delegation of authority. Two formal delegations—one for health care access units and another for medical facility activations—have already occurred. In May 2013 the receiver submitted 10 draft delegations of authority for Corrections to review. However, the receiver has not yet decided to proceed with these additional delegations of authority. One major concern noted in the receiver's May 2013 report that could slow down the pace of the delegations of authority is Corrections' handling of a recent outbreak of coccidioidomycosis (valley fever) in certain state institutions. Valley fever is an illness caused by a fungus and may lead to hospitalization or death. The receiver established a policy requiring that specific at-risk populations not be incarcerated at the two institutions most severely affected by valley fever. In May 2013 the receiver indicated that he did not believe Corrections' response to the valley fever threat was adequate, and he stated that he will take Corrections' response to the valley fever outbreak into consideration before returning any additional elements of the prison health care system to Corrections' control. As of July 2013 no update was available about when the next delegation of authority will occur.

Maintaining Consistent Leadership

Although Corrections has made progress in its planning to meet its long-term goals, more remains to be done, and it continues to experience difficulty in permanently filling senior positions. Therefore, Corrections' leadership continues to be a high-risk issue for the State.

The receiver noted that more work needs to be done to solve the challenge of providing timely access to health care and delivery of medications to all inmates who need them.

We noted Corrections' lack of organizational stability in senior leadership positions in our August 2011 high risk report, as Corrections struggled to fully staff its management ranks. Corrections' May 2011 organizational chart showed seven acting and two vacant senior leadership positions. Our current review of Corrections' June 2013 organizational chart found that Corrections has been successful in filling its vacant leadership positions; however, it continues to have six leaders serving in an acting capacity. In addition, vacancies in its warden ranks increased from 12 in May 2011 to 13 in April 2013.⁷ With a facility in Stockton becoming fully operational in 2013, Corrections now has 34 warden positions. Corrections commented that vacancies in its warden ranks are due to retirements. It further stated that the process of selecting and hiring wardens is rigorous and can take over a year to complete, and includes background checks by Corrections, investigation by the inspector general, review by the Governor's Office, and final determination by the governor.

In addition, Corrections lacks a formal succession plan to ensure stability in leadership positions. Corrections stated that its succession planning and headquarters training units, which were charged with the responsibility of identifying and training future leaders, were eliminated during budget cuts in prior years. All positions in the succession planning unit were vacant as of October 2010, and these positions were officially abolished on January 1, 2011. According to Corrections' deputy director of human resources, since the abolishment of the succession planning unit, senior leadership positions have been filled on an as-needed basis, as the old succession plan is no longer being used. As for the training unit, some positions were eliminated in May 2011 and the last positions were abolished in October 2011. Though it anticipates reestablishing these units in the future, Corrections currently has no written plan for achieving this goal. As a result, Corrections has set no firm implementation date for when a new succession plan may be available. In the meantime, Corrections stated that it uses an informal mentoring program in which retired annuitants provide some guidance for future leaders and also uses an executive development orientation program to provide an orientation and overview of information beneficial to new or upcoming managers. Corrections intends to formalize these programs when the succession planning and training units are reestablished.

Corrections also has yet to finalize a new strategic plan. According to its director of internal oversight and research, in February 2012 Corrections stopped using its 2010–2015 strategic plan and

Corrections has set no firm implementation date for when a new succession plan may be available.

⁷ Each vacant warden position was filled with an employee operating in an acting capacity.

stopped tracking its progress toward achieving the plan's goals because, in response to the 2011 realignment, it shifted focus to the development of the multi-year blueprint. To help ensure its success in implementing the blueprint, Corrections developed a commitment matrix in February 2013 to identify goals, responsible parties, due dates, and status reports to help management track goal completion. Although the matrix appears to address all major goals listed in the blueprint, program directors are responsible for creating their own tracking methods within their divisions. For example, the Facility Planning, Management, and Construction Division prepares monthly reports to track progress and provides bi-weekly updates to leadership. Because, according to the acting director, certain components of the blueprint involve staffing and funding that were incorporated into the 2012–13 Budget Act and related trailer bills, the California Department of Finance (Finance) and inspector general also measure Corrections' progress toward selected blueprint goals. In their most recent reports, Finance and the inspector general report that Corrections has made progress toward goal completion. So while Corrections does not yet have its new strategic plan in place, it is making progress toward completing the goals listed in the blueprint.

The director of internal oversight and research stated that the blueprint has served as Corrections' strategic plan since April 2012; however, we identified certain goals and objectives in its draft strategic plan that are not covered by the blueprint. For example, one of the objectives of the draft strategic plan is to increase the number of victims participating in or receiving victim services by 20 percent by June 30, 2013. However, the blueprint does not include this objective in the list of goals. Corrections stated that, while the blueprint is designed to save money, end federal court oversight, and improve the prison system, it needs to finalize its strategic plan to complement the blueprint. Under three overall goals of operations, administration, and health care, the draft strategic plan contains 17 objectives. Corrections has no firm date for implementing the strategic plan, and the draft plan is subject to change at any time by Corrections' leadership in response to changing priorities. When the strategic plan is final, Corrections will publicize it on its Web site and develop a dashboard to monitor the progress toward goal completion. With the timeline for implementation of the draft strategic plan uncertain and the ability of management to change or modify the listed goals, the consistency of future leadership cannot be assured and, therefore, remains a high-risk issue.

While Corrections does not yet have its new strategic plan in place, it is making progress toward completing certain goals listed in its multi-year planning document, called the blueprint.

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Chapter 4

MODERNIZING AND IMPROVING THE STATE'S INFRASTRUCTURE

In 2009 the California State Auditor (state auditor) designated the State's aging infrastructure and its ability to supply reliable electricity to its residents as areas of high risk. The State's investments in transportation and water supply and flood management infrastructure have not kept up with demands. As a result, the State's transportation systems and water infrastructure are showing signs of deterioration. In addition, although the State has made progress in updating its electricity infrastructure to better protect the environment and is currently on track to meet its renewable energy target by 2020. However, because the supply of electricity is critical to the State's economy, and the shift in its production to sources and technologies that will have less impact on the environment is an important ongoing effort, we will continue to monitor this aspect of the State's infrastructure as an area of high risk.

The State's Infrastructure Needs

California's infrastructure is the foundation that connects the State's businesses, communities, and people, driving its economy and improving the quality of life of its citizens. Much of the State's infrastructure is aging and needs to be improved to meet current and future demands. However, infrastructure upgrades have not kept up with changing conditions, particularly in the areas of transportation and water. As a result, the State's transportation systems and water infrastructure are showing signs of deterioration and require attention. Additionally, California will continue to need new infrastructures to accommodate population growth, which in turn will require additional resources for operations and maintenance.

Improving Investment in Transportation

The preservation, maintenance, and expansion of the State's aging transportation infrastructure, including roads, highways, bridges, and railways, are critical to the State's ability to meet the needs and demands of a growing population. However, current revenues available from federal, state, and local sources for maintaining and improving the State's transportation infrastructure are not sufficient. As a result of this underfunding, the condition of the State's transportation systems continues to deteriorate. For example, 25 percent of the State's roadways were in fair or poor condition as

The Transportation Commission projected a shortfall of over \$290 billion, which means that there will be only enough funding to cover approximately 45 percent of the overall estimated costs of transportation projects and programs that were identified in the State's needs analysis.

of December 2011, compared to 21 percent in 2001. The California Transportation Commission (Transportation Commission), which exists under the newly created California State Transportation Agency (Transportation Agency), projected a shortfall of over \$290 billion in its 2011 Statewide Transportation System Needs Assessment for the 10-year period from 2011 to 2020. The Transportation Commission estimated the costs of maintaining, managing, and expanding the State's transportation infrastructure for the same 10-year period as being approximately \$536 billion. However, it also estimated that over the same 10-year period, the State will raise \$242 billion from local, state, and federal sources for investment in transportation infrastructure. This funding discrepancy means that there will be only enough funding to cover approximately 45 percent of the overall estimated costs of transportation projects and programs that were identified in the needs analysis.

The State, under the direction of the Transportation Agency, has convened a workgroup of state and local transportation stakeholders to explore and evaluate options to meet the infrastructure needs over the next decade, as well as to advise the governor on infrastructure funding for the fiscal year 2014–15 budget. The Transportation Agency became operational in July 2013 and, under the governor's 2012 reorganization plan, includes the transportation entities that were formerly part of the Business, Transportation and Housing Agency. The secretary at the Transportation Agency explained that the workgroup held multiple meetings in 2013 and that, although it will not be able to solve the State's vast funding gap, the workgroup plans to prioritize the State's transportation infrastructure needs, determine how to measure outcomes, and evaluate the costs and benefits of various policy options to use the State's limited resources in the most effective manner. As part of our ongoing assessment of high-risk issues, we will continue to monitor the State's efforts to address its transportation infrastructure needs.

Ensuring a Stable Water Supply and Upgrading Flood Management Infrastructure

Upgrades of water infrastructure have not kept pace with estimates of needs. According to the Public Policy Institute of California (policy institute), there has been little expansion of the State's major water infrastructure since the early 1970s. Specifically, the State's water storage and delivery system is more than 35 years old, the federal system in the State is more than 50 years old, and some local facilities were constructed nearly 100 years ago. These systems require costly maintenance and rehabilitation as they age. Aging facilities are a risk to public safety, water supply reliability, and water quality.

Current infrastructure disrepair, outages, and failures and the degradation of local water delivery systems are in part the result of many years of underinvestment in preventive maintenance, repair, and rehabilitation. According to the California Department of Water Resources (Water Resources), with annual expenditures for 2010 totaling about \$18 billion, local entities such as special districts, water districts, utilities, and cities account for the largest portion of spending on water infrastructure.⁸ Even with a significant investment by these agencies in water infrastructure, water projects at all levels of government are commonly underfunded. In fact, a 2012 infrastructure report by the American Society of Civil Engineers (ASCE) indicates that significant investments are still needed to address the renewal and replacement, maintenance, security, and reliability of California's water infrastructure. The report estimates that an additional annual investment of \$4.6 billion is needed for the next 10 years.

At the heart of California's water supply issue is the Sacramento–San Joaquin Delta (delta). Generally, the supply of water in California does not naturally occur where demand is currently the highest. Precipitation, the primary source of the State's water supply, occurs in the mountains in the north and eastern parts of the State, while most water is used in the Central and southern valleys and along the coast. The delta connects many of these regions. In fact, the delta supplies an estimated 25 million people with their drinking water and irrigates 4 million acres of farmland. This has led to the development of vast infrastructure systems that store and convey water to demand centers, such as the State Water Project (SWP) and the federal Central Valley Project (CVP). According to the U.S. Congressional Research Service (CRS), for decades the transfer of water from the northern part of the State through the delta to supply farms and cities in Southern California has had profound impacts on fish and wildlife resources, water quality, and regional water supplies. In response, state and federal lawmakers have enacted legislation to protect the delta resources.

However, environmental protection laws and the resulting regulatory restrictions have reduced water supplies and flexibility to meet the quantity and timing of water delivered from the delta. For example, according to the CRS, the U.S. Fish and Wildlife Service and the National Marine Fisheries Service have each issued federal biological opinions (biological opinions), which found that increased pumping by the CVP and SWP would jeopardize

Even with a significant investment by local entities in water infrastructure, water projects at all level of government are commonly underfunded.

⁸ According to Water Resources, completion of a full assessment of actual investment and fund sources is difficult because of wide variations in how different entities prepare budgets, and the sheer number of entities involved in providing water-related services. Finally, local funding is especially difficult to track because activities often occur in the same proximity, many projects serve multiple purposes, and many activities have multiple fund sources.

the continued existence of several species protected under the Endangered Species Act. The biological opinions included proposed actions that essentially resulted in restrictions on the amount of water exported from the delta. The CRS stated that the resulting restrictions, combined with reductions necessitated by drought conditions, have resulted in some water users receiving a fraction of the water normally supplied by the SWP and CVP.

One possible solution to problems involving the delta is the Bay-Delta Conservation Plan (Conservation Plan), which is the governor's plan to restore the delta ecosystem and improve the reliability of water supplies in the State. The Conservation Plan proposes to move water under the delta in order to reduce the ecological impact on the delta. To achieve this, the plan calls for the construction of two 35-mile underground tunnels to divert water from the Sacramento River southward. Water Resources estimated that the Conservation Plan will cost about \$24.5 billion over the 50-year lifetime of the project. It also estimated that although funding will come primarily from user fees, state and federal funding sources will make up 15 percent and 16 percent, respectively. Initial state funding is anticipated to come from future water bonds, only a portion of which have been approved by voters, and the remainder is contingent on the passage of future bond measures. In addition, Water Resources, the State's lead agency in compiling the environmental documents in support of the Conservation Plan, stated that it expects that litigation may arise in the future, which could potentially hinder the completion of the plan. Therefore, although the Conservation Plan aims to solve crucial problems for California's water resources, it is still in the planning stage and is expected to face challenges regarding time of completion and funding.

Another area of infrastructure need concerns the flood control and drainage systems serving California cities, including channels, levees, dams, and pump stations, which vary widely in condition and capacity to prevent flooding from major storms. According to Water Resources, California's flood protection system, composed of aging infrastructure with major design and construction deficiencies, has been further weakened by the lack of maintenance, due in part to limited funding. The flood management sector has traditionally relied on a large (65 percent) federal cost share for new investments, but according to the policy institute, federal contributions have been lagging and are likely to decline in the future. State investments in flood prevention increased considerably after Hurricane Katrina, with voters approving \$5 billion in state general obligation bonds in 2006. However, the remaining funding falls far short of estimated needs. Specifically, the ASCE estimated that flood control funding shortfalls across the State total \$2.8 billion over the next 10 years.

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According to Water Resources, climate change may worsen the State's flood risk by producing higher peak flows and a shift toward more intense winter precipitation. An increase in the snowfall caused by climate change will allow more of the Sierra Nevada watersheds to contribute to peak storm runoff. High-frequency flood events may increase with changing climate. Water Resources believes that the risk of flood has put California's public safety and financial stability at risk. For instance, Water Resources indicated that catastrophic flooding within the Central Valley alone could equal or exceed the economic, social, and environmental damage caused by Hurricane Katrina in 2005, which the U.S. Bureau of Labor Statistics estimated cost in excess of \$200 billion.

Although state law requires that the governor submit a five-year infrastructure plan annually to the Legislature, the most recent plan is from 2008. When we followed up with the California Department of Finance (Finance) for our 2011 high risk report, Finance stated that it has not produced an infrastructure plan in the past four years because the State's severe fiscal challenges took priority. However, Finance's chief deputy director indicated that now that the State's fiscal condition has stabilized, Finance will once again produce the infrastructure plan. Finance is currently working on an updated five-year infrastructure plan. Once the infrastructure plan is complete, we will evaluate and monitor the State's efforts as part of our assessment of high-risk issues.

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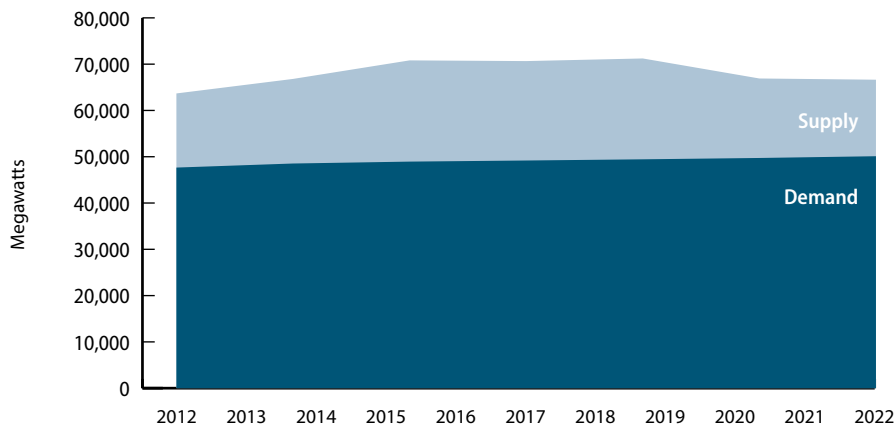
Ensuring a Stable Supply of Electricity

A reliable supply of electricity provides a critical foundation for California's economy and its citizens' standard of living. In 2000 and 2001 the State experienced an energy crisis that led to supply disruptions. Several factors contributed to the energy crisis, including a shortage of generating capacity and design flaws in the energy market, which allowed for the manipulation of wholesale prices by generators and electricity brokers. Additionally, droughts in the Pacific Northwest reduced the availability of hydroelectric power to import into California. In 2009 we reported that, although the State had taken steps to address the problems that caused the crisis, new challenges in the electricity sector had arisen, and therefore designated the production and delivery of electricity as a high-risk issue for the State.

We continued to designate electricity as a high-risk issue in our 2011 high risk report due to uncertainties related to the need to retrofit aging power plants and meet the State's renewable energy target. In 2010 the State Water Resources Control Board (Water Board) adopted a policy requiring the modification of

aging power plants' cooling systems to reduce the mortality rates of marine life. Despite fears that this action would disrupt the supply of electricity, expert projections now indicate that the supply will continue to meet demand. Since 2004 the California Public Utilities Commission (CPUC) has been implementing a resource adequacy program to ensure the reliability of electrical service in California. Under this program, the entities that provide retail power to customers, including investor-owned utilities, are required to demonstrate that they have sufficient capacity to meet 115 percent of the forecasted demand. This ensures that sufficient resources are available to meet peak load and contingencies. Since 2006 the CPUC has been authorizing additional capacity to generate electricity and energy efficiency programs. As a result, the State's electric generation capacity has increased by nearly 20,000 megawatts—mainly from natural gas and wind resources—since the peak of the energy crisis in 2001. As shown in Figure 6, the CPUC projects that the electricity market has more capacity than is needed for the next 10 years. In fact, the margin by which forecasted capacity exceeds forecasted demand ranges from 45 percent in 2014 to 20 percent in 2022. The CPUC has established that, for system planning purposes, an appropriate reserve margin is between 15 percent and 17 percent.

Figure 6
Forecast Supply and Demand for 2012 to 2022



Source: California Public Utilities Commission's *Long-Term Procurement Plan*, December 2012.

Moreover, an unexpected major event did not significantly affect the State's ability to meet the demand for electricity. The San Onofre Nuclear Generating Station (San Onofre plant), which provided nearly 20 percent of the power to more than 15 million people in Southern California, has been offline since January 2012.

This disruption created a need for additional electricity resources in Orange County and northern San Diego County. Fortunately, there were adequate resources to meet the electrical system needs and no loss of electric service occurred due to insufficient generation. Even with the San Onofre plant permanently going offline, the electricity supply is forecasted to meet expected demand.

Recognizing that the supply of electricity needs to remain stable, the State is retaining the use of certain aging power plants on an as-needed basis and retiring others in advance of schedule while implementing the Water Board's 2010 policy. This policy requires the modification of power plants' once-through cooling systems or other comparable measures to reduce the mortality rates of marine life. The once-through cooling method involves drawing in ocean water, circulating it through heat exchangers, and then discharging the water back into the ocean at a higher temperature. The intent of this policy is to ensure that the beneficial uses of the State's coastal water are protected while also ensuring that the electrical power needs of the State's residents are met.

In our 2011 high risk report, we noted that as of June 2011 all 14 fossil-fueled plants using once-through cooling had submitted implementation plans and schedules to comply with the new policy. According to its staff, the Water Board has reviewed all of the implementation plans and is in the process of working with various state entities, as well as the power plants, to implement the policy. Additionally, the Water Board is working with the California Independent System Operator (System Operator) to assess the demand for electricity and the supply affected by the implementation of the policy. If necessary, the implementation deadline may be extended to keep certain once-through cooling plants running longer than originally planned. In March 2012 the California Office of Administrative Law approved a policy amendment that delayed some of the deadlines for complying with the original implementation policy. To reduce the environmental effect, the amendment requires specified fossil-fueled power plants that are not able to comply by the deadline to install devices that will minimize the environmental impacts caused by once-through cooling by the end of 2020. According to the April 2013 draft report prepared by the Water Board on the implementation of this policy, some facilities using once-through cooling are retiring their power plants in advance of the compliance dates established by the policy, while others may require extensions.

By using more renewable resources in the production of electricity, the State expects to meet its renewable energy target by the established deadline. As noted in our 2011 high risk report, in April 2011 the governor signed into law a bill that set the State's target for renewable energy production at 33 percent of retail

Even with the San Onofre plant permanently going offline, the electricity supply is forecasted to meet expected demand.

A 2012 CPUC forecast shows that the State is on track to meet its interim requirement of 25 percent renewable energy target by 2016 and is well positioned to meet the 33 percent target by 2020.

electricity sales in California by 2020. In addition, a 2012 CPUC forecast shows that the State is on track to meet its interim requirement of 25 percent by 2016 and is well positioned to meet the 33 percent target by 2020. In fact, the CPUC reported that California's three large investor-owned utilities generated 20 percent of their electricity from renewable sources in 2012. Also, more new generating capacity using renewable resources was built in 2012 than in any prior year. Specifically, 1,957 megawatts of renewable resources were added in 2012, compared to 2,541 megawatts of total renewable resources added between 2003 and 2011. Currently, the majority of renewable resources are wind and geothermal. The CPUC's forecast shows that there will also be a larger proportion of solar as part of the total renewable resource mix by 2020.

In our previous high risk report, we stated that the ability to transmit renewable energy was a barrier to meeting the State's renewable energy target. In 2012 significant progress was made toward the construction of CPUC-approved transmission lines providing capacity for solar, wind, and geothermal renewable resources. Three transmission lines—Sunrise Powerlink, Devers-Palo Verde #2, and Tehachapi—were completed or are expected to be completed in 2012, 2013, and 2015, respectively. In fact, in its March 2013 transmission plan, the System Operator found that given currently approved transmission projects, no additional major transmission upgrades will be needed to meet the 33 percent renewable target by 2020.

Although California's capacity for generating electricity appears sufficient, disruptions such as prolonged droughts, natural disasters, or fuel supply disturbances will always remain a risk at some level. Because California imports a significant amount of electricity, the risk of these disruptions comes not only from within the State, but also from surrounding regions. In a typical year, California generates 70 percent of its electricity within the State, importing 30 percent from the Pacific Northwest and the U.S. Southwest. As noted earlier, reduced availability of imported electricity resulting from drought conditions in the Pacific Northwest contributed to the energy crisis of 2000 and 2001. Given these inherent risks, and because the supply of electricity is a cornerstone of California's economic infrastructure and is undergoing a transformation to technologies that have less impact on the environment, we will continue to monitor the supply and distribution of electricity in the State and to designate the issue as a high risk.

Chapter 5

EFFECTIVELY MANAGING THE STATE’S WORKFORCE

The State continues to face challenges related to its workforce and succession planning as the percentage of employees approaching retirement age increases. Although state agencies we reviewed had generally developed workforce and succession plans to ensure continuity of critical services, we identified notable exceptions. Further, with the recent reorganization that merged most of the functions of the State Personnel Board and the California Department of Personnel Administration into the new California Department of Human Resources, the State faces the general risk associated with this type of structural change.

State Workforce Retirements

The portion of the State’s workforce approaching retirement age continues to grow, and the State’s older workers are retiring at an increasing rate. The retirements of these workers in both leadership and rank-and-file positions could deprive the State of both the institutional knowledge and the experience these workers possess. As a result, this issue remains a high risk to the State.

Since fiscal year 2007–08, an increasing segment of the State’s workforce has been approaching retirement age. At the end of fiscal year 2007–08, 37.5 percent of state employees were 50 years of age or older, and in fiscal year 2012–13 that number had increased to over 41 percent. As shown in Table 8, the portion of state employees under the age of 50 has fallen, while the two oldest age groups steadily represent more of the workforce. Specifically, the number of employees 60 years of age or older increased from 7.4 percent to just over 10 percent from fiscal years 2007–08 through 2012–13. This trend suggests that the percentage of state employees eligible for retirement is increasing.

Table 8
Percentage of State Employees by Age Group
Fiscal Years 2007–08 Through 2012–13

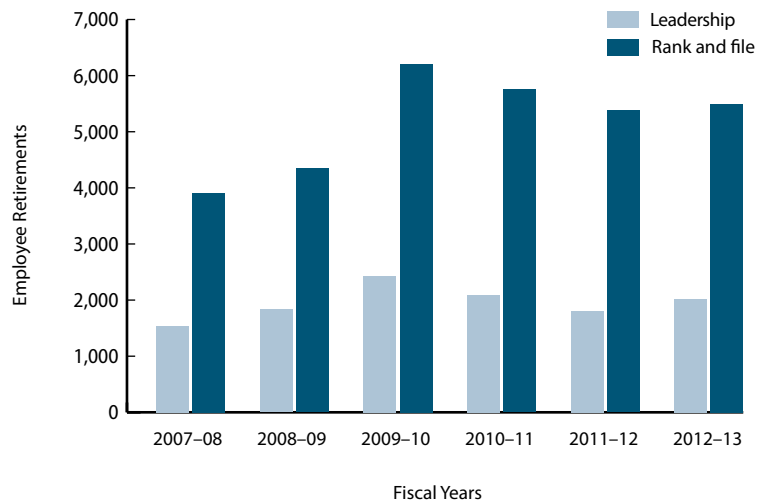
AGE GROUP	FISCAL YEARS					
	2007–08	2008–09	2009–10	2010–11	2011–12	2012–13
Under 50 years	62.5%	62.6%	62.1%	60.6%	59.5%	58.9%
50 to 54 years	17.5	17.1	16.9	17.2	17.4	17.2
55 to 59 years	12.6	12.5	12.6	13.1	13.5	13.7
60 years and older	7.4	7.9	8.4	9.1	9.6	10.1

Sources: California State Auditor’s analysis of separation and employment data obtained from the California Department of Human Resources and the California State Controller’s Office.

In addition, an increasing number of state employees have been retiring since fiscal year 2007–08. As shown in Figure 7, in fiscal year 2007–08, 1,534 employees in leadership positions chose to retire. By fiscal year 2012–13, that number had risen to 2,019, an increase of over 31 percent. The rising number of employees choosing to retire is even more pronounced for employees in rank-and-file positions during the same time frame. Specifically, the number of retirements rose from 3,907 in fiscal year 2007–08 to 5,497 in fiscal year 2012–13 (a 41 percent increase).

In our review, we found that employees in leadership positions who were 55 to 59 years of age have been retiring at an increasing rate over the past six years. For example, in fiscal year 2007–08, 11.5 percent of employees age 55 to 59 in leadership positions chose to retire, while in fiscal year 2012–13, this percentage climbed to 13.7. In addition, over a quarter of employees age 60 and older in leadership positions retire each year. With these retirements, the State stands to lose the institutional knowledge and experience these older workers possess. As a result, succession planning is prudent to ensure continued delivery of high-quality state services.

Figure 7
Employee Retirements by Position Type
Fiscal Years 2007–08 Through 2012–13



Sources: California State Auditor’s analysis of data provided by the California Department of Human Resources (CalHR) and the California State Controller’s Office.

Note: The Statewide Workforce Planning Coordinator (planning coordinator) at CalHR stated that CalHR could not determine the reasons that caused the increase in retirements in fiscal year 2009–10; however, the planning coordinator indicated that there may be a correlation with the implementation of statewide furlough days. The planning coordinator also stated that CalHR developed and is in the process of implementing a confidential exit survey, which will provide retirement data in the future.

Conducting Workforce and Succession Planning

Our review of the succession and workforce planning efforts of six departments critical to the State’s mission revealed that, while some agencies have generally continued to develop and implement their workforce and succession plans, others have suspended their workforce planning efforts. In our 2011 high risk report, our review of five departments found that the California Department of Public Health (Public Health), the California Department of Social Services (Social Services), and the California Department of Transportation (Caltrans) had completed workforce and succession plans, and that the Governor’s Office of Emergency Services (Cal OES) and the California Department of Health Care Services (Health Care Services) had not yet completed them.

In our current review of workforce and succession planning efforts, we added the California Department of Corrections and Rehabilitation (Corrections) to the five agencies previously reviewed. Our assessment revealed that, with the exception of Corrections, all the departments we reviewed had either developed or updated their succession plans. For example, in January 2013, Caltrans released an updated succession plan that included solutions for training and developing new leaders. Similarly, four of the six agencies—Public Health, Social Services, Caltrans, and Health Care Services⁹—have developed workforce plans. Both Cal OES and Corrections cited extenuating circumstances that prevented them from completing these plans. Cal OES indicated that the death of a key contractor had slowed its planning, and as discussed in Chapter 3, Corrections indicated that its succession planning unit was eliminated during budget cuts in prior years. Both Cal OES and Corrections anticipate continuing their workforce and succession planning efforts in the future; however, they do not have specific timelines or implementation plans in place.

Several agencies we reviewed indicated that they have undertaken new projects in workforce and succession planning. For example, Caltrans indicated that it recently developed a “knowledge transfer” guidebook to address a potential loss of knowledge as a result of retiring employees. Health Care Services indicated that it is implementing a “DHCS University” focused on developing the skills of its next managers. Finally, Public Health noted that it was partnering with the Regents of the University of California to develop a workforce and succession plan that would allow it to meet the standards required for accreditation by the National Public Health Department by December 2013.

Our assessment revealed that, with the exception of Corrections, all the departments we reviewed had either developed or updated their succession plans.

⁹ Health Care Services’ workforce plan is dated October 2008, which appears outdated when compared to the other agencies’ workforce plans.

The recent reorganization that created the Department of Human Resources comes at a critical time when the State's workforce is aging and retirements are increasing.

Monitoring the Effects of the Governor's Reorganization Plan

The Governor's Reorganization Plan No. 1, which became operative July 1, 2012, merged the California Department of Personnel Administration (Personnel Administration) and the State Personnel Board (Personnel Board) into the California Department of Human Resources (CalHR), among other actions. As a result of the reorganization, CalHR assumed most of the day-to-day roles of both the Personnel Administration and the Personnel Board, including the responsibility of managing the State's workforce. As the State faces a growing number of retirements, the impact of this restructuring and consolidation of duties is an area of high risk that we will continue to monitor.

The mission of the CalHR's Modernization Project's (HR-Mod) was to modernize and streamline the State's human resources program. Although the governor's reorganization plan abolished HR-Mod, CalHR has generally incorporated HR-Mod's goals and objectives into its mission. For example, CalHR has continued HR-Mod's work in simplifying the classification system, and indicated that it has consolidated over 450 classifications. CalHR also has continued HR-Mod's work in improving recruitment and hiring, indicating that it has continued to make over 100 exams available online, allowing easy access for applicants who can search jobs, submit applications, take the state civil service test, and receive their scores at their convenience. Additionally, CalHR has used servicewide exam lists that allow candidates to take a single test for multiple similar positions. Further, the department is continuing to work on the Exam Certification Online System, which was envisioned to be a one-stop shop for state job seekers, allowing applicants to take a test and apply for a vacancy all in one place.

CalHR is also responsible for providing agencies with materials and training related to workforce and succession planning. It has made most of its basic workforce planning materials, such as information on California's Seven Step Workforce Planning Model, available to agencies on its Workforce Planning Web page, and similarly offers most of its basic workforce planning training through online webinars. CalHR indicated that it is reevaluating the need for face-to-face classes due to low participation, and currently relies on the online resources to meet the needs of state departments. It also indicated that it directs agencies to other sources, such as e-books or e-mail lists that can be used for workforce planning material, and noted that aspects of workforce planning training are involved in all basic supervision classes. Finally, CalHR has partnered with California State University, Sacramento, to establish credentials to designate human resources specialists with knowledge in topics such as recruitment and selection, workforce development and training, and workforce and succession planning. These efforts

come at a critical time, as indicated by the increasing number of retirements described earlier, and we will continue to monitor developments in this high-risk area.

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Chapter 6

STRENGTHENING EMERGENCY PREPAREDNESS

The State's emergency preparedness remains an area of high risk. Two key California agencies that oversee statewide emergency management—the California Department of Public Health (Public Health) and the California Governor's Office of Emergency Services (Cal OES)—formerly known as the California Emergency Management Agency (CalEMA)—lack fully developed strategic plans to guide their emergency preparedness efforts. In addition, Public Health continues to face funding challenges and Cal OES's strategic priorities lack clarity. Public Health's emergency preparedness office has the responsibility to coordinate planning and other efforts to prepare Californians for public health emergencies, including planning for the strategic stockpile of medical supplies, maintaining contact information for crisis response, and distributing funds to local health departments for disaster planning. Cal OES exists to enhance safety and preparedness in California and to protect lives and property by effectively preparing for, preventing, responding to, and assisting California in recovering from all threats, crimes, hazards, and emergencies. However, our review found that both agencies face challenges in meeting these objectives.

Meeting Public Health Challenges

In our August 2011 high risk report, we noted that Public Health's strategic plan lacked specific performance measures and that it faced challenges due to funding uncertainties. Our current review found that Public Health still does not have a fully developed strategic plan and continues to face challenges involving reduced funding for its emergency preparedness programs and increased federal requirements. Given its critical role in statewide public health emergency management, Public Health remains on our high-risk list.

Public Health does not currently have a fully developed strategic plan. In July 2011 Public Health released—as a transition document between its previous strategic plan and a new, revised strategic plan—an internal operations and performance plan (operations plan). In fiscal year 2010–11, while Public Health was in the process of drafting a new strategic plan, it experienced a number of changes, including having three different directors between February and June of 2011. These leadership and other changes created the need for clarification of priorities and strategies but also made it difficult for Public Health to create and finalize

its strategic plan. Although Public Health intended to ultimately release a new strategic plan, two years have passed and it has not done so.

Under the operations plan, Public Health reduced performance measures related to emergency preparedness from six to four and lowered the benchmarks associated with staff training. The deputy director of Public Health's emergency preparedness office (deputy director) stated that the reduction in performance measures and benchmarks was necessary to set more realistic expectations. The deputy director further explained that because the operations plan has become outdated, Public Health produced a one-page strategic map outlining Public Health's objectives and priorities. Although the strategic map lays out the organization's vision, mission, goals, and objectives in a one-page diagram, it only briefly refers to emergency preparedness and contains no specific plans or measures.

Despite the lack of a fully developed strategic plan, Public Health has helped publish California's statewide emergency plan and has participated in emergency preparedness exercises and training.

Despite the lack of a fully developed strategic plan, Public Health has made some progress in other areas. Since our last review, Public Health partnered with the Emergency Medical Services Authority in a 180-page plan detailing the public health and medical function of California's statewide emergency plan. This document provides the framework for statewide coordination of public health and medical activities and services to support local jurisdictions with their resource needs for emergency preparedness, response, and recovery. Public Health also finalized the *California Public Health and Medical Emergency Operation Manual*, which describes individual roles and activities within the public health and medical systems and outlines coordination between all levels of the State's emergency management structure.

In addition, Public Health informed us that it tracks its staff's participation in emergency preparedness exercises and training. Such exercises and training are critical to ensure that those who participate in the response to emergencies are properly trained and familiar with emergency operating systems and standardized procedures. Specifically, Public Health indicated that, in fiscal year 2012–13, its staff participated in three major exercises, which are simulations to test and validate emergency plans and identify capability gaps and areas for improvement. According to the deputy director, the training participation rate for staff has grown from 19 percent in fiscal year 2010–11 to 81 percent in fiscal year 2012–13. However, the deputy director acknowledged that the participation rate in training for management functions in the emergency operation center remained at roughly 50 percent during the same time period.

Public Health also continues to work with local health departments to improve their Strategic National Stockpile Technical Assistance Review scores—a performance measure that is required to receive federal funding. The national stockpile is a depository of medical supplies, such as chemical antidotes, antibiotics, and surgical items, designed to supplement and resupply state and local public health agencies in the event of a national emergency. Scores of 69 to 100 indicate a location's readiness to receive, distribute, and dispense medical supplies from the stockpile. Public Health's data indicate that the average score of all 59 local departments improved slightly, from 85.66 percent in June 2012 to 86.10 percent in June 2013.

Public Health continues to experience reduced funding for emergency preparedness. Its federal funding for emergency and hospital preparedness programs declined from approximately \$110 million in fiscal year 2003–04 to a little more than \$71 million in fiscal year 2012–13. Data provided by Public Health indicate that state funding for Public Health's emergency preparedness office decreased from \$8 million in fiscal year 2010–11 to \$6 million in fiscal year 2012–13.

At the same time that it has experienced deep budget cuts, Public Health has had to respond to more stringent federal requirements. Federal funding agreements require Public Health to meet certain target capabilities for emergency preparedness (capabilities). Each capability has a unique definition requiring specific functions, tasks, and resource elements. For example, the *Emergency Operations Coordination* capability is defined as actions taken in the immediate aftermath of an incident to save and sustain lives, meet basic human needs, and reduce the loss of property and the effect on critical infrastructure and the environment. The deputy director explained that in the past states could select, based on their own needs assessment, capabilities to work on without any prescriptive requirements for how they would address their selected capabilities. However, effective in fiscal year 2011–12, the federal emergency preparedness program issued new standards containing a total of 23 capabilities. Public Health stated that its reduced funding limits its ability to address such a broad scope of capabilities and sustain its progress in emergency preparedness. Because of Public Health's lack of a fully developed strategic plan to guide its emergency preparedness efforts and its funding uncertainty and increased responsibility, it remains a high risk to the State.

Preparing for Emergencies

The emergency preparedness efforts of Cal OES continue to be a high-risk issue because Cal OES's strategic priorities lack clarity and it has not adequately developed performance measures to ensure

Public Health continues to experience reduced funding for emergency preparedness. Federal funding for emergency and hospital preparedness programs declined from approximately \$110 million in fiscal year 2003–04 to a little more than \$71 million in fiscal year 2012–13.

that it is continually improving the State's preparedness status. In our 2009 high risk report, we noted that Cal OES had developed its first strategic plan covering the five-year period from 2010 to 2015, including various goals and objectives that it believed would help it better accomplish its mission. However, this plan did not include any performance measures to gauge Cal OES's success at meeting those goals and objectives. At that time, Cal OES indicated that it planned to develop measurements and benchmarks to quantify its progress toward the strategic plan objectives. In addition, we noted that Cal OES's priority and objective task report (task report), which was used to establish the priority tasks tied to the goals and objectives in the strategic plan, was not up to date. Cal OES stated that it planned to update the task report by June 2011.

Our current review found that Cal OES is still in the process of developing performance measures and no longer uses the task report. According to the chief of its performance and evaluations division (division chief), an internal reorganization in 2012 caused delays in the development of performance measures. Cal OES created the performance and evaluations division in April 2013 to lead a new strategic planning process for the agency. As part of this process, Cal OES plans to update its strategic plan and create a performance evaluation system, which will include performance measures and a quarterly reporting mechanism. Currently, Cal OES is training key staff and management in developing performance measures for its new strategic plan, which it expects to complete by December 2013. In addition, according to the division chief, the task report was suspended because Cal OES needed to update its strategic plan due to the recent reorganization and change in leadership. Until Cal OES fully develops its strategic plan with performance measures and the assignment of tasks, it cannot ensure that it is making progress toward achieving effective emergency management.

Until Cal OES fully develops its strategic plan with performance measures and the assignment of tasks, it cannot ensure that it is making progress toward achieving effective emergency management.

Our current review also found that Cal OES has discontinued a project to centrally store data on the statewide inventory of emergency resources and capabilities. Specifically, the Metrics project was intended to be an online system that helped local communities define, organize, and display emergency resource data. Cal OES originally initiated the project to address resource management needs highlighted in its 2007 gap analysis report, which attempted to identify the shortfalls between the resources available and what will be needed in a catastrophic event. In our August 2011 high risk report, we noted that the Metrics project had made some progress but was still incomplete. Cal OES informed us at that time that it was expecting the project to achieve its next milestone—launching the online

system statewide by July 2012. However, Cal OES now states that it determined that the project was not a sustainable model because it required Cal OES's limited resources to coordinate the effort and perform a great deal of data management across the jurisdictions involved.

Cal OES stated that it has essentially replaced the Metrics project by using an existing information system and other tools to capture the State's emergency preparedness capabilities and to assess gaps in coverage. For instance, it has undertaken four major catastrophic disaster planning projects that involve assessing statewide capabilities. Additionally, to validate statewide emergency planning efforts, Cal OES participates in statewide emergency exercises and helps develop corresponding action reports. However, without an updated strategic plan and corresponding performance measures, such as the number of exercises per year it desires to have occur and what outcomes should result, it is difficult for Cal OES to quantify and demonstrate its success in accomplishing its mission. Due to the lack of development of a strategic plan and the absence of meaningful performance measures, Cal OES emergency planning continues to be a high-risk issue.

Cal OES now states that it determined that the project to centrally store data on the statewide inventory of emergency resources and capabilities was not sustainable because of limited resources.

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Chapter 7

PROVIDING EFFECTIVE OVERSIGHT OF THE STATE'S INFORMATION TECHNOLOGY

The high costs of certain projects and the failure of others continues to make the State's oversight of information technology (IT) projects an area of high risk. According to the California Department of Technology's (CalTech) Web site, as of July 2013 there were 46 IT projects with a total cost of more than \$4.9 billion under development. Moreover, although CalTech is responsible for ensuring that state agencies comply with the general controls specified in Chapter 5300 of the *State Administrative Manual* (SAM), it does little to verify their compliance. Given the pervasive general control deficiencies at two agencies we reviewed, we believe CalTech's oversight of the general controls state agencies have implemented over their information systems represents a new area of high risk.

High Costs and Failure of Certain Major IT Projects

In our August 2011 high risk report, we discussed four large IT projects that could have a major impact on state operations—the California State Controller's Office's (state controller) 21st Century Project, the Judicial Branch's California Court Case Management System (CCMS), the California Department of Finance's Financial Information System for California (FI\$Cal), and the California Department of Corrections and Rehabilitation's (Corrections) Strategic Offender Management System (SOMS). Additionally, another project has recently raised concerns: the California Department of Motor Vehicles' IT Modernization Project (Modernization Project), which CalTech terminated after the completion of only one system of the two-system project. Table 9 on the following page summarizes the status of the projects we reviewed. The failures associated with some of these IT projects continue to highlight IT oversight as a high-risk issue for the State.

Three of the five IT projects listed in Table 9 experienced major problems, while two others have not had the same level of difficulty. The 21st Century Project, a project of the state controller, the largest payroll modernization effort in the nation, was designed to combine the State's various payroll, employment history, leave, position, and attendance data into one statewide system. However, the project has been suspended after initial testing revealed a significant number of errors and the system integrator's lack of progress in correcting the errors. In 2010 the state controller hired a system integrator to develop, test, and implement the new system. In June 2012 a pilot phase covering 1,300 state controller employees was implemented.

As explained on the state controller's Web site, eight months of payroll testing of the new system failed to produce one pay cycle without material errors. These errors included improper deductions, payments delivered late or to the wrong payee, payroll and pensionable wages incorrectly calculated, and union deductions incorrectly determined. As a result, state employees were paid too much, paid too little, or they and their family members were denied medical coverage to which they were entitled. In February 2013 the state controller terminated its contract with the system integrator for failure to meet its contractual obligations, and CalTech suspended the project pending an independent assessment and a determination of appropriate next steps. According to the project director, the state controller is planning to have this assessment performed but is waiting for funding approval. If funding for the assessment cannot be obtained, the implementation of the 21st Century Project could be further delayed, resulting in the State's continued reliance on its current payroll systems that are said to be outdated, inflexible, and costly to maintain.

Table 9
Estimated Costs and Status of Certain Information Technology Projects

PROJECT NAME	OVERSIGHT AUTHORITY	ESTIMATED COST MAY 2011	ESTIMATED COST JULY 2013	CHANGE IN ESTIMATED COST	PROJECT STATUS AS OF JULY 2013
21 st Century Project	California Department of Technology (CalTech)*	\$308,000,000	\$371,000,000	\$63,000,000	The 21 st Century Project is currently suspended.
California Court Case Management System (CCMS)	Judicial Council†	1,900,000,000 (projected as of April 2010)	NA	NA	The Judicial Council terminated CCMS.
Financial Information System for California (FI\$Cal)	CalTech*	1,620,000,000	617,000,000	(1,000,000,000)	FI\$Cal reported that the overall project cost has been reduced by over 45 percent without changes in scope.‡
IT Modernization Project	CalTech§	208,000,000	208,000,000	0	CalTech terminated the IT Modernization Project.
Strategic Offender Management System	California Department of Corrections and Rehabilitation†	416,000,000	416,000,000	0	Final acceptance is scheduled for June 2014.

Sources: California Department of Technology May 2011 and July 2013 IT Project Tracking Spreadsheet and the California State Auditor's analysis of individual projects' status reports.

NA = Not applicable. In March 2012, the Judicial Council terminated the project.

* CalTech has direct oversight authority over the 21st Century and FI\$Cal projects. CalTech prepares oversight reports, and provides advice and consultation.

† CalTech had no oversight authority over this project; however, it provided advice and consultation.

‡ A large part of this reduction is the result of the project no longer including the cost of the subject matter experts working at the state departments participating in FI\$Cal.

§ CalTech had direct oversight authority over this project. It reviewed independent project oversight reports prepared by the Department of Motor Vehicles' consultant and provided advice and consultation.

The Judicial Branch's CCMS was an attempt by the Administrative Office of the Courts (AOC) to develop a statewide court case management system. We reported that the AOC had experienced significant challenges with the project that resulted from inadequate planning and uncertain funding. Specifically, in February 2011 we issued a report¹⁰ regarding CCMS, which found that the AOC inadequately planned the project and consistently failed to develop accurate cost estimates. In addition, the AOC did not structure its contract with the development vendor to adequately control contract costs. As a result, over the course of seven years, the AOC entered into 102 amendments, and the contract grew from \$33 million to \$310 million. As of June 2010 the AOC and several superior courts had spent \$407 million on the project. Subsequently, the Legislature did not provide additional funds for the deployment of CCMS, and in March 2012, the Judicial Council voted to halt the deployment.

Although the AOC and superior courts had spent \$407 million on the Court Case Management System, in March 2012 the Judicial Council voted to halt the deployment.

The California Department of Motor Vehicles' (DMV) Modernization Project was intended to upgrade DMV's existing driver license and vehicle registration systems using more current and easier to support technology. In December 2005 DMV submitted a feasibility study report requesting to use a total of \$242 million over eight fiscal years for the Modernization Project. In May 2012 DMV issued a notice to the systems developer expressing concern regarding the developer's ability to successfully complete the Modernization Project. In January 2013 CalTech, concerned by the lack of progress between DMV and the developer, terminated the Modernization Project and directed DMV to suspend all work related to the vehicle registration system and to complete only the portion of the driver license system that was near completion. As of February 2013 DMV had spent a total of \$136 million on the Modernization Project.

FI\$Cal is a business transformation project for state government in the areas of budgeting, accounting, procurement, and cash management. In its March 2012 special project report, the FI\$Cal project reduced its November 2007 total cost estimate of approximately \$1.6 billion to \$616.8 million while noting that there were no scope changes from what the project had originally reported. In April 2012¹¹ we reported that the four largest cost reductions were in the categories of project and program staff; contract services; hardware, software, and telecommunications; and data center services. However, the project is not requiring departments to track and report the cost of staff who are working as subject matter experts on the project, which will cause FI\$Cal's

¹⁰ *Administrative Office of the Courts: The Statewide Case Management Project Faces Significant Challenges Due to Poor Project Management* (Report 2010-102, February 2011).

¹¹ *FI\$Cal, Status Letter* (Report 2012-039, April 2012).

true cost to be underreported. This underreported cost could be significant, as the project estimated the cost of subject matter expert staff to be \$264.4 million in November 2007.

Corrections SOMS project will consolidate existing databases and records to provide an automated system that replaces manual paper processes and improves offender management. Corrections maintains responsibility for the implementation of SOMS and is working with the court-appointed federal health care receiver (receiver). The receiver filed a request on behalf of Corrections to the federal court to waive contracting statutes, regulations, and procedures for SOMS which was approved by the court. The waiver exempted SOMS from the State's IT oversight. However, Corrections has chosen to report certain project information to CalTech. In our prior high risk report, we stated that Corrections' SOMS project was scheduled for completion in October 2014 and would cost \$500 million. However, according to the Corrections' June 2013 special project report, final completion of SOMS has been rescheduled to June 2014, and the cost estimate has been reduced to \$385 million. Further, the special project report stated that the project is now under CalTech oversight. Although some projects are projected to cost less than originally anticipated, the high costs and failure of certain projects continues to make IT project oversight a high-risk issue.

Overseeing IT Projects

Five Stages of the Project Management Life Cycle

1. **Concept:** Summarize information about a project.
2. **Initiation:** Authorize and define the scope of a new project.
3. **Planning:** Define the project scope, develop the project management plan, and identify and schedule the activities that occur within the project.
4. **Executing:** Complete the work defined in the project management plan to accomplish the project's objectives as defined in the scope statement.
5. **Closing:** Formally terminate all activities of a project, transfer the complete project to others, or close a cancelled project.

Source: California Department of Technology's Project Management Methodology.

CalTech continues to use the California Project Management Methodology (management methodology) as a guideline to manage state IT projects. Although the management methodology appears adequate, CalTech's oversight of these projects remains an area of high risk.

The management methodology is based on the work of the Project Management Institute. The purpose of the management methodology is to provide consistent project information regardless of the state agency that is managing the project; to provide policy makers greater visibility as to the status of the IT projects; and to enable project executives, control agencies, and other interested parties to review and evaluate the status of the IT projects as well as provide informed direction and guidance to IT project managers. The management methodology provides the framework for the Project Management Life Cycle (project life cycle), which we describe in the text box. Included in the management

methodology are templates for project team members to complete for each stage of the project life cycle. This enables CalTech to review a consistent set of data for all its projects.

The management methodology relies on departments' project teams and managers to report accurate and complete information to CalTech regarding the status of their IT projects. For example, during the initiation stage, project team members complete a complexity assessment, classifying their IT projects as high, medium, or low complexity based on criteria established in the management methodology. This information is used to determine the level of project oversight needed. All projects receive department-level oversight, medium-complexity projects receive additional oversight from the appropriate agency (or from CalTech for departments not organized under agency oversight), and high-complexity projects receive oversight from CalTech or from a consultant.

CalTech appears to have appropriate steps in place to ensure that IT projects are completed on time and within budget, if the steps are followed. However, in the case of the FI\$Cal project, CalTech's project oversight was not fully effective. According to CalTech, it has direct project oversight of the FI\$Cal project, meaning that CalTech staff provide advice and consultation and prepare independent project oversight reports (oversight reports) for the project, among other responsibilities. In our September 2013 FI\$Cal status letter,¹² we concluded that although CalTech's oversight reports provide good information on many aspects of the project, they often lack meaningful assessments of the project's schedule and budget. For example, although the oversight reports have consistently reported that the project is on schedule, they have also communicated significant concerns over the project's progress in the area of data management. However, the oversight reports do not adequately discuss or evaluate this potential delay at a level of detail that would allow stakeholders to appreciate the risks to the schedule going forward and whether the project's efforts to mitigate these risks are effective. Further, the oversight reports simply present cost information the project has reported to date, and provide little or no insight as to how the expenditures affect the future course of the project. According to our IT expert, a more meaningful analysis would include a detailed comparison of actual expenditures to date with planned expenditures to date and an explanation of material variances. As a result of these observations on the FI\$Cal project, the effectiveness of CalTech's oversight of IT projects remains a high-risk issue.

Although CalTech's oversight reports provide good information on many aspects of the FI\$Cal project, they lack meaningful assessments of the project's schedule and budget.

¹² FI\$Cal Status Letter (Report 2013-039, September 2013).

It is unclear at this time what impact, if any, the latest reorganization will have on the future ability of CalTech to provide oversight of state IT projects.

Reorganizing IT Governance and Implementing the Strategic Plan

In our August 2011 high risk report, we concluded that CalTech's IT governance had improved and that its strategic planning appeared adequate. The report also discussed how Governor Schwarzenegger's reorganization plan of 2009 integrated the Department of Technology Services, the Office of Information Security and Privacy Protection, and the Telecommunications Division of the California Department of General Services into the California Technology Agency. In 2012 the State's IT governance was again reorganized. In Governor Brown's reorganization plan of 2012, which became operational in July 2013, the California Technology Agency became a department within the newly formed Government Operations Agency. Although the State's chief information officer continues to report to the governor on issues involving IT, it is unclear at this time what impact, if any, this latest reorganization will have on the future ability of CalTech to provide oversight of state IT projects. Additionally, as we discuss next, we found CalTech's current strategic planning efforts to be insufficient. Consequently, we will continue to monitor IT governance as a high-risk issue.

CalTech needs to better track its progress toward meeting the goals and objectives outlined in its strategic plan. State law requires CalTech to produce an annual strategic plan and take appropriate steps to implement the plan. In 2013 CalTech updated the strategic plan originally presented in 2012, laying out a strategic vision and direction for the State's technology community. The strategic plan outlines the mission, vision, and philosophy of the State's IT program; describes challenges and opportunities that will affect the State's IT environment; specifies the statewide IT goals and objectives; and includes recent accomplishments and initiatives. However, the strategic plan's goals and objectives are not sufficiently measurable, and the strategic plan does not describe the specific tasks, timelines, and coordination necessary to achieve the plan's goals and objectives.

For example, one of the goals of the strategic plan is to leverage "a reliable technology infrastructure and shared services that are secure and economically and environmentally sustainable." To achieve this goal, the strategic plan lays out three objectives and five high-level action items, but it does not provide specific information about the tasks and coordination needed to achieve the goal. For instance, one of the objectives is to streamline data center operations and infrastructure to eliminate costly and unnecessary duplication, increase efficiency, reduce costs, and reduce energy consumption. The strategic plan indicates that it will achieve this objective by implementing e-mail, desktop, network, data center, server, and storage consolidation and virtualization. However, the

strategic plan does not specify what, if any, savings these changes will provide or how it defines success in achieving the objective, and it does not include a timeline for its completion.

We inquired about CalTech's effort to monitor progress on the strategic plan, and the deputy director of health IT told us that CalTech uses various reports that it generates, such as the IT Cost Savings and Avoidance Report, IT Performance Metrics Report, and IT Capital Plan to ensure that the State's IT resources are in alignment with the strategic plan. While we recognize the importance of these reports, the information they present generally does not relate to the strategic plan's goals and objectives. Consequently, CalTech does not appear to track the dates and completion status for the goals and objectives outlined in its strategic plan, and thus it is unable to effectively measure its progress.

Overseeing IT General Control Assessments

Due to the limited reviews CalTech performs to assess the general controls¹³ that state agencies have implemented for their existing information systems, and the pervasive deficiencies we noted in such controls at two agencies we visited, we believe CalTech's oversight of general controls is an issue that poses a high risk to the State. Specifically, the State's information assets—its data processing capabilities, IT infrastructure, and data—are an essential public resource. For many state agencies, program operations would effectively cease in the absence of key information systems. In some cases, public health and safety would be immediately jeopardized by the failure or disruption of an information system. Further, the nonavailability of the State's information assets can also have a detrimental impact on the state economy and the citizens who rely on state programs. Finally, the unauthorized modification, deletion, or disclosure of information included in agency files and databases can compromise the integrity of state programs, violate individuals' right to privacy, and constitute a criminal act.

Accordingly, to protect the State's information assets from a wide spectrum of threats and risks, state agencies are generally required to implement general controls, including information security and privacy policies, standards, and procedures specified in Chapter 5300 of SAM. Although CalTech's Office of Information Security requires state agencies to certify their compliance

CalTech's Office of Information Security performs limited reviews to validate the accuracy of what information agencies specify in their certifications of compliance.

¹³ General controls are the policies and procedures that apply to all or a large segment of a state agency's information systems and help ensure their proper operation. They include controls related to security management, access control, configuration management, segregation of duties, and contingency planning.

The Office of Information Security does not believe it currently has sufficient resources for conducting or monitoring general control assessments or audits of state agencies.

with SAM Chapter 5300 by January 31 of each year, it performs limited reviews to validate what information agencies specify in these certifications is accurate. Rather, the Office of Information Security reviews the self-certification documents to ensure that they are completely filled out by each state agency and may follow up with those state agencies that have not submitted the required documentation.

The director and chief information security officer of the Office of Information Security acknowledged that it has the authority to conduct independent general control assessments or audits of any state agency, or to require them to be conducted at the expense of the agency being evaluated. However, she stated that the Office of Information Security does not currently have sufficient resources for conducting or monitoring such assessments or audits.

As further evidence of the State's poor oversight of general controls, in 2012 we reported on the significant weaknesses we identified at the Employment Development Department (Employment Development) and Corrections during our review of their compliance with the general control requirements specified in SAM Chapter 5300. For example, in our March 2012 report titled *State of California: Internal Control and State and Federal Compliance Audit Report for the Fiscal Year Ended June 30, 2011* (Report 2011-002), we reported that although Employment Development's director certified in January 2011 that it had implemented a fully developed Risk Management and Privacy Program that complied with all applicable policy requirements, we found major deficiencies in several areas that Employment Development certified as fully implemented.

We found that Employment Development's entitywide information security policy was outdated, it had an insufficient risk management program due to the inadequate risk assessment it completed in August 2011, and it did not have an incident response plan prior to January 2012. Consequently, we concluded that unless Employment Development implements adequate general controls over its information systems, the completeness, accuracy, validity, and confidentiality of agency data will continue to be at risk. In response to our finding, we noted in March 2013 that Employment Development has partially corrected the weaknesses we identified in its general controls. Specifically, since January 2012, Employment Development has released 13 information security policies that reflect changes in the direction of the Employment Development's information security program that more closely align its program with federal and state guidelines.

Given the pervasiveness of our findings and the limited reviews CalTech's Office of Information Security performs to assess state agency compliance with the general controls specified in SAM Chapter 5300, we suspect that similar control deficiencies currently exist at other agencies throughout the State. Therefore, we believe that CalTech's oversight of the general controls state agencies have implemented over their existing information systems should be designated as an issue of high risk for the State.

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Chapter 8

INDIVIDUAL AGENCIES EXHIBITING HIGH-RISK CHARACTERISTICS

The California Department of Public Health (Public Health) and the California Department of Health Care Services (Health Care Services) continue to be on our list of departments posing a high risk to the State, because they met a number of the criteria we use to determine whether an agency presents a high risk. Our current review suggests that these two departments still exhibit high-risk characteristics.

Public Health

Public Health remains a high-risk agency due to weaknesses in program administration, and because it has been slow to implement recommendations with a direct impact on public health. Public Health's management and program functions are critical to the State's preparation for and response to public health emergencies, such as preventing disease, disability, and premature death. Weak performance and accountability at Public Health could adversely affect the health and safety of Californians.

In our August 2011 high risk report we noted that Public Health had 20 unresolved recommendations from previous audits, including 15 with a direct impact on public health and safety. Our current review revealed that the number of Public Health's unresolved recommendations has increased to 23. In fact, as of January 2013, only 15 of these recommendations had estimated completion dates, and many of these dates extend into 2015 and beyond. Thus, even if Public Health eventually implements these recommendations, which we made in 2008 and 2010, it will have taken between five and seven years to take needed action.

As we discuss in our August 2011 high risk report, many of these recommendations have a direct impact on public health and safety. For example, we released a report in September 2008 regarding Public Health's laboratory field services, recommending that it perform all of its mandated oversight responsibilities for laboratories subject to its jurisdiction, operating within and outside California, including inspecting licensed laboratories every two years, sanctioning laboratories as appropriate, and handling complaints. These recommendations have now been outstanding for five years.

In addition, other outstanding recommendations involve issues that reveal significant weaknesses in Public Health's program administration. For example, as a result of a series of audits

Based on a continued pattern of failing to perform required duties and failure to implement audit recommendations, we are keeping Public Health on our high-risk list.

involving Public Health in the past four years, we discovered that it must improve its oversight to better protect the public from low-level radioactive waste, that it reported inaccurate financial information in its management of the State and Federal Health Facilities Citation Penalties Accounts, and that it did not adequately manage the Kid's Plate Program. Most recently, in a July 2013 audit report, we found that Public Health had not conducted a significant number of statutorily required licensing visits to developmental centers. Based on a continued pattern of failing to perform required duties and failure to implement audit recommendations, we are keeping Public Health on our high-risk list.

Health Care Services

Although Health Care Services has made significant progress in implementing unresolved audit recommendations, it remains a high risk due to its recently increased responsibilities. In our August 2011 high risk report, we noted that Health Care Services was a high-risk agency because it had 11 unresolved recommendations from past audits. As of January 2013 the agency had resolved nine of these outstanding recommendations. In addition, it received two additional recommendations as a result of recent audits.¹⁴ However, Health Care Services remains a high-risk entity due to its new responsibilities under the Mental Health Services Act (MHSA) and federal Patient Protection and Affordable Care Act (Care Act). Effective July 2012 changes in state law transferred certain responsibilities from the California Department of Mental Health (Mental Health) to Health Care Services. These responsibilities include guiding and monitoring counties' implementation of the MHSA. However, as we state in our August 2013 report,¹⁵ Health Care Services faces several challenges regarding effective oversight of county spending of MHSA funds and must provide guidance to counties to effectively implement MHSA-funded programs. Our report recommends that Health Care Services conduct comprehensive on-site reviews of county MHSA programs, including verifying county compliance with MHSA requirements.

In addition, to expand health insurance coverage and make health care more accessible and affordable, the U.S. Congress enacted the Care Act. The Care Act empowers states to take the lead in implementing many of the legislation's reforms, including options to significantly

¹⁴ Due to a July 2012 shift of responsibility from Public Health to Health Care Services for the Every Woman Counts program, Health Care Services inherited two additional recommendations to implement for this program.

¹⁵ *Mental Health Services Act: The State's Oversight Has Provided Little Assurance of the Act's Effectiveness, and Some Counties Can Improve Measurement of Their Program Performance* (Report 2012-122, August 2013).

expand their Medicaid programs, which are partially funded by the federal government. According to its fiscal year 2013–14 budget, California opted to provide health care coverage to over 1 million adults with incomes at or below 133 percent of the federal poverty level; these Californians were ineligible to receive Medicaid benefits prior to the implementation of the Care Act. As a result, California expects a significantly increased number of recipients of Medi-Cal, the State’s Medicaid program. Because it has oversight over Medi-Cal, Health Care Services is responsible for ensuring that these individuals receive eligible services. Consequently, although our current review found that it has made significant progress in implementing our recommendations since our last high risk report, we continue to designate Health Care Services as a high-risk entity because of its recently increased responsibilities.

We prepared this report under the authority vested in the California State Auditor by Section 8546.5 of the California Government Code.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

Date: September 26, 2013

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Appendix

CONSIDERATIONS FOR DETERMINING HIGH RISK

Senate Bill 1437 of the 2003–04 Regular Session of the Legislature (Chapter 251, Statutes of 2004) added Section 8546.5 to the California Government Code to provide the California State Auditor (state auditor) with the following authority:

- To establish a high-risk government agency audit program for the purpose of identifying, auditing, and issuing reports on any agency of the State, whether created by the Constitution or otherwise (state agency), that the state auditor identifies as being at high risk for the potential of waste, fraud, abuse, or mismanagement or that has major challenges associated with its economy, efficiency, or effectiveness. This includes challenges that cut across programs or management functions at all state agencies or multiple state agencies; we refer to these as statewide issues.
- When identifying state agencies or statewide issues that are at high risk, in addition to reviewing the audit and investigative reports produced by the state auditor, to consult with the Legislative Analyst's Office, the Little Hoover Commission, the Office of the Inspector General, the California Department of Finance, and other state agencies with oversight responsibilities.
- To issue audit reports with recommendations for improvements in state agencies or with regard to statewide issues identified as being at high risk not less than once every two years.
- To require state agencies identified as being at high risk, including state agencies with responsibility for a statewide issue, to periodically report to the state auditor on the status of recommendations for improvement made by the state auditor or other state oversight agencies.

In addition, Section 8546.5 requires the state auditor to notify the Joint Legislative Audit Committee whenever it identifies a state agency or statewide issue as being at high risk.

Qualitative and Quantitative Factors

In determining whether a state agency or statewide issue should be identified as being at high risk, we consider a number of qualitative and quantitative factors. Although we consider many qualitative factors, we focus in particular on whether the risk could result in significantly impaired service; program failure; significantly

reduced efficiency and/or effectiveness; public injury or loss of life; reduced confidence in government; or unauthorized disclosure, manipulation, or misuse of sensitive information.

To the extent possible, we take into account the risk to the State in terms of monetary or other quantitative aspects. We consider that a \$1 billion investment by the State for a program would be an indicator of potential material loss. We also look at changes in assets—additions and deletions—as an indicator of potential risk to major agency assets being lost, stolen, or damaged. We further consider risks that revenue sources may not be realized or improper payments may be made. Finally, we also consider the number of employees each state agency is authorized to hire in determining the magnitude of human capital.

Responsiveness to Recommendations and Corrective Measures

Senate Bill 1452 of the 2005–06 Regular Session of the Legislature (Chapter 452, Statutes of 2006) requires that state agencies provide the state auditor with updates on the implementation of recommendations we have made to them in the form and at intervals prescribed by the state auditor. Moreover, Chapter 452, Statutes of 2006, places additional reporting requirements on state agencies that have not implemented audit recommendations that are over one year old.

The state auditor also receives whistleblower complaints about improper governmental activities under the California Whistleblower Protection Act and regularly issues public reports on substantiated complaints. That act requires state agencies either to take corrective action on substantiated complaints and report to us what action is taken or, if no action is taken, to indicate the reason for not doing so.

We consider whether each state agency audited or investigated demonstrated commitment in implementing audit recommendations or taking corrective measures for any substantiated complaints or issues noted in our reports. The final determination as to how committed agencies are to making changes to address audit recommendations or taking corrective measures stemming from investigations may include additional follow-up reviews by the state auditor and ultimately is based on our professional judgment.

Ongoing Reporting and Future Audits

Once the state auditor identifies a state agency or statewide issue as being high risk, the state auditor may require the affected agencies to report on the status of recommendations for improvement made by the state auditor or other state oversight agencies. Related to that, the state auditor may require affected agencies to periodically report their efforts to mitigate or resolve the risks identified by the state auditor or other state oversight agencies. In addition, the state auditor may initiate audits and issue audit reports with recommendations for improvement in the affected agencies.

Removal of High-Risk Designations

When we designate agencies or statewide issues as being at high risk and place them on our high-risk list, removing the designation takes a demonstrated commitment by the leadership of the state agency or agencies responsible for addressing the risk. The agency or agencies should appoint a person, group, or entity responsible to address the risk, and those responsible must devote sufficient resources to mitigate or resolve it. Further, those responsible must develop detailed and definitive action plans, including, when necessary, plans to seek legislative action. Those plans should define the root cause of the risk, identify cost-effective solutions, and provide a timetable for completion. Moreover, the responsible party must have a process for independently monitoring and measuring the effectiveness of steps taken and for periodic reporting regarding progress.

When legislative and agency actions result in significant progress toward resolving or mitigating a high-risk issue, we will remove the high-risk designation. The agency or agencies must also demonstrate progress in implementing corrective measures. However, we will continue to closely monitor these issues. If risks again arise, we will consider reapplying the high-risk designation. The final determination of whether to remove a high-risk designation will be based on our professional judgment.

cc: Members of the Legislature
Office of the Lieutenant Governor
Little Hoover Commission
Department of Finance
Attorney General
State Controller
State Treasurer
Legislative Analyst
Senate Office of Research
California Research Bureau
Capitol Press