



preparation of specified information relative to the proposed rule action, public notice, a public hearing, and publication in the *California Code of Regulations*. This bill would require Department policies, guidelines, rules, and documents not subject to these rulemaking procedures to be made reasonably available to state agencies, state employees and their representatives, and other interested parties. This provision, rather than the APA, would also apply to the state Personnel Board for the purposes of adopting, amending, and repealing civil service classifications in accordance with the California Constitution. This bill would continue all Department regulations, policies, guidelines, rules, and documents in effect on the effective date of this article until they are amended or repealed, as specified. [S. GO]

**SB 235 (Hughes).** Existing law establishes procedures for the enforcement of child support obligations through the courts and through state and local agencies. Under existing law, the state Department of Social Services is the administrator of the state plan for securing child and spousal support and determining paternity. Existing law requires each county to maintain a unit in the office of the district attorney for the same purposes. As introduced February 7, this bill would establish the Division of Child Support Enforcement in OAL, and would provide for the administrative adjudication of child support obligations. The bill would establish procedures for hearings to establish child support and paternity, the enforcement and modification of support obligations so established, and for judicial review of final orders issued by an administrative law judge. [S. Jud]

## BUREAU OF STATE AUDITS

State Auditor: Kurt Sjoberg  
(916) 445-0255

Created by SB 37 (Maddy) (Chapter 12, Statutes of 1993), the Bureau of State Audits (BSA) is an auditing and investigative agency under the direction of the Commission on California State Government Organization and Economy (Little Hoover Commission). SB 37 delegated to BSA most of the duties previously performed by the Office of Auditor General, such as examining and reporting annually upon the financial statements prepared by the executive branch of the state, performing other related assignments (such as performance audits) that are mandated by statute, and administering the Reporting

of Improper Governmental Activities Act, Government Code section 10540 *et seq.* BSA is also required to conduct audits of state and local government requested by the Joint Legislative Audit Committee (JLAC) to the extent that funding is available. BSA is headed by the State Auditor, appointed by the Governor to a four-year term from a list of three qualified individuals submitted by JLAC.

The Little Hoover Commission reviews reports completed by the Bureau and makes recommendations to the legislature, the Governor, and the public concerning the operations of the state, its departments, subdivisions, agencies, and other public entities; oversees the activities of BSA to ensure its compliance with specified statutes; and reviews the annual audit of the State Audit Fund created by SB 37.

## MAJOR PROJECTS

**The Department of Health Services' Information On Drug Treatment Authorization Requests** (February 1995) is the eighth in a series of semiannual reports by BSA concerning the way the Department of Health Services (DHS) processes drug treatment authorization requests (TARs) for certain prescribed drugs under the Medi-Cal program [14:4 CRLR 15; 14:2&3 CRLR 13; 14:1 CRLR 15]; this report focuses on drug TARs processed from June 1994 through November 1994. During this six-month period, DHS processed 214,303 drug TARs, a 177% increase in requests since the first six-month period reviewed; according to BSA, this increase is largely due to changes in the governing code. BSA found that DHS was not able to process the drug TARs in a timely manner and a backlog of 2,344 requests developed by November 1994. Ten pharmacists contacted by BSA reported experiencing processing delays, but also reported that patient care was not affected because the pharmacists filled the patients' prescriptions in advance of receiving the TAR approval. Also, 79 new positions were added in DHS' drug TAR processing units in October 1994 due to the increase of drug TARs received during this period.

**Orange County: Treasurer's Investment Strategy Was Excessively Risky and Violated the Public Trust** (March 1995) is BSA's audit of the Orange County Treasurer's Office; the County Treasurer-Tax Collector is an elected official, serves a four-year term, and is responsible for receiving, investing, and keeping safe all funds belonging to the County and other monies deposited with the Treasurer. BSA found that during the 1990s, the Treasurer sacrificed his portfolio's safety and liquidity in a futile attempt to maintain yields;

as a result of his failed strategies, the County's investment portfolio ultimately lost \$1.69 billion, the County filed for bankruptcy protection on December 6, 1994, and critical public services are in jeopardy throughout Orange County.

In addition to managing County monies from such sources as property taxes, the Treasurer also manages the monies of approximately 190 public agencies, including cities, special districts, and school districts; the vast majority of these agencies are within Orange County. BSA found that the former Treasurer pursued an investment strategy that placed the funds of the 190 participants in his portfolio at unnecessary risk. For example, the Treasurer excessively utilized short-term reverse repurchase agreements to leverage his portfolio, and purchased highly volatile, long-term structured notes with the proceeds in an attempt to capture higher yields. In a reverse repurchase (or "reverse repo") agreement, the owner of a security, such as the County, "borrows" by selling the security to an investment broker with an agreement to repurchase it a short time later and to pay a stipulated interest rate as the cost of borrowing the money. The security owner can then use the cash received, leveraging the original principal by, in effect, investing the same money twice. If the cost of borrowing is less than the earnings on the investment, then the reverse repo transaction is beneficial to the security owner. To maintain a high rate of earning, and to cover the interest payments, the Treasurer invested in long-range investments with higher interest rates. Interest rates rose in 1994, causing borrowing costs to increase and the value of the investments to decline; the leveraging strategy thus failed.

Among other things, BSA also found that the Treasurer violated the public trust in two ways. First, he altered County accounting records for investment pool interest earnings. As a result, the County's general fund received approximately \$93 million more in interest earnings than it was entitled to receive from the investment portfolio. Second, the Treasurer violated the public trust by shifting nearly \$300 million in losses incurred by specific investments of the County to all portfolio investors.

BSA made the following recommendations to the Orange County Board of Supervisors to assist it in formulating a corrective action plan for the future:

- The Board of Supervisors should direct the Treasurer's Office to prepare a comprehensive investment policy that establishes safe investment guidelines by limiting the use of risky investments and



ensuring yield, diversification, and liquidity; specifies authority and accountability over investment practices; requires a quarterly Treasurer's report to the Board of Supervisors; requires a competitive bidding process for brokers and dealers; creates an investment advisory committee independent of the Treasurer's Office; and limits the use of reverse repurchase agreements to 5% of the portfolio.

- The Board of Supervisors should establish strict rules governing ethics, conflict of interest, and asset safekeeping for all the County's investment activities.

- The Board should rectify the misallocations of interest and losses.

BSA also noted that the Government Code allows local government investment officers wide latitude in their investment practices, and recommended that the legislature amend state law to assure that local government investment problems like those in Orange County do not recur by requiring written investment policies for all local governing bodies to ensure that safety and liquidity are paramount to yield; limiting the use of reverse repurchase agreements to 20% of the portfolio and only for specified purposes; establishing and defining a "prudent person rule" which details the fiduciary responsibilities and level of expertise expected of local investment officers; requiring investment reports, at least quarterly, to the governing body and investment participants; and prohibiting the issuance of taxable or nontaxable debt for speculation or risk arbitrage investment purposes.

**The Medical Board Needs To Maximize Its Recovery of Costs** (March 1995) is BSA's audit of the enforcement and disciplinary system administered by the Division of Medical Quality (DMQ) within the Medical Board of California (MBC), as required by SB 916 (Presley) (Chapter 1267, Statutes of 1993). [13:4 CRLR 54-56] DMQ receives, screens, and formally investigates complaints and reports of physician misconduct; completed investigations are forwarded to the Health Quality Enforcement Section (HQES) of the Attorney General's Office, a unit of attorneys who specialize in prosecuting medical discipline cases. BSA's review focused on DMQ/HQES enforcement and disciplinary activities that occurred during fiscal years 1992-93 and 1993-94. As a result of its review, BSA reached the following conclusions:

- MBC is not maximizing its efforts to recover the costs of its enforcement and disciplinary system. Effective January 1, 1993, Business and Professions Code section 125.3 gave MBC the authority to request administrative law judges (ALJs) to direct physicians found to have violated

the Medical Practice Act to reimburse the Board for its reasonable costs of investigation and enforcement of their respective cases up to dates of their hearings; in addition, MBC is not precluded from recovering costs incurred for investigation and enforcement of cases resolved through stipulated settlements. During fiscal year 1993-94, MBC spent more than \$25 million on enforcement and disciplinary efforts; of those costs, BSA determined that MBC could have attempted to recover more than \$6.3 million. However, MBC recovered only \$94,053 of its costs for that period.

- Prior to January 1, 1995, HQES and MBC had no way of knowing whether the Board was paying for necessary and reasonable services actually rendered by HQES on its behalf, because neither MBC nor HQES maintained a system to identify the type of activities HQES performed for MBC. Effective January 1, 1995, the Attorney General's Office finally enhanced its Legal Time Reporting System in order to comply with SB 2038 (McCorquodale) (Chapter 1273, Statutes of 1994), which requires the AG to provide itemized statements of services rendered to agencies to which it provides legal representation. [14:4 CRLR 21]

- Finally, the Department of General Services' Office of Administrative Hearings (OAH), whose ALJs preside over physician discipline hearings, overcharged MBC for services provided by hearing reporters and failed to reimburse the Board for the costs of some transcripts. As a result, BSA estimates that OAH owes MBC approximately \$283,000. In addition, BSA determined that OAH also owes MBC an undetermined amount for the cost of transcripts and copies of transcripts ordered by third parties for appealed cases from January 1, 1991 through June 30, 1994.

BSA made the following recommendation to ensure that MBC maximizes its recovery of costs:

- MBC should be more aggressive in recovering disciplinary costs through stipulated settlements and as part of proposed disciplinary decisions rendered by ALJs.

- MBC should include in its recovery the costs of prosecuting cases, administering psychiatric examinations, and a portion of the administrative costs of its Diversion Program for substance-abusing physicians that represents the number of participants ordered to participate in the program as an alternative to other disciplinary action. The Board disagreed with BSA regarding recovery of costs from the diversion program; according to MBC, these costs should be evaluated on a case-

by-case basis depending on a physician's ability to pay.

- Finally, MBC should seek a change in the Business and Professions Code to allow the recovery of disciplinary costs incurred once the administrative hearing process begins.

BSA also recommended that the Attorney General require supervisors in each HQES office to review the number of hours and types of tasks for which attorneys and legal assistants are charging to assure MBC that the hours charged are reasonable and necessary. Also, MBC should develop its own procedure for reviewing invoices received from the Attorney General's Office.

To avoid overcharging MBC in the future and to compensate the Board for past overcharges, BSA recommended that OAH compute the future hours worked by private court reporters in tenths of hours; recompute all hours worked by private court reporters since January 1993 using tenths of hours and reimburse MBC for the amount of the overcharges; reinstate the practice of quarterly reimbursement of MBC for the amounts collected for transcripts ordered by third parties; review invoices received for transcripts ordered by third parties not involving appealed cases that were received from January 1, 1993 through January 31, 1995, and reimburse MBC for the total amount collected on its behalf; and review invoices received for transcripts of appealed cases ordered by third parties that were received from January 1, 1991 through June 30, 1994, and reimburse MBC for the amount OAH failed to collect from third parties as required by law.

**State Architect: Contracting Practices Need Improvement** (March 1995) is BSA's audit of the Division of the State Architect (DSA) within the Department of General Services, as required by the Budget Act of 1994. This review focused on whether DSA complied with state contracting laws and regulations in awarding its contracts; BSA also looked at DSA's involvement in the seismic upgrading of the Armory and Ahmanson buildings owned by the California Museum of Science and Industry.

The report concludes that DSA did not always comply with state requirements when procuring architectural, engineering, construction, and other services. BSA found numerous instances in the museum upgrade where DSA did not follow proper procedures before awarding contracts, did not always prepare independent estimates before it negotiated fees, and did not follow the proper building codes. BSA recommended that DSA take full advantage



of the competitive bidding process by preparing estimates and advertising contracts. BSA also recommended that DSA take certain steps to ensure that it does not expose the state to potential financial liability for work performed if the contract is not approved.

**Department of Social Services: Review and Assessment of the Cost Effectiveness of AFDC Fraud Detection Programs** (March 1995). The Aid to Families with Dependent Children (AFDC) program provides cash grants to children and their parents or guardians whose income is insufficient to meet the children's basic needs. Under the general oversight of the Department of Social Services (DSS), AFDC Fraud Detection and Prevention Programs are administered at the local level by each of the 58 county welfare departments and district attorney's offices. This audit by BSA of the cost-effectiveness of AFDC fraud detection programs is required by the Budget Act of 1994 (Chapter 139, Statutes of 1994). The audit concluded that early and continuing fraud programs are clearly cost-effective, but found that DSS could improve its management and oversight activities.

BSA reviewed the performance of seven counties and this report details the results on six of those counties: Los Angeles, Mendocino, Merced, Riverside, Shasta, and Tuolumne. The results of the seventh county, San Bernardino, were non-quantifiable due to errors by the County in preparing the Fraud Investigation Activity Report. BSA found that the counties' early and continuing fraud programs are clearly cost-effective. The program returns between \$6-\$67 in fraud costs avoided to state, federal, and county governments for every \$1 spent for early fraud prevention and detection activities; the program returns between \$3-\$12 in fraud costs avoided to state, federal, and county governments for every \$1 spent for continuing fraud prevention and detection activities. Riverside County was the most cost-effective county reviewed, primarily due to its preventive fraud investigations in which it investigates welfare applicants.

BSA's audit found that all the counties committed errors in their reporting and accumulation of fraud activity data, including the use of inadequate and outdated information; these errors made BSA's calculations less precise, but are not likely to affect the overall conclusions of the audit. Although the AFDC fraud programs appear to be cost-effective, BSA found that significant improvement could be realized with improved management and oversight by DSS. BSA made the following recommendations to improve management and oversight:

- DSS should ensure that accurate, timely, and relevant fraud information is gathered from the counties that is needed to manage the program and is cost-beneficial to gather.

- DSS should develop performance measures to help evaluate the effectiveness of the various fraud programs, techniques, and investigators.

- DSS should strengthen its monitoring of the counties receiving enhanced funding for the utilization of the statewide matching system to ensure their compliance.

**Department of Social Services: The Department's Approach To Welfare Automation Is Too Costly and Unlikely To Succeed** (April 1995) is BSA's audit of the welfare automation system being implemented by DSS; as required by the 1994-95 Budget Act. The Welfare and Institutions Code requires DSS to implement a Statewide Automated Welfare System (SAWS) for the following public assistance programs: AFDC, food stamps, Medi-Cal, aid for the adoption of children, special adult programs, and—where feasible—social services programs. Although in 1984 DSS planned to complete SAWS by June 1990, it has yet to be implemented. DSS has set no date for completing statewide automation, and is not required to have a schedule under applicable law.

The purpose of BSA's review was to evaluate the effectiveness and efficiency of DSS' approach to statewide automation. The review included the evaluation of two completed pilot projects developed by Napa and Merced counties, and an assessment of a third welfare automation project being developed by Los Angeles County. BSA also examined DSS' strategy and evaluation plan for a pilot system in fourteen small- to medium-sized counties known as the Interim Statewide Automated Welfare System (ISAWS). Nine of the fourteen ISAWS counties are in various stages of installation, with the remaining five counties to begin later this year.

BSA projected that DSS will spend \$166 million to automate the fourteen counties; projected costs for statewide automation may exceed \$1 billion, or \$455 million over DSS' original budget estimates. Also, some of the savings expected by DSS from automation may not be attainable, and may not be sufficient to recover projected costs for nearly ten years.

According to BSA, the approach chosen for automating the fourteen ISAWS counties is unlikely to succeed as a cost-effective approach to statewide welfare automation. Administrative cost savings of \$231,000 during fiscal year 1993-94 in

Napa County are below what should be expected after the system was implemented. The annual cost of keeping the application software up-to-date with welfare laws is \$6.8 million and increasing; a backlog of requested rules and other changes to the software may take \$3 million to resolve, and indicates that the underlying software is difficult to maintain. BSA also found that the Napa software may not be suitable to accommodate a high volume of transactions and records, is based on a proprietary system not suitable for competitive procurement statewide, and is inefficient.

BSA noted that the state is bearing the full risk for ensuring that the ISAWS counties' software performs as originally planned. However, DSS is not requiring that the software vendor and maintenance supplier meet system availability and response time standards, and has not established a fixed price to meet performance objectives; as a result, DSS does not know what the final price will be for the ISAWS counties' hardware and software.

According to BSA, support for the ISAWS automation approach is waning. Counties believe that DSS and the federal government have been unwilling to allow counties to pursue viable alternatives. In California, other welfare automation systems, such as the system developed by Merced County, compare favorably with the SAWS in place in Napa County. The Merced system has already been paid for by the state and is in the public domain; annual net cost savings in Merced County are estimated at \$5 million. Also, Merced County reduced its total 1993-94 costs per case by 55% since 1989-90, the largest reduction of any county in California over the same period.

A proposed system for Los Angeles County also compares favorably with the SAWS system in place in Napa County. Though no contract has yet been signed to deliver the system, planned commitments are to implement the system in 42 months. The total projected costs, including County actual and projected costs, are less than the costs of the ISAWS for four times as many cases. The contract being negotiated now to produce the Los Angeles County system will require the contractor to meet specified and measurable performance targets for the system, provide for penalties and damages for failure to meet these targets, and establish a fixed-price bid.

BSA found that, in organizing and conducting its activities to provide welfare automation to counties, DSS has failed to deliver a statewide system. The results of BSA's review, which included activities from 1984-95, indicate the need for substantial changes in how



DSS is organized and how it performs its responsibilities for welfare automation. According to BSA, the complexity of this project has overwhelmed DSS' ability to manage it. BSA estimates that statewide welfare automation may not be available until 2000, ten years after DSS' original plans for SAWS.

Specifically, BSA noted the following problems in the SAWS project: DSS has no strategic plan for statewide welfare automation; DSS has not developed measurable objectives, and as a result is unable to measure the effectiveness of the project; DSS has not established an effective cost accounting or reporting system for the welfare automation efforts, and as a result is unable to tell the legislature how much has been spent; DSS placed the SAWS branch chief at too low a level to command authority and accountability, and has had six changes in the branch chief in the last eight years; DSS has not prepared a risk assessment plan and does not share risks of the project with vendors providing the ISAWS; DSS has not complied with legislative and administrative reporting requirements; DSS has not provided the legislature with a complete cost estimate for the ISAWS, and continually underestimates costs of statewide automation; DSS has made, and is planning, expensive and unnecessary enhancements to the ISAWS; DSS does not have an evaluation plan for the ISAWS which would result in a recommendation to continue with or to cease the ISAWS; and DSS does not properly utilize outside expertise where staff do not have the specialized skills to meet a specific need. Also, there has been no independent validation or verification of the project's progress, budget, or performance.

BSA made the following recommendations:

- The legislature should limit welfare automation funding for fiscal year 1995-96 to six months until certain conditions are met and certain information is known.

- DSS should competitively bid the statewide implementation of welfare automation.

- DSS should improve its management of welfare automation.

- The legislature should consider continued independent review of welfare automation.

**State of California: Financial Report Year Ended June 30, 1994** (April 1995) is BSA's financial report for the state prepared pursuant to Government Code section 8546.4. The financial statements show that the state's general fund generated approximately \$1.1 billion more in revenues than it spent for the fiscal year ended June 30, 1994. However, the general fund still

ended the fiscal year with a fund deficit of \$1.1 billion.

**Other Reports.** Since January, BSA has also released the following reports: *The State's Use of Transportation Funds Allowed by the 1989 Transportation Blueprint Legislation* (January 1995); *Investigations of Improper Governmental Activities from August 1, 1994 through December 31, 1994* (February 1995); *A Review of the State's Bond Sales for 1993 and 1994* (March 1995); and *State of California: Statement of Securities Accountability of the State Treasurer's Office* (April 1995).

## LEGISLATION

**SB 477 (Maddy).** Existing law specifies that the head of BSA is the State Auditor who shall be appointed by the Governor from a list of the three qualified individuals submitted by the Joint Legislative Audit Committee. As amended March 23, this bill specifies that the three qualified individuals be nominated by that Committee.

Under existing law, whenever a state agency is authorized by special or general statute to fix the salary of an employee, the salary is subject only to the approval of the Department of Personnel Administration before it becomes effective and payable, except for the salaries paid to state court and judicial employees; consistent with this authority, the State Auditor may fix the compensation of the employees working under his/her charge. This bill would instead provide that consistent with authority to establish and administer the personnel policies and practices of BSA without oversight or approval of the Department, the State Auditor may employ and fix the compensation of BSA personnel.

Existing law specifies that persons employed by BSA shall be allowed to enroll in civil service employee benefit programs. This bill would specify that those employees shall be allowed to enroll in Public Employees' Medical and Hospital Care Act programs.

Existing law specifies that there shall be appropriated annually in the Budget Act to the State Audit Fund the amount necessary to reimburse the State Audit Fund for the cost of audits to be performed. This bill would also authorize the State Auditor to directly bill state agencies for the costs of specified audits of the executive branch.

Existing law authorizes the State Auditor or his/her authorized representative to have access to the records and property of any public entity being audited or investigated to the same extent that employees or

officers of that agency or public entity have access. This bill would extend that authority to include access to the records of any private entity or person subject to review or regulation by the public agency or public entity being audited to the extent that the agency employees have that access.

Existing law specifies the requirements of an administrative subpoena in order for a governmental agency to obtain financial records. This bill would exempt the State Auditor from these specific requirements when he/she issues a subpoena for financial records of financial institutions.

Existing law exempts the State Auditor from supervision by certain state control agencies that would otherwise be applicable. This bill would, subject to the California Constitution, delegate authority to the State Auditor to establish and administer BSA's personnel policies and practices, and would permit the participation of BSA officers and employees in benefits programs administered by the Department of Personnel Administration, as specified, at the election of the State Auditor.

This bill would specifically authorize the State Auditor to audit accounts and records necessary for proper reporting under the federal Single Audit Act of 1984.

Existing law requires the State Auditor, in conjunction with an annual audit of state financial statements, to test compliance with internal state auditing requirements and to report to the legislature, the Governor, and respective governmental entities on the significant variances from the general and specific standards for the professional practice of internal auditing. This bill would delete this requirement. [A. CPGE&ED]

**SB 974 (Alquist, Johnston, Killea, Leonard, Mello, O'Connell).** Under the State Government Strategic Planning and Performance Review Act, the Department of Finance—in consultation with the Controller, BSA, and the Legislative Analyst—is required to develop a plan for conducting performance reviews of all state agencies. As amended May 15, this bill would create the Performance Audit Joint Task Force, consisting of the Governor and the Controller, that would be required to periodically identify the executive branch agencies, programs, or practices that are likely to benefit from performance audits. The bill would provide that agencies, programs, or practices that are so identified would be in addition to those otherwise identified under the Act. [A. CPGE&ED]