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March 9, 2011

Honorable Edmund "Jerry" G. Brown, Jr., Governor
State of California
State Capitol
Sacramento, California 95814

Dear Governor Brown:

Thank you for the opportunity to provide input as you contemplate solutions to California's projected \$25 billion deficit. I can appreciate the very difficult task ahead of you as you work towards closing that gap. I applaud your efforts in reaching out to the accountability community for input and respectfully provide you our ideas on cutting government waste and increasing efficiency. As California's independent auditor, I take pride in my office's history of conducting independent audits and reviews and providing decision makers and Californians with accurate assessments and making recommendations that, if taken, will result in cost savings, increased revenue, and enhanced efficiency and effectiveness of government operations. Given the current fiscal environment, it is imperative that the accountability community and government leaders work towards the common goal of helping California become more fiscally sound.

In response to your request, enclosed is a series of recommendations for ways to reduce government waste, increase revenue, and improve efficiency. The recommendations included were drawn from my office's prior work and ongoing research. Some of the recommendations can be acted on promptly, while others may take longer to reap the benefits, but the State can begin immediately to unilaterally act on them. We have not given the recommendations any particular priority order.

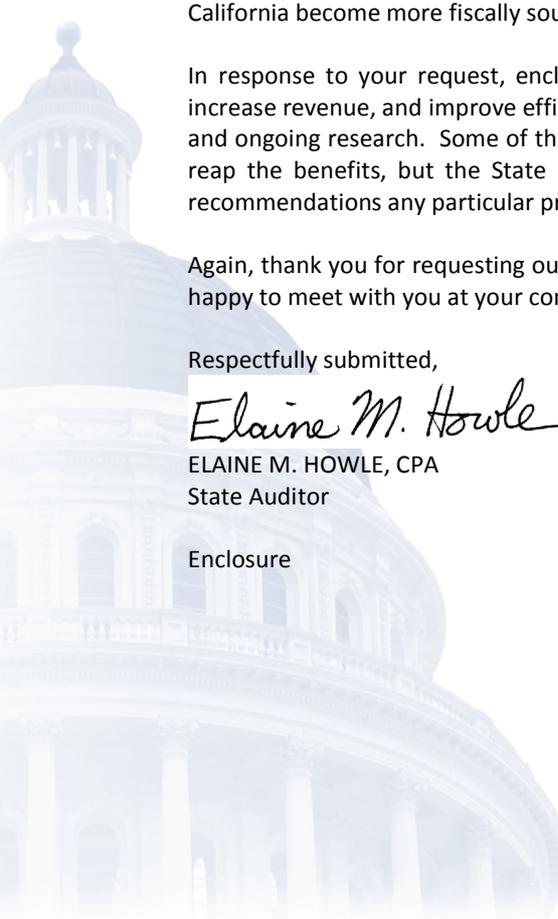
Again, thank you for requesting our assistance in suggesting ways to make government more efficient. I would be happy to meet with you at your convenience to further discuss these recommendations.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

Enclosure



Enclosure

California State Auditor

**Cutting Government Waste and Increasing Efficiency
Recommendations to the Governor**

Adjust Fines and Penalties

RECOMMENDATION

Direct state agencies and departments that have the authority to impose and collect a fine or penalty to review those fines and penalties to determine when they were established or last adjusted. For those fines and penalties that have not been adjusted in the last two years, adjust for inflation.

State Auditor's Work Supporting This Recommendation

Our June 2010 audit report titled *Department of Public Health: It Reported Inaccurate Financial Information and Can Likely Increase Revenues for the State and Federal Health Facilities Citation Penalties Accounts* (Report 2010-108) revealed that the Department of Public Health could have increased revenue by revising the monetary penalty amounts for citations it issues to long-term health care facilities (facilities) that failed to comply with state requirements. Specifically, we determined monetary penalties for certain violations had not been revised since 2001 while others had not been revised since 1985. By adjusting the monetary penalty amounts for inflation, we estimated that the State could have collected nearly \$3.3 million more for penalties imposed on facilities.

Potential Benefit

In fiscal year 2008–09, the State collected \$860 million in penalties. The exact amount of increased revenue that may be realized by implementing this recommendation statewide is unknown but likely substantial. For example, the Department of Industrial Relations (Industrial Relations) collected Cal/OSHA penalty assessments for deposit into the General Fund. The rate schedule for these penalty assessments has not been updated since 2000. In fiscal year 2009–10, Industrial Relations reported General Fund penalty assessments of \$18 million. However, if Industrial Relations had adjusted its Cal/OSHA penalty assessments for inflation, the amount of penalties it would have assessed would have been \$23.8 million instead of \$18 million—an increase of \$5.8 million (32 percent). Given the considerable amount of money collected by the State in fines and penalties each year, we believe it is worthwhile to assess and analyze the potential increase in revenue that could be realized if the amount collected through fines and penalties by each state agency or department is increased to reflect inflation in cases where it has been two or more years since the fine or penalty was last adjusted.

Action Needed

The Governor can implement this recommendation by issuing an Executive Order, except to the extent a fine or penalty is established by statute.

Adjust Regulatory Fees

RECOMMENDATION

Direct state agencies and departments that have authority to impose and collect a regulatory fee to review the amount collected for purposes of that fee to determine whether the amount collected reasonably relates to the cost of providing the service.

State Auditor's Work Supporting This Recommendation

Our September 2008 audit report titled *Department of Public Health: Laboratory Field Services' Lack of Clinical Laboratory Oversight Places the Public at Risk* (Report 2007-040), contained a finding regarding the failure of Laboratory Field Services (Laboratory Services) to appropriately assess fees. In three instances since fiscal year 2003–04, Laboratory Services incorrectly adjusted the fees it charged to clinical laboratories, resulting in more than \$1 million in lost revenue. State law requires Laboratory Services to adjust its fees annually by a percentage published in the budget act. From fiscal years 2003–04 through 2007–08, the budget acts included two fee increases: an increase of 22.5 percent effective July 1 of fiscal year 2006–07 and an increase of 7.61 percent effective July 1 of fiscal year 2007–08. However, Laboratory Services raised fees by 1.51 percent effective July 1 of fiscal year 2003–04, when it was not authorized to do so, and failed to raise fees effective July 1 of fiscal years 2006–07 and 2007–08, when it should have done so. Laboratory Services relied on an incorrect provision of the budget act in calculating its fees, and we found evidence of communication from the budget section within the Department of Public Health directing Laboratory Services not to raise its fees and citing the wrong provision of the budget act.

Another example involving fees is found in our July 2009 audit report titled *State Bar of California: It Can Do More to Manage Its Disciplinary System and Probation Processes Effectively and to Control Costs* (Report 2009-030), where we noted that the State Bar of California had not updated the formula it uses to impose a fee on attorneys who are subject to disciplinary action during the last five years. We estimated that if it had updated its billing formula to reflect the increased cost of service (disciplinary proceedings), it could have billed \$850,000 more during the period from 2006 to 2008 than it did.

Potential Benefit

The exact amount of potential revenue that this review may reveal is unknown. However, given that regulatory fees collected totaled \$5.3 billion in fiscal year 2008–09 and should cover the cost of the services they support, it is important to undertake this analysis on a statewide basis.

Action Needed

This recommendation can be implemented through an Executive Order. To the extent that the amount of the fee is established by statute and there is no discretion for the agency or department to modify the amount of the fee, then statutory authorization will be needed.

Resolve Disputed Drug Rebates

RECOMMENDATION

Ensure the Department of Health Care Services (Health Services) eliminates or substantially reduces its backlog of disputed rebates with drug manufacturers.

State Auditor's Work Supporting This Recommendation

Health Services administers the State's Medi-Cal program and in doing so it purchases drugs for Medi-Cal beneficiaries—generally low-income individuals and families who receive public assistance or lack health coverage. The State and federal governments jointly finance health care services provided under the Medi-Cal program, including optional services such as prescription drugs.

In addition to receiving rebates for the purchase of prescription drugs, state law requires Health Services to contract with drug manufacturers to obtain high-volume discount prices. Manufacturers can dispute the rebate amount Health Services invoices for federal and applicable state supplemental rebates. State law also requires Health Services and manufacturers to make every effort to resolve these disputes within 90 days of the manufacturer notifying Health Services of a dispute. In our audit report issued in April 2003 titled *Department of Health Services: Its Efforts to Further Reduce Prescription Drug Costs Have Been Hindered by Its Inability to Hire More Pharmacists and Its Lack of Aggressiveness in Pursuing Available Cost-Saving Measures* (Report 2002-118), Health Services had just begun to work with manufacturers to reconcile \$216 million in disputed rebates accumulating from January 1991 to September 2001.

In our follow-up report issued in June 2007 titled *Pharmaceuticals Follow-Up: State Departments That Purchase Prescription Drugs Have Not Yet Fully Implemented Recommendations to Further Refine Their Cost Savings Strategies* (Report 2007-501), Health Services indicated that it had reduced the amount of disputed rebates we previously reported by \$63 million or down to \$153 million. However, the total amount of the disputed rebates from January 2002 to December 2006 had grown to about \$270 million, for a combined total of \$423 million in disputed rebates. At the time, Health Services attributed the increasing backlog to the difficulty in retaining personnel.

The U.S. Department of Health and Human Services, Office of Inspector General, has also reviewed California's drug rebate program as part of a nationwide series of reviews. In one of its reports dated February 27, 2008, the federal agency reported that our State Legislature directed Health Services to resolve the older disputed rebates and convert 11 limited-term positions to seven permanent positions.

Potential Benefit

The State may generate a substantial amount of revenue by resolving the backlog of disputed rebates. For example, in 2004 the former deputy director of medical care services indicated that the State managed to recover 25 cents for every disputed dollar. Health Services recently reported that its backlog for the period of January 1991 through December 2006 totaled \$285 million. However, we do not have the backlog data to review for the period January 2007 through December 2010.

Action Needed

The Governor can implement this recommendation by issuing an Executive Order.

Justify State Vehicle Use

RECOMMENDATION

Direct all state agencies and departments that have issued state cars to employees to justify the business need and evaluate whether issuing cars to state employees is cost-effective.

State Auditor's Work Supporting This Recommendation

This is a frequent subject of allegations received by our investigative division under the Whistleblower Protection Act. For example, in September 2004 we reported on an investigation involving managers and employees at the Department of Health Services' Medical Review Branch Office in Southern California that regularly used state vehicles for their personal use (*Investigations of Improper Activities by State Employees: January 2004 Through June 2004*, Report I2004-2). Nine employees, including two managers, used state vehicles to commute between their homes and the office in violation of state laws and regulations.

In September 2007 we reported another instance in which the Department of Mental Health (Mental Health) violated provisions of state law that require a state agency to justify its need to purchase vehicles and receive prior approval for the purchase from General Services (*Investigations of Improper Activities by State Employees: February 2007 Through June 2007*, Report I2007-2). Mental Health indicated that it intended to use two Ford Crown Victoria Police Interceptors for law enforcement purposes in its request for approval. However, after receiving approval and purchasing the vehicles, the hospital used them for non-law enforcement purposes, including commuting.

The Office of Fleet Administration (fleet administration) within the Department of General Services (General Services) is responsible for the administration of state-owned vehicles. To ensure that departments are efficiently using the state vehicles they lease, General Services reviews vehicle usage reports, which it requires departments to submit biannually, explaining the usage and action taken on any vehicles not driven at least 6,000 miles or 80 percent of workdays within a six-month period.

Potential Benefit

A significant, but unknown, cost savings would result to the extent that it is found that there is insufficient justification for many of the cars or that providing cars to state employees is not cost-effective. For example, it may be more cost-effective to reimburse employees for use of a personal vehicle to conduct state business rather than providing them a state car.

Action Needed

The Governor can implement this recommendation by issuing an Executive Order.

Reduce State Motor Pool

RECOMMENDATION

Direct fleet administration to compare the actual cost of operating its motor pool to the amount the State would pay commercial rental companies. Consider closing state garages that are not cost-effective.

State Auditor's Work Supporting This Recommendation

In our July 2005 audit report titled *Department of General Services: Opportunities Exist Within the Office of Fleet Administration to Reduce Costs* (Report 2004-113), and a follow-up audit we completed in May 2007, we found fleet administration operated five garages and owned over 6,000 vehicles. As of August 2010, the number of vehicles increased to more than 7,200. Fleet administration rents its vehicles on short- and long-term bases, depending on agency need. As of May 2007 fleet administration had not conducted the analyses we had previously recommended to measure its cost-effectiveness by comparing the actual costs to operate the motor pool to the amount that the State would pay using similar vehicles at the rates charged by commercial rental companies. During our follow-up review, we also noted that despite capturing the relevant financial data, fleet administration was not aware that two of its garages have been operating at a loss. For fiscal year 2010–11, the amount estimated to operate the motor pool has increased to \$50.5 million, which includes personnel costs to run the garages and maintain the vehicles, general costs such as fuel, and the cost of vehicle depreciation.

A 2006 consultant's study performed for the Department of General Services (General Services) supports the need for this recommendation. The consultant indicated that fleet administration's maintenance management program, which is responsible for approving maintenance of all state vehicles "is not providing competitive services in this area—both in terms of costs and service levels." The consultant concluded that fleet administration's estimated annual maintenance and repair costs are \$312 higher per vehicle than the costs of the largest U.S. fleet management company it chose for comparison purposes. The consultant stated it believed the higher costs were generally the result of the replacement practices in place at General Services. The consultant also indicated that many issues could be resolved if the State adopted more rational replacement policies and practices instead of the current criterion for replacing most passenger vehicles at 120,000 miles, regardless of the vehicle's age.

Potential Benefit

Significant cost savings may result if General Services reduces the size of its fleet and has state employees rent from commercial rental companies instead or use alternative transportation. If General Services were able to consolidate and close some of its less-active garages, the State would be able to save a significant portion of the roughly \$50.5 million annual cost to operate the motor pool each year.

Action Needed

The Governor can implement this recommendation by issuing an Executive Order.

Leverage State Purchasing Power

RECOMMENDATION

Create a task force comprised of representatives from various state agencies' procurement staff to discuss purchasing patterns and needs, and consider applying various techniques and best practices throughout the State to maximize savings to the State for future purchases.

State Auditor's Work Supporting This Recommendation

Contracts for statewide goods typically last several years and can involve millions of dollars in purchases by multiple state agencies. In 2004 the Department of General Services (General Services) hired a consultant to assist in implementing a strategic-sourcing initiative to leverage the State's buying power and save money on goods and services that state agencies purchase most frequently. Between February 2005 and July 2006, General Services awarded a series of strategically sourced contracts, establishing these contracts as mandatory for state agencies to use in order to achieve savings.

In our 2010 audit report titled *Department of General Services: It No Longer Strategically Sources Contracts and Has Not Assessed Their Impact on Small Businesses and Disabled Veteran Business Enterprises* (Report 2009-114), we reported that General Services had awarded 33 statewide strategically sourced contracts for 10 categories of goods between February 2005 and July 2006. Although General Services had realized at least \$160 million in net savings to the State through June 2007 from these contracts and incurred costs to train staff, create a specialized unit, and develop written procedures on strategic sourcing, it had not awarded any new strategically sourced contracts. Moreover, even though the consultant it hired in 2004 had identified 20 other categories of goods and services as candidates for strategic sourcing, General Services did not award any additional contracts. We recommended that General Services conduct reviews of these categories to determine if there are further opportunities to achieve savings and that it should work with state agencies to identify detailed purchases for categories that it identifies as viable opportunities.

Additionally, we have identified problems with procurement practices involving various state agencies and departments in numerous other reports we have issued, including information technology, prescription drugs, medical supplies, and other goods.

Potential Benefit

If the State leveraged its purchasing power, significant, but unknown, savings could be achieved given the many purchases it makes each year. General Services subsequently reported to us that none of the 20 other categories warranted additional strategic-sourcing contracting efforts. General Services states that, in consultation with its customers, it uses available data on purchasing patterns to identify if strategic sourcing or another procurement vehicle should be used. However, it is unclear to what extent General Services implemented new procedures since the audit, nor was it able to provide information that would allow us to fully substantiate the actions it reported it was taking.

Action Needed

The Governor can implement this recommendation by issuing an Executive Order.

Re-examine Safety Retirement Classifications

RECOMMENDATION

Direct all state agencies and departments to re-examine the job classifications and benefits packages provided for positions designated as having safety status or that may otherwise receive enhanced retirement and other benefits. By examining current job duty descriptions for these positions, determine whether such duties justify the job classification and benefits packages provided. If the job duties do not warrant the enhanced benefits, modify the job classifications or alternatively negotiate a more appropriate benefits package on a going-forward basis.

State Auditor's Work Supporting This Recommendation

Preliminary analysis we performed using June 2009 payroll data shows that of the approximately 262,000 state employees who received regular monthly pay, 78,000 employees, or 30 percent, were granted safety status or otherwise received enhanced retirement or other benefits.

To receive safety status, the employee in that job classification must (1) be actively engaged in protecting the public and (2) be physically fit in order to accomplish this duty. Employees who have safety status receive enhanced retirement benefits. For example, while a typical state employee receives a retirement benefit that is calculated based on 2 percent per year of his or her highest salary at age 55, an employee with safety status may receive 3 percent per year at age 50, or, in some cases, 3 percent at age 55 or 2.5 percent at age 55. While we recognize there may be compelling public policy reasons for granting safety status and the enhanced retirement benefits associated with that status, given the considerable number of state employees currently granted safety status, it is important to carefully review these designations. In fact, the *Report of the California Performance Review*, published in 2004, made several recommendations regarding enhanced retirement benefits, including recommendations that called for a re-examination of positions that were designated as safety classifications.

Potential Benefit

Modifying the number of job classifications and positions that receive safety status as new employees are hired could result in considerable savings in future years, not only in terms of future retirement benefits but also in terms of the monthly contribution that the State makes to these employees' retirement during employment. While the state contribution for a typical state employee who will earn 2 percent for each year worked if the employee retires at age 55 is 19 percent of their monthly salary, the state contribution for safety employees and employees who otherwise receive enhanced retirement benefits ranges from 21 percent to 33 percent.

Action Needed

The Governor can implement this recommendation by issuing an Executive Order.

Review Retired Annuitants Duties

RECOMMENDATION

Direct all state agencies and departments that employ retired annuitants to review their current duties to determine whether those duties are consistent with the job classification and pay being received or whether the duties could be performed by lower paid state employees. Based on the results, revise hiring practices or adjust compensation accordingly to ensure that the employment of retired annuitants is a fiscally prudent use of state funds.

State Auditor's Work Supporting This Recommendation

Retired employees who return to work as retired annuitants can serve as a valuable resource and their institutional knowledge is often critical. This is particularly true in light of the fact that, as we state in our June 2009 report titled *High Risk: The California State Auditor's Updated Assessment of High-Risk Issues the State and Select State Agencies Face* (Report 2008-601), the State will continue to face the retirement of a significant number of today's workers in both leadership and rank-and-file positions. At the time of our report, we estimated that by fiscal year 2014–15, 42 percent of the fiscal year 2008–09 employees in leadership positions could potentially retire. Thus, the use of retired annuitants may grow as more and more state employees in leadership positions retire.

Further, we reviewed information that shows the State is employing a number of retired annuitants who previously held leadership positions and, although we have not performed extensive analysis in this area, it appears that some retired annuitants did not return to the same position, yet may have been or are being paid at the same rate as when they were employed in the leadership position. To the extent that retired annuitants return to state service and are paid more than the State would otherwise pay for the type of work they perform, this may constitute a waste of state funds and create a sense of unfairness among current state employees.

Potential Benefit

Paying retired annuitants an amount that is commensurate with the type of work actually performed will result in savings, although the exact amount of such savings is not known at this time.

Action Needed

The Governor can implement this recommendation by issuing an Executive Order.

Modify State Leases as Necessary

RECOMMENDATION

Direct state agencies and departments to review any leases of real property to determine whether that property is unoccupied or underoccupied. If space leased is unoccupied, the Department of General Services (General Services) should terminate the lease as soon as legally possible. If space leased is underoccupied, General Services should renegotiate the lease so that it only covers the space that is occupied.

State Auditor's Work Supporting This Recommendation

In our April 2009 investigative report titled *Investigations of Improper Activities by State Employees: July 2008 Through December 2008* (I2009-1), we reported that the Department of Corrections and Rehabilitation (Corrections) and General Services wasted \$580,000 in state funds by continuing to lease 5,900 square feet of office space that Corrections had not occupied for more than four years.

Potential Benefit

Our investigation only involved 5,900 square feet over a four-year period, yet it still resulted in the waste of nearly \$600,000 in state funds. Leases are a significant cost in state government. For example, total minimum lease payments over the life of state leases in effect as of June 30, 2010, is estimated at \$9.1 billion. Thus, if state agencies and departments identify leases of space that is unoccupied or underoccupied, the future savings for the State could be significant.

Action Needed

The Governor can implement this recommendation by issuing an Executive Order.

Eliminate Optional Drug Classifications

RECOMMENDATION

Discontinue all or a portion of the remaining optional drug therapeutic classifications for the Medi-Cal program.

State Auditor's Work Supporting This Recommendation

The Department of Health Care Services (Health Services) administers the State's Medi-Cal program and in doing so it purchases drugs for Medi-Cal beneficiaries—generally low-income individuals and families who receive public assistance or lack health coverage. The State and federal governments jointly finance health care services provided under the Medi-Cal program, including optional services such as prescription drugs. Health Services made a policy decision to include the following optional classes of drugs as part of its pharmacy benefit: anorexia, weight loss, or weight gain drugs; drugs for symptomatic relief of cough or colds; smoking-cessation drugs; barbiturates; and benzodiazepines, which include antianxiety drugs.

In our audit report issued in April 2003 titled *Department of Health Services: Its Efforts to Further Reduce Prescription Drug Costs Have Been Hindered by Its Inability to Hire More Pharmacists and Its Lack of Aggressiveness in Pursuing Available Cost-Saving Measures* (Report 2002-118), Health Services' data showed that had it excluded the optional classes of drugs as part of its pharmacy benefit, it might have saved the State nearly \$80 million during 2001. The bulk of this cost, \$70 million, represented Health Services' reimbursement for cough and cold drugs. We recommended that Health Services conduct a study to identify the effect of discontinuing all or a portion of the optional drug therapeutic classifications from its benefits to Medi-Cal beneficiaries and Medi-Cal's drug costs. We advised Health Services that if it determined it was cost-effective to do so, it should discontinue some or all of the optional drug classifications.

In fact, the 2011–12 Governor's Budget proposes the elimination of over-the-counter cough and cold medications as a Medi-Cal benefit. However, additional opportunities exist to further reduce Medi-Cal costs by eliminating all or a portion of the remaining optional drug therapeutic classifications.

Potential Benefit

Based on the analyses performed in 2003, we believe discontinuing all or a portion of the remaining optional drug therapeutic classifications will potentially yield significant savings to the State's General Fund.

Action Needed

This recommendation will require modifications to state law and federal approval through modification of the State Plan.

Revise Pharmaceutical Reimbursement Method

RECOMMENDATION

Direct the California Department of Health Care Services (Health Services) to use the Average Acquisition Cost (AAC) instead of the Average Wholesale Price (AWP) to reimburse Medi-Cal pharmacy providers.

State Auditor's Work Supporting This Recommendation

Health Services administers the State's Medi-Cal program and in doing so it purchases drugs for Medi-Cal beneficiaries—generally low-income individuals and families who receive public assistance or lack health coverage. The State and federal governments jointly finance health care services provided under the Medi-Cal program, including optional services such as prescription drugs.

We have studied certain state departments' purchase of prescription drugs and reported on their pharmacy reimbursement methodologies. In our May 2005 audit report titled *Pharmaceuticals: State Departments That Purchase Prescription Drugs Can Further Refine Their Cost Savings Strategies* (Report 2004-033), we discussed Health Services' purchase of drugs for Medi-Cal beneficiaries. A Medi-Cal beneficiary can obtain prescription drugs from a pharmacy enrolled as a provider in the Medi-Cal program. The pharmacy in turn seeks reimbursement from Health Services. Historically, Health Services has reimbursed pharmacies using the AWP minus a specified percentage using First DataBank, Inc. as its primary price reference source for the AWP. However, First DataBank, Inc. has announced that it will cease publishing the Blue Book AWP data field for all drugs no later than September 2011.

More recently, states became interested in moving to a reimbursement methodology that uses AAC, which is the actual cost of the drugs to the pharmacies based on their invoices. For example, the federal Centers for Medicare and Medicaid Services (CMS) approved the state of Alabama Medicaid's use of an AAC, instead of AWP, in September 2010. Alabama selects a random sample of all enrolled pharmacies at least weekly and requests that they submit one month's invoices from all sources. Alabama's contractor then calculates the average cost per drug.

The CMS acknowledges that it is difficult and costly for each state to create its own data source for AAC. Thus, CMS is about to undertake a national survey of pharmacies to create a database of AAC that states may use as a basis for determining state-specific rates. The CMS anticipates that the data will be available later this year.

Potential Benefit

Alabama plans to adopt AAC as the benchmark for drug reimbursement in 2011, and expects to save a total of 6 percent of its pharmacy costs or \$30 million of which \$8.9 million is the State's share. Given that Health Services procured more than \$4 billion in prescription drugs during fiscal year 2003–04, once implemented this change could potentially yield significant savings for California.

Action Needed

This recommendation will require modifications to Welfare and Institutions Code and related state laws.

Review State Mandates

RECOMMENDATION

Direct the Department of Finance to review all existing state-mandated local programs (mandates) and identify any mandates that are candidates for elimination for public policy reasons or that could be changed to discretionary programs, any mandates that are candidates for suspension in view of the State's fiscal crisis, and any mandate formulas that should be revisited.

State Auditor's Work Supporting This Recommendation

Whenever the Legislature or any state agency mandates a new program or higher level of service for a local entity, the State is required, with certain exceptions, to provide funding to reimburse the associated costs. The Commission on State Mandates (Commission) hears and decides if a test claim filed by a local entity identifies the reimbursable cost for paying the mandate. As of June 30, 2010, the State's liability for mandates is estimated at \$5.2 billion.

In our October 2003 audit report titled *State Mandates: The High Level of Questionable Costs Claimed Highlights the Need for Structural Reforms of the Process* (Report 2003-106), we recommended that the Legislature direct the Commission to amend the guidelines of the animal adoption mandate to correct a flawed formula. We also found that the local entities we reviewed claimed costs under the peace officer bill of rights mandate for activities that far exceeded the Commission's intent, and entities lacked supporting documentation for most of the costs claimed under this mandate. Further, in 2009, we conducted a follow-up audit and reviewed the mandate determination and payment processes. In our follow-up report titled *State Mandates: Operational and Structural Changes Have Yielded Limited Improvements in Expediting Processes and in Controlling Costs and Liabilities* (Report 2009-501), we noted that the Commission's backlog of incorrect reduction claims, which local entities file to contest audit adjustments, amounted to \$57 million as of June 2009, and creates uncertainty about what constitutes a proper claim.

Potential Benefit

The State could potentially achieve significant savings by (1) eliminating mandates that the Governor and Legislature find are no longer necessary or changing existing mandates to discretionary programs, (2) suspending mandates that would not have a significant impact on public safety or the health and well-being of those affected by the mandate, and (3) reviewing mandate reimbursement formulas to ensure they are carrying out the intent of the Legislature in enacting the mandate.

Action Needed

An Executive Order directed to the director of the Department of Finance is needed to review all existing state mandates. To eliminate, change, or suspend existing mandates, legislative action is needed.

Release Permanently Medically Incapacitated Inmates

RECOMMENDATION

Consider using the constitutional power of commutation to release permanently medically incapacitated inmates. If releasing these inmates would result in cost savings to the State without compromising public safety, we believe exercising this power may be warranted.

State Auditor's Work Supporting This Recommendation

In our May 2010 audit report titled *California Department of Corrections and Rehabilitation: Inmates Sentenced Under the Three Strikes Law and a Small Number of Inmates Receiving Specialty Health Care Represent Significant Costs* (Report 2009-107.2), we found that specialty health care costs for 1,175 inmates, or just one-half of 1 percent of the inmates incarcerated during the year, totaled \$185 million. Also, specialty health care costs totaled \$8.8 million for the 72 inmates who died during the last quarter of the year, exceeding \$1 million in the case of one inmate. Many of the specialty health care costs were incurred for permanently medically incapacitated inmates.

Potential Benefit

According to an analysis of Senate Bill 1399 of the 2009–10 Regular Session, as amended August 2, 2010, the Receiver of California Prison Health Care Services has identified 32 inmates who are the most likely and immediate candidates for medical parole and the Receiver estimates a net first-year savings of about \$30 million. According to that analysis, this includes 21 incapacitated inmates housed in nursing facilities or hospitals outside the prison at a cost of about \$5,800 per day (\$2.1 million per year) and 11 incapacitated inmates in a correctional treatment center bed at a cost of about \$433 per day (\$158,000 per year). The analysis also states that according to the Receiver's figures, the annual cost for these 32 inmates alone is \$46 million.

Action Needed

If the Governor determines that exercising his power of commutation is a feasible option, it would be necessary to follow the process outlined in the Penal Code.

Stabilize Revenue Stream

RECOMMENDATION

Work with the Legislature to place a Constitutional Amendment on the ballot that lowers the vote-threshold for increasing taxes to a majority vote or some other form of super-majority vote, such as a 55 percent requirement.

State Auditor's Work Supporting This Recommendation

State law authorizes the State Auditor' Office to issue reports on state agencies or statewide issue areas that are at high risk for the potential of waste, fraud, abuse, and mismanagement or that has major challenges associated with its economy, efficiency, or effectiveness. In 2009 we added California's budget process to the list of state agencies and issue areas that are at high risk. In our February 2009 report titled *High Risk: The California State Auditor Has Designated the State Budget as a High-Risk Area* (Report 2008-603), we describe the various constraints on the State's General Fund and the difficulty lawmakers have balancing the budget each year simply by reducing expenditures to the level of estimated revenues. We concluded that given the long-term imbalance between the General Fund's revenues and expenditures that the State has experienced, decision makers will need to consider some sort of broad-based tax increase to bring revenues in line with expenditures. However, given the two-thirds vote requirement for taxes, lawmakers have difficulty passing any increases.

Potential Benefit

Lowering the vote threshold would benefit the State in several ways. First, the Legislature will more likely meet the constitutional deadline for passing the budget, which would ensure that those dependent on state revenues, such as local government and vendors, receive funds in a timely manner. It also would eliminate the need for costly loans and the costs associated with extended legislative sessions. Finally, the consistent failure to pass a budget on time has affected California's credit rating. This results in less favorable interest rates on loans and bonds, which in turn increases debt service costs for the State.

Action Needed

This recommendation requires a change to the California Constitution.
