CALIFORNIA PRISON HEALTH CARE RECEIVERSHIP CORPORATION USE OF STATE FUNDS FOR FISCAL YEAR 2007–08

OFFICE OF THE INSPECTOR GENERAL

DAVID R. SHAW
INSPECTOR GENERAL

STATE OF CALIFORNIA

JUNE 2009

June 30, 2009

J. Clark Kelso, Receiver
California Prison Health Care Receivership Corporation
501 J Street, Suite 605
Sacramento, California 95814

Dear Mr. Kelso:

Enclosed is my office's report on the California Prison Health Care Receivership Corporation's (receivership's) use of state funds during fiscal year 2007–08.

Our review found that the receivership spent $51.2 million during the year for its operating costs and long-term capital assets purchased on behalf of the California Department of Corrections and Rehabilitation (CDCR). This amount represents four percent of the $1.4 billion spent in fiscal year 2007–08 to provide medical care to CDCR's adult inmate population.

The largest expense category was capital assets, for which the receivership spent $28.7 million. In addition, the receivership spent $13.5 million on professional fees, $7.3 million on employee compensation and benefits, and $1.7 million on other expenses and travel. With regard to employee compensation, during fiscal year 2007-08, eight employees received salaries of $225,000 or more – equal to or greater than the salary of the CDCR secretary. However, the receivership also reduced its total number of employees from 40 to 22 during the fiscal year.

The review also disclosed that the receivership maintained a large cash balance outside the state treasury that was invested in an underinsured money market savings account. This practice posed an unnecessary risk of losing state funds.

The review also disclosed that the receivership implemented our prior recommendations to establish and enforce travel policies and corporate credit card procedures. Our current report makes two new recommendations regarding cash management and leased office space in Campbell.

Thank you for the courtesy and cooperation extended to my staff during the review. Please call Jerry Twomey, Chief Assistant Inspector General, at (916) 830-3610 if you have any questions.

Sincerely,

DAVID R. SHAW
Inspector General

cc: Thelton E. Henderson, Senior United States Judge for the Northern District of California

Enclosure

Contents

Executive Summary

In April 2006, the U.S. District Court for the Northern District of California appointed a Receiver with broad powers over the California Department of Corrections and Rehabilitation's (department) delivery of medical care to prisoners after the court found the department's medical care efforts did not meet federal constitutional standards. As a result, the court suspended the department Secretary's authority over California's prison medical system and granted this power to the Receiver. The court ordered the state to pay all costs the receivership incurs in carrying out its responsibilities.

Pursuant to the Federal court's order in Plata v. Tilton establishing the California Prison Health Care Receivership Corporation (receivership), the Office of the Inspector General (OIG) entered into an agreement with the Receiver to perform periodic reviews of the receivership's use of state funds for its administrative operations. These reviews were intended to provide transparency and accountability for the receivership's operation. However, consistent with the court's intent, the scope of the reviews were limited to only the receivership's administrative expenditures made outside of the state accounting system. As a result, the OIG reviews were not intended and do not include review of expenditures for direct costs of medical care delivery made through the state disbursement process. While these reviews involve less detailed testing than a typical financial audit, they nevertheless are intended to report any instances of fraud, waste, or abuse that we identify.

As the executive manager over adult medical services, the Receiver is responsible for managing all medical programs and their related costs, including those costs incurred by the department and those incurred for the receivership's operations.[1] The Receiver refers to this combined effort, which spent $1.4 billion on adult inmate medical care in fiscal year 2007–08, as California Prison Health Care Services. This review for fiscal year 2007-08 covers only the $51.2 million portion of the $1.4 billion in state funds spent on receivership operations. However, notwithstanding the established scope of these reviews, in light of the recent disclosure of an approximately $500 million budget overrun for contracted medical services, we will explore expanding the scope of our 2008-09 review to include review of the actual costs of medical care delivery overseen by the receiver.

Table 1
California Prison Health Care Receivership
Fiscal Year 2007-2008
Total Expenditures, by Category

Category	**(In millions)**
Capital Assets	$28.7
Professional Fees	13.5
Compensation	5.9
Benefits	1.4
Other Expenses	1.2
Travel	0.5
Total Expenditures	**$51.2**

[1] Medical services do not include dental, mental health, substance abuse, or juvenile healthcare.

Table 1 presents the details of the receivership's fiscal year 2007–08 expenditures within the six major expense categories detailed in this report. Key observations we made during our review of these expense categories include:

- Most of the receivership's capital asset expenditures were made to construct or improve assets, such as buildings and information systems, for the department and its prisons.
- Over half of the professional fees were paid to Maxor National Services Corporation to help improve the department's prison pharmacy system.
- The receivership paid eight of its 22 employees the same or more than the salaries paid to the department Secretary and the Receiver.
- The receivership consolidated most of its operations in Sacramento, but it still operates a small office near San Jose for two employees.
- The receivership maintained an average daily balance of $22 million in bank accounts that had only minimal depository insurance.

To ensure that the receivership effectively manages its public funds, this report presents two recommendations:

- To ensure the safest and most prudent management of public funds, the Receiver should work with the appropriate state offices to establish a cash management process that minimizes the amount of cash that the receivership holds outside of the State treasury.
- To ensure the receivership operates in the most cost-effective way possible, the Receiver should consolidate operations in Sacramento by closing the Campbell office no later than that office's lease expiration date of October 31, 2009.

The OIG also performed follow-up work on recommendations presented in our February 2008 report, and we found that the receivership took the following corrective action during fiscal year 2007–08:

- Reduced the number of receivership employees from 40 to 22, discontinued cash in lieu of benefit payments, and reduced the Receiver's compensation.
- Implemented and enforced a travel policy and corporate credit card usage and payment procedures.

Receivership's Response

In its response to this report, the receivership concurs with the report's recommendations.

Introduction

Background

The court created a receivership to correct the state's failure to provide the constitutionally required level of inmate medical care.

In April 2001, California prisoners filed a class action lawsuit against the state alleging that California officials inflicted cruel and unusual punishment by being deliberately indifferent to serious inmate medical needs.[2] The state settled the lawsuit in 2002, agreeing to overhaul its medical delivery system to ensure timely access to adequate medical care. However, in 2005, the U.S. District Court for the Northern District of California, which oversees the case, found that despite the best efforts of the state, little real progress was being made. Therefore, the court decided to establish a receivership to control the delivery of medical services to inmates in California prisons. In its October 2005 order, the court stated:

> *By all accounts, the California prison medical care system is broken beyond repair…and the threat of future injury and death is virtually guaranteed in the absence of drastic action.*
>
> *It is clear to the Court that this unconscionable degree of suffering and death is sure to continue if the system is not dramatically overhauled.*
>
> *Accordingly, through the Court's oral ruling and with this Order, the Court imposes the drastic but necessary remedy of a Receivership in anticipation that a Receiver can reverse the entrenched paralysis and dysfunction and bring the delivery of health care in California prisons up to constitutional standards. Once the system is stabilized and a constitutionally adequate medical system is established, the Court will remove the Receiver and return control to the State.*[3]

Effective April 17, 2006, the court appointed Robert Sillen to serve as the Receiver over the delivery of medical care to prisoners. Later, on January 23, 2008, the court terminated Robert Sillen as Receiver and appointed J. Clark Kelso to that position. In his court order, the judge wrote, "The Receivership has reached a critical juncture at which it must now move from a primarily investigative and evaluative phase…into an implementation phase…." He concluded that, "such work would best be accomplished by appointing a new Receiver who brings a different set of strengths appropriate to guiding the Receivership through its second phase."

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[2] *Plata v. Schwarzenegger,* C01-1351 TEH.

[3] *Plata v. Schwarzenegger,* C01-1351 TEH, October 3, 2005, Findings of Fact and Conclusions of Law RE Appointment of Receiver.

The court gave the Receiver broad powers over prison medical care.

The court suspended the department Secretary's exercise of power related to the administration, control, management, operation, and financing of the California prison medical healthcare system and granted these powers to the Receiver. The court also provided the Receiver with the power to acquire, dispose of, modernize, repair, and lease property, equipment, and other tangible goods as necessary to carry out his duties under the order. To enable the Receiver to carry out these duties, the court provided the Receiver unlimited access to all records, files, and facilities maintained by the department, as well as access to prisoners and department staff. The court also ordered the state to pay all costs the receivership incurs in carrying out its responsibilities under the order, and established the following duties for the Receiver:

- Provide leadership and executive management of the California prison medical care delivery system.
- Develop a detailed plan of action designed to restructure and develop a constitutionally adequate medical care delivery system.
- Determine the annual medical care budget and implement an accounting system that meets professional standards.
- Provide the court with bimonthly reports addressing the receivership's progress made, particular problems encountered, successes achieved, and an accounting of its expenditures and all other matters deemed relevant.

Furthermore, the court required that the Receiver make all reasonable efforts to exercise his powers in a manner consistent with California laws, regulations, and contracts, including labor contracts. However, if the Receiver finds that a state law, regulation, contract, or other state action or inaction is clearly preventing the Receiver from developing or implementing a constitutionally adequate medical health care system, the Receiver shall ask the court to waive the state or contractual requirement causing the impediment.

The California Prison Health Care Receivership Corporation collaborates with department employees to deliver medical services.

In response to the class action lawsuit, the California Prison Health Care Receivership Corporation was created to carry out the role established by the court order and serve as the entity through which the Receiver carries out his responsibilities under the order. The department subsequently established the Plata Support Division to provide administrative support functions for operations related to medical care delivery.[4] Receivership and department employees work together under the Receiver's direction to manage and

[4] Medical services do not include dental, mental health, substance abuse, or juvenile healthcare.

implement his action plan to reform the state's delivery of prison medical care. The Receiver refers to this combined effort as California Prison Health Care Services.

The Office of the Inspector General agreed to complete periodic reviews of the receivership's use of state funds.

As the executive manager over adult inmate medical services, the Receiver is responsible for managing all costs associated with these services. These costs include those that are incurred both by the department's medical operations and by the receivership's operations. To ensure the transparency and accountability of the receivership's operations, the court required the receivership to coordinate with the Office of the Inspector General (OIG) to facilitate periodic reviews of its budget operations. To carry out this responsibility, we agreed with the Receiver to periodically review the receivership's expenditures—which amounted to $51.2 million for fiscal year 2007–08—and to produce a public report for the court that describes how the receivership uses state funds. We will perform similar reviews annually until the court terminates the receivership. This is our second annual report.

Objectives, Scope, and Methodology

Our agreement with the receivership calls for the OIG to issue a public report periodically that describes how the receivership uses state funds. Consistent with the federal court's intent, these reviews cover only that portion of state funds spent directly by the receivership for its operations; they do not include the portion of state funds spent by the department under the Receiver's authority. These reviews involve less detailed testing than a typical financial audit, but they are intended to report any instances of fraud, waste, or abuse that the OIG becomes aware of during its review.

This is our second review, and it covers the receivership's expenditures for fiscal year 2007–08. In conducting this review, we performed the procedures described below:

1. To understand the receivership's operations and the nature and scope of projects undertaken, we reviewed documents related to the receivership's creation and interviewed key receivership and department employees.

2. To verify the amount of state funds that the department paid to the receivership, we reviewed budget and banking-related documents and interviewed key employees from the receivership, the department, and the California Department of Finance. We then reconciled this amount to the amount the receivership reported in its financial statements.

3. To understand how the receivership managed its unused cash compared to how the state performs this function, we reviewed banking-related documents and state treasury information.

4. To determine the receivership's portion of the department's total expenditures for inmate medical services, we reviewed the department's expenditure data.

5. To determine the nature of the receivership's expenditures, we obtained detailed accounting reports and identified significant expense accounts. We then reviewed a sample of transactions from selected expense categories and determined the purpose of the expense by reviewing various source documents. We did not evaluate the efficacy of the goods or services for which the receivership expended funds.

6. To familiarize ourselves with the work performed by the Bureau of State Audits (bureau) pertaining to the receivership, we obtained and reviewed two reports issued by the bureau in January 2009. [5] After reviewing these reports, we concluded that their findings did not affect the scope of our review or our conclusions.

In addition, we contacted the public accounting firm that audited the receivership's financial statements. The firm told us that it did not become aware of any instances of fraud, waste, or abuse, during its audit of the receivership's financial statements for the period July 1, 2007 through June 30, 2008. Within the scope of our review, we did not become aware of any instances of fraud, waste, or abuse.

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[5] Bureau of State Audits, January 2009 Report I2008-0805, *California Prison Health Care Services: Improper Contracting Decisions and Poor Internal Controls,* and, January 2009 Report 2008-501, *California Prison Health Care Services: It Lacks Accurate Data and Does Not Always Comply With State and Court-Ordered Requirements When Acquiring Information Technology Goods and Services*. They can be viewed at http://bsa.ca.gov/.

Review Results

During fiscal year 2007–08, California spent $1.4 billion to provide medical services to its adult inmate population.[6] Under the direction and authority of the federally appointed Receiver, California Prison Health Care Services, which consists of both receivership and department employees, incurred this cost while managing various medical services. The Receiver expended 96 percent of these funds for the California Department of Corrections and Rehabilitation (department). The Receiver spent the remaining 4 percent, or $51.2 million, through the California Prison Health Care Receivership Corporation (receivership) to support its operations and to purchase and construct capital assets for the department. Of the $51.2 million, $28.7 million was spent for capital assets, and nearly this entire amount was for the direct benefit of a particular prison or for all the department's adult institutions. The receivership spent the remaining $22.5 million in five general categories: compensation, benefits, professional fees, travel, and other expenses. In this report, we describe how the receivership received, managed, and used the $51.2 million in state funds through its corporation.[7]

Receipt of State Funds

The court ordered the state to pay all costs the receivership incurs in carrying out its responsibilities. To manage its operating funds and comply with the court's order, the receivership established its own bank accounts and arranged with the department to replenish its accounts regularly. The Receiver worked with the department, the California Department of Finance, and the State Controller's Office to establish a system to authorize and transfer state general funds to the receivership.

The receivership managed a large amount of unused cash during the year.

The receivership started fiscal year 2007–08 with a $15.8 million cash balance and received another $41.1 million in state funds during the year. Further, the receivership maintained an average daily balance of $22 million, which it held in numerous bank accounts, including a money market account. However, according to the receivership's independent financial auditor, the Federal Deposit Insurance Corporation insured only $100,000 of the receivership's cash balance.[8] Nonetheless, according to the Receiver, the receivership is reluctant to request more frequent, smaller replenishments to its operating funds because the state's budget process is unpredictable and the receivership may not receive timely transfers of state funds. Because the receivership manages its unused funds by maintaining them with a bank, it risks losing some or most of those funds through a

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[6] This amount excludes the cost to provide dental, mental health, substance abuse, and juvenile healthcare services.
[7] We describe how the receivership spent the $51.2 million; however, as cited in the scope section of this report, we did not review the remainder of the $1.4 billion in state costs for medical care.
[8] Effective October 3, 2008, through December 31, 2009, the FDIC temporarily raised the federal deposit insurance coverage to $250,000.

bank failure. Further, although the receivership's accounts earned $912,701, by performing its own investment function, the receivership is performing a service already provided by the state treasury system.

In a March 4, 2008, letter to the Receiver, the Inspector General recommended that the receivership consider using the State's Local Agency Investment Fund rather than perform its own investment function. Although the Receiver agreed and his controller worked with state officials throughout the year, as of February 2009, the receivership still maintained large cash balances outside the State treasury and was performing its own treasury function. Therefore, on February 27, 2009, the Inspector General sent another letter to the Receiver urging him to move the receivership's treasury function to the State and immediately transfer most of its unused cash to the State Treasurer's Office.

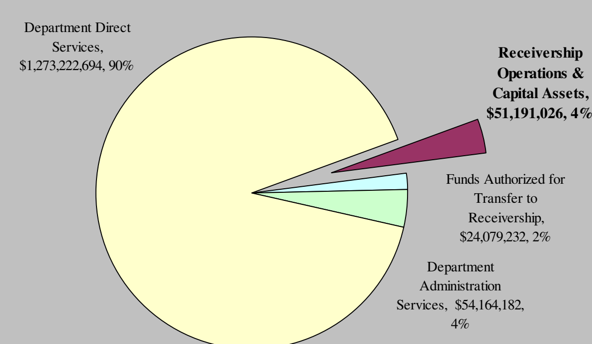
Recommendation

To ensure the safest and most prudent management of public funds, we recommend that the Receiver work with the appropriate state offices to establish a cash management process that minimizes the amount of cash that the receivership holds outside the State treasury.

Use of State Funds

As shown in Figure 1, the department and the receivership spent $1.4 billion for adult inmate medical services during fiscal year 2007–08.[9] Most of these funds—96 percent—were spent for activities undertaken by the department under the Receivership's authority. The receivership spent the remaining 4 percent of the $1.4 billion, or $51.2 million, to support its operations and to purchase capital assets.

Figure 1 **California Adult Inmate Medical Services - $1,402,657,134 Fiscal Year 2007–08**



Source: California Prison Health Care Services

To carry out its court-ordered mandate, the receivership hires employees, executes contracts, and otherwise incurs costs of doing business. Of the $51.2 million spent by the receivership, $22.5 million was for its operating costs, most of which were for personnel services related to salaries and benefits for the receivership's employees and for professional services provided by consultants. The receivership spent the remaining $28.7 million to acquire capital assets. Although this amount includes the costs of furnishing

[9] The department considers the entire $1.4 billion as expended in fiscal year 2007–08. This includes the $24 million we identify in Figure 1 as funds the department authorized for transfer to the receivership as of June 30, 2008. These funds were not transferred to, and therefore were not spent by the receivership until after the fiscal year ended.

and equipping the receivership's Sacramento office, most of the costs were for construction and capital projects the receivership spent on the department's behalf.

As shown in Table 2, the receivership spent 154 percent more in fiscal year 2007–08 than in fiscal year 2006–07. This increase was primarily due to increased spending for the receivership's expanding construction projects and associated consulting services. In the following sections, we present in greater detail the $51.2 million spent by the receivership.

Table 2 **How the Receivership Used State Funds**

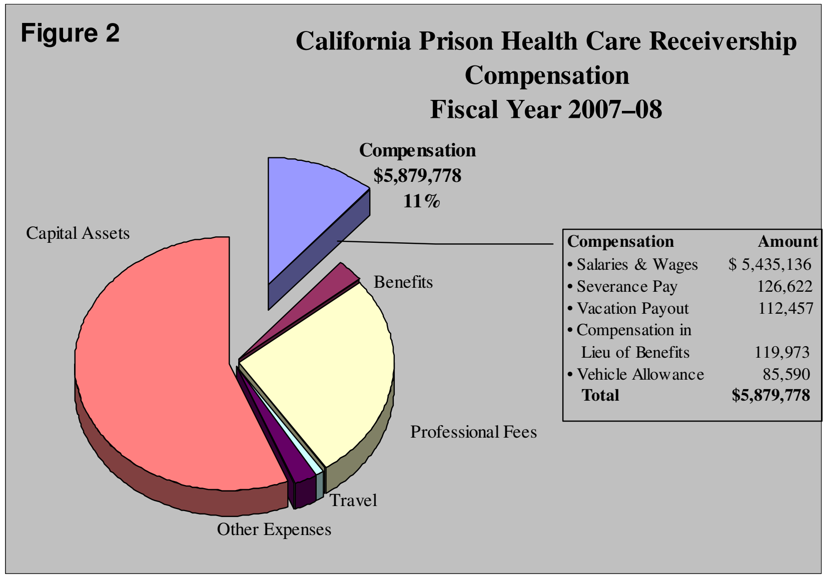
Two-Year Comparison

Description	**FY2006–07 Amount**	**Fy2007–08 Amount**	**% Increase**
Salaries and Wages	$4,583,880	$5,879,778	28%
Benefits	972,988	1,370,613	41%
Rent and Lease	191,675	230,258	20%
Professional Fees	4,768,527	13,469,645	182%
Insurance	53,948	86,516	60%
Office Expenses	69,169	111,388	61%
Travel	337,189	501,099	49%
Telephone and Network Lines	59,014	109,071	85%
Other Expenses	358,390	701,714	96%
Total Operating Expenses	***$11,394,780***	***$22,460,082***	***97%***
Total Capital Assets	***$8,766,710***	***$28,730,944***	***228%***
Total Expenses	***$20,161,490***	***$51,191,026***	***154%***

Compensation

As shown in Figure 2, during fiscal year 2007–08 the receivership incurred over $5.8 million in compensation-related expenses, amounting to 11 percent of the receivership's total expenditures. Employee compensation included salaries and wages, severance pay, vacation payout, compensation in lieu of benefits (from July 1 through October 31, 2007), and vehicle allowances.

Figure 2



Compensation	Amount
• Salaries & Wages	$ 5,435,136
• Severance Pay	126,622
• Vacation Payout	112,457
• Compensation in Lieu of Benefits	119,973
• Vehicle Allowance	85,590
Total	**$5,879,778**

From July 2007 through June 2008, in addition to the Receiver, the receivership employed as many as 40 people, to whom it paid either a salary or an hourly rate. The receivership separated 18 of the 40 employees during the fiscal year and as of June 30, 2008, there were 22 employees on payroll—13 executives and 9 non-executives.

Table 3 at the end of this section details the total compensation the receivership paid to the previous Receiver and each of the 40 employees during the review period. As shown in the table, eight of the remaining 22 employees (36 percent) received annual salaries that were the same or more than the department Secretary's $225,000 annual salary and the new Receiver's $224,000 annual salary.[10] However, seven of the eight were medical professionals whose salaries ranged from $225,000 to $350,000. The eighth employee was the director of custody support, whose salary was $231,875[11].

The reduction in receivership employees from 40 to 22 appears consistent with the receivership's intention to return management of inmate medical services to the department. However, the reduction in employees may not have resulted in a net savings to the state because some of the separated employees may have transferred from the receivership to positions in the department. For example, in January 2009, three medical professionals left the receivership and transferred to the department.

In addition to receiving a salary or wages and a vehicle allowance of $500 per month, for a portion of the year some employees received additional cash compensation—30 percent

[10] The new Receiver's compensation is not included in this category; it is presented in the Professional Fees section on page 15.

[11] Five of these eight employees, including the director of custody support, were no longer employed by the receivership as of May 31, 2009.

of their base salary—in lieu of benefits. Specifically, from July 1, 2007, through October 31, 2007, the receivership paid 11 executives $119,973 in lieu of benefits such as medical insurance and a retirement plan. As we discussed in our February 2008 report, the receivership did not initially provide benefits to its employees; however, as of March 2007, the receivership was offering health-related and retirement benefits to its employees. Further, the receivership gave its executive employees the option of either continuing to receive the entire in lieu payment or adding the benefits and having the in lieu payment reduced by the receivership's cost of providing benefits.

However, in September 2007, the judge who created the receivership and oversees its operation directed the receivership to discontinue in lieu of benefit payments effective October 31, 2007. In his memorandum to the Receiver, the judge stated that he was previously under the impression that once an employee benefit package became available that employees would transition to the employee benefit package. The Receiver complied with the judge's directive.

As we mentioned above, employee compensation also included a monthly vehicle allowance of $500. As indicated in Table 3, the receivership paid 17 employees vehicle allowances totaling $85,590 during fiscal year 2007–08.

Follow-Up on Prior OIG Recommendation

In February 2008, we recommended that the receivership regularly reevaluate the salary and wage package it provides to staff members to ensure the level of compensation paid to employees is an appropriate use of state funds. Although the Receiver reduced the number of receivership employees from 40 to 22, we are unaware of any changes to the salary and wage package paid to receivership employees that occurred after our February 2008 recommendation. As stated above, the judge did direct the Receiver in October 2007 to discontinue in lieu of benefit payments to receivership employees and in January 2008 the court appointed a new Receiver whose compensation is less than that of the former Receiver.

Table 3 Total Employee Compensation Paid by Receivership
Fiscal Year 2007–08

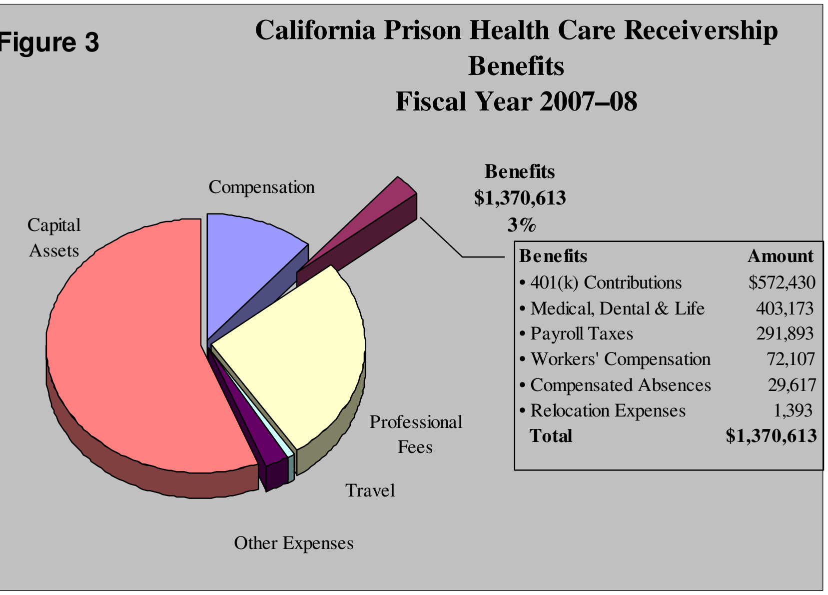
Employee	Position	No. of Mos.	Salary & Wages	C-I-L Benefit	Vehicle Allowance	Severance Pay	Vacation Payout *	Total Paid
Remaining Employees, as of July 1, 2008								
Hill, T. (a)	Chief Medical Officer	12	$350,000	$24,791	$6,000	N/A	N/A	$380,791
Ha	Chief Nurse Executive	12	300,000	0	6,000	N/A	N/A	306,000
Graham	Chief Medical Information Officer	12	275,000	12,147	6,000	N/A	N/A	293,147
Clark	Director of Nursing Operations	12	250,000	0	6,000	N/A	N/A	256,000
Scott	Nursing Director	12	225,000	2,400	6,000	N/A	N/A	233,400
McGrath (b)	Director, Custody Support Services	12	231,875	0	0	N/A	N/A	231,875
Robinson	Nursing Director	12	225,000	0	6,000	N/A	N/A	231,000
Rea	Nursing Director	12	225,000	0	6,000	N/A	N/A	231,000
Kirkland	Director, Plata Support Division	12	189,630	0	6,000	N/A	N/A	195,630
Russell	Health Care Project Officer	12	150,868	8,422	0	N/A	N/A	159,290
Buzzini	Staff Attorney	12	141,779	8,750	5,675	N/A	N/A	156,204
Goldman	Chief Counsel	12	147,375	1,631	6,000	N/A	N/A	155,006
Moy	Director, Health Information Integration	12	150,000	0	0	N/A	N/A	150,000
Meier (b)	Custody Support Services Specialist	12	145,116	0	0	N/A	N/A	145,116
Cambra Jr.	Custody Support Services Specialist	12	142,228	0	0	N/A	N/A	142,228
Dovey (b)	Custody Support Services Specialist	12	141,737	0	0	N/A	N/A	141,737
Weston (a)	Special Assistant	12	138,667	0	0	N/A	N/A	138,667
Cameron (c)	Controller	12	125,000	0	0	N/A	N/A	125,000
Lucas	Investigation & Discipline Coordinator	12	109,000	0	0	N/A	N/A	109,000
Hector	Staff Attorney	12	93,375	0	0	N/A	N/A	93,375
Hill, D. (b)	Custody Support Services Specialist	12	72,558	0	0	N/A	N/A	72,558
Lerner (d)	Staff Attorney	12	38,320	0	0	N/A	N/A	38,320
Separated Employees, as of June 30, 2008								
Sillen (e)	Receiver	6.75	282,372	38,027	0	41,667	24,999	387,065
Wood	Chief Financial Officer	9.25	210,481	8,143	4,592	45,833	11,099	280,148
Hummel	Chief Information Officer	7.75	177,163	9,855	3,865	0	25,384	216,267
Turner	Statewide Nursing Officer	6	137,500	0	3,000	0	17,981	158,481
Whittaker	Manager, Program Management Office	10.5	132,500	0	0	0	7,249	139,749
Kagan	Director of Communications	7.5	112,500	4,182	3,750	0	16,616	137,048
Norcio	Director, Clinical Integration	7.25	100,524	0	3,569	0	0	104,093
Estrada-Kirn	Special Assistant	7.25	61,248	1,625	3,639	16,833	9,129	92,474
Saich (f)	Coordinator	9	60,118	0	0	N/A	N/A	60,118
Sgro	Administrative Manager	8.25	52,880	0	0	6,667	0	59,547
Sampson	Manager, Medical Records	9.5	39,982	0	3,500	0	0	43,482
Stuart	Administrative Assistant	8.25	36,189	0	0	4,167	0	40,356
Huber	Administrative Assistant	8.25	34,778	0	0	4,167	0	38,945
Bartle	Administrative Assistant	8.25	36,426	0	0	0	0	36,426
Knox	Administrative Assistant	7.25	32,066	0	0	4,167	0	36,233
McPherson	Personnel Specialist	8.25	28,620	0	0	0	0	28,620
Sandoval	Administrative Aide	8.25	25,415	0	0	3,121	0	28,536
Matranga	Receptionist	2.75	4,839	0	0	0	0	4,839
Kasik (g)	Receptionist	5.75	2,007	0	0	0	0	2,007
TOTALS			**$5,435,136**	**$119,973**	**$85,590**	**$126,622**	**$112,457**	**$5,879,778**

(a) This person's employment ended effective March 12, 2009.
(b) This person's employment ended effective May 31, 2009.
(c) The Controller is a half-time position. If the position were full-time, the annual salary would be $250,000.
(d) This employee worked part-time at an hourly rate of $80.
(e) Effective January 23, 2008, the U. S. District Court terminated Mr. Sillen and appointed Mr. Kelso as Receiver. Kelso's compensation is presented in the professional fees section at page 15.
(f) This employee did not work February – April. Had she worked the entire year, her annual salary would have been $80,000.
(g) This employee worked part-time at an hourly rate of $9.
* Vacation payout represents payment for vacation earned but not used as of separation date.

Benefits

In addition to the compensation the receivership paid to its employees, the receivership also paid for certain employee benefits. The category designated as "Benefits" is comprised of the six sub-accounts shown in Figure 3. Our review of the receivership's financial statements for fiscal year 2007–08 found that the receivership incurred $1.37 million in total benefit costs for its employees. This amount represents 3 percent of total expenditures for the receivership during our review period.

Figure 3



Benefits	Amount
• 401(k) Contributions	$572,430
• Medical, Dental & Life	403,173
• Payroll Taxes	291,893
• Workers' Compensation	72,107
• Compensated Absences	29,617
• Relocation Expenses	1,393
Total	**$1,370,613**

The largest benefit expense during the review period was receivership contributions to its employees' 401(k) retirement plan, which totaled $572,430. The receivership made monthly 401(k) contributions equal to 12.5 percent of base salary for executive employees and 7.5 percent for non-executive employees.

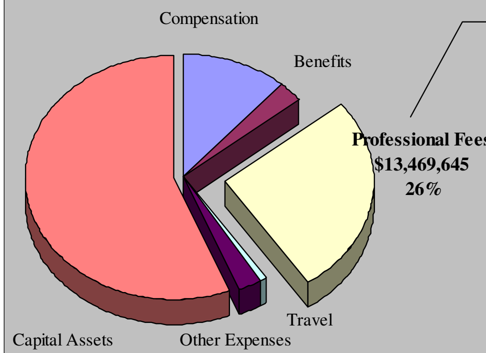
In addition, the receivership paid $403,173 for medical, dental, and life insurance for its employees electing to receive the benefit from July 2007 through June 2008. The receivership paid the entire cost of these insurance items for its employees.

Payroll taxes represented another large benefit expense during the review period. This benefit included the employer portion of Social Security and Medicare payments, totaling $291,893. The receivership also paid $72,107 for worker's compensation insurance and recognized a liability of $29,617 as of June 30, 2008, for compensated absences.

Professional Fees

Figure 4

California Prison Health Care Receivership
Professional Fees
Fiscal Year 2007–08



Professional Fees	Amount
• Pharmacy Consulting	$7,080,728
• Other Professional Fees	4,522,184
• Legal & Professional Services	745,772
• Chief of Staff	453,197
• Temporary Agencies	192,409
• Physicians	163,600
• Nursing	157,488
• HR Consulting	88,131
• Recruitment	66,136
Total	**$13,469,645**

The receivership enters into contracts for the services of certain professionals to carry out its duties. As shown in Figure 4, the receivership spent $13.5 million on professional fees during fiscal year 2007–08. Over half of these payments were to a contractor that provides pharmacy management consulting services. Professional fee expenditures also included payments for other professional services, including the Receiver's compensation, legal services, and compensation for the Receiver's chief of staff. The $13.5 million for professional fees represents 26 percent of the receivership's expenditures for fiscal year 2007–08.

Pharmacy consulting represents more than half of the receivership's professional fee costs.

For fiscal year 2007–08, the receivership paid Maxor National Services Corporation (Maxor) $7.1 million to help improve the department's prison pharmacy system.[12] According to the terms of its competitively bid contract, Maxor has seven specific goals:

1. Develop meaningful and effective centralized oversight, control, and monitoring over the pharmacy services program;
2. Implement and enforce clinical pharmacy management processes;
3. Establish a comprehensive program to review, audit, and monitor pharmaceutical contracting and procurement processes;
4. Develop a meaningful pharmacy human resource program;
5. Redesign and standardize overall institution level pharmacy drug distribution operations;
6. Design and implement a uniform pharmacy information management system; and
7. Develop a process to assure the department's pharmacy meets accreditation standards.

[12] Maxor's initial work produced a "road map," or plan, to improve the pharmacy services delivery system. Its subsequent work entails carrying out the plan. Under normal circumstances, Public Contract Code section 10365.5 would prohibit the entity that developed the plan from bidding on and receiving the contract for carrying out the plan. However, citing the urgent need to improve pharmacy operations, the receivership obtained a court order dated March 30, 2007, that retroactively waived this and other statutes.

The receivership's contract with Maxor began in 2007 and is scheduled to terminate at the end of 2010. Since Maxor initiated contract work, the contract term was extended by one year and the total value increased from $15,082,929 to $39,897,141, due to two amendments. The first amendment, which the Receiver signed in February 2007, increased the original contract amount by $7,135,773 and modified the scope of work and the budget by adding eight additional clinical pharmacists, a "Drop-in" pharmacy team, and a nurse pharmacy liaison. These positions were added to implement new objectives to establish: 1) a central pharmacy services administration, budget, and enforcement authority; and, 2) methodologies and schedules for tracking and monitoring formulary compliance and prescribing behavior. The second amendment, signed in January 2008, extended the contract term by one year and further increased the contract amount by an additional $17,678,439. It called for the implementation of a uniform interim pharmacy management system and the addition of implementation pharmacy teams and additional nurse pharmacy liaison services.

The receivership spent $4.5 million for various other professional fees.

The receivership contracted for professional services in business matters for which it did not have in-house expertise. Examples of professional fees paid include:

- $612,533 to McKenzie Stephenson, Inc., for radiology consulting services;
- $608,063 to Chancellor Consulting Group for consultation on managed care issues, conducting financial analysis, and providing support for contract negotiations or analysis related to health plans, medical groups, and physician services;
- $595,195 to Enterprise Networking Solutions for information technology consulting related to the design, development and implementation of the department's Health Care Document Management System. This system is intended to help the department better manage the processing, renewing, and payment of medical care contracts;
- $585,461 to Navigant Consulting for services related to hospital inpatient and physician payment rate information, clinical laboratory services and strategic planning assessment, and an improvement plan for the department's health care contracting unit;
- $396,888 to Health Management Associates for an assessment of the prison health care system related to chronic disease and asthma screening and treatment; and
- $105,168 to the State of California Administrative Office of the Courts (AOC) for reimbursement of the Receiver's compensation and a monthly administrative processing fee of $150. The receivership did not pay the Receiver from its payroll system; rather, the Receiver is on loan to the receivership from the AOC, which

pays the Receiver and is reimbursed by the receivership.[13] As noted at page 10 of this report, the Receiver's annual compensation is $224,000.

The receivership also spent $745,772 on legal services during the year.

The receivership paid the law firm of Futterman & Dupree LLP $563,296 to serve as the receivership's attorney. According to its agreement with the receivership, Futterman & Dupree LLP provides general legal services, including representation in federal receivership proceedings involving the California prison health care system. The hourly rates for attorneys range from $225 to $350. The receivership also retained Hooper, Lundy & Bookman, Inc., to provide legal services related to the Health Insurance Portability and Accountability Act. The hourly rate for attorneys is $350. The receivership paid this firm $159,484 during fiscal year 2007–08. Payments to these two firms totaled $722,780, which represents 97 percent of the total legal fees paid by the receivership in the fiscal year.

Payments to the receivership's chief of staff totaled $452,375.

Also, the receivership paid its chief of staff, John Hagar, $452,375 for his services during fiscal year 2007-08. Mr. Hagar worked for the receivership as an independent contractor rather than an employee.[14] Under his agreement with the receivership, Mr. Hagar was paid $250 per hour for his services and was reimbursed for ordinary and reasonable expenses he incurred in performing his services. He was responsible for (1) coordinating the Receiver's activities; (2) ensuring the flow of accurate information to and from the Receiver and the receivership; and (3) providing integrated policy analysis and strategic consultation to the Receiver and the receivership.

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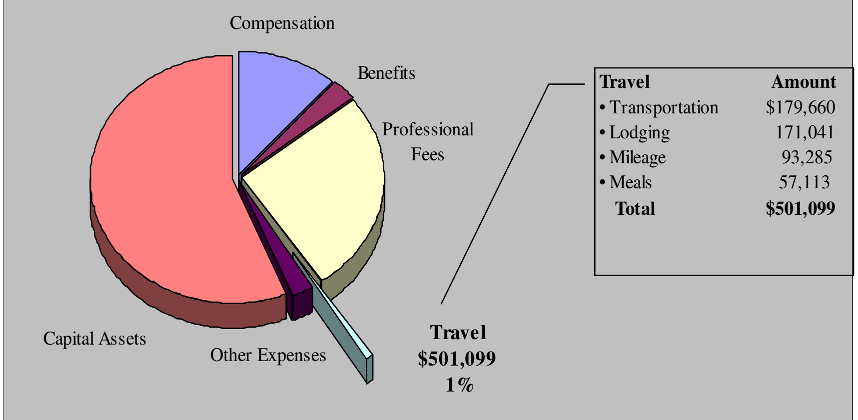
[13] The agreement between the AOC and the receivership also states that, "Mr. Kelso may receive from the AOC supplemental performance based payments, in the amounts determined by (the court)." There were no reimbursements for supplemental payments made by the AOC during fiscal year 2007–08.
[14] Mr. Hagar's position with the receivership ended effective March 12, 2009.

Travel

Figure 5

California Prison Health Care Receivership
Travel
Fiscal Year 2007–08



The receivership's policy is to pay for reasonable and customary travel expenses incurred by its employees and contractors when conducting official business away from their offices. These costs include transportation, lodging, mileage, and meals. As shown in Figure 5, the receivership spent $501,099 on travel during our review period. This amount is about 1 percent of the receivership's expenditures for fiscal year 2007–08.

The receivership implemented a formal reimbursement policy for travel related expenses and certain other business activity in February 2007. This policy requires its employees to substantiate the amount, time, location, and business purpose of lodging expenses incurred while traveling away from home. The policy states that the employee must submit an expense report with receipts to obtain reimbursement. The policy also specifies that documentation must be in the form of "**original invoices or receipts** and not photo copies [*sic*]" [*emphasis in original*].

We reviewed selected reimbursements the receivership made to employees and contractors for transportation, lodging, and meal expenses incurred while on travel status. All reimbursements reviewed were supported with original receipts and were consistent with the receivership's travel policy. In addition, meal reimbursements did not exceed the $50 daily allowance.[15]

Moreover, we found that as of June 30, 2008, the receivership had one corporate credit card issued in the name of one of its executive staff. During fiscal year 2007–08, that employee incurred $14,898 in expenses on behalf of the receivership. This amount included various types of expenditures, including office and other miscellaneous expenses as well as travel reimbursements. Our February 2008 report noted that receivership employees did not always provide proper documentation for credit card expenses that were related to travel. Often, the accountant paid credit card bills without proper supporting documentation to avoid finance charges. Our review of selected travel-related transactions disclosed that the receivership had improved its procedures and that travel costs charged to the corporate credit card were supported by original documentation.[16]

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[15] This amount is $10 per day more than the state's daily $40 reimbursement rate for meals and incidentals.
[16] We did not review any non-travel related charges made to the corporate credit card.

In our February 2008 review, we also noted that in addition to an hourly rate for services and travel time, an independent contractor received reimbursement for actual expenses incurred, plus a per diem amount of $125. This per diem covered meal costs, and it exceeded the $50 a day amount to which the receivership limited its own staff. In our fiscal year 2007–08 review, we confirmed that the receivership revised the terms of its agreement with this contractor effective July 1, 2007, and eliminated the $125 per diem amount. Consequently, in our review of the meal reimbursements submitted by the contractor in June 2008, the amounts claimed did not exceed the $50 daily meal allowance.

Follow-Up on Prior OIG Recommendations

Based on our review of travel and corporate credit card expenses incurred by the receivership during fiscal year 2007–08, for the samples selected, we confirmed that the receivership had implemented our recommendations to ensure that:

- Employees and contractors properly support all travel expense claims with original receipts or invoices and include a description of the business purpose, and verify that the amounts are within established policy limits; and

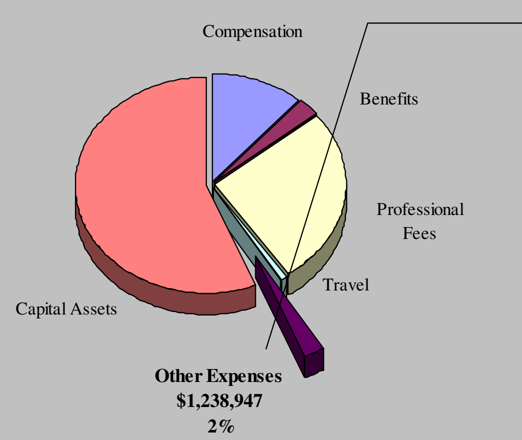
- Employees properly support charges appearing on corporate credit card accounts before paying the bill.

Other Expenses

Other expenses include all of the remaining expenses incurred by the receivership. As indicated in Figure 6, a wide range of items is included in this category, which totaled $1,238,947. This amount accounted for 2 percent of the receivership's expenditures for fiscal year 2007–08.

Figure 6

California Prison Health Care Receivership
Other Expenses
Fiscal Year 2007–08



Other Expenses	Amount
• Advertising	$480,934
• Rent or Lease	230,258
• Office Expenses	111,388
• Telephone/ Network Lines	109,071
• Conferences/ Seminars	88,795
• Insurance	86,516
• Leasing – Modulars	57,181
• Minor Equipment	25,690
• Employee Development	22,044
• Miscellaneous	16,033
• Dues and Subscriptions	11,037
Total	**$1,238,947**

The largest item in this cost category was advertising expenses associated with recruiting medical professionals. The receivership contracted with the Bernard Hodes Group for a project called the "Marketing and Recruitment Campaign for CDCR Health Care Professionals." The purpose of the project was for the contractor to develop a recruitment campaign targeted to fill 90 percent of all physician vacancies in the department's adult correctional institutions. The receivership spent $480,934 on advertising during fiscal year 2007–08, of which all but $1,989 was paid to the Bernard Hodes Group.

Another significant cost incurred by the receivership was for lease expenses. During fiscal year 2007–08, the receivership spent $230,258 on leases. Most of the expenses were related to the receivership's San Jose office. The receivership moved from San Jose to Sacramento, but it remained liable for a five-year non-cancelable lease obligation for the San Jose office. On July 9, 2008, the receivership signed a sub-lease agreement to cover the remaining liability period. However, while the receivership's monthly lease obligation totaled $18,488, the sub-tenant agreed to pay the receivership $17,146 per month. The receivership continues to pay the remaining amount of $1,342 per month. In May 2008, the receivership began renting an office in Campbell, near San Jose. The controller and an accountant use this office and retain records there. The receivership spent $3,368 on lease and storage unit expenses over the remaining two months of the fiscal year, and it has a lease obligation of $1,100 per month through October 31, 2009.

The receivership also spent $88,795 on conferences and seminars attended by its employees. Included in this cost was $53,750 in registration fees for 43 participants attending a "Foundation for Leadership Excellence" seminar provided by the Association of California Nurse Leaders. The receivership also paid $10,050 for six participants to attend an "Engaging with Physicians in a Shared Quality Agenda" conference provided by the Institute for Healthcare Improvement.

Finally, the receivership paid $20,000 to the Bernard Hodes Group for two one-day human resources seminars and paid another $2,044 to other vendors for employee development classes and books.

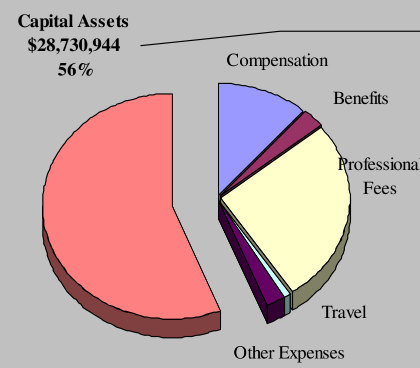
Recommendation

To ensure the receivership operates in the most cost-effective way possible, we recommend that the Receiver consolidate operations in Sacramento by closing the Campbell office no later than that office's lease expiration date of October 31, 2009.

Capital Assets

Figure 7

California Prison Health Care Receivership
Capital Assets
Fiscal Year 2007–08



Capital Assets Receiver Held for the Department	Amount
• Construction/Capital Projects	18,324,021
• Building and Improvements	6,150,844
• Information Systems	4,002,836
Total	**$28,477,701**
Receiver Capital Assets	**Amount**
• Furniture & Fixtures	129,625
• Computer Equipment	123,618
Total	**$253,243**

During fiscal year 2007–08, the receivership spent $28.7 million on capital assets, as shown in Figure 7. Capital assets—sometimes called fixed assets—are assets the receivership purchases to carry out its responsibilities over a long period, such as buildings, office equipment, and information systems. The receivership capitalizes asset purchases exceeding $1,000 and depreciates the cost over the assets' useful lives. For this report, we present the actual amount the receivership spent on capital assets and projects in progress between July 1, 2007 and June 30, 2008. The receivership's acquisition of capital assets during this period accounted for 56 percent of its expenditures. The receivership includes in this expense category two subcategories: assets held for the department and assets held for receivership use. Since the receivership's inception in April 2006, the total value of capital assets acquired as of June 30, 2008 (net of accumulated depreciation), is $36,986,630. Of this amount, $36,433,772 is held on behalf of the department and $552,858 is held for receivership operations.

Most of the receivership's capital asset costs were for construction and capital projects in progress.

Of the receivership's $28.7 million in capital asset purchases, it spent $28.4 million for the direct benefit of a particular prison or for all the department's institutions. More than half of the capital asset costs made on behalf of the department occurred for construction and capital project costs. This cost amounted to $18,324,021 during the fiscal year. The following are the two largest projects in this category of expenditures:

- $9,817,982 to URS/BLL (a joint venture with URS Corporation and Bovis Lend Lease) for program management and other services. Specifically, the agreement called for URS/BLL to provide consulting services "in connection with the evaluation and assessment of the condition of existing CDCR health care facilities, the need for renovation, improvement, replacement or expansion of these facilities, and management of design, construction, and commissioning of any related projects"; and

- $2,929,505 to JL Modular, Inc., for work completed on the "San Quentin State Prison, Modular Health Services Building at Upper Yard" project, which is a temporary health and administrative space to be used until the new Central Health Services Center can be completed.

The receivership spent $6.2 million on building and improvement costs.

Building and improvement costs are additions or structures that enhance a property, or replacements or upgrades that extend the useful life of an asset that has been placed into service. The receivership paid $6,150,844 for building and improvement costs during fiscal year 2007–08. Examples of these expenditures include the following:

- $2,112,442 to River View Construction to construct 13 exercise yards, which are individual fenced enclosures within San Quentin State Prison's Carson Yard. Among other things, this project also included the installation of plumbing for underground water and utilities, and a 12-foot perimeter security fence around the site. This work made room in San Quentin's Upper Yard for construction of temporary clinical offices and examination areas;

- $1,143,962 to American Custom Coach, Inc., to fabricate and deliver six mobile clinics (medical trailers) to Avenal State Prison. The medical trailers each have a reception area, a restroom, and two exam rooms. Costs for the project also include work related to electrical, cooling/heating, cabinetry/furniture, lighting, plumbing systems, and other incidental equipment; and

- $321,175 to Ghilotti Bros., Inc., to upsize the sewer lift station pumps located near Tower 1 at San Quentin State Prison, and replace two lift station pumps, upgrade electrical services and pump controls, and exchange smaller pipes and valves with larger ones.

Information systems equipment and software was another large capital outlay area.

The receivership spent $4 million for information systems equipment and software on behalf of the department during the fiscal year. We reviewed a payment for the annual renewal and maintenance fees for the Health Care Document Management System (HCDMS), which is an electronic medical contract and invoice processing system. We also reviewed a payment for the purchase and installation of hardware and software related to the Clinical Data Repository and Portal Solution, which is an enterprise master patient index and portal solution for all department facilities. Examples of payments the receivership made include the following:

- $843,655 to Unisys for work on the HCDMS, including $531,350 for an annual renewal of software maintenance and support for software procured under the original contract; and

- $3,086,064 to IBM for the purchase and installation at two locations of hardware and software, related to the Clinical Data Repository and Portal Solution.

The receivership spent $253,243 on furniture and fixtures and computer hardware and software.

Historically, capital asset acquisitions the receivership made for its use included leasehold improvements, furniture and fixtures, office equipment including a comprehensive telephone system, and computer hardware and software. During fiscal year 2007–08, the receivership spent $253,243 to furnish its Sacramento office and to set up computer hardware and software for its employees working there. Of that amount, the receivership paid $129,625 for office furniture and fixtures, and $123,618 for computer hardware and software.

Response from the California Prison Health Care Receivership Corporation

June 26, 2009

Mr. David R. Shaw
Inspector General
Office of the Inspector General
P.O. Box 348780
Sacramento, CA 95834-8780

Dear Mr. Shaw:

My staff and I have reviewed the Office of the Inspector General (OIG) draft report entitled, *California Prison Health Care Receivership, Use of State Funds for Fiscal Year 2007-08*. We would like to thank you and your staff for preparing the review. It will be invaluable to us in our ongoing effort to ensure transparency and accountability in managing California Prison Health Care Receivership (CPR) operations.

I am very pleased that your report noted that you found no instances of fraud, waste, or abuse. I am also pleased that your report includes sections that demonstrate our follow-up on recommendations from your prior review.

We concur with your recommendation to move cash from the private banking system into the state treasury system to increase interest earned and eliminate the concern with minimal deposit insurance. In fact, my staff has been working with the Department of Finance and the State Controller's Office, and a special deposit fund was created in April 2009. By the end of June 2009, the Receiver's office will be transferring the expected fiscal year-end balance, approximately $10 million, from the private banking system into this fund. This will allow the transfer of smaller replenishments out of the special deposit fund for monthly expenditures and will provide the state with earned interest, as recommended by the OIG.

We concur in part with your recommendation that we consolidate Receivership operations in Sacramento and close the Campbell office no later than October 31, 2009. While we do intend to consolidate our operations in Sacramento, and close the office in Campbell, we need to accomplish the transition in an orderly and efficient manner. We will explore options that will allow us to maintain essential functions without having to bear the expense of the separate office.

Lastly, in your report you noted that the number of CPR employees had been reduced from 40 to 22, with eight receiving salaries that were more than those of the Department of Corrections and Rehabilitation Secretary and the Receiver. We have continued our effort to reduce CPR staff and, as of now, that number is down to four full- and one part-time employee, none of whom have salaries above the Secretary and the Receiver. By September of this year, we expect to have only two full- and one part-time CPR employees.

I very much appreciate the opportunity to provide these comments on the draft report. Thanks again to you and your staff for all of their hard work in putting it together.

Sincerely,

J. Clark Kelso
Receiver

cc: Honorable Thelton E. Henderson
Elaine Bush, Chief Deputy Receiver, California Prison Health Care Services