CALIFORNIA PRISON HEALTH CARE RECEIVERSHIP CORPORATION USE OF STATE FUNDS FOR FISCAL YEAR 2009-2010

OFFICE OF THE INSPECTOR GENERAL

STATE OF CALIFORNIA

APRIL 2011

April 27, 2011

J. Clark Kelso, Receiver
California Prison Health Care Receivership Corporation
501 J Street, Suite 100
Sacramento, California 95814

Dear Mr. Kelso:

Enclosed is our fourth annual report on the California Prison Health Care Receivership Corporation's (corporation) expenditures for fiscal year 2009–2010.

During the year, the corporation spent $12.4 million for its operating costs and long-term capital assets. This amount represents less than 1 percent of the $1.5 billion spent in fiscal year 2009–2010 to provide medical care to the California Department of Corrections and Rehabilitation's adult inmate population. We noted in the report that the total corporation expenditures decreased by $78.8 million, from $91.2 million in fiscal year 2008-2009 to $12.4 million in fiscal year 2009-2010. The decrease was attributable to a significant decline in capital asset and operational expenditures.

Of the $12.4 million the corporation spent, $9.3 million was for capital asset final construction costs to improve medical facilities at the Avenal and San Quentin State Prisons. The corporation also paid $2.0 million in professional fees, which included $1.6 million for legal services and the receiver's compensation.

Finally, our review disclosed that the corporation implemented corrective action to address recommendations we made in our prior report. Specifically, we found that the corporation initiated the transfer of capital assets for the Avenal and San Quentin projects to CDCR.

Thank you for the cooperation and responsiveness of your employees. If you have any questions, please call Bill Shepherd, Deputy Inspector General, In-Charge, Bureau of Audits, at (916) 830-3621.

Sincerely,

BRUCE A. MONFROSS
Inspector General (A)

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

Enclosure

Contents

Executive Summary

In October 2005, as a result of the lawsuit known as *Plata v. Schwarzenegger*, the U.S. District Court for the Northern District of California found that the California Department of Corrections and Rehabilitation's (CDCR) delivery of medical care to inmates did not meet federal constitutional standards. The court therefore appointed a receiver, currently J. Clark Kelso, with broad powers over CDCR's medical care efforts. The court suspended the CDCR secretary's authority over California's prison medical system and granted this power to the receiver. In turn, the receiver established the California Prison Health Care Receivership Corporation (corporation) as the vehicle through which the receiver exercises his authority and ordered the state to pay all costs that the receiver incurs in carrying out his responsibilities.

Pursuant to the federal court's order establishing the receivership, the Office of the Inspector General (OIG) entered into an agreement with the receiver to perform periodic reviews of the corporation's use of state funds for its administrative operations. This report is OIG's fourth annual report describing those expenditures. Our reviews provide transparency and accountability for the corporation's operation. However, consistent with the court's intent and direction, the scope of these reviews is limited to the corporation's administrative expenditures. As a result, the OIG reviews do not include a review of expenditures for direct medical care delivery. Although these reports involve less detailed testing than a typical financial audit, we will nevertheless report any instances of fraud, waste, or abuse that we identify.

The receiver is responsible for managing all medical programs and their support costs, including those costs incurred by CDCR and those incurred for the corporation's operations.[1] The receiver refers to this combined effort, which spent $1.5 billion on adult inmate medical care in fiscal year 2009-2010, as California Prison Health Care Services (CPHCS). The present review for fiscal year 2009-2010 covers only the $12.4 million portion of the $1.5 billion in state funds spent on corporation operations.

Table 1 presents the details of the corporation's fiscal year 2009-2010 expenditures in the four major expense categories detailed in this report. The corporation spent the majority of the $12.4 million in expenditures on final construction costs at two prisons and on legal professional fees. The remaining portion was spent on more

Table 1
California Prison Health Care Receivership Corporation
Total Expenditures, by Category and Percentage
Fiscal Year 2009-2010 (unaudited data)

Category	(In millions)	%
Capital Assets	$ 9.3	75%
Professional Fees	2.0	16
Compensation & Benefits	0.8	7
Other Expenses	0.3	2
Total Expenditures	**$ 12.4**	**100%**

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

typical administrative costs, such as rent or lease payments and employee salaries, wages, and benefits.

Key observations made during our review of these expenditure categories include the following:

- Total corporation expenditures decreased by $78.8 million, from $91.2 million in fiscal year 2008-2009 to $12.4 million in fiscal year 2009-2010. The decrease was attributable to a significant decline in capital asset and operational expenditures.

- Most of the corporation's $9.3 million in capital asset expenditures were for final construction costs to improve medical facilities at Avenal State Prison (Avenal) and San Quentin State Prison (San Quentin). The clinics at Avenal were fully operational as of February 2010, and the Central Health Services Building at San Quentin was opened for inmate services in December 2009.
- The corporation contracted out those legal services for which it did not have in-house expertise. The corporation paid $1.6 million of the $2.0 million in professional fees to various law firms.

- The receiver's compensation is reported as part of professional fees.

Following up on recommendations presented in our earlier report regarding capital assets, we found that the corporation initiated corrective action during the last quarter of 2010, subsequent to our review period, which ended on June 30, 2010. Specifically, CPHCS requested the transfer of capital assets for the San Quentin project to CDCR on October 28, 2010, and for the Avenal project on December 1, 2010. The actual transfer date of these assets is contingent on the processing of the transfer requests by the CDCR accounting office and subsequently by the Department of General Services.

Most of the funding for the capital assets came from sources outside of the corporation's operational expenditures. When we asked for schedules or other details supporting the asset valuations, we found that the corporation has not yet prepared a full accounting or reconciliation of the sources and uses of funds related to these completed capital asset projects. For transparency and accountability of the corporation's operating transactions, we recommend that CPHCS prepare reconciliations for the San Quentin and Avenal projects as well as for all future construction projects. The reconciliations for the completed projects can then be reviewed by the corporation's public accounting firm and by our inspectors during the next fiscal year review period.

California Prison Health Care Receivership Corporation's Response

The corporation concurred with the OIG report.

Introduction

Background

The court appointed a receiver to correct the state's failure to provide the constitutionally required level of inmate medical care

In April 2001, California inmates 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 appointed a receiver to control the delivery of medical services to inmates in California prisons. In its October 2005 order, the court made the following declaration:

> *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.*
>
> *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]

The court gave the receiver broad powers over prison medical care

The court suspended the CDCR secretary's exercise of power related to the administration, control, management, operation, and financing of the California prison medical health care system and granted these powers to the receiver, currently J. Clark Kelso. 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 receiver established the California Prison Health Care Receivership Corporation (corporation) as the vehicle through which the receiver exercises his authority and granted to the receiver unlimited access to all records, files, and facilities maintained by CDCR, as well as access to prisoners and CDCR staff. The court also ordered the state to

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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.

pay all costs that the corporation incurs in carrying out its responsibilities under the order and established the following duties for the receiver:

- Provide leadership and executive management of California's prison medical care delivery system. The receiver shall have the duty to control, oversee, supervise, and direct all administrative, personnel, financial, accounting, contractual, legal, and other operational functions of the medical delivery component of CDCR.

- 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 status reports addressing the corporation's progress, 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 clearly prevents the receiver from developing or implementing a constitutionally adequate medical health care system, the court stipulates that the receiver shall ask the court to waive the state or contractual requirement causing the impediment.

The CPHCS collaborates with CDCR on the planned construction and CDCR breaks ground at the California Health Care Facility in Stockton

As noted in the receiver's thirteenth triannual report, dated January 15, 2010, collaboration between the receiver's office and CDCR resulted in scaled back construction plans more consistent with available resources from the state.[4] The revised plan calls for the construction of one new facility with approximately 1,600 medical and mental health care beds, the conversion of three juvenile justice facilities to hold approximately 3,200 inmates with medical and mental health conditions, and the allocation of $700 million for improvements to existing facilities.

To carry out the new construction plan, the receiver and the CDCR secretary approved construction of a new 1,722-bed health care facility in Stockton, California. This project involves the demolition and re-use of the former Karl Holton youth correctional site.

[4] The receiver issues a report to the court three times each year to provide status updates on the progress made in fulfilling its Turnaround Plan of Action. Objective 6.2 of the Turnaround Plan is to "[e]xpand administrative, clinical and housing facilities to serve up to 10,000 patient-inmates with medical and/or mental health needs."

Project construction costs will be administered and funded through CDCR and not through the corporation's administrative operations.

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

The California Prison Health Care Receivership Corporation, referred to in this report as the corporation, is a private non-profit public benefit corporation established by the first receiver to house his offices and executive staff. The second receiver substantially reduced the role of the receivership, which now maintains no offices of its own and currently employs only seven employees who are embedded within CDCR. The corporation continues to hold several contracts related to the receiver's remedial plans. However, the second receiver currently operates his executive, administrative, and patient care operations primarily through a subdivision of the CDCR known as the California Prison Health Care Services (CPHCS), which is not the subject of this review.

The Office of the Inspector General agreed to complete periodic reviews of the corporation'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 CPHCS' medical operations and by the corporation's operations. To ensure the transparency and accountability of the corporation's operations, the court required the corporation to coordinate with OIG to facilitate periodic reviews of its administrative operations. To carry out this responsibility, we agreed with the receiver to periodically review the corporation's expenditures—which amounted to $12.4 million for fiscal year 2009-2010—and to produce a public report for the court that describes how the corporation uses state funds. We will perform similar reviews annually until the court terminates the corporation. This is our fourth annual report.

Objectives, Scope, and Methodology

Our agreement with the receiver calls for OIG to issue a public report periodically that describes how the corporation uses state funds. Consistent with the federal court's intent, these reports cover only that portion of state funds spent directly by the corporation for its administrative operations; they do not cover the portion of state funds that CPHCS spends under the receiver's authority. Also, we inquired about certain events that took place subsequent to our fiscal year 2009-2010 review period because these events affected transactions that took place during the year under our review.

Specifically, during the current review period ending June 30, 2010, CPHCS completed its medical facility construction projects at Avenal and San Quentin. However, the scope of our review is limited to the funds and expenditures reported on the California Prison Health Care Receivership Corporation's financial statements.[5] Therefore, only a small part of the funding and expenditures for these CPHCS construction projects was subject to our review. Although 75 percent of the corporation's administrative operating funds were spent on medical facility construction projects, that amount represented only a small portion of the total cost to construct the facilities. Accordingly, we obtained an understanding of the primary funding sources, which included the state's General Fund, lease-purchase financing authorized by AB 900,[6] and a loan from the Pooled Money Investment Fund authorized by SB 99.[7] Furthermore, we inquired about the capital asset transfer process related to the completion of those facilities, even though the corporation initiated the transfer after our review period ending June 30, 2010, but during the course of our fieldwork.

This fourth review covers the corporation's expenditures for fiscal year 2009-2010. In conducting this review, we performed the following procedures:

- We updated our understanding of the nature and scope of the corporation's operations. This included identifying changes in organizational structure, personnel, professional fees, and capital outlay. We also interviewed key corporation and CPHCS employees.

- We quantified and verified the amount of state funds that CPHCS transferred to the corporation during fiscal year 2009-2010.

- We quantified CPHCS' total fiscal year 2009-2010 expenditures for the delivery of medical care to adult inmates and calculated the corporation's portion of those costs.

- We traced sample transactions from each major expenditure category to accounting source documents. We tested expenditures for program approval, accuracy, and completeness. We did not assess the value of the goods or services for which the corporation expended the funds.

- We conducted follow-up testing to determine whether the corporation had undertaken corrective action regarding OIG comments and recommendations from the preceding year's review. Specifically, we verified the transfer of unused funds into a state treasury special deposit account in July 2009,

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[5] A separate financial statement audit of the corporation is conducted annually by a public accounting firm.

[6] Chapter 7 of the Statutes of 2007 (AB 900) authorized the financing and construction of state prison facilities by CDCR using lease-purchase financing arrangements by means of the issuance of state revenue bonds.

[7] Chapter 245 of the Statutes of 2007 (SB 99) authorized the financing and construction of state prison facilities by CDCR using lease-purchase financing arrangements by means of the issuance of state revenue bonds. SB 99 also permitted CDCR to borrow funds for project costs from the Pooled Money Investment Account.

verified the closure of the Campbell office on October 31, 2009, and inquired about the corporation's controls over capital assets, including its procedures to transfer assets back to CDCR.

- We contacted the public accounting firm that audited the corporation's financial statements for fiscal year 2009-2010. Because the firm had not issued its audit report at the time we completed our fieldwork, we relied on the corporation's unaudited financial statement records to conduct this review. However, the public accounting firm later issued its report in February 2011; and, as a result of its audit, recommended that the corporation make two adjustments to its financial statement records. We noted those adjustments in respective areas of this report. Also, the public accounting firm told us it did not become aware of any instances of fraud, waste, or abuse during its audit of the corporation's financial statements for the period July 1, 2009, through June 30, 2010. Similarly, within the scope of our limited review, we did not become aware of any instances of fraud, waste, or abuse.

Review Results

Under the direction and authority of the federally appointed receiver, the state spent $1.5 billion during fiscal year 2009-2010 to provide medical services to its adult inmate population. The California Prison Health Care Services (CPHCS) expended 99 percent of these funds, and the California Prison Health Care Receivership Corporation (corporation) spent the remaining 1 percent, or $12.4 million. Of the $12.4 million, the corporation spent $9.3 million for capital assets, which primarily funded a small portion of the final construction costs to improve medical facilities at San Quentin State Prison and Avenal State Prison. The corporation spent the remaining $3.1 million in three general categories: professional fees, compensation and benefits, and other expenses. In this report, we describe how the corporation received, managed, and used the $12.4 million in state funds through its corporation.

Source of Funds

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

The corporation established a special deposit fund account

The corporation previously maintained high cash balances in numerous banking institutions that exceeded Federal Deposit Insurance Corporation[8] insurance levels. To avoid the risk of losing part or most of those funds through a bank failure and to conserve the state's cash, we recommended that the receiver work with the appropriate state offices to establish a cash management process that minimizes the amount of cash that the corporation holds outside the state treasury. In April 2009, the corporation obtained authorization to establish a special deposit fund account on a temporary basis through April 2011. In July 2009, the corporation transferred $10 million into the special deposit fund within the state treasury. Accordingly, the corporation has minimized the risk of losing funds through a bank failure and maintained minimal balances throughout fiscal year 2009-2010.

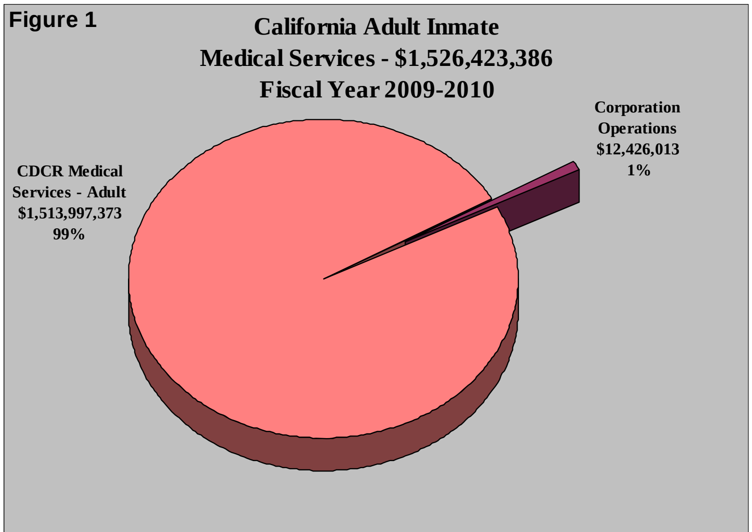
With the establishment of the special deposit fund, the corporation no longer received large quarterly transfers of state funds for operations. During fiscal year 2009-2010, the corporation requested monthly transfers to cover its monthly operating expenditures.

[8] Effective October 3, 2008, through December 31, 2013, the FDIC temporarily raised the federal deposit insurance coverage to $250,000.

Use of Funds

As shown in Figure 1, CPHCS and the corporation spent $1.5 billion for adult inmate medical services during fiscal year 2009-2010. Over 99 percent of those funds were spent for activities undertaken by CPHCS under the corporation's authority. The corporation spent less than one percent of the $1.5 billion, or $12.4 million, to support its operations and to pay for the construction and program management of capital assets.

Figure 1



Source: California Prison Health Care Services

To carry out its court-ordered mandate, the corporation hires employees, executes contracts, and otherwise incurs costs of doing business. Of the $12.4 million spent by the corporation, $3.1 million went for its operating costs, most of which were for professional services provided by consultants and for personnel services related to salaries and benefits for the corporation's employees. The corporation spent the remaining $9.3 million for final construction costs to improve medical facilities at San Quentin State Prison and Avenal State Prison.

As shown in Table 2, the corporation spent 86 percent less than in the previous fiscal year. Operating expenses decreased by 84 percent primarily due to the decrease in professional fees. Further, capital asset activity declined by 87 percent primarily because the corporation completed construction projects at two prisons and has now moved to the final phase of transferring the related assets to CDCR.

Table 2
How the Corporation Used State Funds, Two-Year Comparison

Description	FY 2009–2010 Amount	FY 2008-2009 Amount	% Increase (Decrease)
Professional Fees	$2,045,232	$12,399,903	(84)%
Salaries, Wages & Benefits	832,691	4,504,415	(82)
Other Expenses	77,893	1,619,866	(95)
Insurance	60,942	67,956	(10)
Office Expenses	45,570	77,593	(41)
Rent and Lease	37,902	93,930	(60)
Travel	16,137	278,987	(94)
Telephone & Network Lines	11,375	59,356	(81)
Total Operating Expenses	***$3,127,742***	***$19,102,006***	***(84)%***
Total Capital Asset Expenses	***$9,298,271***	***$72,096,479***	***(87)%***
Total Expenses	***$12,426,013***	***$91,198,485***	***(86)%***

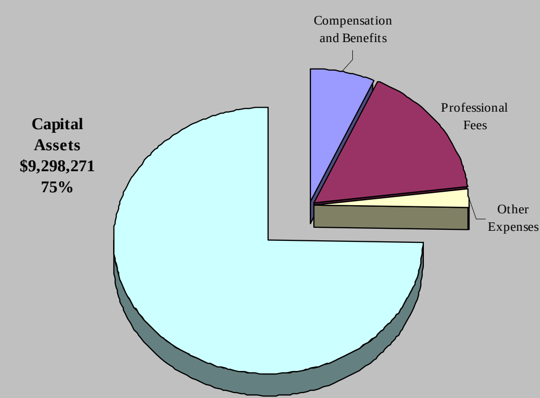
In the following sections, we present in detail how the corporation spent the $12.4 million on operating costs in fiscal year 2009-2010.

Capital Assets

During fiscal year 2009–2010, the corporation spent \$9.3 million[9] on capital asset expenditures, as shown in Figure 2. Capital assets, sometimes called fixed assets, are assets that the corporation purchases to carry out its responsibilities. Capital assets include items such as buildings, office equipment, and information systems. The corporation capitalizes asset purchases exceeding \$1,000 and depreciates the cost over the useful life of the asset.

Figure 2

California Prison Health Care Receivership Corporation
Capital Assets
Fiscal Year 2009-2010



Source: Corporation unaudited financial statements

For this report, we present the amount that the corporation spent on capital assets and projects that were in progress between July 1, 2009, and June 30, 2010. The corporation's capital asset costs during this period accounted for 75 percent of its total expenditures. The corporation includes in its capital asset category two subcategories: assets held for CDCR and assets held for the corporation.

The corporation's capital asset expenditures paid for a portion of final construction costs at Avenal State Prison and San Quentin State Prison

Of its \$9.3 million in capital asset expenditures, the corporation spent the majority of funds (\$8.3 million) on the final construction of health services clinics and the administration building at Avenal State Prison. The remaining expenditures were primarily used to complete various capital improvements at San Quentin State Prison. As we explained in the Objectives, Scope, and Methodology section of this report, the corporation's operational funding represented only a small portion of the CPHCS' total funding of those projects.

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[9] In accordance with generally accepted accounting principles (GAAP), the audited financial statements included an accounting transaction adjustment that effectively increased the corporation's revenue and capital outlay expenditures by approximately \$320,000. The original transaction related to CDCR's payment of a vendor's final retention payment on a contract. The original contract was negotiated by the corporation.

For fiscal year 2009-2010, we sampled several capital asset expense transactions from the total amount paid to the following two vendors for construction projects at Avenal State Prison.

- $8,307,169 was paid to JL Modular, Inc. to complete construction of modular health services clinics and administration buildings at Avenal State Prison. JL Modular was originally contracted in 2008 as the design-builder for the project. The work completed includes three yard clinics to provide medical and mental health treatment space, an administrative segregation clinic, and a healthcare administration building to provide support for healthcare access and administration. The upgraded Avenal clinics became fully operational in February 2010.

- $712,229 was paid to Vanir Construction Management, Inc. for construction phase management services for the health care facility capital improvement program at Avenal State Prison. Vanir was originally contracted in 2007 to develop conceptual design packages for projects being initiated at ten different prisons including Avenal State Prison. The contract was subsequently amended for Vanir to act as the Avenal project manager during the project's design and construction phases. The final phase of the project required that Vanir provide construction-phase management, implement transition and occupancy plans, and conduct a post-occupancy evaluation. The Vanir payments included both labor and non-labor costs. Non-labor costs that we examined included reimbursements for travel costs, office supplies, cell phone and car rentals.

The corporation initiated the transfer of San Quentin and Avenal assets to CDCR

In multiple court orders, the court has reiterated that the receiver's task is to establish a constitutionally adequate health care system for California's prisons that will ultimately be transferred back to state control. Because CPHCS completed its various construction projects for medical facilities at the San Quentin and Avenal prisons during fiscal years 2008-2009 and 2009-2010, the corporation initiated the transfer of the related capital assets to CDCR during the last quarter of 2010 — after our review period ending June 30, 2010. As we noted earlier in this report, the majority of the state's funding for the San Quentin and Avenal projects came from lease-purchase financing authorized by AB 900 and a loan from the Pooled Money Investment Fund. Therefore, the corporation's operational funding, which is the focus of our review, represented only a small portion of the total costs for constructing and completing the projects.

As shown in Table 3 below, the receiver's use of operating funds to acquire capital assets increased progressively from $8.8 million in fiscal year 2006-2007 to $72.1 million in fiscal year 2008-2009, accounting for 79 percent of the corporation's total expenditures that year. But for the first time in four years, capital asset expenditures decreased in fiscal year 2009-2010, to $9.3 million. Capital asset expenditures, however, still represent 75 percent of total corporation expenditures for fiscal year 2009-2010.

Table 3 **Corporation's Total Capital Asset Spending Comparison**

Description	**FY 2006–2007**	**FY 2007–2008**	**FY 2008-2009**	**FY 2009-2010**
Total Capital Asset Costs	***$8,766,710***	***$28,730,944***	***$72,096,479***	***$9.298,271***
Total Expenditures	***$20,161,490***	***$51,191,026***	***$91,198,485***	***$12,426,013***
Percentage of Total Capital Asset Spending	***43%***	***56%***	***79%***	***75%***

Capital asset projects for health care facilities at San Quentin and Avenal were completed during fiscal year 2009-2010. Consequently, the accounting and reporting of those assets were required to be transferred from the corporation's books to CDCR and then to the Department of General Services' (DGS) State Property Inventory. As reported to us by corporation staff and reflected in OIG's report of the preceding year, issued in June 2010, the corporation planned to establish procedures to transfer all completed capital asset projects to CDCR. Accordingly, during our current-year review, we inquired about the status of the capital asset transfers and asked to review the process documentation used to determine the capital asset valuations.

We reviewed the memorandums sent from a CPHCS manager to a CDCR associate director of accounting services. These memorandums requested that CDCR process attached data entry forms to complete the asset transfer of the San Quentin and Avenal projects from the corporation to CDCR. The memorandums were dated October 28, 2010, and December 1, 2010, respectively. Although the corporation initiated the transfer of the capital assets during the last quarter of calendar year 2010, the actual transfer date is contingent upon the processing of the transfer requests first by CDCR's accounting office and then by DGS.

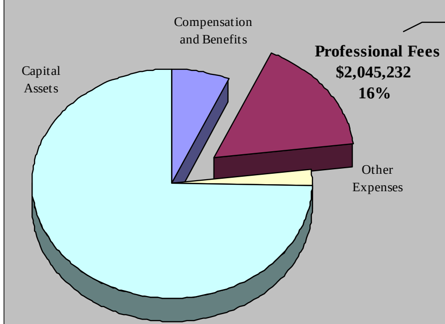
The asset transfer of the San Quentin and Avenal projects was initiated after our review period, which ended June 30, 2010. To provide transparency and accountability for the corporation's operations, we recommend that CPHCS prepare formal documentation clearly identifying the sources and uses of funds, including both corporation funds and funds provided by other sources for the completed San Quentin and Avenal projects. This accounting of the San Quentin and Avenal projects should then be reviewed by the corporation's independent public accounting firm, and by our inspectors, during the fiscal year 2010-2011 review period.

Professional Fees

To carry out its duties, the corporation enters into contracts for the services of certain professionals. As shown in Figure 3, the corporation spent $2,045,232 on professional fees during fiscal year 2009-2010. The payments were for various legal, consulting, auditing, and other professional services for which the corporation did not have in-house expertise. The $2 million for professional fees represents 16 percent of the corporation's expenditures for fiscal year 2009-2010.

Figure 3

California Prison Health Care Receivership Corporation
Professional Fees
Fiscal Year 2009–2010



Professional Fees	Amount
• Legal & Professional Services	$ 1,643,023
• Other Professional Fees	395,669
• HR Consulting Services	6,060
• IT Consulting Services	480
Total	**$ 2,045,232**

Source: Corporation unaudited financial statements

The corporation spent $1,643,023 on legal and professional services during the year

The corporation contracted for legal services for which it did not have in-house expertise. Examples of legal services paid include the following:

- $571,337 to McDonough Holland & Allen for providing legal services regarding construction issues at various proposed sites. Hourly rates for paralegals and attorneys ranged from $175 to $350.

- $419,906 to Futterman Dupree Dodd Croley Maier, LLP, for providing general legal services including representation in federal corporation proceedings involving the California prison health care system, *habeas corpus* cases, and personnel matters. The hourly rates for attorneys ranged from $225 to $350.

- $264,177 to Morrison & Foerster, LLP, for providing ongoing legal services related to contempt proceedings in the *Plata v. Schwarzenegger* case. The hourly rates for attorneys ranged from $295 to $600.

- $254,571 to The Ochoa & Moore Law Firm for providing community outreach for the Stockton facility construction proposal. According to the corporation's chief counsel, the firm was the liaison with the local Stockton community leadership and was not necessarily hired to handle legal matters. The hourly rate was $300 per hour. The invoice billings also included outside consultant fees billed at $300 per hour.

- The corporation paid $70,000 on behalf of both the receiver and CDCR to the Greater Stockton Chamber of Commerce (chamber) as a settlement for legal fees incurred by the chamber. The settlement included a covenant by the chamber not to sue or bring any actions against CDCR or the receiver resulting from or based on the Environmental Impact Report (EIR) and/or approval of the re-purposed DeWitt Nelson Facility or the Northern California Reentry Facility. The negotiated settlement and previously identified EIR mitigations included approximately $12 million in other fees paid from AB 900 bond funds. The fees have been or are scheduled to be paid by CDCR and are outside the scope of this review.

The corporation spent $395,669 for various other professional fees

The corporation also contracted for professional services in business matters for which it did not have in-house expertise. Examples of other professional fees included audit and consulting services, including the reimbursement of the receiver's services.[10] The corporation reimburses the State of California Administrative Office of the Courts (AOC) for the receiver's services (salary and benefits, plus an administrative fee of $1,800 per year). For 2009-2010, payments to the receiver totaled $332,139 of the $395,669, or 84% of the category "other professional fees"; that amount includes a salary of $269,655 and benefits of $62,484 (benefits inclusive of a $1,800 administrative fee).

In January 2008, the court appointed J. Clark Kelso as the receiver. Reimbursement for the receiver's services included supplemental performance-based payment in amounts determined by the court. In January 2009, the judge approved a supplemental performance-based payment of 25 percent of the receiver's base compensation, "based on Mr. Kelso's exceptional leadership and performance under the Turnaround Plan of Action I approved in June 2008." Further, in May 2009, the judge wrote, "my approval of this supplemental payment extends until revoked."

The receiver's salary in the preceding year was $224,000; however, in 2009-2010, the AOC furloughed its employees one day per month for a 4.62 percent reduction in pay, resulting in a net salary of $213,655 paid to the receiver. With the addition of the supplemental performance-based pay of $56,000, the receiver's total salary equaled $269,655.

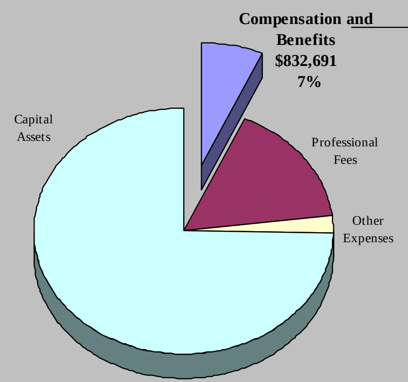
[10] The corporation did not pay the receiver from its payroll system; rather, the receiver is on loan to the corporation from the Administrative Office of the Courts.

Compensation and Benefits

During fiscal year 2009-2010, the corporation incurred $832,691 in compensation and benefits-related expenses amounting to seven percent of the corporation's total expenditures. Employee compensation included salaries and wages, vacation payout, severance pay, and vehicle allowances. Benefits were comprised of the five sub-accounts shown in Figure 4. We included a review account adjustment in Figure 4 of $56,416. The adjustment relates to the total amount of manual checks paid to four employees at the end of the preceding fiscal year; these checks did not clear and post to the corporation's payroll account until the current fiscal year. The amount represents a change in accounting transactions or accounts that should be addressed during a financial audit of the total account balance. Because our work involves less detailed testing than a financial audit, we noted it as an adjustment.

Figure 4

California Prison Health Care Receivership Corporation
Compensation and Benefits
Fiscal Year 2009-2010



Compensation	Amount
• Salaries & Wages	$ 613,224
• Vacation Payout	11,825
• Severance Pay	114,583
• Vehicle Allowance	12,000
Total Compensation	**$ 751,632**
Benefits	**Amount**
• 401(k) Contributions	54,593
• Medical, Dental & Life	47,669
• Payroll Taxes	45,440
• Workers' Compensation	5,220
• Compensated Absences	(15,447)
Total Benefits	**$ 137,475**
Review Account Adjustment	(56,416)
Total	**$ 832,691**

Source: Corporation unaudited financial statements

From July 2009 through June 2010, in addition to the receiver, the corporation employed up to seven people, three executives and four non-executives, to whom it paid either a salary or an hourly rate. Of the seven employees who remained on payroll at July 1, 2009, three ended their employment with the corporation as of September 30, 2009, leaving only two executives and two non-executives. However, the receiver later rehired two Custody Support Services Specialists on a part-time hourly basis, effective October 1, 2009, and March 1, 2010, respectively. Both specialists had been employed with the corporation during the preceding fiscal year. At the fiscal year ending June 30, 2010, the corporation had six employees.

After our review period ending June 30, 2010, the corporation rehired another employee who had previously worked for CPHCS and changed the employment terms of two existing employees as follows:

- On July 8, 2010, the receiver hired a full-time, exempt employee with no benefits. Immediately prior to employment with the corporation, the individual was a full-time state employee working with CPHCS. The CPHCS organization chart listed the individual as the Corrections Services Executive both before and after the change in employment terms.

- On August 1, 2010, the corporation changed the employment terms for two existing employees from hourly part-time employees to exempt, temporary, full-time salaried employees. Their pay rate changed from $75 per hour to an annual salary of $130,000, with no benefits. However, both employees receive standard non-executive vacation, holidays, and sick leave (24 vacation days, 12 sick days, and all official holidays recognized by the State of California). According to their Personnel Action Notices, their employment with the corporation is expected to last no longer than the activation date of the health care facilities under construction by CDCR.

During the fiscal year, a severance payment was paid to an executive employee that separated in the preceding year. The employee received a severance payment totaling five months of their salary, or $114,583. Executive employees had severance clauses in their employment agreements approved by the previous receiver. The severance provided is not intended to be compensation for past or future services but to “assist Employee to transition to other opportunities, to protect the [corporation] interests, to preserve the goodwill existing between Employee and the [corporation], and to resolve any and all issues and disputes that may exist arising from or relating to Employee’s employment, and termination of employment, with the [corporation].”

The other three separated employees did not receive severance payments. Specifically, the chief of rehabilitation voluntarily left employment with the receiver; the investigation and discipline coordinator transitioned to state service; and the staff attorney was rehired as a consultant the next day and subsequently paid $22,125 in legal professional fees during the fiscal year.

Table 4 at the end of this section details compensation the corporation paid to each of its employees during our review period. The compensation totaled $751,632. As indicated in the table, employee compensation included a monthly vehicle allowance of $500 paid to two employees, which totaled $12,000 during fiscal year 2009-2010.[11]

The largest benefit expense during the review period was corporation contributions to its employees’ 401(k) retirement plans, which totaled $54,593. The corporation 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 corporation paid $47,669 for medical, dental, and life insurance for its employees electing to receive the benefit from July 2009 through June 2010. The corporation 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

[11] The receiver’s base salary of $224,000 and supplemental performance payments of $56,000 are presented in the Professional Fees section and are not included in this category.

$45,440. The corporation also paid $5,220 for workers' compensation insurance and recognized a liability of $15,447 as of June 30, 2010, for compensated absences.

Compensated absences, or unused vacation pay, is payable upon termination from employment with the corporation. The corporation reduced its reserve for compensated absences by $15,447 based on the current pay rates of its employees as of June 30, 2010.[12]

Table 4 **Total Employee Compensation Paid by the Corporation Fiscal Year 2009–2010**

Employee	Position	Number of Months	Salary & Wages	Vehicle Allowance	Severance Pay	Vacation Payout *	Total Paid
Employees as of July 1, 2009**							
Employee 1 (a)	Director of Construction Oversight	12	$156,990	$6,000	N/A	N/A	$162,990
Employee 2	Chief Counsel	12	150,000	6,000	N/A	N/A	156,000
Employee 3	Controller (Part-Time Hourly)	12	45,852	0	N/A	N/A	45,852
Employee 4	Staff Accountant	12	62,400	0	N/A	N/A	62,400
Employee 5	Chief of Rehabilitation	1.5	18,872	0	N/A	$ 6,769	25,641
Employee 6	Investigation & Discipline Coordinator	2	18,167	0	N/A	5,056	23,223
Employee 7 (b)	Staff Attorney	3	12,000	0	N/A	N/A	12,000
Employee 8 (c)	Chief Medical Information Officer	0	N/A	N/A	$114,583	N/A	114,583
Employees Rehired During the Fiscal Year							
Employee 9 (d)	Custody Support Specialist	9	105,338	0	0	0	105,338
Employee 10 (d)	Custody Support Specialist	4	43,605	0	0	0	43,605
TOTALS			**$613,224**	**$12,000**	**$114,583**	**$11,825**	**$751,632**

a) Employee 1 was the only corporation employee furloughed at the fiscal year start. The furlough comprised of three unpaid days or a 13.85 percent monthly salary reduction.

b) Employee 7's part-time employment ended effective September 30, 2009; however, the employee was rehired the next day as a legal consultant on October 1, 2009. Hourly rate changed from $80 to $100/hour.

c) Employee 8's employment ended effective June 19, 2009; however, the employee's severance payout was not issued until August 2009.

d) Employees 9 and 10 were rehired during the fiscal year as part-time hourly employees paid $75/hour; both were previously employed full-time in fiscal year 2008-09. Effective August 1, 2010, both employees' employment terms changed from hourly employees with no benefits to exempt full-time salaried ($130,000/year) employees with no benefits.

* Vacation payout represents payment for vacation earned but not used as of the employee's separation date.
** Compensation for the receiver, Mr. Kelso, is presented in the professional fees section.

Source: Corporation unaudited financial statements

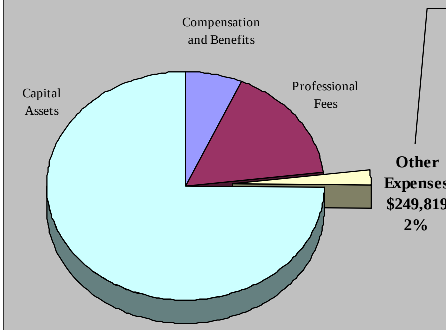
[12] Compensated absences reported in the financial statements do not require the use of current financial resources and are, therefore, not reported as expenditures in the General Fund.

Other Expenses

Other expenses include all of the remaining costs incurred by the corporation. As indicated in Figure 5, a wide range of items is included in this category, which totaled $249,819. This amount accounted for only two percent of the corporation’s expenditures for fiscal year 2009-2010.

Figure 5

California Prison Health Care Receivership Corporation
Other Expenses
Fiscal Year 2009-2010



Other Expenses	Amount
• Leasing - Modular	$ 67,242
• Insurance	60,942
• Office Expenses	45,570
• Rent or Lease	37,902
• Travel	16,137
• Telephone/Network Line	11,375
• Payroll Processing	4,189
• Filing Fees	2,768
• Dues and Subscriptions	2,371
• Miscellaneous	1,323
Total	**$ 249,819**

Source: Corporation unaudited financial statements

Following our recommendations from the preceding year’s review, the receiver continues to reduce rent or lease costs. The receiver closed its Campbell office at the lease’s expiration on October 31, 2009, saving an additional $1,100 per month. Although the corporation remains liable for a five-year non-cancelable lease obligation through July 31, 2011, for its San Jose office, which it had closed in fiscal year 2008-2009, a sub-tenant agreed to pay the corporation $17,146 per month for the remaining liability period. As a result, for fiscal year 2009-2010, the corporation paid net rent expenditures of $29,459 for the San Jose office ($235,215 for rent and related charges offset by $205,756 of rental income). Therefore, rent or lease costs were reduced by approximately 60 percent and amounted to $37,902[13] in fiscal year 2009-2010.

Other variable costs included the leasing of modular buildings, a cost which declined from the preceding fiscal year due to the completion of construction projects. Insurance and office expenses also decreased; but those expenses declined at a lower rate than lease expenses due to the fixed nature of the costs. For example, office expenses include fixed lease fees based on an annual copier contract.

[13] The corporation’s recorded rent or lease expenditures of $37,902 represent the netting of rental income of $205,756 and rental expenditures of $243,658 during fiscal year 2009-2010. However, in accordance with GAAP, the audited financial statements included an accounting transaction adjustment to reflect the rental income and rental expenditures separately.

Response from the California Prison Health Care Receivership Corporation

STATE OF CALIFORNIA | J. Clark Kelso, Receiver

PRISON HEALTH CARE SERVICES

April 22, 2011

Mr. Bruce A. Monfross
Inspector General, Acting
Office of Inspector General
P.O. Box 348780
Sacramento, CA 95834-8780

Re: Response to OIG – Review of CPR's Expenditures for FY 2009-10

Dear Mr. Monfross:

Thank you for the opportunity to review the above draft report from the Office of Inspector General. We appreciate the thoroughness of the review and the acknowledgement that no instances of waste, fraud or abuse were identified. We also concur with the review results and the recommendation. The Receivership will ensure that upon project closeout, finalized reconciliations which include all sources and uses of funds for the Avenal and San Quentin projects will be completed and available for the inspector for the next review.

Again, we would like to thank you and your staff for the valuable review and recommendation.

Sincerely,

J. Clark Kelso
Receiver

cc: Honorable Thelton E. Henderson, Senior District Judge, United States District Court, Northern District of California

P.O. Box 4038 • Sacramento, CA 95812-4038