REPORT BY THE

AUDITOR GENERAL

OF CALIFORNIA

THE STATE OF CALIFORNIA SHOULD FURTHER IMPROVE CONTROLS OVER FINANCIAL OPERATIONS

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Auditor General

March 4, 1987

F-644

Honorable Art Agnos, Chairman
Members, Joint Legislative
Audit Committee
State Capitol, Room 3151
Sacramento, California 95814

Dear Mr. Chairman and Members:

The Office of the Auditor General presents its report concerning weaknesses in the State of California's control of its financial operations. We noted deficiencies during our review and evaluation of the State's internal accounting controls, its internal audit activities, its electronic data processing controls, its compliance with federal grant requirements, and its compliance with state regulations.

The State continues to lose millions of dollars each year because agencies do not promptly identify and collect amounts owed to the State, do not effectively control expenditures, do not manage cash to maximize benefits to the State, and do not maintain sufficient equipment records. In addition, the State's inability to produce financial statements on time remains a problem. The financial statements also are not eligible for the Certificate of Achievement for Excellence in Financial Reporting, awarded by the Government Finance Officers Association. We also noted the failure of many internal audit units to comply with their professional standards, established by the Institute of Internal Auditors, Inc., which precludes external auditors from relying on their work. Because the Office of the Auditor General could not always rely on the work of the internal auditors, the State's audit costs are higher than they should be. Finally, we also found widespread noncompliance with the federal regulations governing the federal grants that the State administers.

Respectfully submitted,

Thomas W. Hayes

THOMAS W. HAYES
Auditor General

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SUMMARY

STATUS OF INTERNAL CONTROLS

The State of California has corrected some of the internal control weaknesses that we have reported in recent years, but numerous weaknesses remain, and the State must further improve its accounting, auditing, and administrative control systems. These systems are essential to ensuring that budgets are not exceeded, that cash and other assets are protected from loss or theft, and that accurate financial information is available to the Governor and the Legislature for financial decisions and to the investment community for investment decisions. Breakdowns in internal control systems identified in this report increase state costs or limit the State's effectiveness in such areas as the collection and depositing of cash, compliance with federal and state requirements, and management of state contracts with private sector firms.

The State's annual financial reports could also be more timely. While major corporations such as IBM, General Motors, and Pacific Gas and Electric are required to issue their annual audited financial reports within 90 days after the close of the fiscal year, the State has repeatedly taken over 200 days. This lack of timeliness automatically disqualifies the State from receiving the prestigious Certificate of Achievement for Excellence in Financial Reporting.

ACTUAL AND POTENTIAL LOSSES

The State lost at least $2.5 million in foregone interest and discounts, will not be able to collect approximately $4.1 million in receivables, and is unlikely to be able to collect an additional $5.1 million in receivables. We base these estimates on the audit work we performed between July 1985 and December 1986, which includes the financial and compliance audit for the 1985-86 fiscal year.

Although the opportunity to recover losses is limited, we have made specific recommendations to help the various agencies improve their internal controls and thus prevent losses in the future.

For fiscal year 1985-86, 30 of the agencies at which we reviewed internal controls had inadequacies in the control systems over financial reporting and revenue and expenditure activities. Amounts that we audited at these agencies were approximately 60 percent of the State's revenues and 63 percent of the State's spending. Further, other independent auditors audited 21 percent of the State's revenue and 10 percent of the State's spending.

FINANCIAL REPORTING

The State continues to be late in issuing annual financial statements. To issue financial statements promptly, the state agencies must perform regular monthly reconciliations of financial records promptly and have more extensive training in several areas related to the preparation of financial reports. In addition, the State Controller's Office, which compiles financial reports submitted by state agencies, must develop a detailed management plan and schedule for its compilation process and use available computers to assist in the compilation.

Other financial reporting problems include the failure to perform critical reconciliations of related accounts or reporting systems, which can result in errors remaining undetected, and the failure to maintain adequate records of fixed assets. As a result of its poor accounting control over billions of dollars in fixed assets, the State is subject to increased risk of loss of assets and is unable to accurately report on general fixed assets in its financial statements. In addition, the State's accounting records and reporting procedures do not fully satisfy the needs of generally accepted accounting principles. Consequently, the State must devote additional resources to convert its financial reports so that they comply with generally accepted accounting principles and are therefore comparable to those of other governmental entities and understandable and acceptable to the investment community.

REVENUE COLLECTION

Seventeen of the agencies we audited had weaknesses in internal controls over revenue activities. These 17 agencies account for approximately 60 percent of the State's revenue. Other independent auditors audited an additional 21 percent of the State's revenue. Problems included the failure to bill for and collect receivables, to deposit receipts promptly, and to follow proper procedures for recognizing revenue earned. These problems resulted in uncollectible receivables, loss of interest revenue, and inaccurate financial reports submitted to the State Controller.

EXPENDITURE CONTROLS

Problems involving internal controls over expenditure activities existed at 25 of the agencies we audited. These 25 agencies accounted for approximately 58 percent of the State's expenditures. Other independent auditors audited an additional 10 percent of the State's spending. The problems included insufficient separation of duties, inadequate control over payroll documents and final payroll disbursements to separating employees, insufficient monitoring and control over revolving fund activity, inadequate adherence to state contracting procedures, and other weaknesses in control over disbursements. Each of these weaknesses in internal control can result in the loss of state funds. For example, the Department of Transportation paid a vendor twice for a $2.1 million invoice. The vendor subsequently returned the duplicate payment. However, the department did not have effective procedures in place to prevent duplicate payments because it relied upon vendors to detect and voluntarily refund duplicate payments.

ELECTRONIC DATA PROCESSING CONTROLS

Of the 12 agencies at which we reviewed electronic data processing activities, 6 had internal control weaknesses, including inadequate separation of duties, insufficient system and security documentation, and improper control over input and output. Failure to control electronic data processing activities can result in unauthorized use of equipment and data files, unauthorized changes to computer programs, and inaccurate processing of data.

INTERNAL AUDIT ACTIVITIES

Thirteen of the 28 internal audit units we reviewed did not fully comply with the professional standards for internal audits established by the Institute of Internal Auditors, Inc. California law requires internal audit units at state agencies to adhere to these standards. Variances from the standards relate to independence, performance of audit work, and professional proficiency.

Because certain internal audit units failed to comply with professional standards, management lacks assurance that the work of the internal auditors is reliable. In addition, the Office of the Auditor General could not rely on their work to minimize its own audit efforts. As a result, state audit costs are greater than necessary.

COMPLIANCE WITH STATE REGULATIONS

Agencies did not comply with all state regulations that materially affect the State's financial statements and that are intended to maintain control over budgeting, collecting, disbursing, reporting, and investing state monies. Weaknesses exist in contracting, reporting, apportioning monies to schools, apportioning retail sales and use tax monies to local governments, and controlling budgeted expenditures. Although these weaknesses did not have a material effect on the financial statements, failure to comply with these state regulations could result in agencies' entering into contracts that do not meet state requirements, paying improper amounts to local jurisdictions, and spending more state monies than budgeted.

COMPLIANCE WITH FEDERAL REGULATIONS

Many state agencies are not complying with federal regulations for administering federal grants. Adherence to these regulations is a condition of continued federal funding. The State did not fully comply with at least one federal regulation in 29 of the 34 grants that we reviewed. These 29 grants represent 86 percent of all federal monies that the State received for fiscal year 1985-86. Our review showed that agencies failed to adhere to reporting, cash management, and program monitoring and auditing requirements. The federal government could penalize the State because of its failure to comply with federal regulations.

ELIGIBILITY FOR CERTIFICATE OF ACHIEVEMENT

The General Purpose Financial Statements of the State fail to qualify for a Certificate of Achievement for Excellence in Financial Reporting for governments. The Government Finance Officers Association awards the certificate to governments that have accurate, complete, and timely financial statements. For fiscal years that ended in 1984, the Government Finance Officers Association awarded the certificate to approximately 60 governmental entities in California and three other state governments in the country. The State of California should take immediate action to make the improvements necessary in accounting and financial reporting to obtain the certificate.

INTRODUCTION

As part of our examination of the General Purpose Financial Statements of the State of California for the fiscal year ended June 30, 1986, we studied and evaluated the State's systems of internal control. The purpose of our study of the systems of internal control was to determine the audit procedures and the extent of testing necessary for (1) expressing an opinion on the State's General Purpose Financial Statements, (2) determining compliance with federal grant requirements, laws, and regulations, and (3) determining compliance with state laws and regulations that could materially affect the General Purpose Financial Statements. In conducting our audit, we reviewed and evaluated fiscal controls at 32 of the 335 state agencies required to submit financial reports. These 32 agencies account for approximately 64 percent of the State's spending and 61 percent of the State's revenue. Other independent auditors audited an additional 10 percent of the State's spending and 21 percent of the State's revenue. We also performed centralized testing that encompassed the operations of all of the State's agencies.

We reviewed controls over the electronic data processing activities in 12 agencies. We evaluated controls over access to and input of data and the adequacy of agencies' provisions for backup, documentation of systems, and separation of duties.

We reviewed the internal audit units of 28 state agencies for compliance with the "Standards for the Professional Practice of Internal Auditing" of the Institute of Internal Auditors, Inc. We selected 12 internal audit units for reviews of compliance with all standards. In addition, we performed 16 reviews to determine audit units' compliance with the standard for independence.

We also reviewed 33 agencies' compliance with state laws and regulations that materially affect the State's financial statements. Compliance with these laws and regulations helps to ensure that the State maintains adequate control over budgeting, investing, collecting, and disbursing state monies and reporting the results of state financial activities.

Finally, we reviewed all federal grants over $20 million for compliance with federal regulations except for the Pell Grant Program, which is reviewed by other independent auditors. In all, we reviewed 34 of the 265 federal grants that the State administers. These grants represent over 95 percent of the federal funds that the State received in fiscal year 1985-86. In addition, as part of our examination of the financial statements, we selected transactions related to other federal programs and reviewed these transactions for compliance with applicable federal regulations.

The following is a list of reports that the U.S. Office of Management and Budget's Circular A-128 requires the State to issue each year. These reports include specific information on the limitations of our audit scope and are included as part of this report.

- Report on the systems of internal control used in preparing the General Purpose Financial Statements and in administering federal assistance programs (Begins on page 55).

- Report on weaknesses and instances of noncompliance at state agencies (Begins on page 59).

- Report on federal assistance programs, including required reports on compliance with laws and regulations related to major and nonmajor federal programs, on the accuracy of the supplementary schedule of federal assistance, and on the resolution of prior year findings related to federal programs (Begins on page 281).

- Report on compliance with state laws and regulations (Begins on page 321).

Between July 1, 1985, and December 31, 1986, the Auditor General issued 71 audit reports, many of which discussed improvements needed in the State's operations. These reports, listed in Appendix A, are available to the public.

AUDIT RESULTS

I

The State of California continues to face unnecessary costs and impaired effectiveness of its operations because of weaknesses in its systems of internal control. Although the State has corrected some of the problems we observed in previous years, the State can still significantly improve its auditing, accounting, electronic data processing, and administrative control systems. In the following sections, we discuss the weaknesses we observed in the State's internal control systems and then recommend changes to correct the deficiencies.

WEAKNESSES IN FINANCIAL REPORTING

The State has numerous shortcomings in its financial reporting system. Financial reporting includes agencies' preparation of reports and the State Controller's compilation of these reports into the State's legal basis financial statements and General Purpose Financial Statements.

Among the problems in financial reporting are the State's failure to issue its financial statements promptly and agencies' failure to send adequate year-end financial reports to the State Controller. The State also does not account for its fixed assets properly, it does not maintain accounting records and reporting procedures that fully satisfy the requirements of generally accepted accounting principles (GAAP), and it does not perform critical reconciliations of related accounts or reporting systems. Finally, the State does not have efficient or thorough procedures in place for converting the financial reports from the legal basis to a GAAP basis. The following paragraphs detail some of the specific deficiencies we noted and provide examples of the types of weaknesses that we found.

Late Financial Reports

The State has been unable to produce the necessary financial reports in time to issue audited financial statements within six months of the end of the fiscal year since an audit requirement was established in 1980.

While major corporations such as IBM, General Motors, and Pacific Gas and Electric are required to issue their annual audited financial reports within 90 days after the close of the fiscal year, the State has repeatedly taken over 200 days. This lack of timeliness automatically disqualifies the State from receiving the prestigious Certificate of Achievement for Excellence in Financial Reporting.

One of the major causes of the State's delay in issuing its financial statements is the state agencies' failure to send their financial reports to the State Controller on time. The State Controller prepares the State's financial statements from the agencies' financial reports. Because late financial statements have been a continuing problem for the State, the Auditor General contracted with a consultant, Price Waterhouse, to study and report on the causes of the delay. The report by Price Waterhouse will be issued in March 1987.

The review being conducted by Price Waterhouse will accomplish three objectives. First, Price Waterhouse will identify the features of the present financial reporting system that result in inefficient budgeting, accounting, or financial reporting. In addition, Price Waterhouse will propose a financial reporting system that will permit the financial statements to be completed within 120 days of the end of the fiscal year. Finally, Price Waterhouse will identify all changes to the existing state financial reporting system that would result in a coordinated set of policies, procedures, and systems that produce timely and reliable financial reports.

Preparation of Financial Reports

The State's system for preparing its financial reports has many weaknesses. For instance, for certain funds, the State does not require agencies to prepare a Report of Accruals to Controller's Accounts, which is important for presenting the General Purpose Financial Statements in accordance with GAAP. In addition, the State's General Purpose Financial Statements do not include the financial activity of all state agencies. Furthermore, we found that agency financial reports were not always complete, had internal inconsistencies, and included erroneous account balances.

The State Administrative Manual does not require agencies to prepare the Report of Accruals to Controller's Accounts for all funds. Without this report, which requires agencies to distinguish between encumbrances and actual liabilities, the State Controller treats encumbrances as actual liabilities, thus overstating the liability accounts for GAAP purposes. Included among the estimated 225 funds for which this report is not required are over 50 that have budget appropriations for the 1985-86 fiscal year and, therefore, are likely to have accruals.

Among the elements of the state entity that are not currently included in the General Purpose Financial Statements are the District Agricultural Associations, the California State University Auxiliary Organizations, and the revenue bond fund of the Hastings College of the Law. The State does not require the agricultural associations and the auxiliary organizations to submit financial reports to the State Controller for inclusion in the General Purpose Financial Statements even though the State has oversight responsibility for these entities and provides funds to the agricultural associations. Although the Hastings College of the Law provides other financial reports to the State Controller, it does not report approximately $7 million in outstanding revenue bonds.

We reviewed the mathematical accuracy, propriety of accounting procedures, and completeness of the financial reports of 32 agencies. Eleven of these agencies inadequately prepared or failed to prepare all of the required financial reports. For example, the California Student Aid Commission split its Federal Trust Fund transactions into two segments and reported one segment of the activity in the General Fund. The Department of Mental Health could not identify the elements of a million dollar item reconciling agency accounts to the State Controller's accounts, could not explain an adjustment for $4.7 million, and did not adjust for an identified processing error of $313,000. The Department of Health Services failed to prepare an Analysis of Change in Fund Balance for the Federal Trust Fund, and the financial reports of two other agencies were internally inconsistent.

Accountability for Fixed Assets

State agencies do not maintain sufficient records either to determine or to estimate the original cost of acquiring general fixed assets. Furthermore, state agencies do not take inventory of fixed assets promptly. For example, the Stephen P. Teale Data Center, which is accountable for over $47 million in fixed assets, has not taken a physical inventory for five years. In addition, the data center does not segregate custodial and accounting duties related to equipment, does not reconcile property cards to accounting records, and does not put identifying tags on equipment that it has purchased and that is sent directly from the vendor to another state agency. The State Department of Education also does not adequately separate duties related to property: the same person takes inventory and maintains property records.

The failure of the State to establish adequate controls over fixed assets and maintain sufficient property records has two important effects. First, the State is exposed to the loss or theft of state assets. In addition, the State Controller is unable to present the General Fixed Assets Account Group in the State's General Purpose Financial Statements. As a result of this omission, the Office of the Auditor General has had to qualify its opinion on the presentation of the General Purpose Financial Statements.

Reconciliations

Some state agencies do not consistently reconcile related accounts or reporting systems. Reconciliations are an important element of internal control because they provide a high level of confidence that transactions have been processed properly and that financial records are complete. Failure to reconcile accounts may prevent the prompt detection of unauthorized transactions or errors and can result in the misstatement of account balances. For example, the Employment Development Department did not reconcile the Trial Balance System with the Employer Tax Subsidiary Ledger for employer taxes receivable; as of June 30, 1986, unreconciled differences amounted to $2.6 million. In addition, the Board of Equalization does not reconcile its accounting system with its allocating system for over $13.5 billion in retail sales and use taxes. Other agencies do not perform reconciliations promptly. As of June 6, 1986, the Department of Transportation was five months in arrears in reconciling its Agency

Trust Fund checking account to the statement from the centralized State Treasury System. Finally, some agencies do not perform reconciliations properly. The Employment Development Department, for example, failed to maintain a list of outstanding checks totaling $21 million.

Conversion to GAAP

The State Controller prepares the Annual Report of the State of California in conformity with the State's legal basis of accounting and prepares the General Purpose Financial Statements in conformity with GAAP. However, the Department of Finance has not provided sufficient instructions in the State Administrative Manual to make the conversion from the legal basis to the GAAP basis efficient and reliable. As a result, the financial information that agencies provide to the State Controller is frequently inadequate.

In addition, some of the financial information required under the GAAP basis of accounting is more extensive than the information provided by the legal basis of accounting. As a result, the State must develop additional information for proprietary funds, lease commitments, and the market value of the State's investments in securities.

The State is in the process of converting from the legal basis to a GAAP basis in certain areas. However, until the State incorporates all of the necessary generally accepted accounting principles into state law, the State must continue to spend time and money to convert its financial records so that they are comparable to those of other governmental entities and, therefore, acceptable to the investment community.

Distribution of Weaknesses by State Agency

The table on the next page depicts the distribution by state agency of weaknesses that we found in financial reporting. The table does not include information provided in other reports issued by the Auditor General. The table also excludes information on preparing financial statements according to GAAP because the problems with that conversion apply to the State as a whole. The page number from the table provides the location of our management report for the indicated agency. The item number provides the location in the management report of the discussion of the weakness identified.

WEAKNESSES IN FINANCIAL REPORTING

Agency	Page Number	Item Number: Financial Statements	Item Number: Accounting Over Property/ Inventory	Item Number: Reconciliations	Item Number: Other
California Community Colleges, Board of Governors of the	81	1	8	7	
California Polytechnic State University, San Luis Obispo	112			2	
California School for the Deaf at Fremont	92	2		5	
California State Polytechnic University, Pomona	104	1		3	
California State University, Fullerton	99	1			
California State University, Los Angeles	101	1			
California Student Aid Commission	114	3	2		
Corrections, Department of	120			1	
Education, State Department of	131	18	14		5
Employment Development Department	163			1,3,4	
Equalization, Board of	173			6	
General Services, Department of	185		5,10,11, 12,15	3,8	18
Health Services, Department of	198	2			
Mental Health, Department of	216	4			
San Francisco State University	109	1			
State Controller	246				4
Stephen P. Teale Data Center	253	5	1,2,4		
Transportation, Department of	257			5	
Water Resources, Department of	273		1,2,3		

II

WEAKNESSES IN REVENUE COLLECTION

Many state agencies have not established internal controls sufficient to assure that revenue transactions are completed, monitored, or recorded properly. Revenue activities include the receipt of tax collections and federal grants, billings for delinquent taxes and for goods delivered and services rendered, and subsequent collection of those billings. The problems with the control of revenue activities include inadequate procedures for billing and collecting receivables, delays in identifying and depositing collections, improper procedures for recognizing revenue, and inadequate separation of duties. The following paragraphs detail some of the specific deficiencies we noted and provide examples of the types of weaknesses that we found.

Billing and Collecting of Receivables

Failure to bill and collect receivables, including amounts due from the federal government, resulted in substantial loss to the State during fiscal year 1985-86. Because of its inadequate collection procedures and monitoring of potential bankruptcies among contractors and vendors, the State Department of Education is in the process of writing off over $4 million in receivables and we predict that it will also be unable to collect another $4.3 million in receivables. In a separate report, the Auditor General noted that the Department of Health Services could increase its recovery of Medi-Cal receivables by an estimated $3 million annually if it improves its collection procedures and implements a recent federal law. (Report P-566, December 1986)

In addition, the Franchise Tax Board does not always calculate penalties and interest correctly, and the Employment Development Department revealed that the department does not consistently assess penalties on delinquent employer tax returns. The Department of Transportation has not attempted to collect $174,000 that other governments have owed to the department for as long as four years. As a result, some of these monies may be uncollectible.

Four agencies delayed in drawing down federal monies, resulting in a loss of interest earnings to the State. Late drawdowns at the Department of Social Services, for example, cost the State at least $740,000 in interest revenue. In addition, the State lost an estimated $240,000 because of late drawdowns at the State Department of Education. Delays in requesting reimbursements for a program at the Department of Health Services resulted in a potential interest loss of approximately $20,300.

Depositing Collections

Although the State Administrative Manual is specific about the amount of time that can elapse before receipts are deposited, ten of the agencies we reviewed did not deposit collections on time. For example, the State lost at least $469,000 in interest earnings during fiscal year 1985-86 because field offices and one headquarters unit at the Department of Motor Vehicles frequently deposited collections late. Also, of the 56 deposits examined at the Administrative Office of the Courts, 48 were deposited late. In one instance, an appellate district held receipts for as much as 51 days before making a deposit of over $58,000. We project that the State lost interest earnings of approximately $4,800 because various courts were late in depositing receipts. When agencies do not deposit collections on time, not only does the State lose interest earnings but also the risk of loss from fire or theft is increased.

Recognition of Revenues

Several state agencies did not accurately report to the State Controller revenue that had been earned as of the end of the fiscal year. Both the State Administrative Manual and GAAP require agencies to accrue as revenue of the current year amounts that are earned but not received by the end of the fiscal year if they are estimated to be collectible within one year. Nevertheless, the Department of Transportation overstated revenue by more than $900,000, and the State

Department of Education overstated revenue in the Federal Trust Fund by approximately $696,000. When agencies submit incorrect or incomplete information and the errors and omissions are not detected, the State's annual financial statements will be incorrect.

Separation of Duties Involving Revenues

Two of the agencies we reviewed did not adequately separate duties relating to revenue. The Chancellor's Office of the California Community Colleges, for example, allows one employee to prepare invoices as well as reconcile the bank accounts, which violates State Administrative Manual provisions.

Distribution of Weaknesses by State Agency

The table on the next page depicts the distribution by state agency of weaknesses that we found in revenue activities. The table does not include information provided in other reports issued by the Auditor General. The page number from the table provides the location of our management report for the indicated agency. The item number provides the location in the management report of the discussion of the weakness identified.

WEAKNESSES IN REVENUE ACTIVITIES

Agency	Page Number	Item Number: Billing and Collecting Receivables	Identifying and Depositing Collections	Recognizing Revenue	Separation Of Duties	Other
Administrative Office of the Courts	75		4			3
California Community Colleges, Board of Governors of the	81	6			2	
California School for the Blind	87		1			4
California School for the Deaf at Fremont	92		1			
Education, State Department of	131	1,29	12,16	11		
Employment Development Department	163	5				
Equalization, Board of	173		10	3		4
Franchise Tax Board	181	2			3	1
General Services, Department of	185	13	4	7,14		
Health Services, Department of	198	10		5		
Justice, Department of	210		1,2			
Motor Vehicles, Department of	222		1,3			2,4
Napa State Hospital	228					2
San Diego State University	107		1			
Social Services, Department of	232	4,5,6	9			
State Controller	246		5			
Transportation, Department of	257	9,10	2,7	13		

III

WEAKNESSES IN EXPENDITURE CONTROLS

Inadequacies in internal controls over expenditure activities were present at most of the state agencies we reviewed. Expenditure activities include processing and distribution of payroll, purchase of and payment for goods and services, and payment of benefits or grants to individuals or other governmental entities. While agencies usually initiate and authorize requests for payment, the State Controller prepares and issues the warrants for payment. However, under circumstances specified in the State Administrative Manual, agencies are authorized to prepare and issue payments from their own revolving funds. The agencies are then reimbursed by the State Controller. Among the problems we found were inadequate control over revolving fund activity, insufficient control over other disbursements, improper recognition of expenditures, inadequate control over payroll, and inadequate separation of duties. The following paragraphs detail some of the specific deficiencies we noted and provide examples of the weaknesses that we found.

Control Over Revolving Fund

Most of the agencies we reviewed had at least one deficiency associated with their revolving funds. Frequently observed problems were the failure to monitor and collect salary or travel advances, overdrawn revolving funds, late or incorrect reconciliations, and improper use of the revolving fund.

Long-outstanding travel or salary advances existed at nine agencies. For example, the Department of Mental Health had $330,000 in salary advances more than 90 days old. At the Department of Social Services, nine employees had temporary travel expense advances, totaling more than $12,500, for over eight months. In addition, some agencies failed to report advances accurately. Instead of reporting them in an advances account, these agencies netted the advances against accounts payable, thereby understating both accounts by the amount of the advances. Furthermore, at the Department of Transportation, advances that headquarters reported in the Revolving Fund Transaction Summary were $1.6 million less than the general ledger balances, and balances at certain district offices also did not agree with general ledger balances.

Both the Department of Transportation and the State Department of Education overdrew their revolving funds during fiscal year 1985-86. The Department of Transportation exceeded the limit authorized for its revolving fund by an average of $9 million for 11 of the 12 months. The State Department of Education overdrew its revolving fund for the first nine months of the fiscal year. We observed the same problem at both agencies during our financial audits for the previous two fiscal years.

Three agencies were either late or incorrect in reconciling their revolving funds. For example, as of June 6, 1986, the Department of Transportation had not prepared monthly reconciliations of its revolving fund checking account for October 1985 through April 1986. In addition, the State Department of Education and the Employment Development Department made unsupported or incorrect adjustments related to the revolving fund. Without an adequate revolving fund reconciliation, the agencies have less assurance that transactions have been processed properly, that financial records are complete, and that the funds are not overdrawn.

The Board of Equalization and the Department of Transportation used their revolving funds for inappropriate purposes. The State Administrative Manual limits the use of the revolving fund to payment of compensation earned, travel expenses, advances, and invoices requiring immediate payment. Of 101 revolving fund disbursements examined at the Department of Transportation headquarters and two district offices, 36 were for inappropriate purposes. Four of 30 revolving fund disbursements examined at the Board of Equalization were also inappropriate. Use of revolving fund checks when a State Controller's warrant could be issued circumvents the pre-disbursement system of review performed at the State Controller's Office and increases the potential for improper payments.

Control Over Disbursements

Fifteen of the agencies we reviewed did not maintain adequate control over disbursements. Failure to control disbursements can result in erroneous, unauthorized, or duplicate payments. Among the problems observed were failure to have approval for purchases, to assure that goods ordered had been received before payment was made, to take advantage of vendor discounts, and to establish procedures to avoid duplicate payments on single invoices. For example, three agencies lost vendor discounts offered for prompt payment on invoices. The Department of Developmental Services failed to take advantage of vendor discounts on 45 of 72 tested invoices offering discounts and, as a result, lost an estimated $3,700. Five agencies also failed to establish effective procedures to avoid duplicate payments to vendors. At the Department of Transportation, we found ten invoices that had been paid twice; one payment alone, which was subsequently returned by the vendor, was for $2.1 million. In addition, the Department of General Services made 26 duplicate payments totaling $3,489 to one vendor.

Recognition of Expenditures

The main problem that agencies had in recognizing expenditures was their failure to distinguish between encumbrances and actual obligations. Obligations are amounts owed for goods or services received before the end of the fiscal year, whereas encumbrances represent amounts owed for goods or services ordered but not received by the end of the fiscal year. We observed this weakness at 13 of the agencies reviewed. For example, improper identification of encumbrances led to a $35 million understatement of accounts payable at the Department of Health Services and an understatement of obligations of approximately $18 million at the Department of Transportation. Because the State Controller uses the information provided by agencies to prepare the State's annual financial statements, agencies' failure to submit accurate information, if undetected, leads to errors in the State's financial statements.

Control Over Payroll

Many state agencies do not maintain sufficient control over payroll expenditures. Included among the weaknesses observed were incorrect calculation of final payroll warrants to separating employees, failure to enforce required clearance procedures for separating employees, and inadequate control over payroll documents. As a result of these weaknesses in internal control, some employees were not paid appropriately and others could have left state service before returning state property and repaying outstanding advances. During statewide testing at 74 agencies comprising a total of 381 separating employees, we found 34 disbursements that agencies had calculated incorrectly. These incorrect calculations resulted in the State's underpaying 20 individuals a total of $8,239 and overpaying 14 individuals a total of $3,055. Furthermore, because of inadequate clearance procedures at the Board of Equalization, 43 percent of the separating employees we tested failed to have a clearance form on file.

Separation of Duties Involving Disbursements

Six of the agencies we reviewed did not sufficiently separate duties involving disbursements. For example, at the California Student Aid Commission, one employee prepared checks, reconciled the bank account, and maintained the general ledger. In addition, the same employee had the cash receipt duties of receiving remittances and preparing deposits. A similar situation existed at the Department of Transportation, where an employee collected receipts, prepared collection reports, had access to the blank-check stock, operated the check-signing machine, and controlled the signature plate and key. Unless these duties are separated, an employee has the opportunity to divert state resources for personal use.

Distribution of Weaknesses by State Agency

The table on the next page depicts the distribution by state agency of weaknesses that we found in expenditure activities. The table does not include detail for the results of statewide testing of final payroll disbursements to separating employees because of the large number of agencies involved. The page number from the table provides the location of our management report for the indicated agency. The item number provides the location in the management report for the discussion of the weakness identified.

WEAKNESSES IN EXPENDITURE CONTROLS

		Item Number				
Agency	Page Number	Control Over Revolving Fund	Control Over Disbursements	Recognizing Expenditures	Control Over Payroll	Separation of Duties
Administrative Office of the Courts	75		5			
California Community Colleges, Board of Governors of the	81		3			
California Polytechnic State University, San Luis Obispo	112	3		1		
California School for the Blind	87	2,5	6	8	7	3
California School for the Deaf at Fremont	92	3	6			4
California State Polytechnic University, Pomona	104		2	4		
California State University, Fullerton	99	2		3		
California State University, Los Angeles	101	2,3		4		
California State University, Chancellor's Office	96	2		1	3	
California Student Aid Commission	114		5	4		1
Developmental Services, Department of	121	1	2,3,4,6,7	5		
Education, State Department of	131	10,13,17	15			
Employment Development Department	163	6				
Equalization, Board of	173	8,9			7	
General Services, Department of	185	17	1,16	2,6	9	
Health Services, Department of	198	1	4,6	3		
Justice, Department of	210	3,4,5	6			
Lanterman Developmental Center	215			2		1
Mental Health, Department of	216	5	2			
Napa State Hospital	228	3				1
San Diego State University	107	2				
San Francisco State University	109	2,3	4			
Social Services, Department of	232	11	3,7,8	1,2,10		
Stephen P. Teale Data Center	253			3		
Transportation, Department of	257	1	3,6	16	17	4

IV

WEAKNESSES IN ELECTRONIC DATA PROCESSING CONTROLS

Of the 12 state agencies at which we reviewed electronic data processing (EDP) activities, 6 did not have adequate internal controls over these activities. EDP activities include recording and processing daily transactions as well as designing and maintaining the EDP system. We found weaknesses in controls over access to equipment and reports, system documentation, input controls, backup provisions, and separation of duties. The following paragraphs detail the specific deficiencies we noted.

Controls Over Access

The Franchise Tax Board and the Chancellor's Office of the California Community Colleges had insufficient controls over access to EDP files. At the Chancellor's Office, the Security Access Request forms for three individuals were not on file and could not be found. As a result, the Chancellor's Office could not determine if the internal controls over access to the system were in place and functioning as prescribed. The Franchise Tax Board did not adequately control access to the "Credit Follow-up Referral" report, which is used to issue refunds to taxpayers. Compounding the access problem was the Franchise Tax Board's failure to keep a record of the disposition of credit balances. As a result of these weaknesses, an employee could use the information on the report to issue fraudulent refunds without detection.

Documentation of Systems

The Administrative Office of the Courts and the Chancellor's Office of the California Community Colleges do not sufficiently document vital EDP systems. The Administrative Office of the Courts does not maintain thorough or well organized written records of the processing performed by its computer accounting system. The Chancellor's Office has insufficiently documented the EDP system that apportions approximately $1.5 billion to the community college districts. Without adequate documentation, insufficient basis exists to determine if the system is working as intended. In addition, if employees who design, program, and implement the systems terminate their employment, the agencies may be unable to maintain or modify their systems effectively.

Control Over Input

Three of the agencies at which we reviewed EDP systems did not have adequate input controls. The Employment Development Department, for example, permits employees to override edit controls over the computer system for the $2.1 billion benefit payments program. The department estimates that benefit payment personnel use the override function to authorize payments nearly 20 percent of the time. As a result, the department could issue improper benefit payments. The Department of Transportation failed to clear error files promptly, causing understatements of the claims in process and expenditure accounts by at least $1 million on June 30, 1986. The Franchise Tax Board does not have a process to ensure that all bank and corporation tax transactions are completely and correctly posted to the taxpayer files. Consequently, the board lacks assurance that all bank and corporation transactions received have been posted to the taxpayers' files.

Provisions for Backup

The Department of Motor Vehicles does not have provisions for emergency off-site backup equipment for its EDP system. The department informed us that no other facilities in California have hardware that is compatible with the department's and that can process the department's volume of work. The department has contracted to use the Stephen P. Teale Data Center for processing the department's work. Total conversion is expected to be completed in 1990. However, a major shutdown of the department's EDP system during the conversion could result in the loss of revenues to the State and to local governments and the loss of information data bases used by law enforcement agencies.

Separation of Duties Involving EDP Activities

The Administrative Office of the Courts allows computer programmers to correct the accounting master file, which contains the financial records for the Supreme Court and the appellate courts. As a result of this weakness in controls, computer programmers could make unauthorized changes to the financial records.

Distribution of Weaknesses by State Agency

The following table depicts the distribution by state agency of weaknesses that we found in EDP controls. The page number from the table provides the location of our management report for the indicated agency. The item number provides the location in the management report of the discussion of the weakness identified.

WEAKNESSES IN ELECTRONIC DATA PROCESSING ACTIVITIES

		Item Number				
Agency	Page Number	Access Controls	System Documentation	Input Controls	Backup Provisions	Separation of Duties
Administrative Office of the Courts	75		1			2
California Community Colleges, Board of Governors of the	81	4	5			
Employment Development Department	163			2		
Franchise Tax Board	181	4		5		
Motor Vehicles, Department of	222				5	
Transportation, Department of	257			15		

V

VARIANCES FROM INTERNAL AUDIT STANDARDS

Many of the internal audit units we reviewed at state agencies did not fully comply with the "Standards for the Professional Practice of Internal Auditing" of the Institute of Internal Auditors, Inc. The California Government Code requires internal audit units of state agencies to comply with these professional standards, which pertain to independence, performance of audit work, and professional proficiency.

Internal audit units are a basic component of internal control. These units review and evaluate an agency's internal controls and appraise the efficiency of the agency's operations. They provide management with recommendations to remedy internal control weaknesses, thus increasing the overall efficiency of agencies' operations. In addition, internal audit units may assist external auditors in performing audit work, reducing the State's cost for audits.

Unless internal audit units comply with professional standards, management lacks assurance that the work of the internal auditors is reliable. In addition, external auditors may be precluded from using the work of internal auditors when the internal auditors do not comply with professional standards.

In July 1986, the Auditor General issued a separate report, "The State of California Should Improve Its Internal Audit Capabilities," Report F-499, that describes the results of the reviews of 31 internal audit units in state agencies for the 1984-85 and 1985-86 fiscal years. For the purposes of that report, the Auditor General conducted 13 limited-scope reviews and 12 full-scope reviews in fiscal year 1985-86. During the financial audit for 1985-86, we conducted an additional 3 limited-scope reviews, which did not result in any additional observed instances of noncompliance with professional standards. The variances from compliance with professional standards described in the following paragraphs, therefore, were originally noted in the separate report and include the data for both years reviewed.

Independence Standard

Six of the 31 internal audit units that we reviewed are not organizationally independent of the activities they audit. The internal audit unit of the Department of Food and Agriculture, for example, reports to the department's assistant director, who has direct authority over various financial functions that the internal audit unit is expected to audit. In addition, the Department of Justice's internal audit unit reports to the person who has direct authority over accounting, budgeting, and personnel, which are subject to internal audit reviews. As a result of these variances from the independence standard, the internal audit units may not be able to render the impartial judgments essential to the proper conduct of audits.

Performance of Work Standard

Many of the internal audit units we reviewed failed to fully satisfy the requirements of the performance of work standard. For example, the internal audit units did not always adequately plan audits, examine and evaluate information, or report findings. Internal audit managers did not always clearly define the objectives or activities of the internal audit units, implement quality control procedures to assure that work performed is properly conducted, or control available staff and time resources. Three of these internal audit units do not have approved audit charters outlining the purpose, authority, and responsibility of the internal audit units as required by the standards related to management.

Professional Proficiency Standard

Several agencies' internal audit units do not have staff with the skills necessary to meet EDP audit responsibilities and do not always provide internal audit staff with training to improve their audit skills. Of the 12 agencies reviewed that failed to report on EDP system controls, at least 3 failed to do so because their internal audit units lacked the computer expertise to perform the necessary work. Seven of the 12 agencies reviewed did not have adequate training programs or training courses to improve the internal auditors' technical skills and knowledge of professional standards. Those agencies that are unable to have their EDP systems reviewed lack assurance that the computer systems and controls are operating properly to safeguard the State's assets, prevent misuse, and provide prompt, accurate, and reliable information.

Distribution of Weaknesses by State Agency

Appendix B provides a table showing the distribution by state agency of weaknesses in internal audit activities during the 1985-86 fiscal year.

VI

WEAKNESSES IN COMPLIANCE WITH STATE REGULATIONS

The State Constitution and certain state statutes establish the requirements that agencies must follow to ensure that the State maintains adequate control over budgeting, reporting, collecting, disbursing, and investing monies. We tested agencies' compliance with 14 specific state requirements that could have a material effect on the State's financial statements. We found instances of noncompliance with 5 of these requirements. However, none of these instances actually had a material effect on the financial statements.

Our report on compliance with state requirements, which begins on page 321 of this report, is a list of the specific state compliance issues we reviewed. The following paragraphs discuss the specific instances of noncompliance that we found.

Contracting

Many state agencies are not following the contracting provisions of the Public Contract Code. We tested 152 contracts at 15 agencies and found 41 contracts that did not contain the required documentation or provisions. In addition, agencies did not evaluate 28 of the contracts tested within 30 days of completion, as required by the Public Contract Code. As a result, the State may have entered into contracts with unreliable vendors.

Apportionments to School Districts

The State Department of Education did not correctly calculate apportionments for school districts reporting independent study program average daily attendance, did not use the standard criteria for apportioning Project Work-Ability funds, and did not calculate the School Improvement Program entitlements for fiscal year 1985-86 in accordance with state statutes. In addition, the State Department of Education could not completely support expenditures to school districts participating in the Awareness Program and Inservice Training for Teachers of Severely Handicapped Children. For the School Improvement Program, for example, the department gave those school districts that were disallowed a cost of living adjustment, as determined by the Education Code, Section 52048, the same amount of funding that they received in fiscal year 1984-85. However, according to our legal counsel's interpretation of the Education Code, the department should have based its calculations of the School Improvement Program funding for the fiscal year 1985-86 on Education Code sections that adjust the previous year's funding by the student attendance figures. If the department maintains district entitlements at the prior year funding level, school districts in which student attendance figures change from year to year would not be granted a corresponding change in the entitlement. The department attempted to have legislation approved that would clarify the code sections, but the legislation was vetoed on September 30, 1986.

Control Over the Budget

The Department of Transportation and the Department of Mental Health failed to monitor their budgets effectively. The Department of Transportation incurred approximately $3.4 million more in expenditures than had been budgeted for the Transportation Planning Program for fiscal year 1984-85 and neglected to submit a budget revision for this amount as of September 30, 1986. The Department of Mental Health failed to submit budget revisions that would enable the department to pay $6.5 million in claims from counties. On August 1, 1986, the State Controller refused to pay the claims because the department had insufficient funds. As of October 2, 1986, however, the department had still not submitted a budget revision.

Distributions of Sales Taxes

The Board of Equalization did not enforce a consistent policy for requiring information on retail sales and use tax returns, did not have a uniform procedure for advancing taxes collected to local governments, and did not establish an efficient or thorough method for assigning tax area codes, which are the basis for the allocations of tax monies to local governments. For example, advances of retail sales and use taxes to 60 cities and counties for two quarters in 1985-86 ranged from 77 percent to 104 percent of the total receipts for the same quarter in the previous year. The board's announced policy is to advance approximately 95 percent of the total tax revenues collected in the same quarter of the previous year, adjusted for economic conditions.

Reconciliations to State Controller's Records

The State Administrative Manual does not require agencies to prepare a Reconciliation of Agency Accounts With Transactions Per State Controller for approximately 225 funds in the state accounting system. As a result, information that contributes to the accuracy of financial statements is not available for all funds.

Distribution of Weaknesses by State Agency

The table on the next page depicts the distribution by state agency of weaknesses that we found in compliance with state regulations. The table does not include information about reconciliations to State Controller's Office balances because the reconciliation problem applies to the State as a whole. A table depicting instances of noncompliance with required contracting procedures appears on page 68 of this report. The page number from the table provides the location of our management report for the indicated agency. The item number provides the location in the management report of the discussion of the weakness identified.

WEAKNESSES IN COMPLIANCE WITH STATE REGULATIONS

Agency	Page Number	Item Number: Apportionments to School Districts	Item Number: Control Over the Budget	Item Number: Distributions of Sales Taxes
Education, State Department of	131	6,7,8,9		
Equalization, Board of	173			1,2,5
Mental Health, Department of	216		1	
Transportation, Department of	257		18	

WEAKNESSES IN COMPLIANCE WITH FEDERAL REGULATIONS

As a condition for receiving federal monies, the federal government requires the State to comply with provisions of the federal grant programs that provide cash or noncash resources to the State. Typically, federal regulations address recipient eligibility, financial reporting, reimbursable costs, and program monitoring. We reviewed compliance with these regulations for all grants that provided $20 million or more to the State, a total of 34 grants. State agencies failed to comply with at least one federal regulation in 29 of the 34 programs we reviewed. Potentially, the federal government could require the State to return funds that the State spent while not in compliance with federal grant regulations.

Our report on compliance with federal grant requirements begins on page 281 of this report; the Schedule of Federal Assistance begins on page 285. The following paragraphs detail the specific areas in which we noted that state agencies did not comply with federal regulations and provide some examples of the instances of noncompliance we found.

Reporting of Grant Expenditures

The U.S. Office of Management and Budget Circular A-128 requires the State to submit an audit report on a schedule of federal assistance showing the total expenditures for each federal assistance program. However, the state accounting method for federal assistance does not provide sufficient expenditure information to permit the preparation of such a schedule. Consequently, the State presents its schedule of federal assistance on a revenue basis and, therefore, does not comply with federal requirements.

Monitoring and Auditing of Programs

Many of the programs we reviewed had federal requirements for monitoring or auditing program activities or for enforcing audit requirements. However, state agencies did not satisfy the monitoring and auditing requirements for 24 of the programs we reviewed.

The Department of Mental Health, for example, does not have effective procedures for either determining the adequacy of corrective action taken by recipients of grant monies disbursed by the State (subrecipients) or resolving differences. Consequently, the department lacks assurance that subrecipients will take corrective action involving $7 million in costs questioned by the department's auditors for fiscal years 1982-83 and 1983-84.

In addition, the Employment Development Department did not effectively monitor subrecipient expenditures for compliance with spending limitations. Federal regulations in general require that not less than 70 percent of the Job Training Partnership Act funds be spent for training costs. Nevertheless, 12 of the 15 subrecipients tested did not meet the 70 percent minimum requirement.

The State Department of Education has not enforced audit requirements for the National School Lunch and Breakfast programs. Fifty-four program sponsors have not submitted acceptable audit reports even though they collectively received approximately $4.4 million. One additional sponsor, a school district, failed to submit an audit report for fiscal years 1981-82 through 1984-85 even though the district received over $1.1 million in federal funds for the National School Lunch and Breakfast programs. Federal law requires the audits to be conducted not less frequently than once every two years.

Federal Financial Reports

Most federal programs require the State to submit financial reports periodically. We reviewed these financial reports for mathematical accuracy, agreement to accounting records, and timeliness of submission. We found that state agencies frequently failed to comply with all of the regulations relating to financial reports.

Agencies were late in submitting required reports for 20 grants. For example, the Employment Development Department was late in submitting the Annual Status Reports for the Job Training Partnership Act, and it failed to submit the Unemployment Insurance Financial Transaction Summary on time for any month between July 1985 and June 1986. Furthermore, the Department of Transportation failed to close out and submit final claims promptly for 6,150 projects. The department could have reallocated $14 million for construction projects and $24 million for local assistance projects if these projects had been closed promptly.

Reports submitted for ten programs were either erroneous or did not agree with agency accounting records. For example, the Department of Rehabilitation's Status of Federal Cash Report understated the ending cash balance by $2.6 million for the Rehabilitation Services--Basic Support Grant. In addition, for the fourth year in a row, the Department of Social Services neglected to reconcile its federal financial reports to departmental accounting records. This failure to reconcile can result in the misstatement of claims for cash advances and reimbursements from the federal government. Irregularities may also be difficult to detect.

Support for Expenditures

To claim federal reimbursement for program costs, the State must have adequate documentation that these costs are appropriately charged to the federal program. However, the State did not accumulate or maintain sufficient documentation for charges against 16 programs that we reviewed. Inaccurate or unsupported charges against federal programs could result in overexpenditures and in questioned costs.

The Department of Social Services, for example, had incorrect or unsupported charges to the Food Stamp, Work Incentive, Assistance Payments--Maintenance Assistance, Child Support Enforcement, Social Services Block Grant, and Refugee and Entrant Assistance programs. Three of the six department units or bureaus we tested had incorrect or unsupported time-reporting summaries that affected these programs.

In addition, 10 of the 26 travel expense claims we tested at the Department of Mental Health were not correctly charged to the Alcohol and Drug Abuse Mental Health Services program. These errors occurred because departmental personnel either failed to designate the proper programs to charge or failed to identify any programs at all.

Drawdown and Disbursement of Federal Funds

Federal regulations require the State to minimize the time between the transfer of funds from the U.S. Treasury (drawdown) and the disbursement of those funds by the State. Similar federal requirements apply to the transfer of federal funds from the State to grant subrecipients. When the State has excess federal funds on hand, the federal government loses interest earnings. We found instances of the State's failure to monitor its own cash balances as well as those of subrecipients.

The Employment Development Department failed to effectively monitor the cash balances of subrecipients. The department allowed 5 of the 24 tested subrecipients of Job Training Partnership Act monies to maintain excessive cash balances. These balances ranged from $363 to $916,634 and resulted in an average daily cash balance of 4 days to 44 days, more than the three-day cash needs limit established by the department. Failure to control cash balances could result in the federal government's charging the State interest on the excess amounts advanced.

Two state agencies also had excess federal cash on hand. The Department of Social Services held $7.6 million in federal funds from 4 to 86 days. The Department of Economic Opportunity held $24 million in Low-Income Home Energy Assistance monies for 34 days. The federal government lost an estimated $181,000 in potential interest earnings on the Low-Income Home Energy Assistance monies alone.

Distribution of Weaknesses by Grant

A table depicting the weaknesses in compliance with federal regulations begins on page 307 of this report.

VIII

ELIGIBILITY FOR CERTIFICATE OF ACHIEVEMENT

The Certificate of Achievement Program of the Government Finance Officers Association exists to encourage and recognize excellence in financial reporting by governments. The program awards a Certificate of Achievement for Excellence in Financial Reporting to those governments whose financial reports meet the program's specific standards. For the fiscal years that ended in 1984, the Government Finance Officers Association awarded certificates to three other states and to approximately 60 government entities within the State of California. The value of receiving the Certificate of Achievement is illustrated by the fact that the Standard and Poors Corporation, which rates California's bonds, is influenced by the certificate when evaluating a government's financial position.

The State fails to qualify for the Certificate of Achievement because its financial statements do not meet three of the major criteria for the award. First, the State does not prepare a comprehensive annual financial report in accordance with generally accepted accounting principles. In addition, the State does not meet the requirement that its financial statements receive an unqualified opinion. Because the State has not maintained adequate records on its fixed assets, it currently receives a qualified opinion on its financial statements. Finally, the Certificate of Achievement Program also requires that the State submit its financial reports within six months of the end of the fiscal year. Until the State satisfies these three requirements, its annual financial report will fail to qualify for the Certificate of Achievement for Excellence in Financial Reporting.

IX

CONCLUSION AND RECOMMENDATIONS

Our reviews of state agencies revealed numerous weaknesses in the systems of internal control designed to protect the State's assets and assure the efficiency and appropriateness of its operations. These problems arose primarily because state agencies failed to follow provisions of the State Administrative Manual, state law, and federal grant agreements. As a result, the State lost at least $2.5 million in potential interest earnings and discounts and at least $4.1 million in uncollectible accounts receivable.

Of particular concern are two weaknesses that can result in substantial loss to the State: the failure to monitor and collect accounts receivable and the failure to control revolving fund activities. When state agencies do not identify accounts receivable and begin collection procedures promptly, they jeopardize the collectibility of those receivables. In addition, the State loses potential interest revenue on outstanding receivables. When agencies do not adequately monitor revolving fund receipts and disbursements, improper payments, long-outstanding advances, and inaccurate financial statements can result.

Recommendations

The State of California should commit itself to improving its internal control systems. These systems help ensure that budgets are not exceeded, that cash and other assets are protected from loss or theft, that state monies are spent for the intended purposes, that assets are managed prudently, and that accurate financial information is available as needed.

State agencies should establish more effective controls over their operations. The Department of Finance should continue to monitor the agencies' control systems, with particular attention paid to those weaknesses that we have identified.

As part of our audit, we sent management letters to each state agency at which we found weaknesses in controls. The management letters describe each of the weaknesses we found and recommend ways to correct them. We present these management letters on pages 75 through 277 of this report.

REPORT ON THE STUDY AND EVALUATION OF INTERNAL CONTROL

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Auditor General

Members of the Joint Legislative Audit Committee
State of California

We have examined the General Purpose Financial Statements of the State of California as of and for the year ended June 30, 1986, and have issued our report dated December 19, 1986. We did not examine the financial statements of the Pension Trust Funds, which reflect total assets constituting 68 percent of the Fiduciary Funds. We also did not examine the financial statements of certain Enterprise Funds, which reflect total assets and revenues constituting 86 percent and 94 percent, respectively, of the Enterprise Funds. In addition, we did not examine the University of California Funds. We did not examine the financial statements of these Pension Trust Funds, Enterprise Funds, and University of California Funds because they were examined by other independent auditors.

As part of our examination, we studied the State's systems of internal control, including applicable internal controls used in administering federal assistance programs, to the extent we considered necessary to evaluate the systems as required by generally accepted auditing standards; the standards for financial and compliance audits contained in the <u>Standards for Audit of Governmental Organizations, Programs, Activities, and Functions</u>, issued by the General Accounting Office; the <u>Single Audit Act of 1984</u>; and the provisions of the U.S. Office of Management and Budget Circular A-128, <u>Audits of State and Local Governments</u>. For this report, we classified the systems of internal control of the State into five areas: financial operations, electronic data processing controls, internal audit activities, state compliance, and federal compliance. We did not study the systems of internal control for the Pension Trust Funds, certain Enterprise Funds, and the University of California Funds.

The Department of Finance and the management of the agencies are responsible for establishing and maintaining internal control systems. In fulfilling that responsibility, management is required to assess the expected benefits and related costs of control procedures. The objectives of internal control systems, including internal control systems used in administering federal assistance programs, are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, that transactions are recorded properly, and that transactions are executed in accordance with the authorization and policy of the Department of Finance and other agencies. Proper recording of transactions permits the preparation of financial statements in accordance with generally accepted accounting principles.

Because of inherent limitations in any system of internal accounting and administrative controls, including those used in administering federal assistance programs, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the systems to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

Our study included all of the applicable control categories listed above. For the year ended June 30, 1986, the State received 95 percent of its total federal assistance under major federal assistance programs. With respect to internal control systems used in administering major federal assistance programs, our study and evaluation considered the types of errors and irregularities that could occur, determined the internal control procedures that should prevent or detect such errors or irregularities, determined whether the necessary procedures are prescribed and are being followed satisfactorily, and evaluated any weaknesses.

With respect to the internal control systems used solely in administering the nonmajor federal assistance programs of the State, our study and evaluation was limited to a preliminary review of the systems to obtain an understanding of the control environment and the flow of transactions through the accounting system. Our study and evaluation of the internal control systems used solely in administering the nonmajor federal assistance programs of the State did not extend beyond this preliminary review phase.

Our study and evaluation, made for the limited purposes described above, would not necessarily disclose all material weaknesses in the State's systems of internal control. Accordingly, we do not express an opinion on the systems of internal accounting control of the State taken as a whole or on any of the five categories of controls identified in the second paragraph. We also do not express an opinion on the internal control systems used in administering the major federal assistance programs of the State. Further, our examination would not necessarily disclose material weaknesses in the internal control systems used solely in administering nonmajor federal assistance programs. However, our evaluation disclosed a weakness in accounting for general fixed assets that involves amounts that could have a material effect on the General Purpose Financial Statements of the State and that could result in errors or irregularities that may not be promptly detected.

Weakness in Accounting
for General Fixed Assets

The State does not maintain sufficient records to support the cost of general fixed assets. Furthermore, the State does not consistently take inventory of fixed assets and does not record all fixed assets in the property records. This weakness in accountability results in an increased risk of loss of assets. Furthermore, it makes it impossible for the State Controller to present the General Fixed Assets Account Group in the General Purpose Financial Statements.

Recommendation

The Department of Finance should require all agencies to comply with property accounting procedures that would allow the State Controller to include the General Fixed Assets Account Group in the General Purpose Financial Statements. Complying with property accounting procedures would assist in safeguarding the assets of the State.

We considered this weakness in determining the nature, timing, and extent of audit tests to be applied in our examination of the financial statements and our examination and review of compliance with laws and regulations, noncompliance with which could have a material effect on the allowability of program expenditures for federal assistance programs. Our reporting of this weakness does not modify our December 19, 1986, report on the General Purpose Financial Statements. While our study did not disclose any other material weaknesses, it did disclose certain conditions requiring the attention of management. The remaining sections of this report will discuss these conditions.

This report is intended for the use of the State and should not be used for any other purpose. This restriction is not intended to limit the distribution of this report which, upon acceptance by the Joint Legislative Audit Committee, is a matter of public record.

OFFICE OF THE AUDITOR GENERAL

CURT DAVIS, CPA
Deputy Auditor General

February 6, 1987

INDEX

DEFICIENCIES COMMON TO MANY AGENCIES

Numerous deficiencies in internal controls and reporting of financial information are common to many agencies. For example, the State does not require agencies to prepare a report that is important in presenting financial information in compliance with generally accepted accounting principles (GAAP), and it does not have an effective system of reporting expenditures of federal monies by grant, which the U.S. Office of Management and Budget Circular A-128 requires. In addition, many agencies are not correctly calculating final payroll disbursements to separating employees and are not complying with required contracting procedures defined in the Public Contract Code.

We discovered these and other deficiencies when we performed our annual financial and compliance audit of the State. We have reported these systemic deficiencies to the Department of Finance, which is the agency having general supervisory responsibility over all matters concerning the financial and business policies of the State. In the following paragraphs, we discuss the deficiencies we found.

Failure To Require Agency Reconciliations to the State Controller

The State Administrative Manual, Section 7951, does not require agencies to prepare a Reconciliation of Agency Accounts With Transactions Per State Controller, Report 15, for approximately 225 funds, numbered 500 to 699 and 800 to 999. As a result, the State Controller's Office does not have evidence that agencies have reconciled financial information that appears in the General Purpose Financial Statements to State Controller's records.

The State Administrative Manual, Section 7900, discusses the importance of making regular reconciliations. Reconciliations represent an important element of internal control because they provide a high level of confidence that transactions have been adequately processed and that the financial records are complete. The reconciliation to the State Controller's Office balances is an important step in assuring the accuracy of the financial statements.

Failure To Require Agencies To Prepare a Report of Accruals to the Controller's Accounts

The State Administrative Manual, Section 7951, also does not require agencies to prepare a Report of Accruals to Controller's Accounts, Report 1, for funds numbered 500 to 699 and 800 to 999. Included among these funds are over 50 that have budget appropriations for the 1985-86 fiscal year. As a result, information that is needed to distinguish encumbrances from accounts payable and to present financial information in accordance with GAAP is not available for all funds.

The Government Code, Section 12460, requires that agencies make it possible to present the State's financial position in accordance with GAAP. In addition, Section 1100.101 of the "Governmental Accounting and Financial Reporting Standards," issued by the Governmental Accounting Standards Board, requires that agencies' accounting systems make it possible to present fairly their financial position and results of operations in accordance with GAAP.

Failure To Require Accounting for Expenditures of Federal Monies by Grant

The State's method of accounting for federal assistance does not provide sufficient information on expenditures. The State has no effective accounting system that reports expenditures of federal monies by grant. As a result, the State is not able to present a schedule of federal assistance that shows total expenditures for each federal assistance program and is, therefore, not in compliance with U.S. Office of Management and Budget Circular A-128.

The U.S. Office of Management and Budget Circular A-128 requires the State to submit an audit report on a schedule of federal assistance showing the total expenditures for each federal assistance program. The California Government Code, Section 13300, assigns the

Department of Finance the responsibility for establishing and supervising a complete accounting system to assure all revenues, expenditures, receipts, disbursements, resources, obligations, and property of the State are properly accounted for and reported.

Incorrect Calculations of Final Payroll for Separating Employees

State agencies do not always correctly calculate final payroll for salary and unused vacation leave for separating employees. From a total of 381 tested disbursements to separating employees at 74 agencies, we found that agencies had incorrectly calculated 34 (9 percent) of the disbursements. As a result, the State underpaid 20 individuals a total of $8,239 and overpaid 14 individuals a total of $3,055. The average underpayment was $412; the average overpayment was $218.

The Government Code, Section 19839, specifies that employees who separate from state service without fault are entitled to a lump sum payment for all accumulated vacation, compensating time off, and personal holidays, projected into future pay periods and accruing additional hours for each qualifying pay period.

Noncompliance With the
Public Contract Code

State agencies do not always comply with the Public Contract Code in establishing and maintaining contracts with vendors. During statewide testing at 15 agencies comprising a total of 152 contracts, we found 41 contracts that did not contain the required documentation or provisions. Moreover, 28 of the 152 contracts tested were not evaluated within 30 days of completion. As a result, the State may have entered into contracts with unreliable vendors.

The Public Contract Code, Sections 10296, 10338, 10353, and 10381(c), explain the required documentation and provisions to be included in state contracts, and Section 10347 requires each state agency to conduct an evaluation of each contract awarded within 30 days of completion of the contract. The table on the next page provides details of the test results.

TEST OF COMPLIANCE WITH STATE CONTRACTING PROCEDURES
FISCAL YEAR 1985-86

Agency	Number of Contracts Tested	Lack of Required Documentation or Provisions	Lack of Required Contract Evaluation
California Exposition and State Fair	10	8	8
California Student Aid Commission	12	2	0
Corrections, Department of	10	0	3
Developmental Services, Department of	10	0	0
Education, State Department of	10	0	0
Employment Development Department	10	7	2
Equalization, Board of	10	0	0
General Services, Department of	10	0	3
Health Services, Department of	10	4	7
Motor Vehicles, Department of	10	0	0
Social Services, Department of	10	10	1
State Controller	10	0	1
State Treasurer	10	8	1
Transportation, Department of	10	0	0
Water Resources, Department of	10	2	2
Total	152	41	28

Accountability for Fixed Assets

State agencies do not maintain sufficient records either to determine or to estimate the original cost of acquiring general fixed assets. Without these records, the State is unable to maintain adequate control over fixed assets, and the State is exposed to an increased risk of loss of assets. Moreover, this lack of records makes it impossible for the State Controller to present the General Fixed Assets Account Group in the State's General Purpose Financial Statements, thus making the State ineligible for a Certificate of Achievement for Excellence in Financial Reporting awarded by the Government Finance Officers Association.

Section 1400.110 of the "Governmental Accounting and Financial Reporting Standards," issued by the Governmental Accounting Standards Board, states that fixed assets should be accounted for at cost or, if the cost cannot be easily determined, at estimated cost.

Inadequate Reporting of Leasing Information

The State's records do not provide sufficient information about its lease obligations for the State Controller to comply with the disclosure requirements under GAAP when preparing the State's annual financial statements. GAAP require that the State as lessee disclose obligations for future minimum lease and rental payments in a summary showing these future payments for each fiscal year. However, the

State's space and equipment lease records maintained by the Department of General Services do not separate future minimum lease and rental payments by fiscal year. As a result, the State has to spend considerable time and effort to separate the information into fiscal years. This lack of separation in the records makes it difficult for the State Controller to extract the information needed to make the disclosures.

Governmental accounting and reporting standards require that governmental accounting systems allow the fair presentation and full disclosure of the financial position and result of financial operations in accordance with GAAP. In addition, the California Government Code, Section 12460, requires the State to present its financial position in accordance with GAAP.

Improper Omissions From the
<u>State Reporting Entity</u>

The District Agricultural Associations, which are organized to hold fairs and expositions, and the California State University Auxiliary Organizations, which promote and assist the California State University, are not currently treated as part of the state reporting entity. As a result, these institutions do not provide financial reports to the State, and the State's General Purpose Financial Statements are therefore incomplete. Moreover, the State Controller's Office does not have sufficient information to exercise its oversight responsibility over the financial records of these institutions.

In addition, Hastings College of the Law does not submit financial reports for all of its funds to the State Controller for inclusion in the State's General Purpose Financial Statements. The college sends financial reports to the State Controller for the General Fund, the Federal Trust Fund, the State Lottery Fund, the General Fixed Assets Group of Accounts, the Capital Outlay Fund for Public Higher Education, and Unclaimed Trust Money, but it does not send reports for its revenue bond fund. As a result, the State's General Purpose Financial Statements are misstated. At June 30, 1986, Hastings College of the Law had approximately $7 million in revenue bonds outstanding.

Section 2100.101 of the "Governmental Accounting and Financial Reporting Standards," issued by the Governmental Accounting Standards Board recommends that governments prepare a comprehensive annual financial report covering all funds and account groups of the reporting entity and establishes criteria for defining the reporting entity. The basic criterion, defined in Section 2100.108, is the ability to exercise oversight responsibility, manifested by financial dependency, selection of governing authority, designation of management, ability to significantly influence operations, and accountability for fiscal matters.

The District Agricultural Associations should be treated as part of the state entity because the State has oversight responsibility over them. The Food and Agriculture Code, Section 3953, states that each District Agricultural Association is in fact a state institution. In addition, the District Agricultural Associations receive state funds.

The California State University Auxiliary Organizations should be treated as part of the state entity because their purpose is to promote or assist the California State University, which is part of the state entity and which reports its financial activity in the State's General Purpose Financial Statements. Moreover, the Education Code, Section 89900, requires the operation of California State University Auxiliary Organizations to be conducted in conformity with regulations established by the trustees of the California State University and requires the accounting procedures of these auxiliary organizations to be approved by the Department of Finance. The Hastings College of the Law should be treated as part of the state entity because the State funds a significant portion of the college's financial activities.

Inconsistent Information in the State Administrative Manual

The State Administrative Manual is inconsistent about the account numbers required for agency use. The Department of Finance has updated Sections 7605 through 7680 of the State Administrative Manual to include the current account numbers, but it has not updated Sections 10401 through 10566 and 7810 through 7832. As a result, users of the State Administrative Manual have inaccurate and conflicting information.

Section 13070 of the Government Code gives the Department of Finance general powers of supervision over all matters concerning the financial and business polices of the State. This includes the development of accurate and consistent administrative policies.

RECOMMENDATION

The State should place greater emphasis on improving its systems of internal control and reporting financial information. These systems are essential for safeguarding state assets, assuring compliance with state law, and providing accurate and complete financial information. State agencies should establish more effective controls to prevent the violations of the Public Contract Code and the errors in final payroll disbursements to separating employees. In addition, the Department of Finance should change the State Administrative Manual so that it is accurate, complete, and consistent; better define which agencies should be included in the state entity; and monitor the state agencies to ensure that agencies correct the other weaknesses we identified.

ADMINISTRATIVE OFFICE OF THE COURTS

Item 1. **Lack of EDP Systems and Program Documentation**

Finding: The administrative office does not maintain a written record of internal processing performed by its computer accounting system. Although the administrative office is maintaining some records, it has not organized them into a usable format to provide the accounting staff with a procedures manual and a description of how the system works or to assure management that the system is operating in accordance with its plans. In addition, if current employees who design, program, and implement the system terminate their employment, the administrative office would have trouble maintaining or modifying its accounting system.

Criteria: The State Administrative Manual, Section 4846.6, recommends that each state agency establish controls to ensure the accuracy of data processed by computer. These controls should include a procedures manual detailing the proper use and internal processing of the computer, management's approval of the system and subsequent system changes, and tests to ensure that the system and programs are functioning as planned.

Recommendation: The administrative office should develop and maintain a procedures manual and an adequate level of system and program documentation to ensure that its computer accounting system is functioning as management planned.

Item 2. **Inadequate Separation of Data Processing Functions**

Finding: Before April 1986, the administrative office allowed computer programmers to correct errors in the accounting master files, which contain financial records of the Supreme Court and the appellate courts. As a result, the administrative office may have difficulty detecting unauthorized modifications to the financial records.

We discussed this issue with the administrative office in May 1986. The administrative office has since reassigned the function of correcting errors to an employee in the accounting office. The administrative office still allows computer programmers access to the accounting masterfiles but only to correct programming problems.

Criteria: The State Administrative Manual, Section 4846.5, requires state agencies to segregate the computer programming duties from all other data processing related duties.

Recommendation: The administrative office should continue to separate the function of correcting errors from the function of computer programming and to deny programmers access to the accounting masterfiles to the extent possible.

Item 3. **Weak Revenue Controls**

Finding: The administrative office does not have sufficient information to determine if all revenues have been collected for services provided by each court. Each court is responsible for determining cases that will be charged a filing fee and then for collecting and depositing the fees. For the 1985-86 fiscal year, the Supreme Court and the appellate courts collected $2.7 million in filing fees. The administrative office records the deposits made by each court, but it does not have independent information to determine whether each court collects and deposits all fees.

Criteria: The Government Code, Section 13403, requires that elements of a satisfactory system of internal accounting and administrative control include a system of recordkeeping adequate to provide effective accounting control over revenues.

Recommendation: The administrative office should require each court to provide sufficient information to enable the administrative office to determine if all revenues have been assessed and collected for services provided by the courts.

Item 4. **Late Deposits of Receipts**

Finding: Some courts are frequently late depositing cash and checks in banks. We found that 48 of the 56 deposits we examined contained receipts that were held between 6 and 45 working days. According to the State Administrative Manual, these receipts should have been deposited within 5 working days. Additionally, we noted 7 instances in which daily receipts exceeded $5,000 and were not deposited by the next working day as required by the State Administrative Manual. In one instance, the Second Appellate District Court held receipts up to 51 days before making a deposit of $58,017. The Second Appellate District Court should have made at least 14 deposits in that 51 day period. When the courts hold collections for an excessive period, there is an increased risk of loss from fire or theft, and the State loses interest earnings.

We estimate that the State lost interest earnings of approximately $4,800 in the first nine months of fiscal year 1985-86 because various courts were late in depositing their receipts. We computed this loss using an assumed interest rate of 9.365 percent, which approximates the interest earned on the State Pooled Money Investment Account for the first nine months of fiscal year 1985-86.

Criteria: The State Administrative Manual, Section 8030.1, requires that state agencies deposit collections in excess of $5,000 on the same day of receipt or by the next working day and that state agencies deposit accumulated collections totaling $50 or more within five working days.

Recommendation: The administrative office should instruct the Supreme Court and the appellate courts to deposit collections promptly.

Item 5. **Inadequate Review of Certain Invoices**

Finding: Before May 1986, the administrative office did not adequately review the mathematical accuracy of certain invoices that it received from the courts and that it scheduled for payment. In a sample of 112 general invoices, we found 10 invoices from the courts for appointed counsel that were mathematically incorrect and resulted in either an underpayment or an overpayment to the appointed counsel. Although we found no overpayment for more than $12 and no underpayment for more that $50, larger errors could occur. The administrative office did not review the mathematical accuracy of appointed counsel invoices before it approved and scheduled the invoices for payment by the State Controller's Office because each court approved the appointed counsel invoices. However, unless the administrative office reviews each invoice for mathematical accuracy, it risks making incorrect payments.

We discussed this issue with the administrative office in May 1986. The administrative office has since revised its written procedures requiring that appointed counsel invoices are reviewed and that the mathematical accuracy of the invoices is verified before they are scheduled for payment.

Criteria: The State Administrative Manual, Section 8422.1, requires state agencies to verify the mathematical accuracy of invoices before scheduling them for payment.

Recommendation: The administrative office should continue to verify the mathematical accuracy of invoices for appointed counsel before scheduling them for payment.

DEPARTMENT OF ALCOHOL AND DRUG PROGRAMS

The Department of Alcohol and Drug Programs administers one of the 34 federal programs we reviewed. It is the U.S. Department of Health and Human Services grant, Federal Catalog Number 13.992.

Item 1. **Failure To Monitor Counties' Cash Balances**

Finding: The department does not require counties to submit reports that detail the amount of federal funds received and used on the block grant programs. These reports provide the information the department needs to determine (1) if the State is advancing federal funds to counties before they are needed, resulting in loss of interest earnings to the state or federal governments, or (2) if counties are using nonfederal money to initially finance the federal block grant program, resulting in loss of interest earnings to counties. The department asserts that its analysis indicates that the State is not advancing federal funds to counties before they are needed. Moreover, on September 25, 1986, the federal Department of Health and Human Services reported that the department's system for requesting federal funds minimizes the time that federal funds are held by recipients and subrecipients. However, the report also says that the State should continue to monitor the system to assure adherence to federal policies.

Criteria: The U.S. Office of Management and Budget, Circular A-102, Attachment G, requires the department to develop procedures to monitor cash balances of counties.

Recommendation: The department should develop procedures to evaluate and monitor the federal cash balances of counties.

Item 2. **Inadequate Accountability of Accounts Receivable**

Finding: The department does not correctly account for amounts due from grant recipients for costs questioned by the department's audits of these grant recipients. As of June 30, 1986, the department's accounts receivable for these questioned costs totaled approximately $1.6 million. However, we found that the $1.6 million balance included $40,154 for accounts that were recorded twice, $221,884 for accounts that had already been collected or written off, and $367,255 for accounts due from grant recipients that were either bankrupt or no longer in operation. Failure to correctly account for accounts receivable increases the amount that the federal government could deduct from future ADAMHS block grants.

Criteria: The U.S. Office of Management and Budget, Circular A-102, Attachment G, requires effective control over and accountability for grant funds, property, and other assets. This circular also requires that accounting records be supported by source documentation. Additionally, the State Administrative Manual, Section 8710.1, requires the department to establish collection procedures for accounts receivable.

Recommendation: The department should delete from its accounts receivable balance all amounts that are not valid. Further, it should regularly review its accounts receivable, determine which are correct and collectible, and follow up on collection efforts.

CALIFORNIA COMMUNITY COLLEGES, CHANCELLOR'S OFFICE

Item 1. **Late and Inaccurate Financial Reports**

Finding: The Chancellor's Office did not submit its financial reports to the State Controller's Office until September 25, 1986, two and one-half months after the deadline. In addition, the Chancellor's Office submitted revised financial reports on November 7, 1986. These revised financial reports contained several deficiencies, including failure to adequately report an operating transfer in the year-end financial reports, and inaccurate classification of expenditures on several reports. The senior accounting officer attributes the inability of the Chancellor's Office to meet financial report deadlines and the deficiencies in the financial reports primarily to a backlog in the accounting unit and the fact that the new accounting officer was unfamiliar with the Chancellor's Office and with the CALSTARS. Failure to submit accurate financial reports by the required deadlines delays the compilation by the State Controller's Office of financial statements for the State of California and the State Treasurer's Official Statement accompanying bond issues.

Criteria: A State Controller's Office memorandum dated April 17, 1986, requires multi-funded agencies to submit their General Fund financial reports by July 31. Financial reports for funds other than the General Fund must be submitted by August 20. In addition, a Department of Finance Management Memo 86-6, dated April 7, 1986, reminded agency executives of their responsibility for preparing accurate year-end financial reports. The State Administrative Manual, Sections 7950 through 7979, describes the requirements for preparing accurate financial reports.

Recommendation: The Chancellor's Office should reduce its accounting backlog and train more staff in the use of the CALSTARS to ensure that it submits accurate year-end financial reports by the required deadlines.

Item 2. **Inadequate Separation of Duties in the Accounting and Budget Section**

Finding: The Chancellor's Office does not provide adequate separation of duties in its accounting and budget section. One employee prepares invoices and reconciles the bank accounts. The fiscal officer for the Chancellor's Office attributes the inadequate separation of duties to understaffing in the accounting and budget section. Unless these duties are properly segregated, an employee can conceal irregularities, and responsibility for errors may not be determined. We observed a similar weakness during our financial audit for fiscal year 1984-85. Although the Chancellor's Office partially corrected the deficiencies we noted by filling the vacant accounting officer position, it was unable to fully segregate all incompatible duties.

Criteria: The State Administrative Manual, Section 8080, specifies that an employee who initiates or prepares invoices is not to reconcile the bank accounts.

Recommendation: The Chancellor's Office should reassign the duties of invoice preparation and bank account reconciliation among employees in the accounting and budget section to provide separation of those duties as required.

Item 3: Lack of Control Over Purchasing Functions

Finding: The Chancellor's Office does not always prepare purchase orders or maintain control over use of purchase orders. Consequently, the Chancellor's Office is not assured that all of its expenditures have been properly authorized and are, in fact, appropriate expenditures. In addition, the Chancellor's Office does not have travel authorizations approved by an employee's supervisor to support the employee's travel expense claims and invoices for airline tickets received from travel agents. Although the Chancellor's Office uses purchase order documents that are prenumbered, it records them using a consecutive numbering system that starts over at the beginning of each fiscal year. As a result, purchase orders with the same number but for different purchases may be outstanding at the same time. Further, in our test of 70 claims transactions, we found 10 transactions that were not supported by a purchase order or a travel authorization.

Criteria: The Government Code, Section 13403(a)(3), sets forth the elements of a satisfactory system of internal accounting and administrative control, including authorization and recordkeeping procedures adequate to provide effective accounting control over expenditures. The State Administrative Manual, Section 8422.1, requires each agency to determine that invoices comply with provisions of purchase orders, sub-purchase orders, contracts, leases, service agreements, and similar documents.

Recommendation: The Chancellor's Office should use the pre-printed numbers on the purchase orders for control purposes and should ensure that its purchasing procedures comply with state requirements. These procedures should include the use of travel authorizations approved by an employee's supervisor to support travel costs incurred.

Item 4. **Lack of Security Documentation for Access to CALSTARS**

Finding: The security officer in the Chancellor's Office has not established and controlled all aspects of security over the CALSTARS. The Security Access Request forms for three individuals were not on file and could not be found. Without these forms, the Chancellor's Office has not documented that it has distributed access to the CALSTARS in the proper manner. In addition, it cannot determine whether the internal controls over access to the CALSTARS are in place and functioning as prescribed. The new security officer and other agency personnel state that they could not locate all Security Access Request forms because of the office reorganization that was taking place.

Criteria: The CALSTARS Procedures Manual, Volume III, Chapter III, states that each agency using the CALSTARS is required to designate an individual within the organization as its security officer. The security officer is responsible for establishing and controlling all aspects of the CALSTARS security within the agency, as required by the State Administrative Manual, Section 8080.1.

Recommendation: The Chancellor's Office should find all current Security Access Request forms and properly file them for safekeeping. If the three missing forms cannot be found, all personnel having access to the CALSTARS should complete new forms, and all forms should be properly safeguarded.

Item 5.	**Incomplete Documentation of the EDP Apportionment System**
Finding:	The Chancellor's Office has not completely documented the EDP system that apportions approximately $1.2 billion to the community college districts. There is insufficient documentation to describe the planning and testing of the EDP system and programs and to describe the creation and maintenance of this system and programs. During fiscal year 1986-87, the Chancellor's Office improved its documenting of the planning and testing of changes. Without system documentation, there is no basis for determining whether the system is working as intended. We observed this same weakness during our financial audit for fiscal year 1984-85. However, the Chancellor's Office has no plans to document the current system because it is developing a completely new EDP system for fiscal year 1987-88, and the contract for this system requires documentation for programs, changes, testing, and implementation.
Criteria:	Effective internal control over EDP activities requires evidence of controls over system design, development, testing, and changes of the EDP system and programs.
Recommendation:	The Chancellor's Office should determine, establish, and ensure compliance with requirements for appropriate documentation of the EDP apportionment system.
Item 6.	**Inadequate Controls Over Accounts Receivable**
Finding:	The Chancellor's Office did not adequately control its accounts receivable in fiscal year 1985-86. Rather than use the Project Billing Activity Report generated by the CALSTARS to bill and monitor its contract activity, the office maintained a manual system that did not include a process for monitoring payments received against invoices billed. Consequently, the Chancellor's Office cannot be sure that all billed receivables related to contracts have been collected. The Chancellor's Office attempted to note all contract payments on the file copy of the invoice; however, this procedure was not consistently followed. Agency personnel explained that this system is not the system normally employed and that they do not plan to use it in future fiscal years.

Criteria: The Government Code, Section 13403(a)(3), requires the elements of a satisfactory system of internal accounting control to include a system of authorization and recordkeeping procedures adequate to provide effective accounting control over assets, liabilities, revenues, and expenditures. The Government Code, Section 13403(a)(4), also requires that an established system of practices be followed when agency staff perform their duties and functions.

Recommendation: The Chancellor's Office should develop and maintain adequate billing, collection, and accounting procedures that will ensure the prompt and accurate billing, recovery, and monitoring of all receivables.

Item 7. **Insufficient Documentation of Accounting Transactions**

Finding: The Chancellor's Office was unable to identify or support six reconciling items, totaling $16,376, included on the June 30, 1986, reconciliation of its general checking account and five revolving fund cash disbursements, totaling $4,163. Further, for at least six months, the Chancellor's Office had in its bank reconciliation seven additional reconciling items, totaling $13,062. Two of these items have been outstanding for over one year. Without sufficient documentation, the Chancellor's Office cannot ensure that all accounting transactions are appropriate and properly authorized.

Criteria: The State Administrative Manual, Section 7967, requires that an explanation of the nature of every unusual reconciling item be made a part of the monthly bank reconciliation.

Recommendation: The Chancellor's Office should identify and support all accounting transactions it makes in its accounting records. Further, it should resolve all general checking account reconciling items within the time frames established by the State Administrative Manual.

Item 8. **Inadequate Control Over Property**

Finding: As we have reported for the last three years, the Chancellor's Office has not reconciled its physical inventory of property to its accounting records within the last four years. In February 1983, the headquarters of the Chancellor's Office was severely damaged by fire. Currently, the Chancellor's Office is comparing the property records of the physical inventory completed in February 1985 to the property records it had before the February 1983 fire. Failure to reconcile the physical inventory counts to the accounting records can result in the failure to detect the loss or theft of state property.

Criteria: The State Administrative Manual, Section 8659, requires that a physical inventory of property be reconciled to accounting records at least once every three years.

Recommendation: The Chancellor's Office should complete its comparison of its 1983 and 1985 physical inventory records and reconcile its property records to its accounting records.

CALIFORNIA SCHOOL FOR THE BLIND

The California School for the Blind administers 2 of the 34 federal programs we reviewed. They are the U.S. Department of Agriculture grants, Federal Catalog Numbers 10.553 and 10.555.

Item 1. Late Remittances to the State Treasurer

Finding: The school does not promptly remit all monies that are determined to be revenue, reimbursement, abatements, and operating income to the State Treasurer. Of the receipts we tested, the school did not remit 60 percent to the State Treasurer within 30 days following the collection date. Dates of these late remittances ranged from 33 to 119 days after the school received the money. The late remittances represented approximately $95,600 of the $128,000 tested. By not remitting these monies on time, the school cannot use the monies to pay its current obligations.

Criteria: The State Administrative Manual, Section 8091, specifies that all monies that are determined to be revenue, reimbursement, abatements, and operating income must be remitted to the State Treasurer within 30 days following the date collected. In addition, the same section requires remittance no later than the first day of the week after monies accumulate to $25,000.

Recommendation: The school should assign to a specific employee the duty of preparing remittance advices within the time guidelines of the State Administrative Manual, Section 8091. In addition, the business manager should occasionally review the remittances to assure that the remittances are prompt.

Item 2. Inadequate Control Over Revolving Fund Accountability

Finding: The school's personnel do not properly account for the revolving fund. For fiscal year 1984-85, the State Controller advanced $40,000 to the school. However, a recorded cash overage existed for the entire 1984-85 fiscal year, and the revolving fund reconciliation showed an ending balance of approximately $41,500. Failure to maintain adequate control over revolving fund activities can result in the misstatement of account balances.

Criteria: The State Administrative Manual, Section 8171, requires that cash overages be cleared as revenue or operating income at least once each quarter.

Recommendation: The school should identify the discrepancy in the revolving fund and clear cash overages as revenue or operating income.

Item 3. Inadequate Separation of Duties

Finding: The school does not adequately separate duties for receiving, recording, and disbursing cash. The accounting officer maintains the cash receipts and cash disbursements registers, prepares the bank reconciliations, and authorizes cash disbursements. Without proper separation of duties, employees can conceal irregularities, and management may be unable to determine the responsibility for errors.

Criteria: The State Administrative Manual, Section 8080, specifies that one person should perform no more than one of the following duties (among others): authorize disbursements, sign checks manually after personally comparing them with authorizations and supporting documents, and reconcile bank accounts and post the general ledger or any subsidiary ledger affected by cash transactions.

Recommendation: The business manager should reassign duties among employees to provide for adequate separation of duties. Employees do not have to be members of the accounting staff to perform some of these duties.

Item 4. Invalid Balance in Accounts Receivable--Abatements

Finding: The Accounts Receivable--Abatements balance is invalid, primarily for two reasons. First, the school does not consistently liquidate its receivables. The school's June 30, 1985, legal basis balance sheet has an Accounts Receivable--Abatements balance of $18,671. Approximately $4,300 of the balance was collected before June 30, 1985, but was not eliminated from the school's records. In addition, according to the business manager, a former employee recorded the remaining balance, and the business manager was not able to explain the entry.

Criteria: The State Administrative Manual, Section 10220, specifies the transactions that should be accounted for as abatements. Good accounting practices require that entries be made to the proper accounts and that recorded receivables be liquidated when monies are received.

Recommendation: The school should eliminate the $18,671 from its books. In addition, the school should liquidate amounts from the accounts receivable balance when they are received. The business manager should review the entries to assure that accounts receivable have been properly liquidated.

Item 5. Inadequate Control Over Salary Advances

Finding: The school does not promptly recover its salary advances. On June 30, 1985, the school's salary advances amounted to $20,075, $4,933 of which had been outstanding since July 1982 or earlier. Of the $4,933, $3,081 is due from employees who are no longer employed by the school. Approximately $15,562 of these advances, which are for non-industrial injuries, State Controller's office errors, and docked salaries, are due from the State Controller. The remaining advances are due from employees. If the school fails to collect salary advances, it cannot use these funds for current obligations. In addition, if an employee leaves state service without repaying an advance, state funds may be lost.

Criteria: The State Administrative Manual, Section 8118, requires agencies to collect a salary advance from the payroll warrant issued for the period covered by the salary advance. In addition, good accounting practices require that personnel follow up to collect amounts due from the State Controller.

Recommendation: The payroll personnel should provide sufficient information to the State Controller's office so that the advances for non-industrial injuries, docked salaries, and State Controller's office errors can be collected from the State Controller. In addition, the payroll personnel should promptly collect all advances due from employees in accordance with the State Administrative Manual guidelines.

Item 6. Invoices Insufficiently Marked To Prevent Duplicate Payment

Finding: The school does not sufficiently mark invoices to prevent duplicate payment. School personnel did not sufficiently mark as paid 5 of the 30 invoices we tested. These invoices totaled approximately $20,338. Invoices could be paid twice if they are not sufficiently marked.

Criteria: The State Administrative Manual, Section 8080, specifies that the person who prepares the checks (or schedules) is to mark authorizations, invoices and supporting documents so that they cannot be reused.

Recommendation: Personnel should mark each invoice separately to prevent duplicate payment. The supervisor should review the invoices before signing the checks or claim schedules.

Item 7. Inadequate Control Over Payroll Documents

Finding: The school's payroll procedures do not always ensure that payroll documents are accurately recorded or properly authorized. Supervisors did not sign two of the five monthly attendance reports we tested. In addition, two of the five employee leave record cards tested did not agree with the absence and additional time worked reports. Failure to keep accurate payroll records can result in employees receiving improper vacation, overtime, and sick leave credits.

Criteria: The State Personnel Board's Personnel Transaction Manual, Section 615.21, requires information on the use of sick leave and vacation to be obtained from monthly attendance reports. For good internal control, the employee leave record cards should agree with the supporting documents, and all attendance documents should be properly verified and authorized by department supervisors.

Recommendation: The school should inform the department supervisors that all payroll documents must be signed. In addition, the payroll personnel should ensure that the attendance documents are consistent before posting them to the leave record cards.

Item 8. Failure To Identify Obligations Correctly

Finding: The school did not accurately identify its true obligations from unliquidated encumbrances at June 30, 1985. Encumbrances were approximately $43,337 of the $218,611 recorded as accounts payable. If the school does not properly identify encumbrances in its financial statements, the State Controller's Office does not have sufficient information to prepare the State of California's financial statements in accordance with generally accepted accounting principles.

Criteria: A State Controller's Office memorandum issued May 24, 1985, requires that agencies analyze unliquidated encumbrances to determine what portion is for outstanding encumbrances (goods or services not received as of June 30) and what portion is for obligations (goods or services received as of June 30).

Recommendation: The school's accounting personnel should accurately determine and report which of its unliquidated encumbrances are obligations at the end of the year.

CALIFORNIA SCHOOL FOR THE DEAF AT FREMONT

The California School for the Deaf at Fremont administers 2 of the 34 federal programs we reviewed. They are the U.S. Department of Agriculture grants, Federal Catalog Numbers 10.553 and 10.555.

Item 1. **Late Remittances to the State Treasurer**

Finding: The school is not promptly remitting monies to the State Treasurer. Of 15 general cash receipts tested, 13 were not remitted to the State Treasurer within 30 days following the collection date. In some cases, the school did not remit these monies for 40 to 93 days after they were received. In one instance, the school did not remit a receipt of $37,500 for over five weeks after it was received. By not remitting these monies, the school cannot use the monies to pay current obligations. The school's accounting officer stated that during the 1984-85 fiscal year, no one employee was responsible for preparing remittance advices, nor was there a specific deadline for completing remittance advices.

Criteria: The State Administrative Manual, Section 8091, requires that receipts be remitted to the State Treasurer within 30 days of collection and that deposits of over $25,000 be remitted no later than the first day of the week following the accumulation of that amount.

Recommendation: The accounting officer should assign to a specific employee the duty of preparing remittance advices within the time guidelines of the State Administrative Manual, Section 8091. In addition, the accounting officer or business manager should review the remittances to assure that the remittances are prompt.

Item 2. **Inaccurate Financial Statements**

Finding: The school submitted inaccurate financial statements to the State Controller's office. For example, the school reported an accounts receivable balance of $403,579 as of June 30, 1985. This balance was overstated by $226,642. The overstatement occurred because the school's accounting staff were unfamiliar with the new computerized accounting system and because the accounting staff did not adjust for known errors.

Criteria: The Department of Finance's memorandum dated July 2, 1985, reminded the school's executives that they are responsible for preparing accurate year-end reports. In addition, the business manager certified that the year-end reports were correct.

Recommendation: The school's personnel should assure that all year-end reports are accurate. In particular, agency personnel should review the accounts receivable listing carefully to determine which receivables are valid. The accounting officer and the business manager should determine whether the school's accounting staff needs additional accounting and computer training to avoid similar errors in the future.

Item 3. Inadequate Control Over Salary Advances

Finding: The school does not adequately account for or promptly collect salary advances. For example, the school reported salary advances of $28,229 as of June 30, 1985, but no records exist to support that balance. A listing showing $17,886 in advances as of July 11, 1985, does not include some advances outstanding since July 1983. In addition, the school has not collected outstanding advances that it has identified because, according to both the accounting officer and the personnel officer, no understanding existed between the business office and personnel office as to who was responsible for collecting salary advances. Since some of these advances are to individuals no longer employed at the school, the advances are less collectible.

Failure to collect salary advances from employees may result in the loss of state funds if the employees leave state service without repaying the advance. In addition, revolving fund monies are not available for other uses when the salary advances are not promptly collected. Finally, failure to monitor and maintain complete lists of salary advances impairs the reliability of the revolving fund accountability statement.

Criteria: The State Administrative Manual, Section 7951, requires agencies to retain supporting detail for year-end general ledger balances. The State Administrative Manual, Section 8118, requires agencies to collect the repayment for a salary advance from the payroll warrant issued to reimburse the revolving fund for the salary advance.

Recommendation:	The school's accounting and personnel units should maintain a complete list of salary advances to record advances as they are made and to cancel advances as they are collected. In addition, the accounting and the personnel units should agree on procedures to ensure that salary advances are collected promptly. The personnel unit should promptly collect amounts due from employees in accordance with the State Administrative Manual, Section 8118.
Item 4.	**Access to Blank Check Stock Not Sufficiently Restricted**
Finding:	The business manager and the accounting officer have access to the blank check stock and have the authority to sign checks. The accounting officer controls the blank check stock. State funds could be misused when persons authorized to sign checks have access to the blank check stock.
Criteria:	The State Administrative Manual, Section 8080, states that employees authorized to manually sign checks should not have access to the blank check stock.
Recommendation:	The school should store the blank check stock in a separately-locked area of the safe and not allow employees authorized to sign checks to have access to the blank check stock. In addition, an employee not responsible for authorizing disbursements or signing checks should have the duty of controlling the blank check stock.
Item 5.	**Bank Reconciliation Prepared Improperly**
Finding:	The Centralized Treasury System bank reconciliation, as prepared, does not clearly show that the balance in the school's records agrees with the balance in the Centralized Treasury System. Although the balances do agree, the proper reconciliations should be done so that errors may be detected.
Criteria:	The State Administrative Manual, Section 7967, requires agencies to reconcile the agency accounts with the adjusted Centralized Treasury System balance. Section 7967 also illustrates the proper format for the reconciliation.
Recommendation:	The accounting supervisor should review the reconciliation to ensure that it is correct and has the proper format.

Item 6. **Long-Outstanding Checks**

Finding: The school does not cancel or stop payment on long-outstanding checks. As of June 30, 1985, 35 general cash and revolving fund checks were over two years old. Of these, 20 checks were over four years old. In addition, 22 trust fund checks were over four years old.

Criteria: The State Administrative Manual, Section 8042, requires General Fund and revolving fund checks outstanding for two years and trust fund checks outstanding for four years to be cancelled. If General Fund and revolving fund checks are over four years old, the school should send stop payment notices to the State Treasurer.

Recommendation: The school's accounting staff should comply with the provisions of the State Administrative Manual, Section 8042, by cancelling checks or by sending stop payment notices to the State Treasurer when checks are outstanding.

Item 7. **Noneligible Meals Claimed for the National School Lunch Program**

Finding: In an isolated instance, the school counted 70 snacks as lunches for reimbursement from the National School Lunch Program. Because snacks do not meet nutritional requirements for reimbursement as lunches, the federal program was overcharged.

Criteria: Only meals meeting the requirements of the Code of Federal Regulations, Title 7, Chapter 11, Section 210.10, are eligible for reimbursement.

Recommendation: After preparing the Record of Meals Served report, food service personnel should review the number of meals claimed for reimbursement for accuracy.

CALIFORNIA STATE UNIVERSITY
OFFICE OF THE CHANCELLOR

Item 1. **Improper Identification of Encumbrances**

Finding: The accounting personnel of the Chancellor's Office did not accurately identify in their Schedule of Accounts Payable which of their unliquidated encumbrances constituted obligations at June 30, 1986. Consequently, encumbrances were overstated by $2.7 million, and obligations were understated by $2.7 million in the General Fund financial reports. Further, encumbrances were overstated by $619,000, and obligations were understated by $619,000 in the Capital Outlay Fund for Public Higher Education financial reports. The misstatements occurred because the accounting personnel did not thoroughly analyze the accounts payable to determine whether goods were received or services were provided before or after June 30.

In addition, because the Chancellor's Office did not properly identify encumbrances in its financial statements, it did not provide the State Controller's Office with sufficient information to prepare the State's financial statements in accordance with generally accepted accounting principles.

Criteria: A State Controller's memorandum dated April 17, 1986, to state agency accounting officers instructed agencies to report the amount of encumbrances applicable to their accruals in such a way that financial statements could be prepared in accordance with generally accepted accounting principles. Under generally accepted accounting principles, encumbrances are that portion of the accruals that represent goods and services received or provided after June 30.

Recommendation: During year-end closing, the Chancellor's Office should analyze its accruals to determine whether goods were received or services provided before or after June 30 and report them appropriately as liabilities or encumbrances.

Item 2. **Inadequate Control Over Cash in Sub-Revolving Funds Not Reported in the Year-End Financial Reports**

Finding: The Chancellor's Office maintains cash funds, held in various overseas locations, that total $50,000. These cash funds were not included as cash in the year-end financial reports. Instead, the amount was incorrectly deducted from accounts payable as a revolving fund adjustment for expenditures not scheduled for reimbursement at the end of the year. Consequently, both cash and accounts payable were understated in the year-end financial reports. In addition, these cash funds are not independently counted by employees other than the custodians of the funds.

Criteria: A Department of Finance Management Memo 86-6, dated April 7, 1986, reminded agency officials of their responsibility for preparing accurate year-end financial reports. The State Administrative Manual, Sections 7950 through 7979, describes the requirements for preparing accurate financial reports. In addition, the State Administrative Manual, Section 8111.2, requires that all cash funds be independently counted at least annually and that cash funds exceeding $200 be counted more than once a year.

Recommendation: The Chancellor's Office should ensure that year-end financial reports are accurate before approving them for distribution. Further, the Chancellor's Office should ensure that cash funds are independently counted in accordance with the requirements of the State Administrative Manual.

Item 3. **Inadequate Certification of Payroll Claims**

Finding: The Chancellor's Office payroll claims are certified by payroll clerks but are not reviewed and certified by a duly appointed, qualified acting officer. The certification is to ensure, among other things, that the payroll is correct, that the work was actually performed for the benefit of the State, that the payments are for the named individuals and that they were employed in accordance with the law, that all provisions of law governing such employment have been fully complied with, and that all deductions for purposes set forth in the Government Code are in conformity with written authorization of the employees. Because of its significance, the certification must be completed by an official of the Chancellor's Office.

Criteria: Title 2, California Administrative Code, Section 654, requires that each payroll claim contain a certification from a duly appointed, qualified acting officer of the state agency.

Recommendation: The Chancellor's Office should require that all payroll claims prepared by the payroll clerks be reviewed and certified by a responsible officer before submitting them to the State Controller's Office for processing.

CALIFORNIA STATE UNIVERSITY, FULLERTON

Item 1. **Inaccurate Financial Reports**

Finding: The CSU Fullerton does not prepare accurate General Fund year-end financial reports in accordance with requirements of the State Administrative Manual. Because of deficiencies, the CSU Fullerton's financial statements are neither complete nor accurate. We found the following specific deficiencies:

- The CSU Fullerton did not correctly prepare its Report of Accruals to Controller's Accounts to show $1.5 million of encumbrances.

- The CSU Fullerton did not reconcile its Accrual Worksheet to its Pre-closing Trial Balance, and to the Analysis and Reconciliation of Revolving Fund Accountability at June 30, 1986. The revolving fund adjustments to the expense advances to employees, due from other funds, and accounts payable shown in the accrual worksheet were misstated by $27,996, $4,784, and $32,780, respectively.

Criteria: A Department of Finance Management Memo 86-6, dated April 7, 1986, reminded agency officials of their responsibility for preparing accurate year-end financial reports. The State Administrative Manual, Sections 7950 through 7979, describes the requirements for preparing accurate financial reports.

Recommendation: The CSU Fullerton should prepare complete and accurate year-end financial reports in accordance with requirements in the State Administrative Manual.

Item 2. **Unreported Employee Expense Advances**

Finding: The CSU Fullerton did not report in its June 30, 1986, financial reports the correct amount of outstanding travel advances to employees; advances totaling $30,745 were incorrectly deducted from the accounts payable balance. Consequently, both expense advances and accounts payable were understated by the same amount.

Criteria: The State Administrative Manual, Section 10420, requires that cash advanced to employees for travel should be reported as expense advances to employees.

Recommendation: The CSU Fullerton should ensure that year-end financial reports are accurate before approving them for distribution.

Item 3. **Improper Identification of Encumbrances**

Finding: The accounting personnel of the CSU Fullerton did not accurately identify in their Schedule of Accounts Payable which of their unliquidated encumbrances constituted obligations at June 30, 1986. Consequently, encumbrances were overstated by $304,644, and obligations were understated by $304,644. The misstatements occurred because the accounting personnel did not thoroughly analyze the accounts payable to determine whether goods were received or services were provided before or after June 30.

Furthermore, as mentioned in Item 1, the CSU Fullerton did not properly identify encumbrances in its financial statements and therefore did not provide the State Controller's Office with sufficient information to prepare the State's financial statements in accordance with generally accepted accounting principles.

Criteria: A State Controller's memorandum dated April 17, 1986, to state agency accounting officers instructed agencies to report the amount of encumbrances applicable to their accruals in such a way that financial statements could be prepared in accordance with generally accepted accounting principles. Under generally accepted accounting principles, encumbrances are that portion of the accruals that represent goods received or services provided after June 30.

Recommendation: During year-end closing, the CSU Fullerton should carefully analyze its accruals to determine whether goods were received or services provided before or after June 30 and report them appropriately as liabilities or encumbrances.

CALIFORNIA STATE UNIVERSITY, LOS ANGELES

Item 1. **Inadequate Financial Reports**

Finding: The CSU Los Angeles does not prepare complete and accurate year-end financial reports in accordance with requirements of the State Administrative Manual. Because of these deficiencies, the CSU Los Angeles' financial statements are neither complete nor accurate. We found the following specific deficiencies:

- The CSU Los Angeles did not reconcile its Accrual Worksheet and Pre-Closing Trial Balance to its Reconciliation of Agency Accounts With Transaction Per State Controller. Prepayments to the Service Revolving Fund were incorrectly reported as $95,112 on both the Accrual Worksheet and the Pre-Closing Trial Balance. The correct balance should have been $146,530 as was reported on the Reconciliation of Agency Accounts With Transactions Per State Controller.

- The CSU Los Angeles did not accurately prepare Reconciliation of Agency Accounts With Transactions Per State Controller. The prior year accruals for 1983-84 appropriations indicated in the 1985-86 report were $26,557 more than those indicated in the 1984-85 report.

Criteria: Department of Finance Management Memo 86-6, dated April 7, 1986, reminded agency officials of their responsibility for preparing accurate year-end financial reports. The State Administrative Manual, Sections 7950 through 7979, describes how year-end financial reports should be prepared.

Recommendation: The CSU Los Angeles should prepare complete and accurate year-end financial reports in accordance with requirements in the State Administrative Manual.

Item 2. **Unreported Employee Expense Advances**

Finding: The CSU Los Angeles did not report in its June 30, 1986, financial reports the correct amounts of outstanding salary and travel advances to employees. Approximately $94,100 of advances were incorrectly deducted from the accounts payable balance. Consequently, both expense advances and accounts payable were understated by the same amount.

Criteria: The State Administrative Manual, Section 10420, requires that cash advanced to employees for travel should be accounted for as expense advances to employees.

Recommendation: The CSU Los Angeles should ensure that year-end financial reports are accurate before approving them for distribution.

Item 3. Failure To Promptly Clear Revolving Fund Advances

Finding: The CSU Los Angeles does not promptly clear outstanding advances made to employees from the revolving fund. For example, as of June 30, 1986, 46 salary advances totaling $11,400 were outstanding over 90 days, with 10 advances dating from 1980 to 1985. In addition, 58 travel advances totaling $12,500 were also outstanding over 90 days. Several employees had more than one salary or travel advance.

The long outstanding advances result from a lack of coordinated efforts among payroll, accounting, and departmental personnel to collect from the employees the amounts as they become due and to require the employees to submit travel claims promptly.

Failure to clear advances due from employees may result in the loss of state funds if the employees leave state service without repaying the advances. In addition, revolving fund monies are not available for other uses when the advances are not promptly cleared.

Criteria: The State Administrative Manual, Section 8118, requires that agencies collect repayments of salary advances from subsequently issued payroll warrants for the period covered by the salary advance. In addition, Section 8116-1 states that agencies should schedule employees' travel expense vouchers in a claim to the State Controller's Office to reimburse the revolving fund advance. If the advance exceeds the travel claim, the State Administrative Manual, Section 8116-1, requires the employee to pay the difference promptly.

Recommendation: The CSU Los Angeles should establish written procedures to collect outstanding revolving fund advances according to the State Administrative Manual requirements. Furthermore, the CSU Los Angeles should expedite recovery of the long outstanding salary and travel advances from separated employees either through the tax offset procedures of the Franchise Tax Board or through relief of accountability from the State Board of Control.

Item 4. **Improper Identification of Encumbrances**

Finding: The accounting personnel of the CSU Los Angeles did not accurately identify in their Schedule of Accounts Payable which of their unliquidated encumbrances constituted obligations at June 30, 1986. Consequently, encumbrances were understated by $119,000, and obligations were overstated by $119,000. The misstatements occurred because the accounting staff did not thoroughly analyze the accruals to determine whether goods were received or services were provided before or after June 30.

Because the CSU Los Angeles did not properly identify encumbrances in the financial statements, it did not provide the State Controller's Office with sufficient information to accurately prepare the State's financial statements in accordance with generally accepted accounting principles.

Criteria: State Controller's Memorandum dated April 17, 1986, to state agency accounting officers instructed agencies to report the amount of encumbrances applicable to their accruals in such a way that financial statements could be prepared in accordance with generally accepted accounting principles. Under generally accepted accounting principles, encumbrances are that portion of the accruals that represent goods received or services provided after June 30.

Recommendation: During year-end closing, the CSU Los Angeles should carefully analyze its accruals to determine whether goods were received or services provided before or after June 30 and report them appropriately as liabilities or encumbrances.

CALIFORNIA STATE POLYTECHNIC UNIVERSITY, POMONA

Item 1. **Inaccurate Financial Reports**

Finding: The CSPU Pomona does not prepare accurate year-end financial reports in accordance with requirements of the State Administrative Manual. Because of deficiencies, the CSPU Pomona's financial statements are neither complete nor accurate. We found the following specific deficiencies:

- The CSPU Pomona did not correctly prepare the Report of Accruals to Controller's Accounts to show $3.4 million of encumbrances.

- The CSPU Pomona did not reconcile the Final Budget Report for the 1983-84 appropriation expenditure and unexpended allotment balances to the Final Reconciliation of Controller's Accounts With Final Budget Report.

- The CSPU Pomona's Pre-closing Trial Balance did not agree with the Accrual Worksheet and with the Reconciliation of Agency Accounts With Transactions Per State Controller. The accounts payable, claims filed, appropriation expenditures, and prior year appropriation adjustments account balances indicated in these reports were not in agreement.

- The CSPU Pomona in its Accrual Worksheet omitted the Accounts Receivable - Other and the related Provision for Deferred Receivable account balances as shown in the Pre-closing Trial Balance.

Criteria: Department of Finance Management Memo 86-6, dated April 7, 1986, reminded agency officials of their responsibility for preparing accurate year-end financial reports. The State Administrative Manual, Sections 7950 through 7979, describes the requirements for preparing accurate financial reports.

Recommendation: The CSPU Pomona should prepare complete and accurate year-end financial reports in accordance with requirements in the State Administrative Manual.

Item 2. **Inadequate Control Over Receipt of Goods**

Finding: The CSPU Pomona does not provide adequate control over the receipt of goods that are directly purchased and delivered to the departments that ordered the goods. The accounts payable clerks do not always verify that billed goods have actually been received before the goods are approved for payment. Because of these weaknesses, it is possible that payments are being made for goods or services that have not been received.

Criteria: The State Administrative Manual, Sections 8410 and 10832, requires agencies to prepare stock received reports. When stock received reports are prepared or signed by a person other than the person actually receiving and checking the goods, the person signing the report should be sure that the goods were actually received and checked.

Recommendation: The CSPU Pomona should require departments ordering goods to prepare stock received reports for direct purchases and deliveries of goods before paying for the goods.

Item 3. **Unsigned and Undated Bank and Revolving Fund Reconciliations**

Finding: The monthly bank and revolving fund reconciliations prepared during the 1985-86 fiscal year were neither signed nor dated by the preparer and reviewer. Properly signed and dated reconciliations will assure that reconciliations are prepared and reviewed promptly and that they are correct.

Criteria: The State Administrative Manual, Section 7908, requires all agency reconciliation statements to show the signatures of the preparer and the reviewer. In addition, the dates prepared and reviewed should be shown on the reconciliations.

Recommendation: The CSPU Pomona should require the preparer and reviewer of the monthly bank and revolving fund reconciliations to sign and date all the reconciliations.

Item 4. **Improper Identification of Encumbrances**

Finding: The accounting personnel of the CSPU Pomona did not accurately identify in their Schedule of Accounts Payable which of their unliquidated encumbrances constituted obligations at June 30, 1986. Consequently, encumbrances were overstated by $634,190 and obligations understated by $634,190. The misstatements occurred because the accounting personnel did not thoroughly analyze the accounts payable to determine whether goods were received or services were provided before or after June 30.

Furthermore, as mentioned in Item 1, the CSPU Pomona did not properly identify encumbrances in the financial statements and therefore did not provide the State Controller's Office with sufficient information to prepare the State's financial statements in accordance with generally accepted accounting principles.

Criteria: State Controller's Memorandum dated April 17, 1986, to state agency accounting officers instructed agencies to report the amount of encumbrances applicable to their accruals in such a way that financial statements could be prepared in accordance with generally accepted accounting principles. Under generally accepted accounting principles, encumbrances are that portion of the accruals that represent goods received or services provided after June 30.

Recommendation: During year-end closing, the CSPU Pomona should carefully analyze its accruals to determine whether goods were received or services provided before or after June 30 and report them appropriately as liabilities or encumbrances.

SAN DIEGO STATE UNIVERSITY

Item 1. **Undelivered Warrants and Undeposited Receipts**

Finding: San Diego State does not process and clear undelivered salary warrants and undeposited controller warrants, checks, and money orders promptly. For example, as of September 1986, the custodian of warrants was holding approximately 600 warrants, checks, and money orders, totaling approximately $333,200, while he awaited disposition instructions and clearance from the payroll office. Of the 600, 280 warrants, checks, and money orders, representing approximately $106,300, had not been cleared and deposited within 30 days of the date they were collected. Of these 280, 117 warrants, totaling approximately $36,000, were at least one year old.

The lack of payment and proper processing and clearance of the payroll and accounts receivable, unclaimed warrants, and other receipts may result in the loss or misapplication of state funds.

Criteria: The State Administrative Manual, Section 8091, requires agencies to remit to the state treasury all monies determined to be revenue, reimbursement, abatements, and operating income within 30 days following the date collected. In addition, the State Administrative Manual, Section 8580.5, states that salary warrants not delivered within 90 calendar days of receipt must be returned to the State Treasurer's Office for monthly deposit in the Special Deposit Fund.

Recommendation: San Diego State should improve its collection procedures to ensure the prompt processing, clearance, and remittance to the State Treasurer's Office of undeposited controller warrants and other receipts within 30 days following the date received. In addition, San Diego State should return within 90 calendar days of receipt all undelivered salary warrants to the State Treasurer's Office for deposit to the Special Deposit Fund.

Item 2. **Failure To Promptly Clear Revolving Fund Advances**

Finding: San Diego State does not promptly clear outstanding salary advances made in the revolving fund. For example, as of June 30, 1986, 139 salary advances, totaling approximately $82,600, were outstanding over six months; several of the advances, which totaled approximately $43,500, were dated 1985 or earlier.

The long-outstanding advances result from a lack of coordinated efforts among payroll, accounting, and department personnel to collect from the employees the amounts as they become due.

Failure to clear advances due from employees may result in the loss of state funds if the employees leave state service without repaying the advances. In addition, revolving fund monies are not available for other uses when the advances are not promptly cleared.

Criteria: The State Administrative Manual, Section 8118, requires the agencies to collect the salary advances from subsequent issued payroll warrants for the period covered by the salary advances.

Recommendation: San Diego State should establish written procedures to assure that salary advances are collected promptly, as the State Administrative Manual requires. In addition, San Diego State should either expedite recovery of the old salary advances from employees who have left state service through the tax offset procedures of the Franchise Tax Board or seek relief of accountability from the State Board of Control.

SAN FRANCISCO STATE UNIVERSITY

Item 1. **Overstated Cash**

Finding: San Francisco State overstated its June 30, 1986, cash balance by $73,046. In fiscal year 1983-84, San Francisco State had an unreconcilable difference between its actual cash balance and its general ledger cash account of $127,046. The difference was believed to be caused by errors made in entering information into San Francisco State's new accounting system. After an extensive review, San Francisco State decided not to continue researching the difference because the cost was too prohibitive. Instead, San Francisco State waited until funds accumulated in its Refunds to Reverted Appropriations account, and intends to charge the $127,046 to that account instead of seeking relief of accountability from the State Board of Control. However, applying an unreconciled difference to the Refunds to Reverted Appropriations account is not the intended use of this account according to the State Administrative Manual. During June 1986, the Refunds to Reverted Appropriations account had a balance of $54,000 that was applied to the overstated cash account at June 30, 1986.

Criteria: The State Administrative Manual, Section 10476, describes the proper use of the Refunds to Reverted Appropriations account.

Recommendation: San Francisco State should file a claim with the State Board of Control for relief of accountability. Further, San Francisco State should not use the Refunds to Reverted Appropriations account for other than its intended purpose.

Item 2. **Unreimbursed Revolving Fund Payments**

Finding: San Francisco State included in its June 30, 1986, financial reports two unreimbursed revolving fund payments totaling $103,293. These payments were made in 1980 pursuant to a judgement against the Trustees of the California State University. The payments were made out of the revolving fund because the judge said that the payments should be made within 30 days. Because the payments were for salary dating back as far as 1970, the State Controller's Office was not able to reimburse the revolving fund because the appropriations had expired. Therefore, San Francisco State does not have the use of all of its revolving fund authority.

Criteria: The State Administrative Manual, Section 8422.7, describes the process for obtaining reimbursement through the State Board of Control for items payable from reverted appropriations.

Recommendation: San Francisco State should file a claim with the State Board of Control requesting funds to replenish its revolving fund.

Item 3. **Unreported and Long Outstanding Employee Travel Advances**

Finding: San Francisco State did not report in its June 30, 1986, financial reports the correct amounts of outstanding travel advances to employees; advances totaling $57,838 were incorrectly deducted from the accounts payable balance. Consequently, both expense advances and accounts payable were understated by the same amount. In addition, San Francisco State does not promptly clear outstanding employee advances made from the revolving fund. For example, as of June 30, 1986, 47 travel advances totaling $13,831 were outstanding over 90 days, and several employees had more than one expense advance.

The long outstanding advances resulted because accounting and departmental personnel did not coordinate efforts to collect from employees the amounts as they became due, and because they did not require the employees to submit travel claims on time.

Failure to clear travel advances made to employees may result in the loss of state funds if the employees leave state service without repaying the advances. In addition, revolving fund monies are not available for other uses when the advances are not promptly cleared.

Criteria: The State Administrative Manual, Section 10420, requires that cash advanced to employees for legitimate expenses be reported as expense advances to employees. In addition, the State Administrative Manual, Section 8116, states that such advances are temporary, and it requires employees to reimburse the advance promptly unless it is known the employee will travel in the near future.

Recommendation: San Francisco State should ensure that year-end financial reports are accurate before approving them for distribution. In addition, San Francisco State should establish written procedures to collect outstanding revolving fund advances pursuant to the State Administrative Manual requirements.

Item 4. **Missed Vendor Discounts**

Finding: San Francisco State did not take advantage of all vendor discounts offered during fiscal year 1985-86. We noted that San Francisco State did not take vendor discounts totaling $271 for 2 of the 32 payments we tested.

Criteria: The State Administrative Manual, Section 8113, states that agencies, to the greatest extent practical, should accumulate discounted invoices and pay such invoices weekly or less frequently than daily to the extent that they can do so without losing cash discounts.

Recommendation: San Francisco State should establish procedures to ensure that vendor discounts are appropriately taken.

CALIFORNIA POLYTECHNIC STATE UNIVERSITY, SAN LUIS OBISPO

Item 1. **Inaccurate Identification of Encumbrances**

Finding: The accounting personnel of the CPSU San Luis Obispo did not accurately identify in their Schedule of Accounts Payable which of their unliquidated encumbrances constituted obligations at June 30, 1986. Consequently, encumbrances were overstated by $151,667, and obligations and expenditures were understated by the net amount of $10,200. The misstatements occurred because the accounting personnel did not thoroughly analyze the accounts payable to determine whether goods were received or services were provided before or after June 30.

Criteria: A State Controller's memorandum dated April 17, 1986, to state agency accounting officers instructed agencies to report the amount of encumbrances applicable to their accruals in such a way that financial statements could be prepared in accordance with generally accepted accounting principles. Under generally accepted accounting principles, encumbrances are that portion of the accruals that represent goods received or services provided after June 30.

Recommendation: During year-end closing, the CPSU San Luis Obispo should carefully analyze its accruals to determine whether goods were received or services provided before or after June 30 and report them appropriately as liabilities or encumbrances.

Item 2. **No Reconciliation of Accounts Receivable Subsidiary Ledger**

Finding: During fiscal year 1985-86, the accounts receivable personnel of the CPSU San Luis Obispo did not prepare monthly reconciliations of the accounts receivable subsidiary ledger with the general ledger. Although we did not find any, errors or irregularities may go undetected if ledgers are not reconciled each month. In addition, the detail receivable balances were not analyzed on a monthly basis in order to identify delinquent accounts. Consequently, the accounts receivable personnel may not be taking prompt action to collect delinquent accounts.

Criteria: The State Administrative Manual, Section 7800, requires that the accounts receivable subsidiary ledger balances be reconciled each month to the general ledger control balance. Prudent business practices require that detail receivable balances be analyzed each month to identify delinquent accounts, and to aid collection efforts.

Recommendation: The Accounts Receivable Unit should prepare monthly reconciliations of the accounts receivable subsidiary balances to the general ledger control balance. In addition, the unit should prepare monthly analyses of the detail accounts receivable balances that will identify delinquent accounts.

Item 3. **Unreported Employee Expense Advances**

Finding: The CPSU San Luis Obispo did not report in its June 30, 1986, financial reports the correct amount of salary and travel advances to employees; advances totaling approximately $93,000 were incorrectly deducted from the accounts payable balance. Consequently, both expense advances and accounts payable were understated.

Criteria: The State Administrative Manual, Section 10420, requires that employee salary and travel advances be reported as advances due from employees.

Recommendation: The CPSU San Luis Obispo should ensure that year-end financial reports are accurate before approving them for distribution.

CALIFORNIA STUDENT AID COMMISSION

The California Student Aid Commission administers one of the 34 federal programs we reviewed. It is the U.S. Department of Education grant, Federal Catalog Number 84.032.

Item 1. Inadequate Separation of Duties Related to Cash

Finding: The commission does not adequately separate all duties related to cash transactions. One employee in the accounting office receives remittances, prepares deposits, prepares checks, reconciles the bank account, and maintains the general ledger. Failure to separate the duties related to cash receipts and disbursements, to reconcile the bank account, and to maintain related accounting records makes it possible for an employee to make unauthorized payments and to conceal other irregularities.

Criteria: The State Administrative Manual, Section 8080, lists seven duties that should be properly separated among employees working with manual accounting systems. Listed among these duties are the following: receiving and depositing remittances, preparing checks, reconciling bank accounts, and posting to the general ledger or any subsidiary ledger affected by cash transactions. If an agency cannot comply with the requirements of Section 8080, it should obtain exemption through written approval from the Department of Finance's fiscal systems and consulting unit.

Recommendation: The commission should reassign the duties in the accounting office so that all staff meet the separation of duties requirement of the State Administrative Manual, Section 8080. If such reassignment should cause operational difficulties, the commission should get the Department of Finance's approval of an exemption from the requirements.

Item 2. Inadequate Separation of Duties Related to Property

Finding: The commission does not adequately separate the duties related to property. One employee receives incoming equipment, has custody of unassigned equipment, develops data for monthly entries to general ledger accounts, maintains the property ledger, and reconciles the physical inventory to perpetual inventory records. Failure to provide for adequate separation of duties can result in the loss of equipment without the commission becoming aware of the loss.

Criteria: The State Administrative Manual, Section 8652, requires that inventories not be exclusively controlled by the custodian of the property records and that the person in charge of the stockroom not be in charge of maintaining the inventory records or taking physical inventories.

Recommendation: The commission should ensure that property records are maintained by someone who does not have custody of the property.

Item 3. **Improper Presentation of Financial Reports**

Finding: The commission segregated the financial transactions in the Federal Trust Fund into two groups and then improperly prepared two different sets of financial reports for the Federal Trust Fund. One set contained transactions between the Federal Trust Fund and the State Guaranteed Loan Reserve Fund. The accounting office submitted this set to the State Controller as the Federal Trust Fund financial reports. The second set contained transactions related to Federal Trust Fund monies used to administer programs accounted for in the General Fund. The accounting office submitted this set as part of the General Fund financial reports. The improper preparation and submission of financial reports can cause the State Controller to prepare incorrect statewide financial statements.

Criteria: Under generally accepted accounting principles, each fund represents a fiscal and accounting entity. The State Administrative Manual, Section 7950, requires that a separate set of financial reports for each fund be prepared under normal circumstances. In rare instances, the accounts of several funds may be combined if the Department of Finance gives written permission for this procedure. Also, the State Controller's Office sent a memo dated April 17, 1986, to all state agencies with instructions for submitting financial reports. The memo stated that each fund must have its own set of reports.

Recommendation: For financial reporting purposes, the commission should never separate a fund into two or more parts. Only the reporting of a fund as a whole will maintain the integrity of the accounting and fiscal entity that each fund represents.

Item 4. **Failure To Identify Encumbrances**

Finding: The commission failed to prepare lists of accounts payable that separate valid obligations and encumbrances outstanding at June 30, 1986. Failure to identify encumbrances at the end of the year makes it impossible for the State Controller to convert the State's legal basis financial statements to those based on generally accepted accounting principles.

Criteria: The State Administrative Manual, Section 10584, requires state agencies to prepare and retain a list of accounts payable for each fund that shows in detail all valid obligations (goods and services received by June 30) and encumbrances outstanding at the end of the year. The amount of encumbrances outstanding have to be reported on the Report of Accruals to Controller's Accounts as illustrated in the State Administrative Manual, Section 7952.

Recommendation: At the end of the year, the commission should analyze the accounts payable to determine which are valid obligations and which are encumbrances. It should then prepare a detailed list as required in the State Administrative Manual, Section 10584, and should report the amount of encumbrances in the Report of Accruals to Controller's Accounts.

Item 5. **Inadequate Contracting Procedures**

Finding: The commission did not follow several contracting procedures that are required by the Public Contract Code. We reviewed 12 contracts, including 7 consulting services contracts. We found that 3 of the 7 consulting services contracts had no contractor evaluation form or contractor resume on file, that one of the 12 contracts did not have a completed Contract Transmittal and Pre-Evaluation Form (STD 15) on file before it was executed, and that one of the 12 contracts did not contain a required sworn statement by the contractor. Failure to adhere to prescribed policies of the Public Contract Code and the State Administrative Manual circumvents established controls and may hinder the efficient processing, implementing, and awarding of contracts. Contracts may also inadvertently be awarded to unreliable vendors or contractors.

Criteria: The Public Contract Code, Section 10371(e), states that no consulting services contractor shall be awarded a contract unless the state agency or department has reviewed a contractor evaluation form on file with the Department of General Services or has obtained a completed resume from each major contract participant who has not previously had a state contract. In addition, the Public Contract Code, Section 10338, and the State Administrative Manual, Section 1212.1, require a Contract Transmittal and Pre-Evaluation Form (STD 15), which should be completed for every contract to document the need for each contract regardless of the type of contract, the amount of the contract, or the need to submit the contract to the Department of General Services for review. Furthermore, the Public Contract Code, Section 10296, requires every contract entered into by any state agency to contain a statement by which the contractor swears under the penalty of perjury that, within the preceding two years, a federal court has issued against the contractor no more than one unappealable finding of contempt of court based on the contractor's failure to obey a federal court order to comply with an order of the National Labor Relations Board.

Recommendation: The commission should establish guidelines and procedures for its staff to follow when they prepare contracts to ensure that all of the contract requirements stated in the Public Contract Code and the State Administrative Manual are met before they approve the contracts.

Item 6. **Insufficient Controls Over Loan Limits**

Finding: The commission did not sufficiently monitor loan guarantees to ensure that the student loans complied with federal loan limits. We performed a computer search of the commission's borrower files as of June 1986. In fiscal year 1985-86, we identified 13 borrowers who had been guaranteed loans that made the cumulative loan balances exceed the federal limits. Specifically, we identified nine undergraduate students whose cumulative loans exceeded the $12,500 limit and four graduate students who were guaranteed undergraduate and graduate loans totaling more than $25,000. In total, these 13 loans exceeded the federal limits by $23,856. Noncompliance with federal loan limits results in a loss to the State Guaranteed Loan Reserve Fund because the federal government will not purchase the portion of defaulted loans that exceed the limit. We reported a similar finding in fiscal year 1983-84. We were informed by Electronic Data Systems Corporation, the commission's service contractor, that they had installed proper program edits to prevent loan guarantees from exceeding the cumulative loan limits.

Criteria: The United States Code, Title 20, Section 1075(a)(2), states that loans are limited to $12,500 for undergraduate students and $25,000 for graduate students.

Recommendation: The commission should ensure that the service contractor maintains procedures that identify and, consequently, reject the loans exceeding federal limits.

Item 7. Late and Potentially Inaccurate Federal Quarterly Reports

Finding: The commission's federal quarterly reports for April through June 1986 contained information that did not reconcile with the commission's accounting records and may have been inaccurate. The commission prepares the quarterly reports and the accounting records using various computer-generated information from the data base maintained by the Electronic Data Systems Corporation, its service contractor. However, the commission was unable to reconcile the computer-generated information used for the quarterly reports with its accounting records. We were unable to ascertain whether the quarterly reports, accounting records, or both, were inaccurate. Additionally, for the three quarters between July 1985 and March 1986, the commission did not file its federal quarterly reports within the 60 days required by law. However, the commission's staff indicated that most of the delays are the result of frequent changes in federal requirements and slow responses by the United States Department of Education. We reported a similar weakness in fiscal year 1984-85. Noncompliance with federal reporting requirements could result in the federal government taking action against the commission's administration of the guaranteed student loan programs.

Criteria: The Office of Management and Budget Circular A-128 requires that federal reports contain accurate and reliable financial data. Federal regulations for the guaranteed student loan program require that accurate federal quarterly reports be filed within 60 days of the end of each quarter.

Recommendation: The commission should reconcile computer-generated data used for the quarterly reports to its accounting records before preparing its federal quarterly reports, and it should file the reports on time.

DEPARTMENT OF CORRECTIONS

Item 1. **Failure To Reconcile Bank Accounts Promptly**

Finding: During fiscal year 1985-86, the department was as much as two months late in attempting to prepare the reconciliations for its administrative and parole general cash accounts, and it failed to reconcile the bank balances to its general ledger balances. At June 30, 1986, the adjusted bank balance for the parole account was approximately $69,000 less than the balance in the department's general ledger. The administrative account adjusted bank balance did agree with the department's general ledger at June 30, 1986. The accounting supervisor stated that the reconciliations were not promptly prepared during 1985-86 because of problems encountered in resolving differences between the bank balances and the general ledger balances and because of the high rate of turnover of staff assigned the bank account reconciliations. Also, the accounting supervisor did not review the parole account bank reconciliations and was not aware of the unreconciled differences. As a result, the department may not promptly detect errors or irregularities such as unauthorized cash disbursements or the failure to deposit money.

Criteria: The State Administrative Manual, Section 8060, requires agencies to reconcile their bank and centralized State Treasury System accounts promptly each month. The Government Code, Section 13403(a)(6), states that an agency's system of internal accounting and administrative control must include an effective system of internal review.

Recommendation: The department should reconcile its bank accounts promptly each month, and the accounting supervisor should review the reconciliations.

DEPARTMENT OF DEVELOPMENTAL SERVICES

The Department of Developmental Services administers 2 of the 34 federal programs we reviewed. They are the U.S. Department of Agriculture grants, Federal Catalog Numbers 10.553 and 10.555.

Item 1. **Inadequate Control Over the Revolving Fund Advances**

Finding: The department does not promptly clear outstanding employee advances and vendor payments made from the revolving fund. For example, vendor payments at the Administrative Division total $239,000; approximately $32,000 of this amount represents vendor payments that were at least six months old as of June 30, 1986. Camarillo State Hospital's outstanding employee advances and vendor payments total $484,000; approximately $21,000 of this amount represents employee advances and approximately $113,000 represents vendor payments that were at least six months old at June 30, 1986. Likewise, Sonoma State Hospital's outstanding employee advances and vendor payments total approximately $254,000, approximately $31,000 of this amount represents employee advances, and approximately $16,000 represents vendor payments that were at least six months old at June 30, 1986. According to department officials, long outstanding advances are the result of understaffing and inadequate support documentation.

Failure to clear advances due from employees may result in the loss of state funds if the employees leave state service without repaying the advances. In addition, revolving fund monies are not available for other uses when the advances are not promptly cleared.

Criteria: The State Administrative Manual, Section 8116, requires travel advances to be cleared when the travel expense claims are submitted. Further, the State Administrative Manual, Section 8118, requires agencies to collect repayment for the salary advance from the subsequently issued payroll warrant for the time period covered by the salary advance. Finally, the State Administrative Manual, Section 8170, provides the procedures that an agency should use to prepare claim schedules to reimburse the revolving fund.

Recommendation: The department should regularly submit all expense advance claims to the State Controller's Office to ensure that reimbursement to the revolving fund is made promptly.

Item 2.	**Inadequate Control Over Purchases**
Finding:	The department is not requiring that all purchases be properly authorized and that the availability of funds be confirmed before purchases are made. For example, 7 of 30 purchases made by one of the department's hospitals that we reviewed did not have the approval of authorized hospital personnel. Moreover, in 15 of the 30 purchases, there was no evidence that anyone had confirmed the availability of funds before the purchases were made.
Criteria:	The State Administrative Manual, Section 8422.1, requires that agencies determine that the authority to obtain goods or services exists before submitting a claim for payment. Also, the State Administrative Manual, Section 8340, requires agencies to confirm the availability of funds.
Recommendation:	The department should require evidence that purchases have been approved and that funds are available to pay for the purchases.
Item 3.	**Inadequate Control Over Disbursements**
Finding:	The department does not always verify that billed services have been received before it pays for them. For example, the department does not verify that transportation services such as airline tickets and car rentals are provided to hospitals before it schedules the vendor invoices for payment. Therefore, it is possible that the department will pay for goods or services that it has not received.
Criteria:	The State Administrative Manual, Section 8422.1, requires agencies to determine that goods or services have been received before payment is made.
Recommendation:	The department should require each hospital to confirm that it has received the goods or services for which it has been billed before submitting invoices to the State Controller's Office.
Item 4.	**Lost Vendor Discounts**
Finding:	The department does not always promptly pay invoices to take advantage of vendor discounts. The

department has been unable to promptly pay invoices because, according to the accounting officer, the recent conversion to a centralized payment system has created a backlog of unpaid invoices. As a result, the Administrative Division lost at least $3,700 in vendor discounts from 45 of the 72 vendors offering discounts that we reviewed.

Criteria: The State Administrative Manual, Section 8422.1, requires state agencies to take all discounts when available.

Recommendation: The department should promptly pay vendor invoices to receive all available vendor discounts.

Item 5. Improper Identification of Encumbrances

Finding: On its General Fund Report of Accruals, the department inappropriately reported $89,000 of accounts payable as encumbrances. Conversely, it reported $585,000 of encumbrances as accounts payable. This discrepancy occurred because the department did not analyze accounts payable to determine whether goods or services were received before or after June 30. If the department does not properly identify encumbrances in its financial statements, the State Controller's Office does not have sufficient information to prepare the State's financial statements in accordance with generally accepted accounting principles.

Criteria: A State Controller's memorandum dated April 17, 1986, to state agency accounting officers instructed agencies to report the amount of encumbrances applicable to their accruals in such a way that the financial statements could be prepared in accordance with generally accepted accounting principles. Under generally accepted accounting principles, encumbrances are that portion of the accruals that represent goods received or services provided after June 30.

Recommendation: During year-end closing, the department should analyze its accruals to determine whether goods were received or services provided before or after June 30 and report them appropriately as liabilities or encumbrances.

Item 6. **Inadequate Control Over Disbursements**

Finding: The Camarillo State Hospital (hospital) has inadequate controls over disbursements made from its revolving fund and trust fund. Specifically, other than the individual who prepares the checks, no other individual compares the signed checks with supporting documentation to ensure that the disbursements are valid. Consequently, unauthorized disbursements could be made and not detected.

Criteria: The State Administrative Manual, Section 8080, requires that different employees perform the tasks of preparing checks, and comparing signed checks with authorizations and supporting documentation. Further, the State Administrative Manual, Section 8080, states that preferably the comparison will be performed by a Business Services Officer 1, or higher classification, in an office section independent of the accounting department.

Recommendation: The department should reassign duties to ensure that individuals who prepare checks do not compare the signed checks to the authorizations and supporting documentation. In addition, the individual who makes the comparison should be at the appropriate management level.

Item 7. **Checks Outstanding Over Two Years**

Finding: The Sonoma State Hospital (hospital) had 48 checks totaling $2,682 that have been outstanding over two years at June 30, 1986. Because the hospital must review these checks each month when the bank reconciliation is prepared, the preparation of the reconciliation is unnecessarily cumbersome and time-consuming. Additionally, by retaining the outstanding amounts in the general checking account, the hospital is delaying the process that allows agencies to remit such monies to the Special Deposit Fund and ultimately to the General Fund.

Criteria: The State Administrative Manual, Section 8042, requires that checks outstanding over two years be cancelled and the amount be remitted to the Special Deposit Fund as unclaimed monies.

Recommendation: The department should cancel all checks over two years old and remit the amount to the Special Deposit Fund.

Item 8. **Inaccurate Meal Counts**

Finding: The department has not documented the program of its reporting system that accumulates meal counts. In addition, the reporting system does not accurately account for all meals that the department can claim for federal reimbursement. We compared the billings for meals that the department claimed for reimbursement to records of the Lanterman and Sonoma developmental centers. The department's count of meals claimed for reimbursement was less than the number of meals we documented at the developmental centers.

It appears that the number of meals that the department claimed for reimbursement were less than amounts indicated by records of the developmental centers because of the way the department accounted for clients who left a developmental center for part of the month. If a client left the developmental center for a weekend, the department's reporting system included only the days in the month after the client returned to the developmental center as eligible for meals.

In addition, the department's meal count for some clients exceeded the number of meals the department was entitled to claim for reimbursement because the department considered clients in acute care units as eligible for the reimbursement when in fact they are not.

In response to this audit finding, the department reports that it has corrected the errors in its reporting system. The errors apparently have been in the reporting system since the department became eligible for the National School Breakfast/Lunch Program in 1977. Records are not readily available to determine the total amount of lost funds since 1977. However, the department determined that for the 21-month period from July 1, 1984, through March 31, 1986, the department did not claim approximately $150,000 of federal reimbursement related to the National School Breakfast/Lunch Program. Reimbursements claimed by the department for this period were approximately $1.6 million.

Criteria: The Code of Federal Regulations, Title 7, Parts 210.2, 210.10, and 220.8 state the requirements for meals that the department can claim for reimbursement. Meals meeting these requirements should be included in the meal count so the department can receive reimbursement from the National School Breakfast/Lunch Program.

Recommendation: The department should document its billing procedures, determine the amount of reimbursement lost since the start of the National School Breakfast/Lunch Program in 1977, and attempt to recover lost federal reimbursement.

DEPARTMENT OF ECONOMIC OPPORTUNITY

Item 1. **Excessive Lag Between Requests for Federal Funds and Their Disbursement**

Finding: The department's process of requesting federal funds does not ensure that the requests are limited to the department's immediate cash needs. In our test of the department's cash requests and disbursements for the Home Energy Assistance Program (HEAP), a component of the LIHEAP block grant, we found that for 24 of the 33 claims that we tested, the lag between the date of submission of the claims to the State Controller's Office and the issuance of warrants for those claims was between 32 and 36 days. Department officials informed us that the State Controller's Office requires the department to request federal funds before the claims can be processed. However, there are frequent problems with the claims, which are submitted on computer tapes, either because the department submits incorrect data or because the State Controller's Office processes the data incorrectly.

The department also lacks written procedures for requesting federal funds for any of its block grants, and it does not have records of its cash need forecasts. Because of the lack of adequate records, we were unable to determine the effect of the excessive cash balances for the whole year. However, we could determine the effect for the largest request. The department requested approximately $24 million from the federal government for the payment of six claims on February 27, 1986, but the State Controller's Office did not pay the claims until April 2, 1986. As a result, the federal government lost at least $180,000 in interest that it could have earned on the $24 million that the State requested too soon. Failure to establish adequate procedures for requesting federal funds may result in the federal government's imposing sanctions on the department.

Criteria: The Code of Federal Regulations, Title 31, Section 205.4(a), requires that the timing and amount of cash advances be as close as administratively feasible to the actual disbursements of the recipient organization.

Recommendation: The department should work with the State Controller's Office to allow the department to request federal funds for the block grants at the time that the State Controller's Office issues the warrants. The department should also establish written guidelines for requesting federal funds and should keep records of its cash need forecast for all federal programs.

Item 2. **Insufficient Monitoring of Cash Advances to Contractors**

Finding: The department disbursed 25 percent of the contract amount to CSBG contractors each quarter regardless of the contractors' actual operating expenses. We reviewed 15 contractor files and found that cash advances for 9 contractors equaled average expenditures ranging from 5 to 22 months. The department said that making quarterly cash advances equal to 25 percent of the contractors' annual operating expenses complies with the Government Code, Section 12781. This section states that the department issue advance payments to grantees in an amount equal to 25 percent of the grantees' annual operating expenses. However, the department based its cash advances on the contract amount rather than on the contractors' operating expenses. To make these payments to contractors, the department had to request funds in advance from the federal government. Consequently, the federal government lost interest that it could have earned on the funds that the department requested too soon. As a result, the federal government may impose sanctions on the department.

Criteria: The Code of Federal Regulations, Title 31, Section 205.4(a), requires that cash advances be limited to the minimum amounts and the actual immediate cash requirements needed for carrying out the purpose of the program. This section also stipulates that the timing and amount of cash advances be as close as administratively feasible to the actual disbursements of the recipient organization.

Recommendation: The department should adjust the quarterly payments to CSBG contractors to reflect actual operating expenses during the year.

Item 3. **Inadequate Procedures for Resolving Disagreements on Audit Findings**

Finding: The department has not developed procedures for resolving disagreements on audit findings, and it has not recorded accounts receivable of $934,715 that arose from questioned costs. As a result of the lack of procedures, the department has not been able to resolve disagreements over questioned costs promptly. In addition, it may not be aware of the status of contingent receivables and cannot adequately pursue the collection of those receivables. During our review, the department indicated that it was developing procedures to correct the deficiencies we identified and that it plans to implement these procedures during the 1986-87 fiscal year.

Criteria: The U.S. Office of Management and Budget Circular A-102, Attachment G, requires the department to develop procedures that will ensure "timely and appropriate resolution" of the audit findings and of the recommendations concerning subrecipients' administration of block grant funds.

Recommendation: The department should complete and implement the procedures that it is developing for resolving audit findings and recommendations. The procedures should include a requirement that contingent receivables resulting from audit exceptions be recorded in the accounting records.

Item 4. Excessive Delays in the Home Energy Assistance Program Appeals Process

Finding: The department does not always hold appeals hearings in the HEAP within a reasonable time. In addition, the department does not promptly notify appellants of its decisions on their appeals of previously denied benefits. We tested 13 of the 584 appeals cases on record as of November 25, 1986; these cases covered program years 1983-84 through 1985-86. The department had not yet held a hearing in 7 cases, and it had not yet notified appellants of its decision in the other 6 cases. For the 13 cases, the number of days that had elapsed since the applicants requested an appeals hearing ranged from 102 to 340 days. The state plan stipulates that a written decision must be rendered within 90 days from the date the request for a hearing was received. Department personnel said that hearings are frequently delayed because appellants are not prepared for the hearing and ask for postponements. Department personnel could not provide an explanation of why the decisions were not communicated promptly. The long delays have denied appellants a fair hearing process and may have imposed undue burdens on them.

Criteria: The state plan, which the department submitted to the U.S. Department of Health and Human Services, requires that an applicant who appeals the denial of benefits under the LIHEAP block grant be notified of the department's decision on the appeal within 90 days from receipt of the request for a hearing.

Recommendation: The department should develop and implement a schedule for each appeal so that an appellant receives a decision within the 90 days stipulated in the state plan. The schedule should provide for prompt notification of decisions after the hearing.

STATE DEPARTMENT OF EDUCATION

The State Department of Education administers 10 of the 34 federal programs we reviewed. They are the U.S. Department of Agriculture grants, Federal Catalog Numbers 10.550, 10.553, 10.555, 10.558, and 10.568, and the U.S. Department of Education grants, Federal Catalog Numbers 84.010, 84.011, 84.027, 84.048, and 84.151.

Item 1. **Poor Collection Efforts**

Finding: The department's procedures for collecting accounts receivable do not ensure that amounts owed to the department are collected. In addition, the department does not have a centralized collection unit to coordinate collection and write-off procedures. As a result of its decentralized and ineffective collection program, the department is writing off approximately $4,005,000 in accounts receivable and will probably not be able to collect approximately $4,372,000 in additional accounts receivable. Most of these accounts receivable relate to the Child Development and Child Nutrition programs. A major reason for the department's having large amounts of uncollectible receivables is that the Child Development and Child Nutrition programs do not adequately monitor sponsors that may be in financial difficulty. During our review, we found that the department is revising collection procedures for fiscal year 1986-87. (For related issues, see Items 23, 24, and 25.)

We observed a similar weakness during our financial audits for fiscal years 1983-84 and 1984-85. In response, the department noted that the Child Development Division had instituted collection efforts for all contractors on the 90-day delinquent list. The department also noted that collecting from inactive contractors is more difficult and that "dunning notices" were being sent to delinquent contractors to assist in the collection effort. Since many of the currently uncollectible amounts were generated in previous years, it may take a year or two to determine if the procedures cited will have an effect.

Criteria: The State Administrative Manual, Section 8710.1, requires agencies to develop collection procedures that will assure prompt follow up on receivables.

Recommendation: The department should consolidate the present staff into a single collection unit to initiate a centralized collection effort that will ensure prompt follow up and collection of receivables. In addition, the department should evaluate its monitoring procedures, which have allowed many contractors and vendors to owe large amounts to the State, and it should consider dropping program sponsors that do not pay invoices from the previous year.

Item 2. **School Districts Do Not Submit Audit Reports on Time**

Finding:

Thirty-six of the 70 school districts we tested did not submit their fiscal year 1984-85 audit reports to the department's Local Educational Agency (LEA) Audit Review Unit on time. Eleven of the 36 districts submitted their reports after the November 15, 1985, deadline, but before December 31, 1985, without having an extension approved by the county superintendent of schools. Twenty-five of the 36 districts submitted their reports after December 31, 1985, the final date by which districts could submit audit reports if they were granted an extension. Three of these 25 districts submitted their reports as late as May 1986, more than four months after the final deadline. Without audit reports, the LEA Audit Review Unit is not able to verify the fiscal integrity of school districts' financial transactions or verify their compliance with applicable state and federal laws and regulations.

We observed this same weakness during our financial audit for fiscal year 1984-85. In response, the department noted the provisions under then current law had proven insufficient in the past. The department stated that it would support strengthening the authority of the county superintendents and the State Controller to take appropriate and prompt action, if audit reports are not submitted on time. The Legislature passed legislation, which took effect on January 1, 1987, that will allow the department to direct the county auditor to withhold payment of any stipend, expenses, or salaries to the district superintendent, county superintendent, or members of the governing boards, as appropriate.

Criteria:

The California Education Code, Section 41020, states that a report of each audit for the preceding fiscal year must be filed with the county superintendent of schools, the State Department of Education, and the State Controller's Office not later than

November 15. The submission date may be extended to December 31 for justifiable cause upon written request by the auditor and approval by the county superintendent of schools.

Recommendation: The department should work with the State Controller's Office and use the new legislation to ensure that school districts submit audit reports on time.

Item 3. **Audit Report Review Efforts Lack Adequate Coordination**

Finding: The department and the State Controller's Office Division of Audits (division) did not adequately coordinate their various review tasks. As a result, neither has performed several review steps that could have identified deficiencies in school district audit reports. Of the 70 reports we tested, we found the following 22 items in 16 separate audit reports that suggested a more comprehensive review is necessary because neither agency's review of school district audit reports included procedures that would have identified these items:

- Two certified public accountants (CPA) reported different amounts of Education Consolidation Improvement Act funding on statements or schedules within the same report.

- One CPA did not include Child Care Food Program receipts on any of the financial statements or the schedule of federal assistance.

- One CPA combined state and federal National School Lunch and School Breakfast receipts.

- Nine CPAs included an auditor's statement of negative assurance but not for all federal programs where monies were received.

- Nine CPAs did not identify all federal programs on the schedule of federal assistance under which the district received funds.

This lack of proper review means that the department has accepted some inaccurate statements of the school districts' financial positions and that it cannot be sure that the school districts have complied with all federal compliance requirements.

Criteria: The California Education Code, Section 14504, requires the State Controller's Office to determine the practicability and effectiveness of the audits and audit guide. In addition, this section requires the State Controller, on an annual basis, to review and monitor annually audit reports performed by independent auditors and to determine whether the audit reports conform to reporting provisions of the audit guide. Further, the Code of Federal Regulations, Title 34, Section 74.62, states that recipients (State Department of Education) are to ensure that audits are performed in accordance with the Comptroller General's "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions," the General Accounting Office's "Guidelines for Financial and Compliance Audits of Federally Assisted Programs" and "successor publications," any compliance supplements approved by the Office of Management and Budget, and the standards established by the American Institute of Certified Public Accountants.

Recommendation: The department and the State Controller's Office should agree upon an appropriate division of responsibilities and communicate and coordinate with each other more frequently. Any changes or updates to the review process should be communicated to ensure that both departments perform a thorough review with minimum duplication of effort.

Item 4. **Inadequate Remedies for Rejected Audit Reports**

Finding: The department and the State Controller's Office Division of Audits (division) do not have adequate remedies to ensure that school district audit reports rejected during the division's quality review are corrected. Three certified public accountants in our sample failed to respond to the rejection letters, and a fourth refused to amend his report. The division currently sends a rejection letter and two follow-up letters to the CPA who prepared the report. If the CPA does not send in an amended report after the three letters have been sent, the division closes the audit file. However, the division is currently planning to notify the State Board of Accountancy of the CPAs who have not revised rejected audit reports. Furthermore, the department does not follow up or take any action against those districts whose audit reports are rejected by the division. If reports that are rejected in the quality review process are not amended, then these reports are not meeting guidelines set forth by the division. The inadequacy of the reports may lead to inaccurate statements of the districts' financial position or noncompliance with state and federal requirements related to state and federal programs.

Criteria: The California Education Code, Section 14504, requires the State Controller's Office, on an annual basis, to review and monitor the school district audit reports prepared by independent auditors. The State Controller is to determine whether audit reports are in conformance with reporting provisions of the school district audit guide and is to notify each school district, office of the county superintendent of schools, Superintendent of Public Instruction, and auditor of his findings.

The Office of Management and Budget Circular A-128, Section 9, further states that a recipient (State Department of Education) receiving federal financial assistance and providing $25,000 or more of it to a subrecipient must ensure that corrective action is taken within six months after the receipt of the audit report in instances of noncompliance with federal laws and regulations.

Recommendation: The department should coordinate efforts with the State Controller's Office to ensure that all rejected reports are amended within six months. Further, the State Controller's Office should continue with plans to notify the State Board of Accountancy of the CPAs who have not revised rejected audit reports. In addition, the State Controller's Office should discuss with its legal counsel the possibility of preparing a list of CPAs who have not amended their rejected reports and forward this list to all school districts for their consideration before they award contracts for the next year. Finally, the department and the State Controller's Office should work together to seek additional legislation that would provide for sanctions against the school districts or the CPAs if rejected audit reports are not revised.

Item 5. Failure To Report to the Joint Legislative Audit Committee

Finding: The department is at least six months late in submitting to the Joint Legislative Audit Committee its analysis of school district audit reports, and as of December 1986, it had not set a date by which the analysis would be released. The department submitted its 1984 report nine months late. Without the report, the Legislature, specifically the Joint Legislative Audit Committee, is not made aware of potential problems related to school district audits.

We observed the same weakness during our audit of fiscal year 1984-85. The department responded that, in December 1985, it had divided the responsibility for audit review and follow up between the Audit Bureau and the Local Assistance Bureau. It believed that this realignment would improve the operations and allow it to prepare and present the annual report to the Joint Legislative Audit Committee on time.

Criteria: The California Education Code, Section 41020.6, requires the department to submit to the Joint Legislative Audit Committee, on June 30 of each year, a report that analyzes the school district audit reports.

Recommendation: The department should submit its analysis of the 1985-86 audit reports to the Joint Legislative Audit Committee as soon as possible. In the future, the department should submit its analysis no later than June 30 of each year.

Item 6. **Incorrect Calculation of Entitlements for the School Improvement Program**

Finding: The department did not calculate the School Improvement Program entitlements for fiscal year 1985-86 in accordance with state statutes. The department gave those school districts that were disallowed a cost of living adjustment, as determined by the California Education Code, Section 52048, the same amount of funding that they received in fiscal year 1984-85. However, according to our legal counsel's interpretation of the California Education Code, the department should have based its calculations of the School Improvement Program funding for fiscal year 1985-86 on the California Education Code, Sections 52046(b)(1) and (2), which adjust the previous year's funding by the student attendance figures. The department's field representative noted that Item 6100-116-001(3) of the Budget Act of 1985 directs the department to "promote the legislative intent" to equalize the School Improvement Program funding as specified in the California Education Code, Section 52048. If the department maintains district entitlements at the fiscal year 1984-85 funding level, school districts whose student attendance figures increase or decrease from year to year would not be granted a corresponding increase or decrease in the entitlement.

We observed this same weakness during our audit for fiscal year 1984-85. As a result, the department attempted to have legislation approved to amend the code sections. However, this legislation was vetoed on September 30, 1986.

Criteria: The California Education Code, Sections 52046(b)(1) and (2), requires that, from funds appropriated, the superintendent is to make allowances to schools with approved school improvement plans through implementation grants in the following amounts:

- $148 per unit of average daily attendance (ADA) in kindergarten and grades 1, 2, and 3, or their equivalent, exclusive of ADA in summer school.

- $90 per unit of ADA in grades 4 through 8, or their equivalent, exclusive of ADA of summer school, regional occupational centers and programs, and adult classes taken by regular high school pupils.

Recommendation: The department should follow the California Education Code, Sections 52046(b)(1) and (2). If the department believes that the California Education Code, Sections 52046(b)(1) and (2), does not reflect legislative intent, the department should again ask the Legislature to revise the California Education Code.

Item 7. **Incorrect Calculations of School Apportionments**

Finding: In calculating apportionments, the department incorrectly reduced the average daily attendance (ADA) figures for school districts by twice the number of students reported to be participating in independent study programs. As a result, the department underpaid 22 districts approximately $43,000 in the second principle apportionment for fiscal year 1985-86. The amount of underpayment for each district equalled the number of students in independent study programs multiplied by $40. The amount of the underpayment is immaterial both to the individual districts and in total. The department is planning to correct these errors in the next apportionment cycle.

Criteria: The California Education Code, Section 46201(a), specifies the formula for determining the ADA figure used for calculating the apportionment for school districts.

Recommendation: The department should review the computer program that calculates ADA and correct it where necessary before calculating the fiscal year 1986-87 revenue limit.

Item 8. **Insufficient Documentation for Apportionments of Project Work-Ability Funds**

Finding: The department has developed its own standard formula for allocating Project Work-Ability funds to school districts because no formula is set by statute. However, the program manager adjusts the allocations without using any standard criteria for the adjustments. Consequently, the department may allocate substantially different amounts to districts that should receive similar amounts. This method of calculating allocations does not provide an adequate audit trail or sufficient support for Project Work-Ability expenditures.

Criteria: The Government Code, Section 13403(a)(3), states that an adequate system of internal accounting and administrative control must include, but not be limited to, a system of authorization and recordkeeping adequate to provide effective accounting control over assets, liabilities, revenues, and expenditures.

Recommendation: The department should standardize and document the criteria it uses to adjust the Project Work-Ability allocations.

Item 9. **Inadequate Monitoring and Support for Apportionments**

Finding: The department does not monitor and cannot completely support expenditures made to local educational agencies (LEAs) participating in the Awareness Program and Inservice Training for Teachers of Severely Handicapped Children. One of the six school districts that participated in the Awareness Program reported receiving and disbursing an amount that did not agree with the department's records. Although the amounts did not agree, the department did not identify the discrepancy. Additionally, the department did not require the five LEAs that received apportionments for Inservice Training for Teachers of Severely Handicapped Children to submit final expenditure reports to verify how they spent the funds they received. Without adequate monitoring of expenditures, the department cannot be assured that the funds it distributed to the LEAs are spent in accordance with each entity's approved program budget.

Criteria: The California Education Code, Section 56463, requires that the department develop a process for evaluating and monitoring the Awareness Program in selected districts. In addition, the Government Code, Section 13402, requires agency heads to establish and maintain a system of internal accounting and administrative control within their agencies. Further, the Government Code, Section 13403, states that elements of this system should include a system of authorization and recordkeeping adequate to provide effective accounting control over assets, liabilities, revenues, and expenditures.

Recommendation: The department should determine the appropriate individuals to monitor expenditure reports submitted by LEAs and compare those reports to the department's records.

Item 10. Unsupported Revolving Fund Adjustment

Finding: The department adjusted the revolving fund's Due From Other Funds and Expense Advances accounts without proper research and documentation. When the revolving fund Claims Filed account did not agree with the Due From Other Funds account, the department reduced the Due From Other Funds account and posted the differences to the Expense Advances account without properly identifying and classifying the differences. Because the department did not properly identify the individual differences between the Claims Filed and the Due From Other Funds accounts, it cannot be assured that these accounts are properly stated.

Criteria: The Government Code, Section 13402, requires agency heads to establish and maintain a system of internal accounting and administrative control within their agencies. Further, the Government Code, Section 13403, states that elements of this system should include a system of authorization and recordkeeping adequate to provide effective accounting control over assets, liabilities, revenues, and expenditures.

Recommendation: The department should research each adjusting entry to ensure that it is appropriately classified and properly stated in the accounting records.

Item 11. Overstatement of Revenue Accruals in the Federal Trust Fund

Finding: The department overstated its Federal Trust Fund revenue accruals by approximately $696,000. The department accrued revenue for expenditures of 23 projects in workphases for which the department no longer had authority to use federal money. Based on our audit work, the department submitted adjustments to its financial statements for the overstated accruals on December 4, 1986.

Criteria: The State Administrative Manual, Section 10584, requires agencies to accrue expenditures at the end of the fiscal year. In addition, the Government Code, Section 13403, requires agencies to ensure that a proper system of internal control is in place to provide effective accounting control over assets, liabilities, revenues, and expenditures.

Recommendation: The department should ask the State Board of Control for approval to write off the $696,000 of expenditures in the Federal Trust Fund that it does not expect the federal government to pay.

Item 12. Late Deposit of Collections

Finding: The department deposited approximately 60 percent of its cash receipts an average of 3 days later than the next working day after receipt. As a result, the State lost approximately $5,000 in interest earnings. Although this amount is not material to the department's total receipts, delays in depositing cash receipts could lead to a material loss of interest to the State. On items held longer than 14 days, agency personnel stated that the delays arose because all mail is date stamped when the department receives it, but staff pull some receipts to investigate. When this investigation is complete, the department processes the receipts for deposit even though the receipts still show the original receipt date.

We observed this same weakness during our financial audit for fiscal year 1984-85. In response, the department noted that "an oversight has been corrected and deposits are being made, as required, within a day or two of receipt."

Criteria: The State Administrative Manual, Section 8030.1, requires agencies to deposit collections greater than $5,000 on the day they are received unless the collections are received late in the day or there is another reason preventing their deposit. In these cases, the collections are to be deposited on the next working day. This section also stipulates that agencies not hold any undeposited collections longer than 15 working days. Furthermore, the State Administrative Manual, Section 10453, requires cash that is not readily identifiable or whose accounting treatment was not determinable at the time of receipt be deposited in the Uncleared Collections account.

Recommendation: The department should deposit collections on the day of receipt or on the next working day, and it should not hold any undeposited collections for more than 15 working days. The department should deposit items that require investigation into the Uncleared Collections account.

Item 13. **Overdrawn Revolving Fund**

Finding: The department overdrew its revolving fund for the first nine months of fiscal year 1985-86. Also, the department's accounting staff did not prepare the monthly revolving fund accountability statement for the first ten months of the fiscal year.

We observed this same weakness during our audits for fiscal years 1983-84 and 1984-85. From November 1985 through February 1986, the department made staffing changes in the Revolving Fund Unit, and the new staff instituted procedures to strengthen controls over the revolving fund. The revolving fund was not overdrawn for the last three months of the fiscal year. The staff also began reconciling the revolving fund on a monthly basis in May 1986.

Criteria: The State's accounting system places dollar limitations on revolving funds to limit the potential loss of state funds. The State Administrative Manual, Section 8193, requires agencies to prepare reconciliations of the revolving fund account at the end of each month.

Recommendation: The department should continue to actively monitor and reconcile its revolving fund to ensure that it does not again become overdrawn.

Item 14. **Inadequate Internal Controls Over Property**

Finding: The department's internal controls over property are deficient because the property clerk both takes the physical inventories and maintains the property records. Failure to separate these duties could result in a loss of state assets without detection.

We observed this same weakness during our audit for fiscal year 1984-85. In response, the department noted that the Business Services Office has a very small staff, but the department did plan to achieve a separation of duties on July 1, 1986. We will verify this during our audit of fiscal year 1986-87.

Criteria: The State Administrative Manual, Section 8652, states that inventories must not be exclusively controlled by the custodian of the property records.

Recommendation: The department should ensure that an employee in each unit is assigned responsibility for property management and that the property clerk is only responsible for monitoring the taking of inventory.

Item 15. **Checks Outstanding Over Two Years**

Finding: The department has 75 checks, totaling approximately $3,500, that have been outstanding for over two years. These checks must be reviewed each month when a bank reconciliation is prepared. This review is unnecessarily cumbersome and time-consuming, and it serves no useful purpose.

Criteria: The State Administrative Manual, Section 8042, requires that checks outstanding over two years be cancelled and that the amount be remitted to the Special Deposit Fund as unclaimed monies.

Recommendation: The department should cancel the checks and remit the funds to the Special Deposit Fund.

Item 16. **Delayed Clearing of Cash Suspense Items**

Finding: The department has failed to clear long outstanding cash suspense items from the General Fund Uncleared Collections account. We identified 24 items, totaling approximately $8,000, that were more than 12 months old as of June 30, 1986. One of these items was more than 48 months old. As a result of the delays in clearing these amounts, the department can no longer find the supporting documentation for some items. In these instances, the department will be unable to properly determine how to clear the item from the General Fund Uncleared Collections account. In addition, if the amounts are not to be refunded, the fund entitled to the revenue does not have the use of the resources. If the amounts are to be refunded, the recipients have been subjected to unreasonable delays in receiving their money.

Criteria: The State Administrative Manual, Section 10453, states that the purpose of the General Fund Uncleared Collections account is to show the amount of cash collections that are being reviewed to determine if they are to be accepted for a fund in the State Treasury or are to be refunded to payers.

Recommendation: The department should strive to clear cash suspense items promptly from the General Fund Uncleared Collections account.

Item 17. Failure To Maintain a Log for Checks Written

Finding: The department improperly used the checks-signed log as a substitute for the checks-written log. In addition, the department does not prepare a monthly reconciliation of the check numbers used during the month. By not maintaining a log for checks written and by not performing monthly reconciliations, the department cannot be assured that the blank-check stock is completely accounted for.

Criteria: The State Administrative Manual, Section 8081, requires all departments with check-signing machines to maintain both a checks-signed log and a checks-written log. These logs are to be reconciled monthly to insure that all checks are accounted for.

Recommendation: The department should establish a checks-written log for general cash and assign a person to perform monthly reconciliations of both the checks-written log and the checks-signed log for revolving fund and general cash disbursements. Additionally, the supervisor should periodically verify that the check logs are maintained and the monthly reconciliations are performed in accordance with established procedures.

Item 18. **Inappropriate Cash Cutoff Procedures**

Finding: Three of the department's July bank deposits contained receipts that the department had received before the end of work on June 30, 1986. The department recorded these receipts as cash for fiscal year 1986-87. As a result, the department understated its cash balances on the financial statements of three funds for fiscal year 1985-86. These funds and the dollar amounts involved are the General Fund, approximately $42,000; the Donated Food Revolving Fund, approximately $64,000; and the Special Deposit Fund, approximately $1,000.

Criteria: The State Administrative Manual, Sections 7620 and 10405, describes the journal entry that agencies should make on the financial statements at the end of the year to include any undeposited general cash on hand at June 30.

Recommendation: The department should ensure that cash received before the end of work on June 30 is recorded in the proper year's accounting records and on the department's financial statements.

Item 19. **Inadequate System Documentation**

Finding: The department did not maintain up-to-date system documentation for the claims processing edit functions of the National School Lunch, School Breakfast, and Child Care Food programs. The edit functions are designed to detect errors, irregularities, and incomplete data in sponsors' reimbursement claims. The edit listing explains the function of each edit and was first printed in fiscal year 1976-77. Since that time, the department has not updated the listing. As a result, we found edits in the listing that are not used, edits that had never become operational, one "fatal" error that has since been reduced to a "possible" error, and one "fatal" error not identified in the listing at all. Without adequate edit documentation, the department is not able to determine if the sponsors have properly prepared claims or if reimbursements are correct.

We observed this same weakness during our financial audit for fiscal year 1984-85. The department stated that it planned to update the system documentation for the Child Care Food Program by September 1986 and the School Nutrition Program by

September 1987. In November 1986, the Child Care Food Program system documentation was in the draft stage.

Criteria: The Code of Federal Regulations, Title 7, Sections 210.13(a) and 220.11(a) (National School Lunch and School Breakfast programs) and Section 226.7(k) (Child Care Food Program), requires sponsors to submit claims in order to receive reimbursement. The department's edit function should ensure that the sponsors' reimbursement claims are complete and properly prepared.

Recommendation: The department should determine and establish requirements to maintain documentation for the edit functions.

Item 20. Inadequate Follow-up on Error Messages

Finding: The department did not follow up on possible error messages generated by the edit function used in processing claims for the National School Lunch, School Breakfast, and Child Care Food programs. Possible error messages allow reimbursement claims to be processed and paid even though the reimbursement claim contains an error or irregularity. The department reviews only "fatal" error messages generated during the claims processing edit function; it ignores "possible" errors. When the department does not review or follow up on the possible error messages, keypunch errors, excess meal errors, and claim completion errors may go undetected and cause an incorrect payment to the sponsor.

We observed this same weakness during our financial audit for fiscal year 1984-85. The department subsequently identified 56 National School Lunch and School Breakfast sponsor reimbursement claims that required adjustments based on a review of 1,867 documented "possible P41" error messages from claims processed in fiscal years 1983-84 and 1984-85. Nevertheless, the department made no effort to document and follow up on "possible P41" error messages from claims processed in fiscal year 1985-86.

Criteria: The Code of Federal Regulations, Title 7, Sections 210.13(b) and 220.11(b) (National School Lunch and School Breakfast programs) and Section 226.7(k) (Child Care Food Program), describes reimbursement procedures that the department should use, including procedures for revision of incomplete or incorrect program claims. The department uses the edit function to ensure that reimbursement claims are complete and correct.

Recommendation: The department should follow up on all computer-generated error messages in which "possible" errors have occurred and determine if keypunch errors or claim filing errors have occurred. In addition, the department should follow up on "possible P41" error messages from claims processed in fiscal year 1985-86.

Item 21. Failure To Ensure Compliance With Nondiscrimination Requirements

Finding: Of the 70 sponsors we tested, 2 did not meet the nondiscrimination requirements of the Child Care Food Program. Further, we could not determine the compliance of 8 other sponsors because the sponsors did not supply adequate documentation and because the Field Services Section did not perform reviews of these sponsors. Because the department is not requiring adequate proof that the nondiscrimination statement has been released to the public and is not performing reviews within the required four-year cycle, it cannot be sure that all sponsors are complying with the terms of the program.

Criteria: The Code of Federal Regulations, Title 7, Section 226.23(d), states that each institution must provide an annual press release to the information media serving the area from which the institution draws its attendance. All releases must state that meals are available to all enrolled children without regard to race, color, national origin, sex, age, or handicap.

Recommendation: The department should revise the press release statement in the application package to include a certification, to be signed by the sponsor, that the sponsor released the statement to the information media serving the area from which the sponsor obtains its attendance. Further, the department should ensure that these statements are complete and appropriate when reviewing program sponsors.

Item 22. **Noncompliance With Federal Review Requirements for the Federal Child Nutrition Program**

Finding: The department did not perform the program reviews within the required four-year cycle for 21 of the 82 sponsors that we tested in the National School Lunch and School Breakfast programs. Although the U.S. Department of Agriculture reported in its management evaluation for fiscal year 1984-85 that the State of California will have reviewed well over 100 percent of all sponsors during the first four-year cycle, this conclusion appears to be based on the total number of reviews conducted during the cycle not on whether all individual sponsors were reviewed. As we identified in our testing, the department did not review some sponsors even once during the first cycle while it reviewed some more than once. Further, the department did not perform program reviews within the required four-year review cycle for 12 of the 78 sponsors that we tested in the Child Care Food Program. Without the proper reviews, the department is unable to verify that the sponsors are complying with the appropriate federal rules and regulations.

We observed this same weakness during our financial audit for fiscal year 1984-85. The department did not completely agree with our finding and cited the comments noted in the U.S. Department of Agriculture's management evaluation.

Criteria: The Code of Federal Regulations, Title 7, Section 210.14(a)(3)(d)(ii), requires a state agency to evaluate National School Lunch Program sponsors at least once every four years. According to a supervising child nutrition consultant, the department uses the same requirement for the School Breakfast Program. The Code of Federal Regulations, Title 7, Section 226.6(k) (Child Care Food Program), requires a state agency to ensure that all institutions are reviewed at least once every four years.

Recommendation: The department should ensure that all sponsors are reviewed at least once every four years as required.

Item 23. **Noncompliance With Audit Requirements of the Federal Child Nutrition Program**

Finding: Fifty-four of the 148 sponsors that we reviewed in the National School Lunch and School Breakfast programs have not submitted acceptable audit reports, as required by federal regulations. Each of these sponsors received more than $25,000 during fiscal year 1984-85, and the sponsors collectively received approximately $4,428,000 in total during that period. Further, one additional sponsor, a school district, failed to submit an audit report for fiscal years 1981-82 through 1984-85. During this four-year period, the school district received approximately $1,100,000 in federal funds under the National School Lunch and School Breakfast programs. In addition, one of the 70 Child Care Food Program sponsors we tested was not audited in accordance with the biennial audit requirement, but instead had an audit covering a three-year period.

We observed this same weakness during our audits for fiscal years 1982-83, 1983-84, and 1984-85. In response, the department noted that many of the sponsors had submitted reports or were having reimbursements withheld. The department was also waiting for clarification of a portion of the finding from the U.S. Department of Agriculture (USDA). As of the ending date of our fiscal year 1985-86 fieldwork, the department had not received an opinion from the USDA to support its disagreement with the criteria we used for a portion of the finding. (See also Item 1.)

Criteria: The Code of Federal Regulations, Title 7, Sections 210.17(a)(4) and 220.15(a)(4) (National School Lunch and School Breakfast programs) and Section 226.8(a) (Child Care Food Program), requires that audits be conducted not less frequently than once every two years.

Recommendation: The department should ensure that all sponsors submit audit reports as required by federal regulations and that all audits are performed at least once every two years.

Item 24. Late Audits and Unreasonable Extensions

Finding: We reviewed 136 of the more than 1,100 sponsors participating in the National School Lunch and School Breakfast programs and found that 66 did not submit an audit report to the department by November 15. In addition, the department granted unreasonable extensions to 17 National School Lunch and School Breakfast sponsors for submitting their fiscal year 1984-85 audit reports. Further, the department extended the due date to March 1986 for a fiscal year 1983-84 audit report for one sponsor.

Without the audit reports, the department is unable to determine promptly whether sponsors in the National School Lunch and School Breakfast programs are complying with federal and state requirements. In addition, if audits are not conducted on time, the department is unable to identify sponsors that may have been overpaid. If these sponsors are not promptly identified, the department may be unable to collect the overpayments. (See also Item 1.)

Criteria: The California Education Code, Section 41020, requires that school districts submit an audit report no later than November 15 for the preceding fiscal year. An extension to December 31 may be granted, upon the written request and approval of the county superintendent of schools. Child Nutrition and Food Distribution Policy Memorandum #85-301 states that audit reports of entities other than school districts are due on November 15 and failure to comply will result in suspension of all payments until an audit is received. Although there is no state regulation regarding extensions granted to entities that are not school districts, we believe that the extension period should not extend past December 31, which is the requirement for school districts.

Recommendation: The department should begin withholding payments from sponsors that do not submit audit reports by the due date. Furthermore, the department should refrain from granting unreasonable extensions for the submission of audit reports.

Item 25. Inadequate Review of Audits

Finding: The department accepts audit reports from sponsors participating in the National School Lunch and School Breakfast programs that do not meet federal requirements. The department uses its "Audit Report Review Checklist" in reviewing audit reports to verify that the audit reports meet federal requirements. However, the department does not always properly conclude that deficient reports should be rejected. In our review of seven audit reports, we found that the department accepted the reports when it should have rejected all of them for not meeting federal requirements. The auditors' reports on entity financial statements did not contain a statement of positive assurance on those items of compliance tested and a statement of negative assurance on those items not tested. Both of these are required by the Comptroller General's

"Standards for Audit of Governmental Organizations, Programs, Activities, and Functions." Since the department does not require that all audits adhere to federal requirements, it is not able to ensure that all of these requirements have been met. (See also Item 1.)

Criteria: The Code of Federal Regulations, Title 34, Section 74.62(e), states that audits must be in accordance with the Comptroller General's "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions," the General Accounting Office's "Guidelines for Financial and Compliance Audits of Federally Assisted Programs" and "successor publications," any compliance supplements approved by the Office of Management and Budget, and generally accepted auditing standards established by the American Institute of Certified Public Accountants.

Recommendation: The department should ensure that the audit reports comply with federal requirements.

Item 26. **Late and Inaccurate Annual Audit Exemption Certification Forms**

Finding: We found that 440 sponsors that participated in the National School Lunch and School Breakfast programs did not submit the Annual Audit Exemption Certification form by the required state deadline. Furthermore, the department is not requiring sponsors to fill out the form properly. Five sponsors submitted the form stating that they received less than $25,000 in total federal assistance even though the department's records showed that the sponsors received more than $25,000 in National School Lunch and School Breakfast funds. In addition, on four of the forms we reviewed, we could not determine whether the sponsor received more or less than $25,000 in the reported year. We believe that it is the department's responsibility to ensure that sponsors submit a properly completed form. Without accurately completed and submitted forms, the department is not provided with useful and current information on the total federal funds received by the sponsors participating in the National School Lunch and School Breakfast programs. Consequently, the department cannot rely on the form as a screening device to determine which participants are required to have an audit for the reported year.

Criteria: The Child Nutrition and Food Distribution Division Policy Memorandum #85-301 states that specified sponsors participating in the National School Lunch and School Breakfast programs are required to complete an Annual Audit Exemption Certification form to certify total annual federal reimbursement from all sources. The form is due on or before October 15 of each year. Failure to comply with this deadline will result in payments being suspended for all claims after the due date.

Recommendation: The department should revise the Annual Audit Exemption Certification form to require sponsors to identify the fiscal year and the total amount of federal financial assistance received from all programs and to certify that the information is correct. In addition, the department should verify that the forms have been properly completed. Further, the department should begin withholding claim reimbursements to sponsors that do not submit the form by the required due date as prescribed in their own policy memorandum.

Item 27. Inadequate Documentation for Changes Made on Reimbursement Claims

Finding: The department changed information on National School Lunch and School Breakfast programs' reimbursement claims without obtaining proper documentation and authorization from the sponsors. In our review of sponsor reimbursement claims, we found that the department changed information on sponsor claims so that the claims could be processed and paid. In eight cases that we reviewed, the department made changes that could affect the dollar amount of the reimbursement to the sponsor. Without adequate documentation from the sponsor, there is no audit trail to follow when the department amends a reimbursement claim. In addition, the department is in an indefensible position when a discrepancy occurs between its records and the sponsor's.

We observed this same weakness in our audit for fiscal year 1984-85. In response, the department noted that procedures to correct this weakness would be implemented by June 30, 1986. However, we found no significant progress towards this goal.

Criteria: The Code of Federal Regulations, Title 7, Sections 210.14(g) and 220.13(b), requires state agencies to maintain the records necessary to support the reimbursement payments made to sponsors.

Recommendation: The department should not make changes to sponsor reimbursement claims without proper documentation and authorization from the sponsor. Further, the department should be willing to postpone payments until adequate documentation and authorization is received.

Item 28. Inaccurate Federal Report

Finding: The department did not accurately prepare the June 30, 1986, Financial Status Report that it submitted to the U.S. Department of Agriculture's Food and Nutrition Service (USDA-FNS). As a result of clerical errors, the department overstated one amount by approximately $67,000, while it understated another amount by approximately $415,000. As result of these errors, the USDA-FNS did not receive accurate information on the expenditures of the programs involved.

Criteria: The Code of Federal Regulations, Title 7, Section 3015.61(a), requires the grantee's financial management system to provide complete, accurate, and current disclosure of the financial results of each grant program.

Recommendation: The department should reconcile all grant awards reported on the financial status report. Before the department submits the report, a supervisor should review and approve the reconciliation.

Item 29. Inadequate Cash Management

Finding: The department is not making drawdowns from the U.S. Treasury at the earliest possible date. The department made no drawdowns of federal funds from July 1, 1985, through December 15, 1985, and it does not have a systematic method for estimating monthly drawdowns of federal funds due to the State. This causes the State to lose the use of money owed to the State by the U.S. Treasury. As a result, we estimate that the State lost an estimated $240,000 in potential interest earnings.

Criteria: The State Administrative Manual, Section 8099, requires state agencies to assure that Federal Trust Fund reimbursements are received by the time expenditures are made from the state fund rather than by the date that the state fund computes the charges and bills the Federal Trust Fund.

Recommendation: The department should establish a method of tracking expenditures and estimating drawdowns for each project. In addition, the department should establish a date by which estimated drawdowns for each project will be made each month. Furthermore, supervisors should make periodic reviews of each project monitor's estimates of expenditures and drawdowns.

Item 30. **Failure To Submit Special Education Program Report on Time**

Finding: The department did not submit the "Report of Handicapped Children and Youth Receiving Special Education" for California by the February 1 deadline. The department submitted a preliminary report on March 5, 1986, but did not submit the revised final report until April 16, 1986, more than two months after the deadline. The federal government uses this report to allocate Handicapped Preschool and School funds to all states. Therefore, it is important for the department to submit accurate information on schedule.

We observed this same weakness during our audit for fiscal year 1984-85. The department responded that it would require only the information needed for the February report on the December pupil count so that the school districts would not have as large a report to file with the department.

Criteria: The Code of Federal Regulations, Title 34, Section 300.750, requires the department to report to the Secretary of the U.S. Department of Education, no later than February 1 of each year, the number of handicapped children residing in the State who are receiving special education and related services.

Recommendation: The department should submit the "Report of Handicapped Children and Youth Receiving Special Education" for California when it is due. If the February 1 deadline is not realistic, the department should apply to the U.S. Department of Education for a waiver from that deadline.

Item 31. **Inadequate Procedures for Ensuring That Handicapped Preschool and School Program Participants Submit Expenditure Reports on Time**

Finding: The department did not receive expenditure reports from some local educational agencies (LEAs) for the Handicapped Preschool and School Program on time. Of the 30 LEAs reviewed, 13 had not submitted their fiscal year 1985-86 final expenditure reports as of the due date of September 1, 1986. One of the 30 had still not submitted its report at the time of our review on November 17, 1986. If expenditure reports are not submitted on time, the department cannot determine if funds are available that could be allocated to other LEAs.

We observed this same weakness during our audit for fiscal year 1984-85. In response, the department noted that beginning in fiscal year 1984-85, the Special Education Division had established the policy that cash advances for current year grants would be withheld pending receipt of overdue expenditure reports.

Criteria: The Code of Federal Regulations, Title 34, Section 76.722, allows a state to require subrecipients "to furnish reports that the State needs to carry out its responsibilities" under a federal program. To carry out its responsibilities, the department requires each LEA to submit expenditure reports no later than September 1.

Recommendation: The department should monitor expenditure reports for all participants and continue to withhold cash advances to those who fail to submit the reports on time. Further, the department should determine if additional penalties could ensure that all participants submit the expenditure reports on time.

Item 32. **Weaknesses in Monitoring the Migrant Education Program**

Finding: During fiscal year 1985-86, the department improved its monitoring of the Migrant Education program, but weaknesses still exist. The department administers its Migrant Education program through 18 regional operating agencies. These agencies oversee approximately 363 school districts participating in the program. In fiscal year 1985-86, as part of the department-wide effort to consolidate the monitoring of federal programs, the department conducted coordination compliance reviews which were developed in 1983. These reviews included the monitoring of certain migrant issues at the local agency level. However, as a result of a federal audit completed in March 1982, which determined that Migrant Education recruiters did not adequately document the eligibility of children participating in the Migrant Education program, the Office of Migrant Education (OME) implemented additional procedures to review all 18 operating agencies annually. Included in the OME's monitoring process is a review of the operating agencies' eligibility procedures and interviews with a sample of families to verify the information used to determine eligibility. The OME also conducts fiscal reviews of the operating agencies to ensure that they are spending funds according to their approved applications.

During our audits for fiscal year 1982-83, 1983-84, and 1984-85, we observed that the OME did not adequately monitor local agencies to ensure that they were serving only eligible migrant children. During fiscal year 1982-83, OME personnel did not conduct visits to local agencies. During fiscal year 1983-84, the department did conduct on-site visits, but the reviewers did not adequately document findings, recommendations, and subsequent resolutions. For fiscal year 1984-85, the OME conducted only one visit to a local agency. Although the OME conducted on-site visits for 17 of the 18 operating agencies in fiscal year 1985-86, we observed a number of weaknesses in the reviews. One reviewer did not perform or document some of the monitoring procedures. For example, the reviewer did not observe parent interviews for 3 operating agencies because the reviewer did not understand Spanish. Additionally, 2 of the 3 operating agencies were not provided with a written report of the review. Also, the sampling techniques used to choose the sample of "certificate of eligibility" forms for review were not objective because the samples were chosen by the operating agency staff, not the OME review staff.

Incomplete reviews may not adequately identify weaknesses in the recruitment process. Further, incorrect eligibility assessments may go unnoticed, allowing ineligible children to participate in the program and eligible children to be turned down. Moreover, if OME reviewers allow operating agency staff to choose the sample for review, the OME staff cannot be sure that the sample chosen is random and unbiased.

Criteria: Included in the California Plan for the Education of Migrant Children, which the OME submits to the Secretary of the U.S. Department of Education, are provisions for annual monitoring and review of migrant education programs. As part of this review, the OME has established guidelines for monitoring the identification and recruitment process. These guidelines include procedures for reviewing district documents, conducting parent or guardian interviews, and choosing objective review samples.

Recommendation: The department should standardize review procedures and ensure that they are followed consistently by the Office of Migrant Education review staff. In addition, reviews of each operating agency should be conducted annually.

Item 33. Weaknesses in the Administration of the Migrant Child Care Program

Finding: Weaknesses exist in the department's administration of the $2.1 million Migrant Child Care program, which provides services to preschool-age children of migrant parents. The Office of Migrant Education administers the Migrant Education program, but the OME has entrusted the administration of the Migrant Child Care program to the Child Development Division (CDD).

During their monitoring reviews of local agencies, the staff of the CDD do not interview any of the parents of migrant children to determine whether recruiters from local agencies are correctly assessing eligibility. As outlined in the OME's state plan for the regular Migrant Education program, interviewing parents is an integral part of the monitoring reviews. By failing to conduct parent interviews, the CDD cannot ensure that recruiters from local agencies are correctly assessing eligibility.

We observed this same weakness during our audits for fiscal years 1982-83, 1983-84, and 1984-85. In its response to our report for fiscal year 1984-85, the CDD stated that it did not consider interviewing parents to be part of its responsibility for administering child care services, which the OME entrusted to the CDD through an intra-agency agreement. Therefore, the CDD concluded that this finding lacked supporting criteria.

We also observed that the CDD did not conduct a review of one of the 21 agencies with CDD contracts in fiscal year 1985-86. This agency (Glenn County) has not been reviewed since December 1984. If reviews of all districts are not performed annually, agencies that do not comply with federal regulations may go unnoticed.

Criteria: The Code of Federal Regulations, Title 34, Part 201.30, states that only properly identified migratory children are eligible to participate in the Migrant Education program. To ensure that only eligible children participate, the OME has established, in its state plan, monitoring procedures for the regular Migrant Education program; these procedures include interviewing parents or guardians of migrant children. Migrant Child Care funds, which the CDD administers, are included in the state plan that the OME submits to the Secretary of the U.S. Department of Education. According to the CDD's Regional Field Services Administrator, the CDD agrees to conduct yearly reviews of agencies to monitor their compliance with federal regulations. Therefore, all of the funds received should be administered according to the approved state plan.

Recommendation: The Child Development Division should follow the same monitoring and review guidelines established in the state plan for the Office of Migrant Education or submit an amendment to the state plan. Additionally, the CDD should review all agencies with CDD contracts each year.

Item 34. Inadequate Documentation and Standardization of Procedures for Determining Cash Advances

Finding: The department's Office of Migrant Education did not adequately document procedures for determining cash advance amounts provided to the 18 operating agencies that administer Migrant Education programs. Although none of the cash advances made to the agencies exceeded the approved budgeted amounts, the procedures for determining cash advance allocations were not written, and the allocations could not be independently calculated for 10 agencies.

Because the OME has not documented its procedures for determining cash advances, it is impossible to determine whether the criteria for determining advances were used consistently for advancing funds to all operating agencies. Therefore, we are unable to conclude that the OME allocated appropriate amounts to agencies.

Criteria: The Government Code, Sections 13403, states that an agency should have a satisfactory system of internal accounting and administrative control including a system of authorization and recordkeeping adequate to provide effective accounting control over assets, liabilities, revenues, and expenditures, and an established system of practices to be followed in the performance of duties and functions.

Recommendation: The Office of Migrant Education should document procedures for determining cash advances. The OME staff should follow these procedures consistently when calculating cash advance amounts.

Item 35. Inadequate Documentation of Data Used in Allocating Funds to Local Agencies

Finding: To allocate funds to local educational agencies for handicapped and disadvantaged programs, the Vocational Education program uses a formula based on the number of handicapped, disadvantaged, limited English proficient, and economically disadvantaged individuals enrolled in vocational education programs. During our review of allocations made to local educational agencies in fiscal year 1985-86, we were unable to verify the accuracy of the data used by the program in its allocation formula. Because the data used in the formula had not been documented, staff were unable to say where the data came from.

Because the source of the data used was not documented, we were unable to determine whether the data used in the formula were correct or that allocations made to local educational agencies for handicapped and disadvantaged programs were accurately calculated.

Criteria: The Government Code, Section 13403(a)(3), states that a satisfactory system of administrative control must include a system of authorization and recordkeeping adequate to provide effective accounting and control over assets, liabilities, and expenditures. Also, the Code of Federal Regulations, Title 34, Section 74.61(b), states that records which identify adequately the source and application of funds for grant- or subgrant-supported activities must be maintained. Finally, the U.S. Code, Title 20, Section 2333, states that the data used in the allocation formula must come from the year previous to the year in which the allocation is determined. Thus, the data used in calculating the allocation for fiscal year 1985-86 would be based on fiscal year 1983-84 information, if the allocation had been determined in fiscal year 1984-85.

Recommendation: The Vocational Education program should keep accurate records of all data used in the allocation formula and should establish adequate review procedures to ensure that the data are used correctly and that amounts allocated to local educational agencies are accurately calculated. Additionally, all allocations made to agencies in fiscal year 1985-86 should be recalculated using the correct data, and any incorrect allocations should be redistributed.

Item 36. Improper Cash Advance Procedures

Finding: The department's Vocational Education program used improper procedures for advancing program funds to local educational agencies. Of the 70 local educational agencies reviewed, we found that 8 agencies had received funds even though their applications had not been approved by the regional vocational education office. For example, Glendale Unified School District received approximately $66,000 and Centinela Valley Joint Unified School District received approximately $48,000 even though their applications had not been approved. Without approved applications, vocational education staff are providing funds to districts without approved budgets or completely approved programs.

Criteria: The U.S. Code, Title 20, Section 2325, requires that any eligible local educational agency that wishes to receive program funds must submit a program application that satisfies the requirements of the department and includes a description of the program to be funded. Further, the department's "Application Processing Check Sheet for Allocated Funds" notes that all applications are to be forwarded to the regional coordinator for final approval.

Recommendation: The Vocational Education program should ensure that applications have been approved before advancing funds to the local educational agencies.

Item 37. **Inadequate Procedures for Ensuring That Local Educational Agencies Submit Expenditure Reports on Time**

Finding: Of the 28 local educational agencies reviewed, we found that 21 had not submitted their fiscal year 1985-86 final expenditure reports as of the due date of October 1, 1986. Because the expenditure reports were not submitted on time, the Vocational Education program was late in submitting the financial status report for fiscal year 1985-86 and the final financial status reports for fiscal years 1983-84 and 1984-85.

We observed this same weakness during our audits for fiscal years 1983-84 and 1984-85. In response, the department noted that the due date for submission of expenditure claims had been changed from October 1 to August 1, 1986. The department also noted that it would follow up on late reports. However, we discovered that the due date was not changed and found that the department simply did not enforce the deadlines for submitting reports.

The Vocational Education program is also not able to calculate the local educational agencies' maintenance of effort promptly. The financial status report and maintenance of effort calculation are both required by federal regulations.

Criteria: The Code of Federal Regulations, Title 34, Section 76.722, says that a state may require a subgrantee to furnish reports that a state needs to carry out its responsibilities under the program. The Code of Federal Regulations, Title 34, Section 74.73(d), states that when the financial status report is required annually, it is due 90 days after the grant year. Final expenditure reports are due 90 days after the expiration or termination of grant support. The Code of Federal Regulations, Title 34, Section 400.325, further states that a local educational agency must maintain its "fiscal effort" on either a per-student basis or on an aggregate basis for vocational education expenditures compared with the amount spent in the previous fiscal year.

Recommendation: The Vocational Education program should change the due date for the submission of expenditure reports to a date that would enable the department to meet the deadline for submitting federal financial and compliance reports. The Vocational Education program should also penalize local educational agencies that do not submit expenditure reports on time.

Item 38. **Inadequate Documentation of Compliance With the Limitation on Costs for Food Storage and Distribution**

Finding: Under the Temporary Emergency Food Assistance Program (TEFAP), which is funded by the federal Food Distribution grant, the department provides funds to reimburse the emergency feeding organizations for local storage and distribution costs. However, for fiscal year 1984-85 the department did not comply with the federal regulation that limits the amount the department can allocate to emergency feeding organizations for storage and distribution costs.

We reviewed the monthly postings to the department's claim summary log in fiscal year 1984-85 for the 51 emergency feeding organizations. The fair market value of the commodities distributed in fiscal year 1984-85 was incorrectly calculated for 2 emergency feeding organizations. As a result, these organizations were paid an approximate total of $200 more than the maximum of 5 percent of the fair market value.

During fiscal year 1984-85, the department did not follow its procedure that requires emergency feeding organizations to submit a form reporting the value of the commodities distributed. For the two months we tested, one emergency feeding organization did not submit the TEFAP - Commodity Utilization and Inventory Report form, which provides the fair market value of commodities distributed. As a result, we could not determine if the department calculated the payment correctly. Finally, the department did not review its calculations for accuracy. Unless the department requires the emergency feeding organizations to properly report the value of commodities distributed and reviews the reports for accuracy, there is no assurance that the department's payments to emergency feeding organizations for storage and distribution costs are within the required limitations.

We observed these same weaknesses during our compliance audit for fiscal year 1983-84. According to the department's manager of the Field Services Unit, Office of Food Distribution, the department has taken action in fiscal year 1985-86 to ensure compliance with federal requirements.

Criteria: Code of Federal Regulations, Title 7, Part 251.9(2), requires that the department maintain records to document that the amount of funds paid to an emergency feeding organization for its actual storage and distribution costs does not exceed five percent of the value of commodities distributed by this organization.

Recommendation: The department should require emergency feeding organizations to submit the TEFAP - Commodity Utilization and Inventory Report form and should review the forms to ensure that the fair market values are accurate.

EMPLOYMENT DEVELOPMENT DEPARTMENT

The Employment Development Department administers 5 of the 34 federal programs we reviewed. They are the U.S. Department of Health and Human Services grant, Federal Catalog Number 13.646, and the U.S. Department of Labor grants, Federal Catalog Numbers 17.207, 17.250, 17.225, and 17.246.

Item 1. Inadequate Bank Reconciliation Procedures

Finding:

The department does not prepare detailed listings of outstanding checks to support the amount of outstanding checks that it reports in the monthly bank reconciliations of the Central Treasury System Account 800 (Unemployment Insurance Benefit Payment Account). Instead, the department computes the amount of outstanding checks based upon the amount of the prior balance, checks issued, and checks redeemed. The department reported $21 million in outstanding checks on its bank reconciliation at June 30, 1986. Because the department does not prepare a detailed list of outstanding checks, it cannot identify long-outstanding checks to stop payment. In addition, the outstanding check balance the department uses in its bank reconciliation may indefinitely hide cash shortages, errors, or irregularities.

We observed this same weakness during our financial audits for fiscal years 1983-84 and 1984-85. In 1985, the department responded that a new payment accounting system would be developed to provide accurate and detailed accounting for checks issued, paid, and outstanding. However, the department has not yet implemented such a system.

In addition, the department's listing of outstanding checks for the Central Treasury System Accounts 600 (Disability Insurance Account) and 820 (Unemployment Insurance Account) did not support the amount of the outstanding checks balance reported on the bank reconciliation at June 30, 1986, by $10,000 and $454, respectively. In addition, the deposits in transit amount reported on the June 30, 1986, bank reconciliation for the Central Treasury System Accounts 012 (Collection Clearing Account) and 407 (Unemployment Administration Account) included deposits totaling $6.9 million and $42,000, respectively, that had been in transit for over six months. Management of the department was unaware of this condition until we brought it to their attention. Subsequently, the department obtained credit for the $6.9 million deposit in transit. The department is working to obtain credit for the $42,000 deposit in transit.

Criteria: The State Administrative Manual, Section 7967, requires the amount of outstanding checks reported in monthly bank reconciliations to be supported by detailed listings that show number, date, and amount of each outstanding check.

Recommendation: The department should prepare detailed listings of outstanding checks to support the amount of outstanding checks reported in its bank reconciliations. In addition, the department should require that employees responsible for reconciling bank accounts to initiate action to obtain credit for long outstanding deposits in transit.

Item 2. Poor Control Over Benefit Payment Systems Override Function

Finding: Benefit payment personnel use the computer system's override function to bypass various computer edit controls designed to detect errors or irregularities in benefit payments. The department estimates that benefit payment personnel use the override function to authorize payments nearly 20 percent of the time, but the department does not require benefit payment personnel to request approval to use the override function. In addition, the benefit payment system does not generate a report identifying use of the override function. Excessive use of the override function implies inadequately trained staff or inadequate systems programming. Because the department does not monitor and control the use of the override function, it lacks control over the $2.1 billion in benefit payments issued during the 1985-86 fiscal year.

Criteria: The State Administrative Manual, Section 4846.6, recommends that departments record and investigate instances in which controls were overridden.

Recommendation: The department should develop records that will allow it to monitor and investigate the use of the benefit payment override function. In addition, the department should review its benefit payment system to determine if staff training and system programming are adequate.

Item 3. **Unreconciled Differences in Accounting for Employer Tax Receivables**

Finding: For over nine years, the department has maintained two Employer Tax Receivable subsidiary ledgers in separate computer systems, the Trial Balance system and the Employer Tax Subsidiary Ledger (ETSL) system. The department has not reconciled the two systems for over three fiscal years. As of June 30, 1986, the unreconciled differences amounted to $2.6 million. Failure to reconcile the two systems may prevent prompt detection and correction of errors and irregularities.

We observed this same weakness during our financial audits for fiscal years 1983-84 and 1984-85. The department implemented the Tax Accounting system in October 1986, and, as a result, the Trial Balance system and the ETSL system have been consolidated. The department claimed that it consolidated into the Tax Accounting system only the reconciled data from the Trial Balance system and the ETSL system and that it would consolidate the remaining data when fully reconciled.

Criteria The State Administrative Manual, Section 7900, discusses the importance of making regular reconciliations. Reconciliations represent an important element of internal control because they provide a high level of confidence that the transactions have been adequately processed and that the financial records are complete.

Recommendation: The department should continue to reconcile the data in the Trial Balance system with the data in the ETSL system to ensure that the Tax Accounting system contains complete and accurate information on employer tax receivables.

Item 4. **Inadequate Accounting for Tax Overpayments**

Finding: The department's general ledger balances of Tax Overpayments in the following funds did not agree with the supporting subsidiary ledger maintained in the Trial Balance system: the Unemployment Fund, the Unemployment Compensation Disability Fund, the Employment and Training Tax Fund, and the Contingent Fund. The department did not reconcile the difference of $3.1 million at June 30, 1986. Failure to reconcile the general ledger may prevent prompt detection of errors and irregularities.

We observed this same weakness during our financial audits for fiscal years 1983-84 and 1984-85. In 1985, the department responded that it would continue its effort to resolve the unreconciled differences until the general ledger is in balance. However, the department has since diverted its staff to implement its new Tax Accounting system, and the general ledger balances of tax overpayments remain unreconciled.

Criteria: The State Administrative Manual, Section 7900, discusses the importance of making regular reconciliations.

Recommendation: The department should reconcile the general ledger balances of Tax Overpayments in the various funds to the supporting subsidiary ledger.

Item 5. Failure To Assess Penalties on Delinquent Employer Tax Returns

Finding: During our test of employer tax returns, we found that the department did not assess penalties on 10 of the 18 late returns that we tested. The department waits five working days, or seven calendar days, after the due date to allow for mail delivery of employer tax returns before it starts to review for delinquent returns. For each of the 10 late returns, the department received the return during the five working day grace period. The department claims that it performed a mail delivery study in a previous fiscal year and that the study indicated that five working days for mail delivery was reasonable. However, the department could not provide the study for our review. The department stated that it would perform a new mail delivery study to again determine if the five working day grace period is reasonable. Failure to assess penalties and interest on delinquent employer tax returns results in lost revenue to the State.

Criteria: The Unemployment Insurance Code, Sections 1112 and 1113, requires the department to assess a 10 percent penalty on delinquent employer tax returns and to charge the employer interest during the delinquent period.

Recommendation: The department should reevaluate its practice of allowing a grace period of five working days before it starts to review for delinquent returns.

Item 6. **Inadequate Accountability Over the Revolving Fund**

Finding: The department did not correctly develop the year-end revolving fund adjusting entry for the Unemployment Administration Fund. The department did not determine the amount of State Controller warrants it had on hand to reimburse the revolving fund as of June 30, 1986. As a result, the Unemployment Administration Fund's cash and claims filed accounts were each understated by $397,200, as of June 30, 1986.

Criteria: The State Administrative Manual, Section 10586, directs the department to report undeposited State Controller warrants to reimburse the revolving fund as cash on hand at the end of the year and to report as claims filed only those claims unpaid by the State Controller.

Recommendation: The department should report at the end of the year as cash on hand undeposited revolving fund warrants and as claims filed only those claims unpaid by the State Controller.

Item 7. **Late Federal Financial Reports**

Finding: The department was late in submitting the Annual Status Reports for the Job Training Partnership Act (JTPA) for the period ending June 30, 1986. Additionally, the department did not promptly submit the Unemployment Insurance Financial Transaction Summary Report for any month between July 1985 and June 1986.

We observed these same weaknesses during our financial audits for fiscal years 1983-84 and 1984-85. The department indicated that, because JTPA grant recipients were late in submitting their year-end expenditure reports to the department, the department was late in submitting the JTPA Annual Status Report. In addition, the department said that, because of the State's size, the department would have difficultly meeting the due date of ten days after the close of each month for the Unemployment Insurance Financial Transaction Summary Report, even with the ideal automated system.

Criteria: A federal Department of Labor memorandum requires the department to submit the Annual Status Reports for the JTPA within 45 days after the end of the reporting period. In addition, the Employment Security Manual, Part V, Section 9320, requires that the Unemployment Insurance Financial Transaction Summary Report be submitted within 10 business days after the close of each month.

Recommendation: The department should file all required federal financial reports by the dates that they are due.

Item 8. **Inadequate Control Over Cash Requests**

Finding: The department allows JTPA subrecipients to request funds by telephone, provided that subrecipients submit a written confirmation signed by an authorized person, of the amount requested. For 2 of the 60 requests we tested, the department disbursed funds even though the written confirmation was not signed by an authorized person. Failure to adequately confirm requests made by telephone could result in the department's making unauthorized payments.

Criteria: The Job Training Partnership Office, Management Directive 69:60/01, requires that subrecipients submit to the department written confirmation requests signed by persons authorized to request such funds and that the department receive the written confirmation within three days of the telephone request date.

Recommendation: The department should assure that persons signing the written request for funds are authorized to do so.

Item 9. **Inadequate Control of Cash Balances Held by Subrecipients**

Finding: The department has not properly controlled the cash balances of subrecipients of JTPA funds. During our review of Monthly Status of Cash reports, we found that the month-end cash balances of 5 of 24 subrecipients that we tested had exceeded the average three-day cash needs limit established by the department. The excessive cash balances held by the 5 subrecipients ranged from $363 to $916,634, resulting in an average daily cash balance ranging from 4 to 44 days, respectively. The department has procedures to withhold cash advances from subrecipients that have excess cash balances. However, the department has not implemented these procedures because it determined that they conflict with the Unemployment Insurance Code, Section 15028. Section 15028 provides that when a subrecipient does not comply with applicable laws and regulations, the State Job Training Coordinating Council will conduct a hearing to determine whether funds should be withheld from the subrecipient. Failure to adequately control the cash balances maintained by JTPA subrecipients could result in the U.S. Secretary of Labor's charging the department interest on the excess cash balances.

We observed this same weakness during our financial audit for fiscal year 1984-85. In a letter dated June 25, 1986, the department changed its criteria for advancing cash balances to each subrecipient from an average of three days' needs to the immediate needs of each subrecipient. The department believes that this change will prevent subrecipients from obtaining and holding excessive cash balances.

Criteria: A department memo, dated December 3, 1984, required that, during fiscal year 1985-86, subrecipients limit cash balances to an average of three days cash needs.

Recommendation: The department should continue to monitor cash balances of subrecipients and restrict cash advances to each subrecipient's immediate cash needs.

Item 10. Subrecipients Are Not Meeting Job Training Partnership Act Expenditure Limitations

Finding: Several of the subrecipient expenditures we tested did not meet the minimum and maximum limitations for JTPA expenditures. Subject to certain exclusions, federal regulations require that not less than 70 percent of the JTPA funds be spent for training costs and that administration costs be limited to 15 percent of available funds. Administration costs of 3 of the 15 subrecipients that we tested exceeded 15 percent of the total allotment for the two-year period ending June 30, 1986. In addition, 12 of the 15 subrecipients tested did not meet the requirement that at least 70 percent of the grant be used for training.

If the subrecipients exceed the maximum limitations or do not meet the minimum limitations prescribed by federal regulations, the U.S. Secretary of Labor may require the repayment of disallowed costs.

We observed this same weakness during our financial audit for fiscal year 1984-85. In 1986, the department stated that it is normal for subrecipients to incur higher administration costs in the beginning of the program and to spend more grant funds on training as the program matures. In addition, the department claimed that a new computer system would be implemented to allow it to monitor subrecipients' expenditures of JTPA funds.

Criteria: Subject to certain limitations, the Code of Federal Regulations, Title 20, Section 629.39, requires that not less than 70 percent of JTPA funds be spent for training costs and that administration costs be limited to 15 percent of available funds.

Recommendation: The department should continue to monitor the subrecipient expenditure of JTPA funds, and it should enforce federal requirements for minimum/maximum limitations.

Item 11. Late Resolution of Job Training Partnership Act Subrecipient Audit Reports

Finding: The department did not resolve 11 of 16 audit reports within six months of the date of issuance of the report. The Job Training Partnership Office assigned a low priority status to 10 of the 11 audits; consequently, they were not resolved within the required time. The subrecipient failed to respond to the audit findings for the remaining audit report. Failure to resolve audit reports can result in additional questioned costs if the subrecipients do not correct deficiencies in their internal controls within a reasonable amount of time.

We observed this same weakness during our financial audit for fiscal year 1984-85. In 1986, the department redirected existing staff to work on the resolution of JTPA subrecipient audit reports. However, the department is still not resolving the audit reports within the required time.

Criteria: A Job Training Partnership Office's policy and procedure bulletin, #84-13, dated July 13, 1984, requires that the department resolve subrecipient audit reports no later than 180 days of the subrecipients receipt of the final audit report.

Recommendation: The department should resolve all subrecipient audit reports within six months of the issuance of the report.

Item 12. **Inadequate Separation of Duties for Payments of Work Incentive Demonstration Programs**

Finding: In one of the 61 Work Incentive Demonstration Program (WIN DEMO) transactions we tested, the same employee signed the authorization for payment document and the request for payment document. In addition, in one of the seven field locations we reviewed, the same employee signed checks and the payment authorization documents. Inadequate separation of duties for the authorization and request for WIN DEMO payments can result in improper payments.

We observed this same weakness related to the WIN DEMO (formerly WIN) program during our audit for fiscal year 1984-85. The department stated that it revised its procedures manual in November 1985, that the WIN DEMO payment system is no longer used, and that no payments have been made since July 1986. The error we noted occurred in September 1985, before the revision to the procedures manual.

Criteria: The WIN DEMO Handbook states that persons authorized to sign WIN DEMO allowance authorization documents (DE 8910 and DE 8911) cannot sign or initial WIN DEMO payment documents (DE 8912). In addition, WIN DEMO petty cash procedures state that employees authorized to sign checks should not approve the payments. These requirements are based on the State Administrative Manual, Section 8080, which addresses separation of duties.

Recommendation: The department should reiterate the WIN DEMO petty cash procedures to the field offices and should periodically review the applicable documents to monitor compliance with the WIN DEMO petty cash procedures.

Item 13. **Failure To Comply With the Davis-Bacon Act**

Finding: We noted that the department did not include provisions concerning prevailing wages in one of the 23 Public Works contracts we tested. Failure to comply with federal regulations may prevent the State from receiving federal funds.

Criteria: The United States Code, Title 40, Section 2762, requires the department to include prevailing wage provisions in every contract in excess of $2,000 for construction, alteration, and repair of public buildings or public works.

Recommendation: The department should ensure that all construction, alteration, and repair contracts contain the required prevailing wage provisions.

BOARD OF EQUALIZATION

Item 1. **Advances of Retail Sales Tax Monies Are Not Uniform**

Finding: The procedures currently used by the Local Tax Unit for calculating advances of retail sales and use tax to cities and counties do not result in uniform advances to each jurisdiction and are not materially more effective in eliminating overpayments or underpayments than a simpler system.

In our test of total advances made to 60 cities and counties for two quarters in 1985-86, we found that the advances ranged from 77 percent to 104 percent of the total receipts for the same quarter in the previous year. The advances ranged from 35 percent to 137 percent of the jurisdictions' actual receipts for the current quarter. In addition, advances from the Local Tax Unit resulted in 14 overpayments amounting to $194,918 (.06 percent of tested amounts).

To determine the effectiveness of a simpler and uniform system of advancing monies, we calculated advances for the same jurisdictions and the same periods as in our original test based solely on 95 percent of receipts for the same quarter in the prior year. This method produced materially similar results on overpayments: 19 overpayments totaling $340,153 (.10 percent of tested amounts). In addition, this method treated all jurisdictions identically and required very little time.

Both the board's Internal Audits Unit and its Research and Statistics Division have recommended that the Local Tax Unit change its current system of determining advances to an automated and more uniform system of applying stated policy. As of October 1986, the Local Tax Unit had not acted on those recommendations.

Criteria: The California Revenue and Taxation Code, Sections 7204 and 7271, require transmittal of retail sales and use tax revenues to local jurisdictions at least twice quarterly. In addition, the board has the announced policy of advancing in three monthly installments approximately 95 percent of the total tax revenues collected in the same quarter of the previous year, adjusted for economic conditions.

Recommendation: The board should advance to each jurisdiction 95 percent of retail sales and use taxes for the same quarter of the prior year adjusted for state economic conditions. For those few jurisdictions in which local economic trends are readily identified and are likely to have a material impact on tax revenues, the board should adjust the advance amount.

Item 2. Inconsistent Policy on Requiring Information

Finding: The verification manual, which documents the Return Review Unit's procedures for reviewing retail sales and use tax returns, and the Computation Schedule for District Sales and Use Tax (Schedule A) disagree on information required from businesses remitting taxes due to transit districts. As a result, the board's Return Review Unit does not consistently require businesses that collect retail sales and use taxes in transit districts to submit a completed Schedule A with their tax returns. For example, in our sample of 120 tax returns, we found one business located outside a transit district that remitted monies it collected in a transit district but did not submit a Schedule A to justify the amount of transit district monies remitted. For businesses located outside transit districts, the practice and policy reflected in the Return Review Unit's verification manual are to accept returns without a Schedule A, even though they include money collected in a transit district. However, the Schedule A itself includes instructions that require all businesses collecting taxes in transit districts to complete the Schedule A. Because the Return Review Unit does not require a completed Schedule A or question the amount of district taxes remitted, transit districts may not be receiving the correct amount of taxes due.

Criteria: The Schedule A requires all businesses collecting retail sales and use taxes in a transit district to complete the schedule. According to a staff counsel in the board's legal unit, the Schedule A states board policy.

Recommendation: The board should enforce the requirement that all businesses collecting retail sales and use taxes in a transit district complete a Schedule A. The board should reject any returns submitted without the required Schedule A.

Item 3. **Inadequate Method for Estimating Ability To Collect Receivables**

Finding: The board does not have an adequate system to estimate taxes receivable that will be collected within the next fiscal year in the Retail Sales Tax Fund. To comply with generally accepted accounting principles, the board's financial statements at June 30, 1986, should reflect only those amounts that are measurable and expected to be collected during the 1986-87 fiscal year. The board estimates that $119 million of its recorded $682 million in taxes receivable at June 30, 1986, will be collected during the 1986-87 fiscal year. In arriving at its estimate, the board did not analyze the collection history of each category of taxes receivable, did not solicit information from knowledgeable personnel in the collection and petitions units, and did not adjust analyses for a receivable of $123 million which the board does not expect to collect.

Criteria: To assist the State Controller in presenting an annual report according to the Government Code, Section 12460, the board should present its financial position in accordance with generally accepted accounting principles. In addition, Section 1100.101 of the "Governmental Accounting and Financial Reporting Standards," issued by the Governmental Accounting Standards Board, requires that the board's accounting system make it possible to present fairly its financial position and results of operations in accordance with generally accepted accounting principles.

Recommendation: To comply with generally accepted accounting principles, the board should develop an adequate system to estimate collection of receivables. The system should include analysis of the collection history of each category of taxes receivable and other factors important to the estimation of accounts receivable.

Item 4. **Failure To Provide an Adequate Audit Trail for Taxes Receivable Transactions**

Finding: The Information Management Division does not retain detailed records for transactions of taxes receivable beyond 30 days. Without these records, we could not audit transactions in taxes receivable for the year.

Criteria: The State Administrative Manual, Section 1671, recommends that agencies retain most fiscal records at least two years or until after audit.

Recommendation: The board should retain records that support the propriety of all financial accounting transactions for at least two years or until after audit to meet the needs of the internal and external auditors.

Item 5. **System for Assigning Tax Area Codes Is Not Thorough or Efficient**

Finding: The Local Tax Unit does not have a thorough or efficient system for reviewing the tax area codes of registered businesses. In our test of the file of registration cards with errors that the unit identified during 1985-86, we found that the district offices had not corrected 12 (20 percent) of the 60 tested errors. In addition, staff in the Local Tax Unit are aware that certain areas of the State have confusing boundaries, and errors in the tax area code are more likely. In one area, in a test comparing tax area codes with business addresses, we found an error rate of 5 percent.

The current computer system does not edit for errors in matching tax area codes and business addresses. Therefore, three staff members review the registration cards manually, which occupies so much of their time that they do not perform other control activities, such as following up on corrections of identified errors or reviewing areas with suspected high error rates in tax area codes.

Errors in assigned tax area codes cause errors in the distribution of sales and use tax monies to other governments and districts. In addition, apparent inefficiencies in the registration process use staff time that could be better used in other control activities.

In August 1985, the board's internal audit unit recommended that the tax area code file be automated as soon as possible. Also in August 1985, the local tax unit submitted a proposal for extensive automation of the area code file, including a process which would edit for errors in matching tax area codes and business addresses. The management analysis section began reviewing the proposal for cost effectiveness in September 1986, but as of October 1, 1986, had not yet decided whether to implement the proposal to automate the tax area code file.

Criteria: The contracts between the State and other governments and districts require the State to distribute to these jurisdictions the amount to which they are entitled. The tax area codes are the basis of this distribution.

Recommendation: If the Management Analysis Section determines that the proposal for extensive automation of the area code file is cost effective, the board should automate the file promptly. If not, the board should consider developing computer applications for less extensive automation that includes a control procedure to test for a proper match between business addresses and tax area codes.

Item 6. **Failure To Reconcile the Two Systems of Allocating Retail Sales and Use Taxes to State and Local Governments**

Finding: The board does not reconcile the Local Tax Unit's allocation of the retail sales and use taxes to state and local governments with the Fiscal Management Division's allocation. The Fiscal Management Division maintains accounting records for taxes received and allocated to state and local governments on a fiscal year basis. The Fiscal Management Division records are the source for the board's financial statements. The Local Tax Unit records, maintained on an allocation period basis, are the source for disbursements to local governments. The reporting bases differ by more than a month. Because of its failure to reconcile the two systems, the board lacks assurance that its financial statements accurately report state revenues and state liabilities to local governments for retail sales and use taxes.

A board internal audit report issued in August 1985 recommended that the board authorize a study of the Local Tax Unit allocation and Fiscal Management Division systems and design a methodology for performing a thorough reconciliation. As of October 1986, the board had not acted upon this recommendation.

Criteria: The State Administrative Manual, Section 7900, discusses the importance of making regular reconciliations. Reconciliations represent an important element of internal control because they provide a high level of confidence that transactions have been adequately processed and that the financial records are complete.

Recommendation: The board should design and implement a reconciliation of the Local Tax Unit and Fiscal Management Division allocation systems.

Item 7. **Inadequate Clearance Procedures for Terminating Employees**

Finding: The board lacks adequate control for clearing outstanding advances and recovering state-owned property before an employee terminates employment. We tested the records of 55 employees who left service at the board during 1985-86. Of these, 24 (43 percent) did not have the required clearance forms on file. When these clearance forms are not completed, the board lacks assurance that employees leaving state service have repaid outstanding advances and returned state-owned property.

The chief of the Fiscal Management Division issued memoranda in January 1984 and November 1985 reminding board executives and administrators of the need for promptly completing clearance forms. However, the Personnel Management Division does not require a completed clearance form before it issues final pay warrants to terminating employees.

We observed this same weakness during our financial audit for fiscal year 1984-85. The board responded that it had implemented internal control procedures to correct the weakness. However, at the time of our testing in June 1986, the board had not corrected the deficiency in the clearance procedures.

Criteria: The State Administrative Manual, Section 8580.4, requires agencies to ensure that terminating employees pay any outstanding salary and travel advances. To ensure that employees repay advances and return state-owned property, the same section of the manual suggests that state agencies incorporate requirements in a general "check-out" list. The board has issued memoranda requiring use of a check-out list for both advances and state-owned property.

Recommendation: The board's Personnel Management Division should withhold final pay warrants from terminating employees until it has the completed clearance forms on file, indicating that the board has collected all outstanding travel and salary advances and recovered all state-owned property.

Item 8. **Improper Use of the Revolving Fund**

Finding: The Fiscal Management Division is using the board's revolving fund to pay invoices that should be paid by a State Controller's Office warrant. Four of the 30 revolving fund disbursements we tested should have been paid with a State Controller's Office warrant. These disbursements were made to vendors for invoices that did not offer discounts or require immediate payment. For example, one disbursement renewed a newspaper subscription due to expire three months after the date of payment. Use of revolving fund checks when a State Controller's Office warrant could be issued circumvents the pre-disbursement system of review performed at the State Controller's Office and increases the potential for improper payments.

Criteria: The State Administrative Manual, Section 8110, requires revolving fund checks to be used only to pay compensation, travel expenses, travel expense advances, or expenses requiring immediate payment.

Recommendation: The Fiscal Management Division should use the revolving fund for only those purposes authorized by the State Administrative Manual.

Item 9. **Failure To Require Two Signatures on Checks Over $15,000 That Are Not Payable to a State Agency**

Finding: We tested 12 checks over $15,000 that were not payable to a state agency; 5 failed to have the required two signatures. This lack of adherence to the dual signature requirement on checks over $15,000 increases the risk that money will be disbursed improperly. The board does not have written authorization from the Department of Finance to deviate from the requirement for two signatures.

Criteria: The State Administrative Manual, Section 8001.2, requires that all checks in excess of $15,000 have two authorizing signatures unless the payee is a state agency or the board has obtained written authorization from the Department of Finance to deviate from this requirement.

Recommendation: The board should require all checks in excess of $15,000 to have two authorizing signatures unless the payee is a state agency or the board has obtained written authorization from the Department of Finance to deviate from this requirement.

Item 10. **Inaccurate Estimate Used in Monitoring the Promptness of Deposits**

Finding: The Fiscal Management Division uses an inaccurate estimate to monitor monies that are not promptly deposited and, therefore, does not correctly determine the interest lost on late deposits. When actual data for the day are not available, the division uses an average estimate of $326,000 per bin of undeposited receipts to determine if it is cost beneficial to take additional procedures to speed deposits. Using actual data, we calculated the average of undeposited receipts per bin as $856,000. For the five and one-half months ended September 30, 1986, the division's use of its $326,000 estimate per bin to determine interest lost resulted in an underestimate of approximately $90,000.

Criteria: The State Administrative Manual, Section 8099, discusses the State's need to maximize its interest earnings and encourages the use of any practical cashiering and depositing procedures to increase interest earnings. In addition, a report by the Commission on California State Government Organization and Economy, issued in April 1986, identified late deposits and the resulting loss of interest as a problem at the board. Therefore, the board designed the monitoring system to provide data on the extent of that problem.

Recommendation: When an actual count of undeposited receipts is not practical, the Fiscal Management Division should use an estimate based on current, actual data.

FRANCHISE TAX BOARD

Item 1. **Exemptions From Controls Over Tax Collections May Be Invalid**

Finding:

The Department of Finance granted the board certain exemptions from cash controls over incoming tax collections. However, these exemptions may no longer be valid because the board has not complied with provisions of the exemptions. Specifically, in December 1985, the board moved to a new facility that does not adequately restrict access to the receipts area, and the board did not notify the Department of Finance of this change in controls. Moreover, the board applied an exemption granted for certain misdirected mail to all misdirected mail. The exemption was granted only for checks payable to the Internal Revenue Service.

In our management letter for fiscal year 1982-83, we reported that the board had inadequate procedures over cash receipts and refund warrants. The board was not preparing a listing of uncashed refund warrants returned to the board, it was not restrictively endorsing all checks and warrants to establish accountability at the point of first receipt, and it was not using transfer receipt documents when warrants are transferred between employees. On January 11, 1983, the Department of Finance granted the board an exemption from these procedures, except for the use of transfer receipt documents, because of the internal controls in use at the time. The exemption included a provision that the board notify the Department of Finance if the board significantly changed its system for processing documents or if any misappropriations occurred. Although we found no indication of misappropriations, there is no longer adequate control over the cash receipts area. As of June 20, 1986, the board was also exempt from preparing transfer receipt documents for misdirected mail addressed to the Internal Revenue Service and transferred between board employees. However, the board is applying this exemption to all misdirected mail. Because the board has not complied with provisions of these exemptions, they may no longer be valid.

Criteria:

The Department of Finance memorandum that granted the board exemption from certain cash controls requires the board to immediately notify the Department of Finance of significant changes in the board's processing system or of any material misappropriations. Also, the exemption from preparing transfer receipt documents applies only to checks made payable to the Internal Revenue Service.

Recommendation: The board should notify the Department of Finance of all changes in internal control and determine if the current exemptions are still valid. In addition, the board should comply with the limited exemption regarding transfer receipts documents.

Item 2. **Inaccurate Processing of Bank and Corporate Billings and Refunds**

Finding: The board did not accurately compute penalties, or interest, or fees in 8 of the 95 transactions we tested in the Bank and Corporation Tax Fund. These inaccuracies occurred because employees responsible for processing taxpayer files did not understand which dates they should be using to calculate the penalties, interest, or fees. Although the dollar amount of the errors noted was not material, they indicate that not all employees are accurately processing tax returns.

Criteria: The board's Bank and Corporation Reference Manual details the procedures required to properly assess penalties, interest, and fees.

Recommendation: The board should provide training to employees processing taxpayer transactions to ensure that taxpayer transactions are accurately processed.

Item 3. **Inadequate Separation of Duties**

Finding: The board does not have adequate separation of duties over cash. An employee in the Cash Receipts Unit who collects receipts and prepares the bank deposit also reconciles the cash to the cashier's report. Unless these duties are properly segregated, an employee can conceal irregularities and they may not be detected.

Criteria: The State Administrative Manual, Section 8080, requires someone other than the employee receiving cash and preparing the bank deposit to reconcile cash transaction reports.

Recommendation: The board should assign the task of reconciling the cash to the cashier's report to someone other than the employee who is receiving cash and preparing the bank deposit.

Item 4. **Inadequate Control of the Credit Follow-up Referral Report**

Finding: The board does not exercise adequate control over the Bank and Corporation Tax Fund "Credit Follow-up Referral" report. The Credit Follow-up Referral report is a listing of all credit balances on the bank and corporations' accounts receivable file and is used to issue refunds to taxpayers. The report is not always kept in a secure location nor is access to the report adequately restricted. Further, the board does not keep a record of the final disposition of the credit balances. We observed this weakness during our fiscal year 1982-83 audit. In response to our management letter for fiscal year 1982-83, the board stated that it would keep the report in a secure location, restrict access to the report, and establish an audit trail on the disposition of credit balances. However, the weaknesses we noted still exist. Consequently, an employee could use the information on the report to issue fraudulent refunds that may not be detected.

Criteria: The Government Code, Section 13403(a)(3), requires that a system of internal control include a system of authorization and recordkeeping procedures that provide effective accounting control over assets.

Recommendation: The report titled Credit Follow-up Referral should be stored in a secured location, and access should be restricted to those employees assigned to work the credit balances. Also, the board should maintain a record of the disposition of the credit balances.

Item 5. **Inadequate Controls To Verify Data Posted to the Bank and Corporation Records**

Finding: The board has not implemented procedures to verify that all bank and corporation tax transactions have been recorded to the taxpayer's files. Specifically, the Corporations Transactions Unit does not have a process to ensure that all bank and corporation tax transactions were completely and correctly posted to the taxpayer files. Currently, the board reconciles all personal income tax transactions received or generated by the board to the taxpayer's files, thus ensuring that all transactions were posted. The board has recognized this weakness and has proposed corrective procedures. However, as of November 7, 1986, the proposed procedures have not been implemented. As a result, there is no assurance that all bank and corporation transactions received have been posted to the taxpayer's file.

Criteria:	The State Administrative Manual, Section 4846.6, requires that the board ensure that all transactions have been posted.
Recommendation:	The board should implement the proposed procedures to ensure that all bank and corporation tax transactions received have been posted to the taxpayer's files.

DEPARTMENT OF GENERAL SERVICES

Item 1. **Inadequate Control Over Disbursements**

Finding: The department's file of remittance advices, which provides documentation of all payments made by the department to a vendor, is inadequate to protect against paying twice for the same goods or services. The department maintains the file in alphabetical order by vendor's name; however, it uses only the first two letters in the vendor's name. Because of the volume of transactions the department processes and the number of vendors, this is not an effective filing method. We tested a sample of payments made to 94 vendors in fiscal year 1985-86 and found that the department made 26 duplicate payments totaling $3,489 to one of these vendors. As of the end of our fieldwork, the department was attempting to recover these funds.

We observed this same weakness during our financial audit of fiscal year 1984-85. In its response to our report of January 29, 1986, the department stated that it had corrected the deficiencies in the remittance advice file.

Criteria: The State Administrative Manual, Section 8422.31, requires state agencies to maintain an alphabetical file of remittance advices as a central reference file to determine that payment has not been made previously.

Recommendation: The department should maintain the file of remittance advices in full alphabetical order by vendor and by date of payment.

Item 2. **Failure To Accrue All Accounts Payable**

Finding: The department failed to accrue in the Architecture Revolving Fund $1,995,792 of accounts payable for goods and services received before June 30, 1986. The accounting officer stated that he believed it was sufficient to accrue only the claims that were filed; he did not realize that he should also accrue all obligations for goods and services received before June 30, 1986. In addition, we found that the department did not provide its accounting personnel with specific instructions for making the accruals. Because the department failed to accrue all of the obligations at the end of the year, the accounts payable and expenditure balances of the

Architecture Revolving Fund were understated by $1,995,792. In addition, because of the misstatement, the department had to revise the financial reports for the Architecture Revolving Fund. These revised reports were not submitted to the State Controller's Office until December, four months after the original reports were submitted.

Criteria: The State Administrative Manual, Section 10584, states that the department must review unliquidated encumbrances as of June 30 to determine whether they are valid obligations as defined by the State Board of Control Rule 610, which requires that expenditures for services, materials, supplies, or equipment be charged to the fiscal year in which they were received.

Recommendation: The department should accrue as accounts payable or due to other funds all valid obligations at June 30 as defined by the State Administrative Manual and the State Board of Control Rule 610. In addition, the department should prepare a detailed listing of accounts payable at June 30 as required by the State Administrative Manual, Section 10584.

Item 3. Failure To Reconcile the General Ledger Encumbrance Account With Subsidiary Records

Finding: The department did not reconcile the encumbrance account in the general ledger with the Transaction Cost Control System (TRACC$). The TRACC$ is the Office of the State Architect's accounting system for project costs; it provides detailed budget and expenditure information by project.

When the Office of the State Architect enters into a contract or an agreement to purchase goods or services, it sends the completed documents to the department for recording in the accounting records. The accounting unit records the information in the general ledger while the data processing unit enters the information into the TRACC$ system. To ensure that the correct information has been recorded into both the general ledger and the TRACC$ system, the department reconciles the two. However, the department did not prepare the reconciliation before preparing the financial reports for the Architecture Revolving Fund. As a result, the department failed to identify a $10.5 million overstatement in the encumbrance account. Since the financial reports included the error, the department had to revise the financial reports for the Architecture Revolving

Fund. The revised reports were not submitted to the State Controller's Office until December, four months after the original reports were submitted.

Criteria: The State Administrative Manual, Section 7900, discusses the importance of making regular reconciliations. Reconciliations represent an important element of internal control because they provide a high level of confidence that the transactions have been adequately recorded and that the financial records are complete. In addition, the Department of General Services' Accounting Manual, Section 6100, states that general ledger accounts should be reconciled regularly with existing subsidiary records.

Recommendation: Before preparing the financial reports for the Architecture Revolving Fund, the department should reconcile the encumbrance account in the general ledger with the TRACC$ system.

Item 4. Failure To Promptly Record Cash Receipts

Finding: At June 30, 1986, the department did not record, in its general cash account, deposits totaling $15,195. Department personnel outside of Sacramento made these deposits before the end of the fiscal year, but the department did not record them until after July 1, 1986. As a result, the department's general cash account was understated by $15,195 at June 30, 1986.

Criteria: Proper accounting procedures prescribe that all cash receipts deposited before the end of the fiscal year should be included in the department's general ledger balance at June 30.

Recommendation: The department should establish procedures to ensure that all cash receipts deposited before June 30 are recorded in the proper fiscal year.

Item 5. Incorrect Recording of Depreciation Expense

Finding: The department records excessive depreciation expense on some equipment. When the department purchases equipment that will be used in the construction and replacement of microwave equipment, the department includes this equipment in its property records. Appropriately, the department does not charge depreciation expense until the equipment is put into service. However, once the equipment is placed into service, the department calculates depreciation expense from the date of acquisition rather than from the date the equipment was placed into service. For example, one item we identified was purchased in July 1984. In February 1986, the item was put into service, and the department recorded 18 months of depreciation expense even though the department had derived no benefit from the equipment before it was put into service. We estimate that in fiscal year 1985-86, the department charged approximately $65,000 in excess depreciation expense on microwave equipment.

Criteria: The State Administrative Manual, Section 8616, states that depreciation is the charging of a tangible asset's cost to the periods benefitted.

Recommendation: The department should charge depreciation for only those periods that benefit from the use of equipment.

Item 6. Failure To Segregate Encumbrances From Obligations

Finding: The department did not segregate the encumbrances from the obligations included in the accounts payable and due to other funds accruals for the Service Revolving Fund. Obligations are amounts owed for goods and services received before June 30 while encumbrances are the reservation of funds to be paid for goods and services ordered but not received by June 30.

Our analysis of the department's accounts payable accrual showed that the department included in its accrual approximately $1.5 million for goods and services that were ordered but not received as of June 30, 1986. If the department does not identify the amount accrued for encumbrances, the State Controller's Office does not have sufficient information to prepare the financial statements for the State in accordance with generally accepted accounting principles.

Criteria: The State Administrative Manual, Section 10584, requires the department to prepare a detailed list of all accounts payable at June 30. This list should distinguish between obligations for goods and services received before June 30 and encumbrances.

Recommendation: The department should prepare a detailed list of accounts payable and due to other funds that segregates obligations from encumbrances.

Item 7. **Improper Revenue Accrual Procedures**

Finding: The department does not properly accrue revenue for the Material Services Division. For billing purposes, the Material Services Division establishes a sales cut-off date before June 30 even though sales continue through the end of June. In addition, the department does not prepare an accrual for sales that occur between the cut-off date and June 30. As a result, at June 30, 1986, the department's due from other funds account was understated and the inventory account was overstated by approximately $280,000. In addition, the department's revenue and cost of goods sold accounts were overstated by approximately $30,000.

Criteria: Proper accounting procedures require that revenue earned but not yet received be recorded in the period in which it was earned.

Recommendation: The department should establish procedures to ensure that sales by the Material Services Division are recorded in the proper fiscal year.

Item 8. **Inaccurate Financial Report**

Finding: The department did not prepare Report 11, Reconciliation of General Checking Account No. 1, in accordance with the State Administrative Manual. The June 30 balances on the department's bank reconciliation for the Office of the State Architect and the State Board of Control-Omnibus were $39,183 less than the department's general ledger balances. Because the department did not record the actual general ledger balances or the related reconciling items for the Office of the State Architect and the State Board of Control-Omnibus, Report 11 was neither complete nor accurate.

Criteria: Report 11 should be prepared from the department's June 30 general ledger account balances. This is consistent with the State Administrative Manual, Section 7967, which states that the department should identify, on the bank reconciliation, each fund's share of the general cash account.

Recommendation: The department's fiscal officer should ensure that the accounting personnel have properly reviewed and reconciled the required financial reports with supporting agency records. All required year-end financial reports should be prepared in accordance with the State Administrative Manual.

Item 9. **Inadequate Separation of Payroll Duties**

Finding: Department employees who process attendance and other payroll documents also receive undistributed salary warrants. Unless these duties are separated, an employee could authorize payment to a fictitious employee for personal use.

We observed this same weakness during our financial audits of fiscal years 1982-83, 1983-84, and 1984-85. According to the department's response to our report of January 29, 1986, the department required all personnel receiving salary warrants to sign a certification form stating that they do not certify or process payroll and personnel documents. In addition, the department reviews the authorization forms of two offices per month and requests changes when required. Despite these changes, the weakness still exists.

Criteria: The State Administrative Manual, Section 8580.1, states that persons who receive salary warrants, distribute salary warrants to employees, or handle salary warrants for any other purpose should not be authorized to process or sign attendance reports, Standard Form 672.

Recommendation: The department should assign the safekeeping of undistributed salary warrants to employees other than those who certify or process payroll and personnel documents.

Item 10. **Inaccurate Accumulated Depreciation Balance**

Finding: The Office of State Printing overstated by \$3.1 million the June 30, 1986, accumulated depreciation balance. We identified various accounting errors that have contributed to the misstatement. For example, the accounting office continues to charge depreciation on fully depreciated assets and does not properly account for the disposition of equipment. We tested 20 fully depreciated assets and found that the accounting office was still depreciating 18 of them. The department has charged \$289,000 in depreciation to these assets which cost only \$190,000. As a result, for these 18 items the accumulated depreciation balance was overstated by \$99,000.

We also tested the records on the disposition of 20 pieces of equipment. We found that the accounting office did not properly record accumulated depreciation for 15 of these disposals. When the accounting office records the disposition of equipment, it charges the accumulated depreciation account for the full cost of the asset regardless of the amount of depreciation that has been charged to that asset. In addition, the accounting office fails to record a gain or loss on the disposition of the asset. As a result, unless the asset is fully depreciated, the accumulated depreciation account will be understated. Further, the surplus adjustment account, which should be used to record the gain or loss, is misstated.

Criteria: The State Administrative Manual, Section 8651.5, requires agencies to use depreciation accounting methods that are consistent with good commercial practice for similar operations. Generally accepted accounting principles define depreciation accounting as the system of accounting that aims to distribute in a systematic and rational manner the cost of an asset over its useful life.

In addition, the State Administrative Manual, Section 8651.3, states that agencies that account for depreciation will reduce the accumulated depreciation account for the accumulated depreciation on the item removed and record in the surplus adjustment account the gain or loss on the item removed.

Recommendation: Before computing depreciation expense, the department's accounting office should remove from the asset group fully depreciated assets. In addition, when recording the disposition of equipment, the accounting office should remove from the accumulated depreciation account only the amount of depreciation that has been charged to the equipment, and it should properly record in the surplus adjustment account the gain or loss.

Item 11. Improper Accounting for Equipment Improvements

Finding: The Office of State Printing's accounting office recorded as maintenance and repair expense an equipment improvement that should have been capitalized. Capitalizing an improvement allocates the cost of the improvement over the improvement's estimated life through depreciation expense. We tested 20 maintenance and repair expense transactions and found one repair costing $15,000 that was improperly recorded. The Office of State Printing incurred the expense to modify an existing printing press. After the repair, the printing press was able to perform functions that it was not able to perform before the modification. Although this repair should have been capitalized, the accounting office recorded it as an expense. The recording error occurred because the accounting office failed to identify the repair as an improvement when the invoice was paid.

Criteria: The State Administrative Manual, Section 8651.4, states that repairs and maintenance that make the facility better than it was originally are considered improvements. Further, the State Administrative Manual, Section 8651.2, states that the cost of improvements should be capitalized.

Recommendation: The department's accounting office should review all maintenance and repair invoices to determine whether the expense was incurred for normal maintenance and repair or for an improvement. The accounting office should capitalize improvements.

Item 12. Unauthorized Dispositions of Property

Finding: The Office of State Printing disposed of at least two pieces of equipment without the necessary approval. According to the department's property inspector, who prepares Property Survey Reports and approves the disposal of property, the Office of State Printing disposed of these items at the sale of obsolete property in July 1985 but failed to obtain, before the sale, a Property Survey Report authorizing the dispositions. As of November 1986, 16 months after the sale, the equipment was still included in the Office of State Printing's property records because the Property Survey Reports for these two items had not been completed. In addition, failure to obtain proper authorizations before disposing of property may result in disposals that are not in accord with management policies.

Criteria: The State Administrative Manual, Section 8656, requires that a Property Survey Report be prepared whenever it is proposed to dispose of state-owned, nonexpendable property by sale, trade in, or junking.

Recommendation: The Office of State Printing should prepare the Property Survey Report and obtain the necessary approval before disposing of property. In addition, the Office of State Printing should remove from the property records property that has been disposed of.

Item 13. **Failure To Promptly Bill State Agencies for Printing Charges**

Finding: At June 30, 1986, the Office of State Printing had not billed at least $966,000 in charges for printing jobs completed and shipped between October 1984 and June 1986. The production department of the Office of State Printing did not provide to the Office of State Printing's accounting office a listing of completed and shipped jobs until May 1986. The accounting office bills state agencies when the production department sends the completed job file to the accounting office. However, without a listing of all completed and shipped jobs, the accounting office cannot ensure that all jobs are billed promptly. Failure to bill may impair the Office of State Printing's ability to collect the amount owed. In addition, until collected, these amounts are not available to pay the Office of State Printing's current obligations.

We observed this same weakness during our financial audit of fiscal year 1984-85. According to the department's response to our report of January 29, 1986, the Office of State Printing was developing a computerized system to produce a daily jobs shipped report for use by the accounting office in its billing. The Office of State Printing has developed a daily jobs shipped report, but it was not available for use by the accounting office until May 1986.

Criteria: The State Administrative Manual, Section 8776.3, requires that bills be prepared and sent as soon as possible after the recognition of a claim.

Recommendation: The production department of the Office of State Printing should provide to the accounting office a listing of all jobs still listed in production that were completed and shipped before the date the daily jobs shipped report was available.

Item 14. **Deficient Revenue Accrual Procedures**

Finding: At June 30, 1986, the Office of State Printing understated the due from other funds, sales, and cost of goods sold accounts and overstated the work in process account balances by $652,000. These errors occurred because the procedures the accounting office used to accrue revenue were deficient. The accounting office determined which jobs were to be included in the revenue accrual by matching job numbers from a list of work in process at June 30, 1986, against a computer screen that indicated the shipping date of the job. Jobs with a shipping date of June 30 or before were accrued. The accounting office erroneously assumed that, when a computer screen did not appear for a job, the job had not been shipped. We determined that the system does not always provide a computer screen for jobs that have been shipped. We also noted that the accounting office accrued some jobs that were not complete and, therefore, should not have been accrued.

Criteria: The State Administrative Manual, Section 8290, requires state agencies to accrue income as of the fiscal year just ended.

Recommendation: The Office of State Printing's accounting office should accrue revenue for all jobs shipped but not yet billed at June 30.

Item 15. **Failure To Promptly Update the Stock Inventory System**

Finding: The Office of State Printing uses the Stock Inventory System (system) to record stock on hand, including the quantity and cost of the stock. When stock is received, the Office of State Printing records the stock in the system at the purchase order price. The Office of State Printing must adjust this price if the amount that it pays for the stock is different from the price on the purchase order. For example, if the Office of State Printing takes advantage of a vendor discount, the discounted price should be recorded in the system. The price recorded in the system is the amount that the Office of State Printing charges other state agencies for the stock used to produce the agency's printing orders. We found that the Office of State Printing never adjusted the stock prices in some cases, and took as long as five months to record other adjustments of stock prices. Failure to promptly update the system results in inequitable charges to agencies for printing costs.

We observed this same weakness during our financial audit of fiscal year 1984-85. According to the department's response to our report of January 29, 1986, the Office of State Printing is initiating a procedure to update the system daily.

Criteria: The Government Code, Section 13401(b)(1), requires state agencies to maintain an effective system of internal accounting control. Good internal control requires that an inventory system provide an accurate record of inventory items.

Recommendation: The Office of State Printing should promptly record in the system the actual price of stock to ensure that it accurately bills state agencies for the stock used in agencies' orders.

Item 16. Unauthorized Disbursements

Finding: The Office of State Printing made disbursements that were not properly authorized. We tested 70 disbursements and found 3 totaling $363, that were not properly authorized for payment. The accounting office made one disbursement even though the person approving the payment also initiated the expense. The accounting office made 2 other disbursements without any management approval. The accounting office made the disbursements in accordance with procedures outlined in an Office of State Printing management memorandum; however, that memorandum was not in conformity with the State Administrative Manual. The accounting office also did not realize that all expenses were to be authorized before submitting the claim to the State Controller's Office for payment.

Criteria: The State Administrative Manual, Section 8080, states that no one person will authorize disbursements and also initiate invoices. The State Administrative Manual, Section 8422.1, also states that an agency will determine that authority existed to obtain goods or services before submitting a claim to the State Controller's Office.

Recommendation: The Office of State Printing should revise its Management Memo #85-15 so that it agrees with the State Administrative Manual, Section 8080. The Office of State Printing's accounting office should ensure that all invoices are properly approved before submitting them for payment.

Item 17. Salary Advances Outstanding for Two Years

Finding: The Office of State Printing's office revolving fund has salary advances totaling $962 that have been outstanding for more than two years. These outstanding salary advances represent 47 percent of all salary advances outstanding at June 30, 1986. The Office of State Printing has been unable to collect these advances because the accounting office, in some cases, does not have all the information it needs to pursue collection. Until the accounting office takes the appropriate actions to either write off or collect these outstanding advances, these amounts are not available to pay current obligations.

Criteria: The State Administrative Manual, Section 8710.1, states that, if all reasonable collection procedures do not result in payment, departments may request from the State Board of Control relief from accountability for uncollectible amounts. Departments file an Application for Discharge from Accountability and Claim for Reimbursement with the State Board of Control.

Recommendation: The Office of State Printing should request from the State Board of Control discharge from accountability and reimbursement for the uncollectible salary advances.

Item 18. Delays in Returning Unencumbered Balances in the Architecture Revolving Fund

Finding: The Office of the State Architect has not promptly returned unused funds after completing projects. The State appropriates monies for construction projects from the funds of agencies that will benefit from the project. The agency receiving the appropriation then transfers the appropriated monies to the Architecture Revolving Fund. After the project is completed, the Office of the State Architect, which administers the Architecture Revolving Fund, returns the "unencumbered balances" to the agency that received the original appropriation.

The Office of the State Architect, however, takes an average of seven months to return the unencumbered balances. Of the seven months, the Department of Finance and the State Controller's Office together take an average of two months to approve and return the unencumbered balance. The Office of the State Architect takes five months to prepare the forms required by the State Controller's Office. Several factors contribute to the delay:

- Information about the cost of the project from the computerized cost control system is not always available on time.

- Some contractors' outstanding claims are not received on time or processed promptly.

- Some contractors' claims require arbitration. Until these funds are returned, they are not available for another appropriation.

We observed this same weakness during our financial audits of fiscal years 1983-84 and 1984-85. According to the department's response to our report of January 29, 1986, the Office of the State Architect is developing a more efficient computerized system to monitor project costs.

Criteria: The Government Code, Section 14959, requires the department to transfer the unencumbered balance of the Architecture Revolving Fund to the original appropriation within three months after the Office of the State Architect completes a project.

Recommendation: The department should develop a more efficient system for monitoring the project costs so that the department can retrieve information more quickly. The department should also develop a system for tracking completed projects to accelerate the return of unencumbered balances.

DEPARTMENT OF HEALTH SERVICES

The Department of Health Services administers 3 of the 34 federal programs we reviewed. They are the U.S. Department of Agriculture grant, Federal Catalog Number 10.557, and the U.S. Department of Health and Human Services grants, Federal Catalog Numbers 13.714 and 13.994.

Item 1. Lack of Accountability for the Revolving Fund

Finding: The department did not completely support its $1.7 million revolving fund advance. The department's revolving fund reconciliation did not include details supporting the $59,693 miscellaneous expenditures that were not scheduled for reimbursement by June 30. In addition, the department overstated the claims filed paid through the revolving fund by $9,557, and it overstated its cash book balance in the revolving fund by $1,080 as of June 30, 1986. Failure to maintain adequate control and accountability over the revolving fund can prevent the early detection of irregularities such as unauthorized or excessive disbursements.

The lack of accountability occurred because the department did not ensure that its entire $1.7 million revolving fund advance was correctly supported by cash in the Centralized State Treasury System, cash on hand in the department, a listing of outstanding salary and travel advances, a listing of claims filed but not yet paid by the State Controller to reimburse the revolving fund, and a list of invoices not yet scheduled for reimbursement.

Criteria: The State Administrative Manual, Section 7964, requires the department to reconcile its revolving fund accounts at the end of each month and to provide details of unreimbursed payments on supporting schedules. The State Administrative Manual, Section 7967, also requires the department to reconcile its Revolving Fund Cash account with the Centralized State Treasury System account.

Recommendation: The department should direct its accounting personnel to reconcile its revolving fund resources properly and to provide correct and sufficient supporting documentation. The department should also reconcile its Revolving Fund Cash account with the Centralized State Treasury System account.

Item 2. **Incorrect Preparation of Financial Reports**

Finding: The department did not include an Analysis of Change in Fund Balance report for the Federal Trust Fund and did not accurately account for and report $3,149,195 Cash in State Treasury account. The department uses the Fund Balance-Clearing account in accounting for cash transactions rather than Cash in State Treasury. As a result, the department's Federal Trust Fund financial reports for fiscal year 1985-86 were not complete, and the Cash in State Treasury account was understated by $3,149,195 as of June 30, 1986.

Criteria: The State Administrative Manual, Section 17135, requires the department to use the Cash in State Treasury account in remitting federal funds to the Federal Trust Fund in the State Treasury. The State Administrative Manual, Section 7951, also requires the department to submit the Analysis of Change in Fund Balance for the Federal Trust Fund at the end of the year.

Recommendation: The department should use the Cash in State Treasury account to account for federal funds in the Federal Trust Fund. The department should also submit the required Analysis of Change in Fund Balance to the State Controller at the end of the year.

Item 3. **Improper Identification of Encumbrances**

Finding: On its General Fund Report of Accruals, the department inappropriately reported $35 million of payables as encumbrances outstanding because the department's program personnel did not comply with the department's instruction for analyzing accounts payable to determine whether goods were received or services were provided before or after June 30. Failure to properly identify encumbrances outstanding resulted in the understatement of the State's obligation as of June 30.

Criteria: A State Controller's memorandum issued on April 17, 1986, requires the department to analyze and report the amount of encumbrances outstanding applicable to its accruals in such a way that the State's financial statements can be prepared in accordance with generally accepted accounting principles. Under generally accepted accounting principles, encumbrances outstanding are that portion of the accruals that represent goods received or services provided after June 30. The

Codification of Governmental Accounting and Financial Reporting Standards provides guidelines on how to separate amounts owed for goods and services. For instance, if a contract ends on June 30, it can only be an obligation since no services would be performed after June 30. The obligation may not be fully liquidated but the amount should not be classified as an encumbrance outstanding. For a multi-year contract, the portion of the contract related to the period after June 30 should be classified as an encumbrance outstanding.

Recommendation: During the year-end closing of accounting records, the department should direct its accounting section to monitor and review the program personnel's differentiation between obligations and encumbrances outstanding.

Item 4. **Errors in Processing Invoices for Payment**

Finding: We tested 30 of 57,000 General Fund payments made from July 1, 1985, through April 30, 1986, and found the following errors in processing invoices:

- The department authorized payment of one invoice without evidence of receipt of goods.

- The department authorized payment of two invoices when invoices contained charges that exceeded allowable rates.

- The department authorized payment of one invoice that contained a mathematical error.

- The department authorized payment of two Child Health and Disability Prevention Program (CHDP) invoices without evidence of procedures to avoid duplicate payment.

These errors occurred because the accounting personnel were not following the State's claim review procedures. Also, the program personnel were not verifying the correct allowable rates. In addition, the CHDP does not have a procedure to avoid duplicate payments even though it is a program that made 25,000 payments totaling $9 million between July 1, 1985, and April 30, 1986.

Criteria: The State Administrative Manual, Section 8422.1, requires the department to determine that it has received items for which it is billed, as evidenced by a stock received report, that payment has not previously been paid, that invoices comply with provisions of contracts, and that the arithmetical accuracy of invoices has been verified.

Recommendation: The department should direct its accounting personnel to comply with appropriate State Administrative Manual sections to ensure correct processing of invoices. In addition, the department should direct the contractor who processes CHDP invoices to include prepayment edits and audits in the invoice processing system to prevent duplicate payments.

Item 5. Failure To Report Revenues

Finding: The department failed to estimate and report General Fund accounts receivable that were collectible within the next fiscal year. The department did not analyze the deferred accounts receivable to estimate which accounts may be collectible in fiscal year 1986-87. The department collected $291,993 of accounts receivable in the first four months of fiscal year 1986-87.

Criteria: The State Administrative Manual, Section 8290, requires the department to accrue accounts receivable earned but not received as income of the fiscal year just ended if they are estimated to be collectible within one year after the end of the current fiscal year.

Recommendation: The department should direct its accounting personnel to analyze, estimate, and report as income those accounts receivable that are collectible within the next fiscal year.

Item 6. Airline and Car Rental Invoices Are Paid Before Determining That Services Were Received

Finding: The department does not currently compare airline and car rental invoices with its employees' used airline tickets and car rental receipts before payment to determine the propriety of charges. We tested ten paid airline invoices and ten car rental invoices. We found that seven of ten paid airline tickets and six of ten paid car rental invoices did not have documentation that the services had been received by employees before the department paid the vendors. Accounting personnel said that there were not enough staff to do the comparison. Failure to compare invoices with used airline tickets and car rental receipts may prevent early detection of irregularities such as unauthorized or excessive disbursements.

Criteria: The State Administrative Manual, Section 8422.1, requires the department to determine that services have been received before payment is made.

Recommendation: Before payment of airline and car rental invoices, the department should compare the charges in the invoices with the employees' travel expenses to determine the propriety of the charges.

Item 7. Failure To Review Medi-Cal Claims Before Payment

Finding: The department did not review Medi-Cal claims to verify the accuracy and validity of claim data to permit the proper adjudication of certain Medi-Cal claims. We tested 114 Medi-Cal claims paid between July 1, 1985, and April 30, 1986, to determine whether the Computer Sciences Corporation (CSC) adequately reviewed these claims. We found the following errors:

- The CSC processed a claim received from Medicare for partial payment by Medi-Cal even though it lacked the code to identify the medical service billed.

- The CSC processed a claim based on the total amount of the claim rather than on claim line detail.

- The CSC erroneously processed another claim that had an inappropriate pricing modifier. The CSC was not able to match a Medi-Cal code with the Medicare code.

- The CSC incorrectly priced one of the pharmacy claims because the processing system does not have a control to detect that an incorrect drug code was used on the claim. As a result, the claim for the drug was paid on the basis of the incorrect code's lower unit value for the drug.

Although the amount of each overpayment was not significant, we believe that these errors occurred because the CSC's prepayment review system does not include edits or audits to detect these types of errors. During fiscal year 1985-86, the Payment Systems Audit Branch of the State Controller's Office found that the department overpaid

$10 million because the system did not detect the first three types of errors listed above. The department said that these payments resulted from a policy decision and were not actually overpayments. The State Controller's Office asked the Attorney General for an opinion to resolve this issue. During our review, the department asked the CSC for its plan to correct the first three types of errors.

Criteria: The Code of Federal Regulations, Title 42, Section 447.45f(1), requires the department to review claims before payment to verify the accuracy and validity of claim data thus permitting the proper adjudication of Medi-Cal claims.

Recommendation: The department should analyze and evaluate the CSC's corrective action plan to ensure that this problem is resolved. The department should also analyze the costs and benefits of requiring prepayment controls to prevent errors like the fourth one above.

Item 8. Food Vouchers Improperly Processed

Finding: The department has not ensured that food vouchers are properly processed by participants and food vendors in the Special Supplemental Food Program for Women, Infants, and Children. Our test of food vouchers issued during 1985-86 fiscal year revealed the following errors:

- Four food vendors deposited the food vouchers before the first date on which the participant may use the food vouchers to obtain supplemental foods.

- Two other food vendors improperly endorsed the food vouchers.

- Another three food vendors altered the prices written on vouchers.

These errors do not significantly affect the value of the food vouchers redeemed or paid and will not affect the propriety of the department's expenditures. However, if the department does not take appropriate action, the procedures may deteriorate to the extent that this failure to comply with federal requirements may jeopardize the State's eligibility for federal funds.

Criteria: The Code of Federal Regulations, Title 7, Section 246.12(s), requires food vendors to submit food vouchers for payment within 90 days after the first date on which the food voucher may be used by the participant to obtain supplemental foods. This section also requires the department to establish procedures to identify vendors' numbers and altered prices on food vouchers.

Recommendation: The department should remind the participants and food vendors of these federal requirements to ensure the State's continued receipts of federal funds.

Item 9. **Food Vouchers Are Not Reconciled Promptly**

Finding: The department does not promptly reconcile food vouchers issued to food vouchers redeemed under the Special Supplemental Food Program for Women, Infants, and Children. As of October 10, 1986, only the January 1986 reconciliation was complete. Thus, the department has not completed the reconciliation for the eight-month period from February 1986 through September 1986. Failure to promptly reconcile the food vouchers may prevent early detection of irregularities. The department does not promptly reconcile vouchers issued to vouchers redeemed because of the large number of transactions and a cumbersome reconciliation process.

Criteria: The Code of Federal Regulations, Title 7, Section 246.12(n)(1), requires the department to reconcile the records of food vouchers issued to the records of food vouchers redeemed within 150 days from the first date of use of vouchers to control the accuracy of the records.

Recommendation: The department should promptly reconcile food vouchers issued to food vouchers redeemed.

Item 10. **Delays in Requesting Federal Funds**

Finding: The Maternal and Child Health Services (MCH) unit of the department disbursed General Fund money on the average of 12 calendar days before receiving federal funds from the MCH block grant. As a result, the State lost at least $20,300 in interest income because of delays in requesting federal funds.

Criteria: The State Administrative Manual, Section 8099, requires state agencies making disbursements from a state fund to ensure that the State receives federal monies by the time disbursements are made.

Recommendation: The department should submit request for federal funds promptly to ensure that the timing and amount of federal monies are as close as is administratively feasible to the actual disbursement by the State Controller's Office.

Item 11. No Review of Third Party Liability

Finding: The department does not review Medi-Cal claims to determine the extent of erroneous payments made to third parties that are legally liable for paying for all or part of the medical services. Federal regulations require the State to implement a Medicaid quality control procedure so that the department can reduce erroneous expenditures by monitoring eligibility determinations, claim processing, and third-party liability activities. The department performs Medi-Cal Quality Control reviews of eligibility determinations, and it monitors claim processing through the Claims Processing Assessment Systems. However, the department did not establish which unit should be responsible for monitoring third-party liability activities. Failure to do a quality control review of Medi-Cal claims that involved third-party liability may affect the federal share for the State's Medi-Cal payments.

Criteria: The Code of Federal Regulations, Title 42, Section 431.800, requires the department to establish a Medicaid Quality Control eligibility system. Under this system, the department must review claims to identify erroneous payments resulting from third-party liability.

Recommendation: The department should review Medi-Cal claims to identify erroneous payments resulting from third-party liability.

Item 12. Audits of Subrecipients Do Not Comply With Federal Block Grant Audit Requirements

Finding: The department did not comply with federal requirements in its audits of subrecipients of the Maternal and Child Health Services block grant. The audit reports prepared by the department's Audits and Investigation Section did not include the following:

- A statement that the examination was made in accordance with generally accepted governmental auditing standards.

- A statement on the study and evaluation of internal accounting controls as part of financial and compliance audits.

- A statement of positive assurance on those block grant items tested for compliance and a statement of negative assurance on those items not tested, together with comments on material instances of noncompliance.

The department failed to comply with federal regulations because the Audits and Investigation Section did not implement the State Controller's recommendation to comply with the requirements for block grant audits. Failure to comply with federal requirements may jeopardize the State's continued receipt of federal block grants.

Criteria: U.S. Office of Management and Budget Circular A-128 requires that the audits of subrecipients of block grants meet the standards established by the Comptroller General for the audit of governmental organizations, programs, activities, and functions.

Recommendation: The department should direct its Audits and Investigation Section to comply with federal requirements for audits of subrecipients of the Maternal and Child Health Services block grant.

DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

The Department of Housing and Community Development administers one of the 34 federal programs we reviewed. It is the Department of Housing and Urban Development grant, Federal Catalog Number 14.228.

Item 1. **Ineffective Monitoring of Cash Advances**

Finding: Three of ten grantees we reviewed showed unneeded cash balances during fiscal year 1985-86. One grantee had unneeded cash balances averaging approximately $38,000 at the end of each month during fiscal year 1985-86. The unneeded balances of the other two grantees were less significant. The federal government requires grantees to return interest earned on advances; however, the federal government loses the interest earnings that the grantees keep in accounts that bear low or no interest. The State did not lose money as a result of giving the unneeded advances because the federal government immediately reimbursed the State for the advances made to grantees.

We observed these same weaknesses during our compliance audit for fiscal year 1984-85. The department has since assigned additional program staff to monitor cash advance requests by grantees. Although it appears that the department has been successful in reducing excessive cash balances kept by grantees, it has not yet eliminated all unneeded balances.

Criteria: Title 31 of the Code of Federal Regulations, Section 205.4(a), requires that cash advances be limited to the minimum amounts and the actual immediate cash requirements needed for carrying out the purpose of the program. Section 205.4(a) also stipulates that the timing and amount of cash advances be as close as administratively feasible to the actual disbursements by the recipient organization. Title 24 of the Code of Federal Regulations, Section 570.506(a) requires grantees to return interest earned on grant funds advanced by treasury check or letter of credit.

Recommendation: The department should establish specific guidelines for the size of the cash balance a grantee may maintain before being required to return the funds to the State. The department should then use the guidelines to monitor cash advances and request the return of funds, if necessary.

Item 2. **Premature Release of Funds**

Finding: In our review of ten grantees, we found one instance in which the department released $200,000 before the grantee had met all of the conditions detailed in the National Environmental Policy Act of 1969. The grantee had not completed the form that the department requires to certify compliance with federal regulations, an environmental clearance, and the required form showing its intent to request the release of funds. As a result, the department placed $200,000 at risk, since the grantee could have spent the funds improperly and the federal government could have requested the return of the monies. The department discovered the oversight in an on-site review five months later. The grantee later terminated the project and returned $169,420, which included $5,250 in interest earned. It retained $35,830 as reimbursement for expenditures that were allowable before the conditions of the National Environmental Policy Act had to be met.

Criteria: Title 24 of the Code of Federal Regulations, Section 58.18, requires states to make sure that grant recipients comply with the provisions of the National Environmental Policy Act and related federal laws. The conditions that must be met before funds can be released are contained in Section 58.41, Section 58.43, Section 58.70, Section 58.71, and Section 58.5.

Recommendation: The department should require two authorized signatures for the release of funds over a certain amount, so that the compliance with federal requirements is verified by two individuals. Such a procedure will reduce the risk that an oversight by one individual remains undetected before the release of funds.

Item 3. **Failure To Enforce Grantee Reporting Requirements**

Finding: In our review of 11 grantees, we found that 4 grantees were at least one month late in submitting an annual performance report and that 2 grantees submitted incomplete reports. The department requires grantees of the Community Development Block Grant to submit an annual performance report by July 31 of each year. Late reports reduce the department's control over the grantees' performance and could also delay the State's annual performance report to the federal government.

Criteria: Title 24 of the Code of Federal Regulations, Section 570.497(b), allows each state to establish recordkeeping requirements for units of local government receiving assistance that are sufficient to facilitate reviews and audits. In accordance with this authority, the department's grant management manual for the Community Development Block Grant requires grantees to submit an annual performance report by July 31 of each year.

Recommendation: Toward the end of each fiscal year, the department should remind grantees of their obligation to submit a performance report by July 31. The grantees should be made aware that late or incomplete reports may jeopardize their receipt of future grants.

Item 4. Late Performance and Evaluation Report

Finding: The department did not submit a performance and evaluation report of the Community Development Block Grant program by the required date of October 1, 1986. The United States Department of Housing and Urban Development (HUD) agreed to a delay of the department's report in order to meet the extensive reporting format changes that the HUD recommended. The department finally submitted the report on December 17, 1986, over two months after the due date. Noncompliance with federal regulations may jeopardize the continued receipt of federal grants.

Criteria: Title 24 of the Code of Federal Regulations, Section 570.498, requires a grantee of the Community Development Block Grant to submit an annual performance report by October 1 of each year.

Recommendation: The department should allocate sufficient staff to prepare the annual performance report by October 1 of each year.

DEPARTMENT OF JUSTICE

Item 1. **Late Deposit of Collections**

Finding: The department's field offices and its headquarters cashiering unit, which is part of the fiscal accounting office, do not promptly deposit collections. Further, the department's attorneys do not always forward receipts promptly to the collections clerk, although in some cases, such delays are necessitated by the nature of the litigation. We found collections that had not been deposited for up to 77 days. Of 793 collection advices reviewed, we found 724 were delayed up to 7 days, 50 were delayed from 8 to 14 days, and 19 were delayed from 14 to 77 days. We estimate that the department lost at least $30,000 in interest earnings in fiscal year 1985-86 because of late depositing of collections.

Criteria: The State Administrative Manual, Section 8030.1, requires agencies to deposit collections of amounts greater than $5,000 on the day they are received unless they are received late in the day or there is another reason preventing their deposit. In these cases, the collections are to be deposited on the next working day. This section also stipulates that agencies must not hold any undeposited collections longer than 15 working days. In addition, Section 15320 of the department's administrative manual requires that all collections be delivered immediately to the designated collections clerk. Section 15330 of that manual states that, when funds cannot be deposited due to extraordinary circumstances, this fact should be noted on the collection advice, which the department uses to record and control receipts from the various field offices. The check should remain under the responsibility of the field office legal support manager, and a copy of the collection advice must be sent to the accounting office. Each week, the collections clerk should forward to the accounting office details about all checks that have remained undeposited for more than 7 days.

Recommendation: The department should ensure that all collections are deposited promptly and that all collections that cannot be deposited on time be reported to the accounting office.

Item 2. **Inadequate Control Over Cash Collections**

Finding: The department's cashiering unit has not reconciled prenumbered collection advices to its accounting records for up to two years for some field offices. We also found that numerous collection advices were missing. The department has not accounted for at least 200 of approximately 4,900 collection advices that were written in fiscal year 1985-86 alone. Because it did not monitor outstanding collection advices, the department did not identify and, therefore, did not record in its general ledger at least $120,000 of cash on hand in the field offices at June 30, 1986.

Criteria: Section 8320 of the department's administrative procedures manual requires that all collection advice forms be prenumbered and used sequentially and that all advices, including those that are voided, be accounted for.

The State Administrative Manual, Section 10405, requires undeposited receipts at June 30 to be recorded as cash on hand. The State Administrative Manual, Section 10590, describes the required accounting entry at June 30.

Recommendation: The department should maintain control over collection advices and should reconcile them to its accounting records. Furthermore, the department should identify and record all cash on hand at June 30.

Item 3. **Insufficient Counts of Cash Funds**

Finding: The department did not count its cash funds as frequently as the State Administrative Manual requires. The department uses the cash funds for cash purchases, for money change funds in the various field offices, and for small cash amounts that its agents need for undercover work. Of the 54 funds, whose balances total $132,570, 16 had not been counted during fiscal year 1985-1986, and an additional 10 funds had not been counted as often as required. As a result, the department cannot be sure that it can account for all the money included in these cash funds.

Criteria: The State Administrative Manual, Section 8111.2, prescribes the frequency with which change funds and other cash funds must be counted. The frequency depends on the size of the fund, but each fund has to be counted at least once a year.

Recommendation: The department should make its accounting officers responsible for having independent counts performed of all cash funds in their offices as frequently as prescribed in the State Administrative Manual.

Item 4. **Inadequate Controls Over Office Revolving Fund**

Finding: The department exceeded the authorized limit for its revolving fund, which amounts to $2,500,000, during seven months in fiscal year 1985-1986. During these seven months, the department overdrew its revolving fund by an average of approximately $440,000. Additionally, the person whose signature is used to mechanically sign revolving fund checks does not control the key to the check-signing machine. Finally, we identified 17 instances in which the department released unsigned checks that were ultimately paid, which indicates that the responsible person did not properly review these checks. Failure to adequately maintain control over revolving fund balances can result in the misstatement of cash balances and can prevent the early detection of irregularities such as unauthorized or excessive disbursements.

Criteria: The Government Code, Section 16400, places dollar limitations on the amounts agencies are able to withdraw from their office revolving fund to limit the potential loss of state funds. The State Administrative Manual, Section 8081, requires the person whose signature is used to mechanically sign checks to control the key to the check-signing machine. If that person is unavailable, the control of the key should be assigned to a responsible person other that the operator of the check-signing machine.

Recommendation: The department should monitor its revolving fund more closely to avoid exceeding its authorized limit. To establish clear authority and responsibility for the use of the check-signing machine, the department should give control over the key for the check-signing machine to the individual whose signature is used to mechanically sign checks. Finally, the department should take appropriate steps to ensure that all checks are reviewed and signed before their release.

Item 5. **Long Outstanding Salary Advances**

Finding: The department does not promptly clear outstanding salary advances. We identified 95 salary advances, totaling approximately $24,000 and dated from October 1979 to June 1986, that were still outstanding on October 31, 1986. The department failed to clear these outstanding advances with the subsequently issued payroll warrant because of a lack of communication between the department's personnel and accounting units. The funds committed to these long outstanding salary advances are not available for use in the revolving fund, increasing the likelihood that the department will overdraw its revolving fund.

Criteria: The State Administrative Manual, Section 8118, states that the department must collect a salary advance from the subsequent payroll warrant issued for the period covered by the salary advance.

Recommendation: The department should collect all outstanding salary advances from employees' subsequently issued payroll warrants. The department should also pursue collection of old outstanding salary advances. If normal collection efforts fail, the department should submit the amounts of outstanding advances to the Franchise Tax Board, which can offset them against future income tax refunds that the Franchise Tax Board would otherwise make to these employees.

Item 6. **Improper Check Signatures**

Finding: One employee from the department's Fresno field office signed revolving fund checks payable to herself. This person signed 15 of the 16 travel advances issued to her in fiscal year 1985-86, even though seven other employees in that field office were also authorized to sign checks. The 15 advances totaled $3,760. Furthermore, an employee in the headquarters' fiscal accounting office signed general checking account checks without a written authorization on file. This person signed ten checks totaling over $350,000 during August 1985. The lack of adherence to controls over check signing authority increases the risk that money will be disbursed improperly.

Criteria: The State Administrative Manual, Section 8180, states that employees are prohibited from authorizing revolving fund checks payable to themselves or to cash. Further, the State

Administrative Manual, Section 8001.2, requires an agency to keep a file of signatures of employees who are currently authorized to sign agency checks. Further, it states that each agency is solely responsible for maintenance and control of its authorized signature file.

Recommendation: The department should remind the employees who are authorized to sign checks that they cannot sign checks payable to themselves. Additionally, the department should ensure that an employee who signs checks has an authorized approval on file in the agency's signature file. Furthermore, the department's fiscal accounting office should properly monitor all field office activities to ensure that this procedure is followed.

Item 7. **Unenforced Prepayment Policy**

Finding: The department's reimbursement unit does not ensure that clients who are delinquent in their payments or whose accounts previously had to be written off pay for their orders before or at the time of the delivery of the goods or services. The reimbursement unit thus increased the risk that the department will have to write off receivables in the future. The staff in the reimbursement unit was not aware that they had the authority to enforce a cash or prepayment policy for private clients to whom the department has provided goods or services.

Criteria: The Government Code, Section 13403, identifies internal accounting and administrative controls and sets forth the elements of a satisfactory system of internal control. A satisfactory system must include a system of authorization and recordkeeping procedures adequate to provide effective control over assets, liabilities, revenues, and expenditures.

Recommendation: The department should require those clients who have delinquent accounts or whose previous accounts had to be written off to pay for their orders before or at the time of the delivery of goods or services.

LANTERMAN DEVELOPMENTAL CENTER

Item 1: **Inadequate Separation of Duties Over Cash Disbursements**

Finding: The separation of duties related to cash disbursements is not adequate. The accounting officer, who operates the warrant-signing machine, also compares machine-signed warrants with vouchers. Assignment of these duties to different individuals would improve internal control over cash disbursements.

Criteria: The State Administrative Manual, Section 8080, requires that the duties of operating a warrant-signing machine and comparing machine-signed warrants with vouchers be performed by different individuals.

Recommendation: The center should assign different individuals the duties of operating the warrant-signing machine and comparing machine-signed warrants with vouchers.

Item 2: **Inaccurate Separation of Obligations From Encumbrances**

Finding: In analyzing the unliquidated encumbrances at year end, the center inaccurately segregated obligations from encumbrances. Five items, totaling $96,000, that were classified as encumbrances were actually obligations, as they were received by June 30, 1985. This inaccurate segregation occurred because the accounting officer did not receive notice that the goods were received before year end.

Criteria: The State Administrative Manual, Section 10584, requires that all unliquidated encumbrances as of June 30 be analyzed to determine if they are valid obligations of the year just ended and if the amounts encumbered are the most accurate that can be determined.

Recommendation: At June 30, the accounting officer should obtain reports of all goods received by that date that have not been recorded as received. This procedure is necessary to accurately separate obligations from encumbrances.

DEPARTMENT OF MENTAL HEALTH

The Department of Mental Health administers one of the 34 federal programs we reviewed. It is the U.S. Department of Health and Human Services grant, Federal Catalog Number 13.992.

Item 1. Inadequate Control Over Local Assistance Program

Finding: The department did not adequately monitor the community services program's expenditures, which included Short-Doyle allocations to counties and counties' claims for Medi-Cal services costs. As of June 30, 1985, the department accrued approximately $44 million in expenditures for the community services program including an estimated $17 million in Medi-Cal expenditures. Because the department failed to recognize that the actual claims submitted for payment totaled $25 million, it did not submit a budget revision to incur the additional Medi-Cal expenditures. Instead, the department used funds in the community services program budget that had been set aside for the Short-Doyle allocations, and, consequently, it does not have sufficient funds to pay approximately $6.5 million of Short-Doyle claims received from the counties. The department became aware of this condition on August 1, 1986, when the State Controller informed the department that it would not pay $2 million in Short-Doyle claims because of insufficient funds in the department's community service budget. However, as of October 2, 1986, it still had not submitted a budget revision, which would enable the department to pay the $6.5 million to counties. Delays in receiving state funding could result in reduced county services to mental health patients.

Criteria: The Government Code, Section 13403, requires that a satisfactory system of internal control include procedures for providing effective accounting control over liabilities and expenditures. Further, the State Administrative Manual, Section 8322, requires that departments submit to the Department of Finance budget revisions to adjust their appropriations before incurring expenditures.

Recommendation: The department should promptly process the budget revision. Further, in the future it should closely monitor actual expenditures and reimbursements, and promptly submit a budget revision when such expenditures and reimbursements exceed approved amounts.

Item 2. **Inadequate Control Over Payments for Mental Health Care**

Finding: The department does not have adequate internal accounting control over the payment of Board and Care claims, which are submitted by private mental health care providers to the Office of Mental Health and Social Services (OMHSS). Specifically, the department's accounting office does not maintain a list of OMHSS' staff authorized to approve Board and Care claims for payment and does not review the respective contract to determine whether the services and the amounts claimed are within the terms of the contract. Failure to properly control Board and Care claims could result in the department making unauthorized payments.

Criteria: The Government Code, Section 13403, requires that a satisfactory system of internal control include an adequate system of authorization and recordkeeping procedures to provide effective accounting control over expenditures.

Recommendation: The department's accounting office needs to maintain a list of signatures of the OMHSS' staff who are authorized to approve Board and Care claims, and use the list to verify that claims were approved by authorized individuals. Also, the accounting office should review the claims to assure that the services and costs are consistent with the contract.

Item 3. **Late Financial Reports**

Finding: The department did not submit its General Fund financial reports to the State Controller's Office until September 11, 1986, 42 days after the due date. The department's fiscal officer claimed that the reports were late because the department was unable to fill two accounting supervisor positions. Failure to submit financial reports promptly by the required deadline delays the State Controller's Office in compiling financial statements for the State of California.

Criteria: The State Administration Manual, Section 7990, requires state agencies to submit year-end financial reports to the State Controller's Office for Governmental Funds no later than July 31.

Recommendation: The department should implement procedures to ensure that it submits accurate year-end financial reports by the required deadlines.

Item 4. **Inaccurate Financial Reports**

Finding:

The department did not submit accurate year-end financial reports to the State Controller's Office. We found that the department included an improper account in its trial balance, failed to identify various items in the reconciliations between its financial records and the State Controller's records, and included in its budget report a budget revision that had not been approved by the Department of Finance. Because of these deficiencies, the department's financial reports are not accurate, and the State Controller's Office may not be able to rely on them. We found the following specific deficiencies:

- The department's post closing trial balance reported a balance of $313,887 for an account that should not have been on the trial balance. The department indicated that this was caused by a CALSTARS processing error. However, it was not corrected before the report was submitted to the State Controller's Office.

- In Report 3, "Adjustments to Controller's Accounts," the department used $1,029,291 of unidentified items to balance its records with those of the State Controller's Office.

- In Report 5, "Final Reconciliation of Controller's Account with Final Budget Report," the department included an unidentified adjustment to the State Controller's Office account for $4,788,836 to balance the State Controller's records with those of the department.

- In an attempt to balance its budget with its expenditures, the department included in Report 6, "Final Budget Report," an unauthorized budget revision increasing the Community Services Program budget by $16 million.

Criteria:

Department of Finance Management Memo 86-06, dated April 7, 1986, reminded agency executives of their responsibility to prepare accurate year-end financial reports promptly. The State Administrative Manual, Sections 7950 through 7979, describes how year-end financial reports should be prepared.

Recommendation: The department should maintain sufficient detailed accounting records to accurately and completely prepare all required year-end financial reports. Further, accounting personnel should review and reconcile the various required reports with each other and with supporting agency records.

Item 5. **Inadequate Control Over Revolving Fund Advances**

Finding: The Atascadero State Mental Hospital (hospital) does not promptly collect its travel and salary advances. For example, of $25,108 in outstanding travel advances, $11,616 have been outstanding for more than 90 days as of June 30, 1986. Similarly, of $481,857 in outstanding salary advances, approximately $329,925 were outstanding at least 90 days. The hospital has not cleared the outstanding travel advances because they have not been persistent in contacting employees to settle their accounts. In regards to the salary advances, hospital officials stated that the hospital's current workload prevents them from preparing and submitting the documentation necessary to have the State Controller's Office reimburse them for the advances.

Failure to collect travel and salary advances may result in the loss of state funds if the employees leave state service without repaying the advance. In addition, revolving fund monies are not available for other uses when the advances are not promptly collected.

Criteria: The State Administrative Manual, Section 8116, requires travel advances to be cleared upon the submission of a travel expense claim. Further, the State Administrative Manual, Section 8118, requires agencies to collect the repayment for a salary advance from the payroll warrant issued to reimburse the revolving fund for the salary advance. Finally, the State Administrative Manual, Section 8776.55, describes procedures for collecting payroll overpayments from current and separated employees.

Recommendation: The hospital should be persistent in contacting employees about their outstanding travel expenses. In addition, it should promptly prepare the documentation necessary to have the State Controller's Office issue a warrant to replace the outstanding advances.

Item 6. **Failure To Develop Procedures To Resolve Audit Findings**

Finding: The department has not developed procedures to determine the corrective action taken or planned by counties that receive block grants, nor has it developed procedures to resolve differences. We noted this same weakness in fiscal year 1984-85. Although since our last audit the department has assigned the responsibility of developing an audit resolution process, it has not finalized specific procedures to resolve audit findings. Because the department does not have such procedures, it lacks assurance that the counties will take corrective action to account for $4 million and $3 million of unresolved costs determined to be questionable by the department's auditors for fiscal years 1982-83 and 1983-84, respectively. The department also lacks assurance that counties will correct other internal control deficiencies reported in the department's audits of county federal block grant funds.

Criteria: The U.S. Office of Management and Budget Circular A-102, Attachment G, requires the department to develop procedures that will ensure prompt and appropriate resolution of audit findings and recommendations concerning counties' administration of block grant funds.

Recommendation: The department should develop procedures to resolve differences and to ensure that counties take appropriate and prompt corrective action to resolve audit issues.

Item 7. **Failure To Monitor Counties' Cash Balances**

Finding: The department does not adequately monitor federal cash balances of counties as required by federal and state regulations. We observed this same weakness in fiscal year 1984-85. Specifically, the department does not require counties to submit quarterly Grant Cash Transaction Reports. These reports provide the information the department needs to determine (1) if the State is advancing federal cash to counties before it is needed, resulting in loss of interest earnings to the State or federal government; or (2) if counties are using nonfederal money to initially finance the federal block grant program, resulting in loss of interest earnings to counties.

Criteria: The U.S. Office of Management and Budget Circular A-102, Attachment G, requires the department to develop procedures to monitor cash balances of counties. The State Administrative Manual, Section 8760, requires that departments administering block grants will require counties to submit a Grant Cash Transactions Report quarterly.

Recommendation: The department should develop procedures to evaluate and monitor federal cash balances of counties by requiring counties to submit Grant Cash Transactions Reports quarterly.

Item 8. Inaccurate Charging of Travel Costs

Finding: We examined 26 travel expense claims (claims) for travel costs the department incurred while auditing subrecipients and found 10 were not correctly charged to the Alcohol and Drug Abuse Mental Health Services (ADAMHS) Program. Although the total amount of the errors is only $1,970, the errors do indicate noncompliance with federal regulations. For instance, three claims that should have been charged to the ADAMHS Program were not. Conversely, two claims that should not have been charged to the ADAMHS Program were. Finally, five other claims that should have been allocated between the ADAMHS and other departmental programs were charged directly; four claims were directly charged to the ADAMHS Program, and one claim was directly charged to another departmental program. Such errors occurred because departmental personnel failed to designate the proper programs to charge or identify any programs at all. Inaccurate charging of travel costs could result in overexpending the block grant administration budget and in questioned costs.

Criteria: The U.S. Office of Management and Budget Circular A-87 requires the department to be accurate and consistent when charging costs to federal or state programs.

Recommendation: The department should improve its review of travel expense claims to assure that federal programs are charged only for costs allowed by the federal government.

DEPARTMENT OF MOTOR VEHICLES

Item 1. **Late Deposits of Receipts**

Finding:

The department's headquarters and field office cashiering units are frequently late in depositing cash and checks in banks. The department collects approximately $2.8 billion annually. In fiscal year 1985-86, approximately 58 percent of all deposits made by the Enhanced Renewal/CALVO unit and other headquarters units and approximately 30 percent of the deposits made by field offices were made later than the next working day following receipt.

At a 9.08 percent interest rate, which approximates the interest earned by the State Pooled Investment Account in fiscal year 1985-86, the State lost at least $469,900 in interest income during fiscal year 1985-86 because of late deposits by the department. Of this amount, $294,300 was due to late deposits made by the Enhanced Renewal/CALVO unit and other headquarters units. The remaining $175,600 was due to late deposits made by field offices.

We observed this same weakness during our financial audit for fiscal year 1984-85 and made recommendations in our management letter dated January 31, 1986. The Commission on California State Government Organization and Economy noted similar weaknesses and made similar recommendations in its report of April 1986.

As a result of these reports and recommendations, beginning in April 1986, the department instituted a pilot program for its headquarters unit that processes remittances. This pilot program includes Saturday mail pickups, Sunday processing of receipts, three early morning mail pickups on Monday, and an earlier starting time for work for certain employees on Monday as well as Tuesday, if necessary. The department completed an assessment of the pilot program in October 1986. According to the department, the pilot program has reduced the number of late deposits by headquarters and brings the department very close to full compliance with the State Administrative Manual.

In addition, to make field office deposits more prompt, the department has provided for later daily armored car service pickup of cash and currency at field offices, and it has allowed field office managers to make a "cash only" deposit in night depositories. Certain field offices are required to make night deposits because a high risk of burglary exists. The department has not yet assessed the effect of these actions to speed deposits to banks.

Finally, the department is designing a deposit monitoring system for both its headquarters and its field office deposits to compare bank validation dates and receipt dates. The department expects its deposit monitoring system to be in operation by January 1987.

Criteria: The State Administrative Manual, Sections 8030.1 and 8030.2, requires bank deposits to be made on the day of receipt if possible and no later than the next working day.

Recommendation: The department should continue its pilot program to deposit more quickly all receipts processed by the headquarters unit, and it should consider fully implementing this program at headquarters.

The department should also promptly complete and implement a deposit monitoring system to compare bank deposit dates with department workdays for both headquarters and field office deposits so that problems and unusual delays can be identified and corrected.

Item 2. Slow Transfer of Receipts to Special Purpose Funds

Finding: The department takes an average of 12 days to transfer receipts to special funds after those receipts have been deposited in banks. During this time, the State's General Fund receives the investment income from the deposits.

The department collected approximately $2.8 billion in fiscal year 1985-86. Nearly all of this money is designated by law for special purposes, including about $1.4 billion, representing fees collected in lieu of local property taxes, that must be allocated to cities and counties. During fiscal year 1985-86, the General Fund earned approximately $8.5 million on the department's deposits during the 12 days before the deposits were transferred to the special funds. These earnings are based on a 9.08 percent interest rate, which approximates the earning rate of the state Pooled Money Investment Account for the year.

The department makes about 84,000 bank deposits annually from 158 field offices. The department requires each field office to submit its deposit slips to headquarters for accounting and control purposes before the department transfers the deposit slips to the State Controller to post to the State Controller's clearing account. Following present procedures, it takes the department and the State Controller combined about 13 days to get deposits recorded in the State Controller's clearing account. However, if the department transfers deposits to special funds before they are posted to the State Controller's clearing account, the clearing account shows a deficit balance. The State Controller's Office has instructed the department to make every effort to keep from overdrawing the clearing account. Some large departments, such as the Employment Development Department which makes nearly all of its deposits in Sacramento, transfer receipts to special funds the day after deposit.

Criteria: The State Administrative Manual, Section 8091, states that deposits exceeding $25,000 should be transferred to the proper fund of the State Treasury as soon as possible, but not later than the first day of the week following accumulation.

Recommendation: The department should ask the Department of Finance for special instructions to enable the department to transfer its deposits to special funds as soon as possible. The department should also ask the Department of Finance to address the concerns of the State Controller's Office.

Item 3. **Inadequate Support for Uncleared Collections**

Finding: The department is unable to provide a detailed list of uncleared collections that supports the account balance, which totaled approximately $99 million as of June 30, 1986. The money that is in the uncleared collections account is unavailable for state expenditure or disbursement to the local governments. Also, because the department cannot provide a detailed listing, we could not verify the uncleared collections account balance by testing transactions that support the total.

We observed this same weakness during our financial audits for fiscal years 1981-82, 1982-83, 1983-84, and 1984-85. To provide a complete detailed listing of uncleared collections, the department has established an automated uncleared collections file for 109 of the 158 field offices. The remaining 49 field offices prepare listings manually. However, the department anticipates that all field offices will be using the automated uncleared collections file by 1992.

In March 1986 the department reduced the uncleared collections balance by $87.3 million by transferring money representing transactions that were between one and four years old. The department estimated that only a small percentage of these uncleared collections would ever be refunded. This money thus became available for state expenditures or for disbursement to local governments. In addition, legislation approved in September 1986 and effective January 1987 will reduce the obligation term from four years to one year for fees received for incomplete transactions. Thus, in the future, money should remain in the uncleared collections account no longer than one year before it is considered revenue.

Criteria: The State Administration Manual, Section 7900, discusses the importance of making regular reconciliations. Reconciliation of subsidiary records with associated control accounts represents an important element of internal control because it provides a high level of confidence that transactions have been correctly processed and that the financial records are complete.

Recommendation: The department should continue to automate its uncleared collections file to provide detail record of the remaining contents of its uncleared collections account.

Item 4. **Inadequate Control Over Accountable Items**

Finding: The department does not monitor the handling of accountable items by field office and headquarters units or keep inventory records of items that should be on hand. The inventory of accountable items includes driver's license applications, registration stickers, suspense receipts, license plates, and many other items. Without adequate control over these items, the department lacks assurance that misuse of these items will be promptly detected.

We observed this same weakness during our financial audit for fiscal year 1982-83. The department reported that it planned to implement an inventory control system for accountable items after the department began automating its field offices in July 1984. As of November 1984, the department had implemented this inventory control system at nine locations as a pilot program, and all nine sites in the pilot program were operating the inventory control system by March 1985. However, the department has not yet implemented its inventory control system in approximately 95 other automated sites because the department has not completed its evaluation of the pilot program.

Criteria: The State Administrative Manual, Section 7819, states that, while the form and content of an inventory record will vary according to the requirements of the type of operation of various agencies, a continuous record should be maintained which shows items received, issued, and on hand.

Recommendation: The department should promptly evaluate the operation of its accountable item inventory system in the pilot sites, resolve problems noted during the evaluation, and consider implementing the system statewide.

Item 5. Inadequate Electronic Data Processing Backup Procedures

Finding: The department does not have provisions for off-site backup equipment for its electronic data processing (EDP) system in the event of a major disaster. The chief of the Data Processing Division said that there are no facilities in California that have data processing equipment that is compatible with the department's equipment and that can process the department's volume of work.

We observed this same weakness during our financial audit for fiscal year 1984-85. The department has been working with the Department of Finance's Office of Information Technology to resolve this problem. The department has contracted to use the Stephen P. Teale Data Center for processing the department's work. Initial implementation of the conversion began in July 1986, and total conversion is expected to be completed in 1990.

Because the Stephen P. Teale Data Center's equipment is the same as that used by other large state data centers, the department's conversion to this equipment will enable the department to recover from major disasters. However, a major shutdown of the department's EDP system during the conversion could result in the loss of revenues to the State and local governments and the loss of information used by law enforcement agencies.

Criteria: The State Administrative Manual, Section 4909.8, requires departments having critical EDP systems involving collection of income to insure that backup procedures are in place.

Recommendation: The department should continue its plans to obtain back-up facilities by transferring its data processing to the Stephen P. Teale Data Center.

NAPA STATE HOSPITAL

The Napa State Hospital administers 2 of the 34 federal programs we reviewed. They are the U.S. Department of Agriculture grants, Federal Catalog Numbers 10.553 and 10.555.

Item 1. **Failure To Comply With the Department of Developmental Services' Policy Against Nepotism**

Finding: In violation of policy of the Department of Developmental Services (department), the hospital's general services administrator indirectly supervises his son and his daughter. The general services administrator is in charge of the hospital's procurement division; the stores warehouse, where his son works; and the mailroom, where his daughter works. These work assignments are in conflict with the department's policy and impair the integrity of the hospital's system of internal control.

Criteria: Section 7302 of the department's Administrative Manual prohibits individuals related by blood, marriage, or cohabitation from working at close quarters with one another, working for the same immediate supervisor, or having a direct or indirect relationship with a supervisor or a subordinate.

Further, this section specifies that any assignments that do not conform with this policy are to be corrected within 90 days.

Recommendation: To improve internal controls, the Executive Director of the hospital should make work assignments that comply with Section 7302 of the department's Administrative Manual.

Item 2. **Failure To Collect Rental Revenue for Employee Housing**

Finding: The hospital has not collected rental revenue of approximately $2,400 from the hospital's executive director for one of two hospital rental units provided to him from March 4, 1984, through January 21, 1985.

The deputy director of the department's Hospital Operations Division advised us that rent was not charged on one unit because it was provided to a family member of the hospital's executive director as an extension of the executive director's primary housing unit. However, the deputy director could neither provide written records nor recall the specifics of his agreement with the executive director. In addition, the deputy director could not provide evidence of his authority to provide an additional housing unit free of charge to a member of the executive director's family. In addition, the deputy director did not request or receive approval from the Department of Personnel Administration to provide the rental unit free of charge to the executive director.

The Hospital Operations Division's lack of records of special rental agreements and its failure to obtain independent approval from the Department of Personnel Administration for free rent give the appearance of favoritism. In addition, failing to collect all rents due decreases the funds necessary to maintain state-owned employee housing units.

Criteria: Pursuant to authority delegated to the department by the Department of Personnel Administration, rental rates for employee housing are established in the department's rental manual. Section 599.644, Article 3, Subchapter 1, Chapter 3, Division 1, Title 2, of the California Administrative Code requires the Department of Personnel Administration to be the final authority for rental rates for all state-owned housing. Further, this section allows the Department of Personnel Administration to review and adjust the rates for any state-owned property when there is evidence that the prescribed rental rate is inequitable.

Recommendation: The Department of Developmental Services should comply with established regulations regarding adjustments to established rental rates. Further, the Department of Developmental Services should collect all rent due to the Napa State Hospital for employee housing units.

Item 3. Inadequate Control Over Salary Advances

Finding: As of June 30, 1985, the hospital had accrued a total of $104,380 in outstanding salary advances. Of this amount, $33,776 had been outstanding for more than three months and, as of February 28, 1986, $7,125 of the $104,380 total remained outstanding. The salary advances remained outstanding because the warrants to clear the outstanding advances had not been received from the State Controller, and because the hospital's personnel office did not report this delay to the State Controller promptly. Of the $7,125 that remained outstanding at February 28, 1986, $1,842 remained outstanding because the hospital did not promptly deposit the payroll warrants for these advances when they were received from the State Controller. Failure to collect these salary advances promptly may result in the loss of state funds if the employee leaves state service without repaying the advance.

Criteria: The State Administrative Manual, Section 8595, stipulates that, if a controller's payroll warrant is not received within 30 days, the amount of the advance must be reported to the State Controller's office. Also, State Administrative Manual Section 8118 requires that agencies deposit the State Controller's payroll warrant promptly to the credit of the revolving fund to clear the amount previously advanced to the employee.

Recommendation: The Napa State Hospital's personnel office should review outstanding salary advances regularly and, when controller's warrants are not received within 30 days, report the amount of the advances to the State Controller's office as required by the State Administrative Manual. In addition, the personnel office should promptly deposit payroll amounts and clear them against the salary advances as required by the State Administrative Manual.

DEPARTMENT OF REHABILITATION

The Department of Rehabilitation administers one of the 34 federal programs we reviewed. It is the U.S. Department of Education grant, Federal Catalog Number 84.126.

Item 1. **Inaccurate Federal Report**

Finding: The department has understated its federal cash balance by $2.6 million for the last three years in the Status of Federal Cash Report that it submits to the federal government. This occurred because the department did not report $2.6 million of federal cash receipts received in fiscal years 1982-83 and 1983-84. After adjusting the department's beginning federal cash balance for fiscal year 1985-86 for these errors, we found that the amount and timing of federal cash advances that the department obtained were as close as administratively feasible to actual disbursements. Thus, the department made no inadvertent overdrafts.

Criteria: The U.S. Office of Management and Budget Circular A-102, Attachment G, requires that federal financial reports contain accurate and reliable financial data.

Recommendation: The department should adjust its next Status of Federal Cash Report for the $2.6 million error made in reporting federal cash receipts in fiscal years 1982-83 and 1983-84.

DEPARTMENT OF SOCIAL SERVICES

The Department of Social Services administers 7 of the 34 federal programs we reviewed. They are the U.S. Department of Agriculture grant, Federal Catalog Number 10.551 and the U.S. Department of Health and Human Services grant, Federal Catalog Numbers 13.667, 13.646, 13.679, 13.802, 13.808, and 13.814.

Item 1. Misstatement of Expenditures and Liabilities

Finding: The department misstated its June 30, 1986, expenditures and liabilities for the General Fund and the Federal Trust Fund (FTF). Consequently, the General Fund was overstated by approximately $2,036,000, and the FTF was understated by approximately $3,338,000.

We found the following specific errors:

- The department overstated its FTF accruals and understated its General Fund accruals by approximately $293,000 because of an error in reporting the Disability Evaluation program expenditures. The department charged the incorrect program cost account that provides the mechanism for identifying expenditures by program and funding source.

- The department overstated its General Fund accruals by approximately $2,329,000. The department did not realize that it had already correctly accrued expenditures for the Adoption Assistance program in the FTF.

- The department understated its FTF accruals by approximately $3,631,000 because the department failed to recognize amounts related to contractual obligations with the Department of Health Services.

Criteria: The Government Code, Section 13403, states that the systems of internal accounting and administrative control are to include authorization and recordkeeping procedures adequate to provide effective accounting control over liabilities and expenditures.

Recommendation: The department should establish procedures to ensure that amounts accrued are as accurate as can be determined and that all appropriate amounts are properly supported.

Item 2. **Improper Identification of Encumbrances**

Finding: On its General Fund Report of Accruals, the department inappropriately reported $110.3 million of accruals as encumbrances because the department did not analyze its accruals to determine whether goods were received or services were provided before or after June 30. If the department does not properly identify encumbrances in its financial statements, the State Controller's Office does not have sufficient information to prepare the State's financial statements in accordance with generally accepted accounting principles.

We observed this same weakness during our financial audit for fiscal year 1984-85. The department responded that it would look into alternative methodologies for the accrual process that would more accurately reflect valid state obligations. However, after reviewing the accrual process, the accounting administrator for the Fund Administration and Reporting Unit concluded that the current CALSTARS automated accounting system does not distinguish between encumbrances and valid obligations. Therefore, additional resources would be needed to prepare this information manually.

Criteria: State Controller's memorandum dated April 17, 1986, to state agency accounting officers instructed agencies to report the amount of encumbrances applicable to their accruals in such a way that financial statements could be prepared in accordance with generally accepted accounting principles. Under generally accepted accounting principles, encumbrances are that portion of the accruals that represent goods and services received or services provided after June 30.

Recommendation: The department, with the help of the Department of Finance, should incorporate CALSTARS applications to identify its accruals appropriately as liabilities or encumbrances.

Item 3. **Inadequate Cash Management**

Finding: The department does not ensure the availability of funds before it submits claim schedules to the State Controller's Office for payment. Six claim schedules, totaling approximately $18.7 million, were returned by the State Controller's Office because of insufficient funds in the department's appropriation. As a result, the department delayed payment of these claim schedules for 20 to 287 days and created additional work for both the State Controller's Office and the department.

We observed this same weakness during our financial audit for fiscal year 1984-85. The department responded that it was looking into alternative methodologies to increase the reliability and ensure better controls of the current process. However, at the time of our testing of expenditure transactions, the department had not corrected the deficiencies in its cash management procedures.

Criteria: The Government Code, Section 13401, requires each agency to maintain effective systems of internal accounting and administrative control to minimize error.

Recommendation: The department should ensure that its expenditure control unit verifies the availability of funds before it submits claim schedules to the State Controller's Office for payment.

Item 4. Delays in Requesting Federal Reimbursement

Finding: The State is losing interest earnings because the department does not promptly request federal reimbursement. We reviewed 59 drawdowns for the In-Home Supportive Services and Disability Evaluation programs. In 39 instances, the department failed to promptly request federal reimbursement. Delays in requesting federal reimbursement ranged from 2 to 97 days. As a result, the State lost potential interest earnings of at least $740,000.

Criteria: The State Administrative Manual, Section 8099, requires state agencies making disbursements from a state fund to ensure that federal monies are received by the time disbursements are made. In addition, U.S. Department of Treasury Circular 1075, Section 205.4, stipulates that the timing and amount of federal cash advances should be as close as administratively feasible to the actual disbursement by the recipient organization.

Recommendation: The department should collect all reimbursements as soon as they become available.

Item 5. **Collection of Statewide Cost Allocation Plan Reimbursements Is Not Prompt**

Finding: The department did not promptly collect federal reimbursements for the federal share of service costs provided by central service agencies. The plan under which each state agency pays for its share of the State's costs for central services is called the Statewide Cost Allocation Plan (SWCAP), and the amount that state agencies must remit to the General Fund is called the SWCAP reimbursement. The department delayed requesting SWCAP reimbursement for several months after the reimbursements were collectable because the department considered this a low priority item. As a result, the General Fund lost potential interest earnings of approximately $37,000.

We observed this same weakness during our financial audit for 1984-85. The department subsequently established procedures to promptly process the SWCAP reimbursement. However, the department does not effectively enforce these procedures.

Criteria: The Government Code, Sections 13332.01 and 13332.02, requires individual agencies to recover SWCAP reimbursements from the federal government and to transfer the SWCAP reimbursement from agency funds to the General Fund "on a timely basis."

Recommendation: The department should ensure that recoveries of SWCAP costs are made promptly to maximize potential interest earnings.

Item 6. **Delays in Executing Interagency Agreements**

Finding: The department does not ensure that interagency agreements are executed promptly. Through an interagency agreement, the department contracts with the Department of Health Services (DHS) to provide some of the services related to the California Medical Assistance Program. The costs incurred to provide these services are charged to the department's general fund appropriation. Periodically, the department bills the DHS for the federal share of these costs. The DHS, in turn, requests the federal funds necessary to reimburse the department for its costs.

Because some of the interagency agreements between the department and the DHS were not executed promptly, the department was unable to request reimbursement promptly. As a result of late requests, we estimated that the State lost at least $148,000 in potential interest earnings.

We observed this same weakness during our financial audit for fiscal year 1984-85. The department responded that the problems surrounding interagency agreements had not been completely overcome but that it would continue to work to improve the timeliness of interagency agreements.

Criteria: Prudent fiscal management requires that interagency agreements be executed promptly so that the State can collect all reimbursements due from the federal government as soon as the State is entitled.

Recommendation: The department should execute interagency agreements promptly so that it can collect all reimbursements as soon as it is entitled.

Item 7. Failure To Pay Vendors Promptly

Finding: The department does not always promptly pay vendors to take advantage of vendor discounts or to avoid late payment penalties. We observed this same weakness during our financial audit for fiscal year 1984-85. The chief of the department's Expenditure Control Unit indicated that payments on invoices are late because of the lack of staffing and the need for a review of the entire accounts payable process. Our limited testing of 47 transactions disclosed that the department lost at least $1,100 in vendor discounts and at least $200 in late payment penalties during the fiscal year 1985-86.

Criteria: The State Administrative Manual, Section 8422.1 requires state agencies to take discounts when available. Prudent fiscal management requires that agencies submit payments to vendors promptly to avoid late payment penalties.

Recommendation: The department should establish procedures to ensure that vendors are paid promptly to receive available discounts and to avoid late payment penalties.

Item 8. Ineffective Monitoring of the State's Supplementary Payment Program

Finding: The department does not provide adequate monitoring over the State's Supplementary Payments Program (SSP). Pursuant to Section 1616 of the Social

Security Act, the State provides to the Federal Social Security Administration supplementary payments for aged, blind, or disabled persons who meet the SSP's income and resource requirements. The Social Security Administration determines eligibility, computes grants, and disburses monthly payments to the recipient.

We found the following specific deficiencies:

- The department failed to monitor the monthly cash advances to the Social Security Administration. Although the department has procedures to reduce the advance requested by the Social Security Administration by the amount of excess cash on hand, in several instances, this procedure was not followed. In 8 out of the 12 months we tested, the Social Security Administration had excessive cash on hand ranging from $1 million to $10.7 million. As a result, the State lost potential interest earnings of approximately $210,000.

- The department failed to resolve differences between the Financial Accountability Statement for the SSP program and the supporting Financial Accounting Exchange file that includes detailed payment and collection information. As a result, significant irregularities could occur and remain undetected until an audit is performed.

- The department overstated its request to augment the fiscal year 1985-86 appropriation by $8,530,650. The funds had been appropriated, but as of October 31, 1986, this balance remains unused. Until these funds are returned, they are not available for another appropriation.

Criteria: Prudent monitoring of cash advances ensures that the Social Security Administration does not receive cash advances that exceed its immediate cash needs. In addition, reconciliation procedures ensure that financial transactions have been adequately processed and controlled. Finally, proper management requires that the request to augment the agency's appropriations is limited to the agency's immediate needs.

Recommendation: The department should carefully monitor the cash advances to the Social Security Administration. In addition, the department should resolve all differences between the Financial Accountability Statement and the Financial Accounting Exchange File. Finally, the department should return the unused appropriation balance, totaling $8,530,650.

Item 9. **Late Remittance of Monies to the State Treasury**

Finding: The department does not promptly remit monies to the State Treasury. Of the 25 remittance transactions that we reviewed, we found that 16 remittances were 8 to 132 days late. The accounting administrator for the Fund Administration and Reporting Unit attributes the department's inability to promptly remit monies primarily to the year-end workload encountered for the fiscal year 1984-85. Failure to promptly remit monies to the State Treasury prevents these funds from being available for their intended purposes.

Criteria: The State Administration Manual, Section 8091, requires departments to remit to the State Treasury all monies determined to be revenue, reimbursement, abatements, and operating income within 30 days following the date collected.

Recommendation: The department should ensure that all monies are remitted to the State Treasury as required.

Item 10. **Incorrect Administrative Cost Apportionment**

Finding: During fiscal year 1985-86, the department did not correctly apportion between the General Fund and the Federal Trust Fund administrative costs for the Adoption Assistance and Foster Care programs. As a result, the department overcharged these Federal Trust Fund programs by approximately $4,700 during the year. According to the department's senior administrative analyst for the Systems Unit, the overcharge resulted when incorrect time reporting indexes for allocating administrative costs were entered into the CALSTARS Employee Master File. The department has subsequently corrected the CALSTARS Employee Master File.

Criteria: The Code of Federal Regulations, Title 45, Section 74.61(c), requires that the department's financial management system maintain effective control and accountability.

Recommendation: The department should report the overstatement as an adjustment to the December 1986 Quarterly Statement of Expenditures of the Adoption Assistance and Foster Care programs. In addition, the department should ensure that the CALSTARS Employee Master File includes accurate, current, and complete information.

Item 11. **Inadequate Monitoring of Travel Expense Advances**

Finding: The department does not adequately monitor temporary travel expense advances to its employees. Nine employees of the department's Disaster Response Services Unit held temporary travel expense advances amounting to $12,685 for over eight months. As of November 1986, these employees had not returned the travel expense advances or submitted to the department's Accounting and Systems Bureau travel expense vouchers that indicate usage of such advances. Failure to adequately monitor travel expense advances can prevent the early detection of irregularities such as unauthorized or misuse of state funds.

Criteria: The State Administrative Manual, Section 8116(3), requires employees to return travel expense advances if they expect to cease traveling for a month or more.

Recommendation: The department should periodically review all travel expense advances and, if employees' current travel requirements do not necessitate such advances, ask for their return.

Item 12. **Delayed Collection of Disallowed Costs**

Finding: The department does not promptly collect disallowed costs from the county welfare departments. The department contracts with the State Controller's Office to conduct "post audits" of county welfare department records. A "post audit" is defined as an after-the-fact review of the accuracy and propriety of expenditures claimed from the State by county welfare departments in their administration of various welfare programs. While conducting these post audits, the State Controller's Office is responsible for determining whether the county welfare departments have adhered to the regulations and instructions promulgated by the U.S. Department of Health and Human Services and the department and reporting the fiscal affects of any lack of compliance. The department is responsible for analyzing and resolving any audit protest between the county welfare departments and the State Controller's Office. In addition, the department is responsible for collecting from the county welfare departments disallowed costs that are identified by the State Controller's Office as a result of the post audits.

We found that the delays in collecting approximately $625,000 in disallowed costs ranged from 4 to 41 months. Of this total, $317,000 represents funds owed to the State. The remaining $308,000 represents funds owed to the federal government. According to the manager of the department's Administrative Claims Unit, delays in the collection process of county disallowed costs are attributed to the backlog of work in the department's Administrative Claims and County Administrative Expenditure Control units. As a result, the county welfare departments held excess state and federal funds on hand, and the State lost potential interest earnings of at least $76,000.

Criteria: The Department of Treasury Circular 1075, Section 205.4, states that "cash advances to a recipient organization shall be limited to the minimum amounts needed." Good business practice dictates that the State promptly collect money that it is owed.

Recommendation: The department should promptly offset county disallowed costs against current county claims to ensure that excess funds are not held by the county welfare departments.

Item 13. Federal Financial Reports Are Not Reconciled to the Accounting Records

Finding: The department did not reconcile its federal financial reports to departmental accounting records for fiscal year 1985-86. Failure to reconcile federal financial reports to the accounting records can result in a misstatement of claims for cash advances and reimbursements from the federal government. It may also prevent the early detection of irregularities such as erroneous adjustments and nonreceipt of federal funds.

We observed this same weakness during our financial audits for fiscal years 1982-83, 1983-84, and 1984-85. The department responded that it would utilize the CALSTARS to deal with this problem.

However, at the time of our review of the federal financial reports, the department had not performed the proper reconciliations.

Criteria: The State Administrative Manual, Section 20014, requires agencies receiving federal funds to reconcile federal financial reports to the official accounting records and to retain all supporting schedules and worksheets for a minimum of three years.

Recommendation: The department should direct its accounting officer to ensure that federal reports are reconciled to the department's official accounting records.

Item 14. **Excess Federal Funds on Hand**

Finding: The department's system of drawing down federal funds does not ensure that the federal disbursements are limited to the department's immediate needs. We reviewed approximately $837 million in federal funds drawn down to pay local assistance expenditures for federal programs. Of the $837 million that we reviewed, approximately $7.6 million was drawn down and held for periods of 4 to 86 days before the State disbursed the money. Consequently, the federal government lost interest that it could have earned on the funds that the department requested too soon. Maintaining excess cash may result in the termination of advance financing by the federal government.

We observed this same weakness during our federal compliance audit for 1984-85. The department responded that the examples cited in our report were isolated cases and that its drawdown procedures were in compliance with our recommendation.

Criteria: The Department of Treasury Circular 1075, Section 205.4, states that "the timing and the amount of cash advances shall be as close as is administratively feasible to the actual disbursement by the recipient organization."

Recommendation: The department should establish procedures to ensure that drawdowns of federal funds are limited to the department's immediate needs.

Item 15. **Late Federal Financial Status Reports**

Finding: The department was late an average of 27 days in submitting quarterly Federal Financial Status Reports for five programs during fiscal year 1985-86. The department's failure to comply with reporting requirements may cause the U.S. Department of Health and Human Services to terminate the department's grant.

We observed this same weakness during our federal compliance audit for fiscal year 1984-85. The department responded that it would look into the appropriate action to be taken pursuant to our recommendation. However, at the time of our review of Federal Financial Status Reports, the department had not taken appropriate action.

Criteria: The Code of Federal Regulations, Title 45, Section 74.73(d), states that Federal Financial Status Reports required on a quarterly basis are due 30 days after the reporting period.

Recommendation: The department should obtain written evidence of any extensions granted by the U.S. Department of Health and Human Services or implement procedures to comply with the Code of Federal Regulations.

Item 16. **Failure To Perform Financial and Compliance Audits of Subrecipients of the Refugee and Entrant Assistance Program**

Finding: The department has not complied with federal requirements to audit, biennially, subrecipients of the Refugee and Entrant Assistance Program. For the period from April 1, 1983, through June 30, 1985, the department entered into contracts totaling approximately $27.1 million with approximately 64 subrecipients. The department has contracted with the State Controller's Office to perform audits on only 20 of these subrecipients. According to the chief of the Refugee Employment Bureau, the department is not budgeted with adequate funds to perform the financial and compliance audits. Since the department has not complied with the federal requirements to audit, biennially, subrecipients of the Refugee and Entrant Assistance Program, the department lacks assurance that all subrecipients used the federal funds for authorized purposes. Further, because the department has failed to comply with federal requirements, it is jeopardizing the continuation of federal funds.

We observed this same weakness during our federal compliance audit for fiscal year 1984-85. The department responded that the responsibility of these audits had been transferred to the State Controller's Office and that the department would work with the State Controller's Office to complete the required audits as soon as possible.

Criteria: The Code of Federal Regulations, Title 45, Section 74.62(3)(b), and the U.S. Office of Management and Budget Circular A-110, require the A-110 department to ensure that subrecipients of Refugee and Entrant Assistance Program funds be audited at least every two years.

Recommendation: The department should ensure that all subrecipients of Refugee and Entrant Assistance Program funds are audited at least every two years to comply with federal audit requirements.

Item 17. Late Submission of the Food Stamp Mail Issuance Reports

Finding: The department has not taken adequate steps to ensure that counties submit the Food Stamp Mail Issuance (FNS-259) report to the U.S. Department of Agriculture-Food and Nutrition Service (USDA-FNS) promptly. For fiscal year 1985-86, 25 reports were 3 to 27 days late and seven reports were 55 to 77 days late. Because the department has failed to comply with the Food Stamp Act, the USDA-FNS may, after written notification to the department, temporarily withhold some or all of the federal reimbursement of the State's cost of administering the Food Stamp Program.

We observed this same weakness during our financial audit for fiscal year 1984-85. The department believes that the USDA-FNS is reluctant to impose sanctions against the State. Therefore, the department is reluctant to impose sanctions against the counties.

Criteria: The Code of Federal Regulations, Title 7, Section 274.8(a)(3), requires the FNS-259 reports to be submitted so that they will be received by the USDA-FNS by the 45th day following the end of each quarter.

Recommendation: The department should ensure that the counties submit the Food Stamp Mail Issuance report to the USDA-FNS by the 45th day following the end of each quarter.

Item 18. **Late Submission of the Status of Claims Against Households Reports**

Finding: The department has not taken adequate steps to ensure that counties submit the Status of Claims Against Households (DFA-209) report to the department promptly. For fiscal year 1985-86, of the 232 reports submitted, 72 reports were one to 20 days late, 26 reports were 21 to 54 days late, and 13 reports were 68 to 158 days late. The late reports place an extra burden on the department to revise its consolidated Status of Claims Against Households reports that are sent to the USDA-FNS.

Criteria: The department's Manual of Policies and Procedures, Section 63-801.821, requires that counties submit to the department a completed DFA-209 report no later than 30 days after the end of each calendar year quarter. Failure to submit the DFA-209 report to the department promptly or in a fully completed format may result in a temporary suspension of a portion of the county's advance.

Recommendation: The department should ensure that the counties submit the Status of Claims Against Households report to the department by the 30th day following the end of the quarter.

Item 19. **Inaccurate Time-Reporting Summaries**

Finding: The department has had incorrect and unsupported financial charges to the following grants: Food Stamp, the Work Incentive Program, Assistance Payments-Maintenance Assistance, the Social Services Block Grant, Child Support Enforcement, and Refugee and Entrant Assistance. We identified incorrect and unsupported charges on time-reporting summaries in three of the six units or bureaus we tested. For example, the Statistical Services Bureau overstated its time-reporting summary for June 1986 by 869 hours. Because of inaccurate time-reporting summaries, we were unable to verify the department's compliance with the Code of Federal Regulations, Title 45, Section 224.16(b), that requires the State to assure a nonfederal cash or in-kind contribution of 10 percent of the cost of supportive services and related administrative expenses incurred by the State for the Work Incentive Program. As a result, the federal government may withhold grant monies.

We observed this same weakness during our financial audit for fiscal year 1984-85. The department responded that it had developed a Time-Reporting Handbook and training classes for departmental staff.

Criteria: The U.S. Office of Management and Budget Circular A-87, Attachment B(10)(b), requires that salaries and wages chargeable to more than one grant program or other cost objective be supported by appropriate time-reporting summaries.

Recommendation: The department should ensure that accurate time-reporting summaries are maintained for employees whose time is chargeable to more than one grant program.

Item 20. Inaccurate Federal Report

Finding: The department did not accurately prepare the March 31, 1986, Quarterly Financial Status Report for the Refugee and Entrant Assistance Program. As a result of a clerical error, the department overstated the federal government's share of Riverside County's Refugee and Entrant Assistance Program costs by $532. Because of this overstatement, the federal grant award for the quarter ending June 30, 1986, is overstated by $532.

Criteria: The Code of Federal Regulations, Title 45, Section 74.61, requires the grantee's financial management system to provide accurate, current, and complete disclosure of the financial results of each grant program.

Recommendation: The department should report the overstatement as an adjustment to the September 30, 1986, Quarterly Financial Status Report for the Refugee and Entrant Assistance Program.

STATE CONTROLLER'S OFFICE

The Office of the State Controller administers 2 of the 34 federal programs we reviewed. They are the U.S. Department of Agriculture grant, Federal Catalog Number 10.665, and the U.S. Department of Interior grant, Federal Catalog Number 15.999.

Item 1. **Eligibility for Certificate of Achievement**

The State does not prepare a comprehensive annual financial report that meets the criteria for receiving a Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officers Association (GFOA). The GFOA awards these certificates to governments that publish excellent comprehensive financial reports. For fiscal years that ended in 1984, the GFOA awarded certificates to approximately 700 governmental entities, approximately 60 of which were within the State of California. Only three state governments received these awards.

The State of California does not qualify for the Certificate of Achievement because its financial statements do not meet three of the major criteria for the award. First, the State does not prepare a comprehensive annual financial report in accordance with generally accepted accounting principles. The State currently prepares an annual report that includes financial statements for all funds but that is not based on generally accepted accounting principles. Although the State's general purpose financial statements are prepared in accordance with these principles, they include only summary data. The State Controller is responsible for financial reporting while the Department of Finance is responsible for designing the State's accounting system. However, the Department of Finance has not developed an accounting system that facilitates the preparation of a comprehensive annual financial report prepared in accordance with generally accepted accounting principles by the State Controller. The second criterion that the State does not meet is the requirement that its financial statements receive an unqualified auditor's opinion. Because the State has not maintained adequate records on its fixed assets, it currently receives a qualified opinion on its financial statements. Finally, the State does not currently complete its financial reporting process promptly and is unable to prepare its audited financial statements within six months of the end of the fiscal year, a third major requirement of the GFOA. Until the State satisfies these three major requirements as well as other minor requirements, it will not qualify for the Certificate of Achievement for Excellence in Financial Reporting.

Criteria: The GFOA's Certificate of Achievement for Excellence in Financial Reporting encourages governments to publish high quality, comprehensive financial statements that are prepared in accordance with generally accepted accounting principles. The certificate is also meant to recognize government officials who play an important role in helping their organizations receive such an honor. The value of receiving the Certificate of Achievement is illustrated by the fact that Standard and Poors Corporation, which rates California's bonds, is influenced by the certificate when it evaluates a government's financial position.

Recommendation: The State Controller should work with the Department of Finance to immediately improve the State's financial accounting and reporting systems so that California will be eligible for the Certificate of Achievement for Financial Reporting and thus be recognized as a leader in the field of financial reporting.

Item 2. **Audit Report Review Efforts Lack Adequate Coordination**

Finding: The Division of Audits (division) of the State Controller's Office and the State Department of Education did not adequately coordinate their various review tasks. As a result, neither has performed several review steps that could have identified deficiencies in school district audit reports. Of 70 reports we tested, we found the following 22 items in 16 separate audit reports:

- Two certified public accountants (CPA) reported different amounts of Education Consolidated Improvement Act funding on statements or schedules within the same report.

- One CPA did not include Child Care Food Program receipts on any of the financial statements or the schedule of federal assistance.

- One CPA combined state and federal National School Lunch and School Breakfast receipts.

- Nine CPAs included an auditor's statement of negative assurance but not for all federal programs where monies were received.

- Nine CPAs did not identify all federal programs on the schedule of federal assistance under which the district received funds.

Neither the division's nor the State Department of Education's school district audit report checklist included procedures that would have identified these items. This lack of proper review means that the division has accepted some inaccurate statements of the school districts' financial position and thus lacks complete assurance that the school districts have complied with all federal compliance requirements.

Criteria: The California Education Code, Section 14504, requires the State Controller to determine the practicability and effectiveness of the audits and audit guide. In addition, this section requires the State Controller, on an annual basis, to review and monitor audit reports prepared by independent auditors and to determine whether the audit reports conform to reporting provisions of the school district audit guide. Further, the Code of Federal Regulations, Title 34, Section 74.62, states that recipients must ensure that audits are performed in accordance with the Comptroller General's "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions," the General Accounting Office's "Guidelines for Financial and Compliance Audits of Federally Assisted Programs," and "successor publications," any compliance supplements approved by the Office of Management and Budget, and the standards established by the American Institute of Certified Public Accountants.

Recommendation: The State Controller's Office and the State Department of Education should agree upon an appropriate allocation of responsibilities and communicate and coordinate with each other more frequently. Any changes or updates to the review process should be communicated to ensure that both parties perform a thorough review with minimum duplication of effort.

Item 3. **Inadequate Remedies for Rejected Audit Reports**

Finding: The Division of Audits (division) of the State Controller's Office and the State Department of

Education do not have adequate remedies to ensure that school district audit reports rejected during the division's quality review are corrected. Three certified public accountants in our sample failed to respond to the rejection letters, and a fourth refused to amend his report. The division currently sends a rejection letter and two follow-up letters to the CPA who prepared the report. If the CPA does not send in an amended report after the three letters have been sent, the division closes the audit file. However, the division is currently planning to notify the State Board of Accountancy of the CPAs who have not revised rejected audit reports. Furthermore, the State Department of Education does not follow up or take any action against those school districts whose audit reports are rejected by the division. If reports that are rejected in the quality review process are not amended, then these reports are not meeting guidelines set forth by the division. The inadequacy of the reports may lead to inaccurate statements of the school districts' financial position or noncompliance with state and federal requirements related to state and federal programs.

Criteria: The California Education Code, Section 14504, requires the State Controller, on an annual basis, to review and monitor the school district audit reports prepared by independent auditors. The State Controller is to determine whether audit reports are in conformance with reporting provisions of the school district audit guide and is to notify each school district, office of the county superintendent of schools, Superintendent of Public Instruction, and auditor of his findings. The Office of Management and Budget Circular A-128, Section 9, further states that a recipient (i.e., the State Department of Education) receiving federal financial assistance and providing $25,000 or more of it to a subrecipient must ensure that corrective action is taken within six months after the receipt of the audit report in instances of noncompliance with federal laws and regulations.

Recommendation: The State Controller's Office should coordinate efforts with the State Department of Education to ensure that all rejected reports are amended within six months. Further, the State Controller's Office should continue with plans to notify the State Board of Accountancy of the CPAs who have not revised rejected audit reports. In addition, the State Controller's Office should discuss with its legal counsel the possibility of preparing a list of CPAs who have not amended rejected reports and forward this list to all school districts for their consideration before they award contracts for the next year. Finally, the State Controller's Office and the State Department of Education should work together to seek additional legislation that would provide for sanctions against the school districts or the CPAs if rejected audit reports are not revised.

Item 4. **Delayed Reports to the Legislature and the State Department of Education**

Finding: The Division of Audits (division) of the State Controller's Office was six months late in submitting to the Legislature and the State Department of Education reports related to its review of school district audits. However, this is the first year these reports were required, and there were numerous obstacles, including late audit reports, to overcome. Without the reports, the Legislature and the State Department of Education are not made aware of potential financial problems or other issues identified in the review of school district audits.

Criteria: The California Education Code, Section 14507, requires the State Controller to report to the State Department of Education by June 30 the school districts and county superintendents that are not in compliance with applicable statutes and regulations. The report must categorize audit exceptions by type and identify reasons for the exceptions. The report must recommend action that the State Department of Education should take. Further, the California Education Code, Section 14508, requires the State Controller to submit a report to the Legislature on or before June 30 regarding any recommendations made to the State Department of Education under Section 14507. Without the reports, neither the Legislature nor the State Department of Education is informed of potential problems or recommended solutions related to school district audits.

Recommendation: The State Controller's Office should submit the required reports to the Legislature and the State Department of Education no later than June 30 of each year.

Item 5. **Failure To Deposit Mineral Lease Receipts When Required by State Law**

Finding: The Financial Reports and Apportionments Section (section) of the State Controller's Office was late in depositing $1.1 million of mineral lease receipts in the Surface Mining and Reclamation account of the General Fund. Because the section did not have formal written procedures regarding the deposit of mineral lease receipts, a new employee did not deposit the funds when the section received them in July 1985. The section did not deposit the receipts until prompted by the Department of Conservation, the administering agency for the Surface Mining and Reclamation account, seven months after receiving the initial $1.1 million. As a result, the Department of Conservation did not have the use of these funds for the seven months.

Criteria: For fiscal year 1985-86, the California Public Resources Code, Section 2795, states that the first $1.1 million of mineral lease receipts received must be deposited in the Surface Mining and Reclamation account in the General Fund.

Recommendation: At the time of our fieldwork, we discussed this issue with staff of the State Controller's Office who subsequently developed written procedures regarding the deposit of these mineral lease receipts. The State Controller's Office should follow the procedures in the future.

Item 6. **Inadequate Review of County Cost Allocation Plans**

Finding: The Division of Local Government Fiscal Affairs (division) did not perform comprehensive field reviews to determine if costs reported in the county cost allocation plans for fiscal year 1985-86 were reasonable, allowable, or properly allocated. Instead, the division performed comprehensive desk reviews on 51 of the 58 county cost allocation plans submitted by the counties; the remaining 7 plans received only a limited desk review. If the division does not perform comprehensive field reviews, it has only limited assurance that counties are properly claiming indirect and central support service costs related to state and federally funded programs.

We observed this same weakness during our federal compliance audit for fiscal year 1984-85. The department responded that it was not possible to perform a comprehensive review of all county cost allocation plans each year because of the staff reduction imposed on the division's Bureau of Cost Allocation Plans by the governor's fiscal year 1983-84 budget. The department also stated that it would continue its effort to obtain the additional staffing through the budget process to provide for more field reviews of cost allocation plans.

Criteria: The Code of Federal Regulation, Title 45, Section 74.61(f), requires that procedures be established for determining the reasonableness, allowability, and allocability of costs in accordance with applicable costs principles.

Recommendation: The Division of Local Government Fiscal Affairs should conduct field reviews to the extent necessary to ensure the adequacy and accuracy of the county cost allocation plans.

STEPHEN P. TEALE DATA CENTER

Item 1. **Improper System To Charge State Agencies Using the Data Center**

Finding: To recover its annual budget appropriations, the data center establishes rates to charge state agencies that use the data center. When establishing these rates, the data center includes the total cost of equipment in the year purchased rather than spreading the cost over the periods benefited. This method of determining rates does not ensure equitable annual charges to individual state agencies using the data center. Some state agencies, in turn, charge part of their costs of using the data center to federal programs. Therefore, the method used to determine rates charged to state agencies that use the data center could also result in inequitable charges to federal programs.

Criteria: Neither the State Administrative Manual nor the California Government Code related to the Stephen P. Teale Data Center Revolving Fund addresses methods to be used to determine charges to state agencies using the data center. However, the State Administrative Manual, Section 13400, stipulates that the Fiscal Systems and Consulting Unit of the Department of Finance may provide special instructions for accounting for proprietary funds such as the Stephen P. Teale Data Center Revolving Fund. Sections 1400.104, 1400.115, and 1600.103 of Governmental Accounting and Financial Reporting Standards, published by the Governmental Accounting Standards Board, state that, for proprietary funds, the cash basis of accounting is not appropriate. These sections require that depreciation be used to determine charges to state agencies.

Recommendation: The data center should request that the Department of Finance provide special instructions for establishing rates to charge state agencies using the data center. These rates should reflect the full accrual basis of accounting including capitalization of equipment and allowances for depreciation.

Item 2. **Inadequate Internal Controls Over Equipment**

Finding: The data center does not maintain adequate internal controls over equipment that cost approximately

$47 million. Specifically, the data center has not properly segregated custodial and accounting duties related to equipment: the warehouseperson receives the equipment and records transactions in the property inventory ledger. In addition, property cards maintained by the warehouseperson are not reconciled to the accounting records, the center has not taken a physical inventory of equipment for five years, and equipment purchased by the data center and shipped directly from a vendor to a state agency using the data center is not tagged with a decal number for control and identification. The lack of adequate internal controls over property could result in a loss of assets to the State.

Criteria: The State Administrative Manual, Section 8652, states that the warehouseperson in charge of the stockroom may not be in charge of maintaining inventory records and that departments must take a physical count of all property and reconcile the count with accounting records at least once a year. The State Administrative Manual, Section 8651, requires all state property to be tagged after acquisition to identify assets belonging to the State.

Recommendation: The data center should segregate incompatible duties for better control of state equipment and ensure that a physical count of all property is made and reconciled to the accounting records at least once a year. In addition, the data center should require that property be tagged immediately after acquisition.

Item 3. **No Established Depreciation Policy**

Finding: The data center has not identified criteria nor established a consistent policy regarding when to begin depreciating purchased equipment. We examined the data center's method of recording depreciation for 33 items of equipment representing 55 percent of the recorded equipment cost and 42 percent of the accumulated depreciation allowance. We found that, for 10 of the 33 items we examined, the department began depreciating the equipment an average of three months before the data center recorded the item as received. On the other hand, for 11 of the 33 items tested, we found that depreciation began an average of two months after the data center, according to its records, received the equipment. The failure to use consistent practices to begin depreciation of equipment results in inaccurate financial statements. For example, when we used the date on which equipment was reported as received to begin depreciation, we determined that, for the items we tested, the accumulated depreciation is overstated approximately $388,000 at June 30, 1986, and that the depreciation expense is overstated approximately $127,000 for the year then ended.

Criteria: The State Administrative Manual, Section 8410, requires agencies to prepare stock received reports at the time goods are received. The State Administrative Manual, Section 8600, states that property accounting procedures are designed to provide accurate records for the acquisition and control of state property. The State Administrative Manual, Section 8616, states that an asset's depreciable cost is to be spread over the time period benefited.

Recommendation: The data center should establish and follow a policy that specifies when to capitalize and when to begin depreciating equipment.

Item 4. **Inadequate Support for Equipment Account Balance**

Finding: The data center does not retain adequate records to support the monthly general journal entries that record equipment purchases capitalized in the general ledger equipment account. The fiscal officer determines the monthly entry to the equipment account by segregating capital equipment purchases from a list of monthly disbursements. However, he does not retain records to identify the equipment he is capitalizing. Therefore, we could not verify the additions to the equipment account without reconstructing the entries.

Criteria: The State Administrative Manual, Section 1671, requires agencies to retain the records needed to support the total costs of acquiring equipment until the records are audited or four years from disposition.

Recommendation: The data center should maintain records, until audit or four years from disposition, to support the monthly general journal entries to record equipment acquisitions capitalized in the general ledger equipment account.

Item 5. **Inaccurate Accounting for Amounts Owed by the Data Center**

Finding: The fiscal officer does not accurately report in the financial statements the amounts owed from the Stephen P. Teale Data Center Revolving Fund for accounts payable and installment contracts payable. In addition, the fiscal officer does not prepare lists that itemize the installment contracts payable reported in the financial statements. We analyzed accounts payable and installment contracts payable at June 30, 1986, and found that accounts payable were overstated by approximately $1,696,000, and that installment contracts payable were understated by approximately $1,671,000. These misstatements occurred because the fiscal officer accrued as accounts payable the cost of items not yet received and did not report installment contracts payable as obligations of the fund until the fiscal year the first payment is made.

Criteria: The State Administrative Manual, Section 13400, provides general directions for accounting for proprietary funds such as the Stephen P. Teale Data Center Revolving Fund. The State Administrative Manual, Section 7630, requires that the balance of accounts payable reflect the cost of goods or services received but not yet paid. In addition, the State Administrative Manual, Section 7634, states that the balance of installment contracts payable should reflect the liability for future installment payments of assets purchased under installment purchase contracts. Finally, the State Administrative Manual, Section 10584, requires state agencies to prepare a detailed list of valid obligations as of June 30.

Recommendation: The data center should ensure that amounts accrued are as accurate as can be determined and that detailed lists are prepared itemizing year-end obligations.

DEPARTMENT OF TRANSPORTATION

The Department of Transportation administers 2 of the 34 federal programs we reviewed. They are the U.S. Department of Transportation grants, Federal Catalog Numbers 20.205 and 20.500.

Item 1. **Inadequate Controls Over and Accountability for the Revolving Fund**

Finding: Because the department uses the revolving fund extensively, having made over $325 million in payments from the revolving fund during fiscal year 1985-86, weaknesses in revolving fund activities can result in significant errors and irregularities that may go undetected. We found the following specific deficiencies:

- The department overdrew its revolving fund in 11 of the 12 months during fiscal year 1985-86 by an average of $9 million per month. We observed this same weakness during our audits for fiscal years 1983-84 and 1984-85. In response to our fiscal year 1984-85 management letter, the department stated that the primary cause of the negative cash balances was the delay in reimbursing the revolving fund for tort claims and that this would be resolved by new legislation granting the department the authority to approve funding for its own tort claims. However, the overdraft condition in the revolving fund still existed throughout fiscal year 1985-86.

- Of 63 revolving fund disbursements that we tested at the headquarters, we found that 24 were for payments to vendors that neither offered discounts nor required immediate payment. We noted similar inappropriate uses of the revolving fund at the San Francisco district office in 3 of 17 instances and at the Los Angeles district office in 9 of 21 instances.

- The Los Angeles district office did not always compare revolving fund checks to vendor invoices, and in two instances, it paid a total of $11,265 to the wrong vendors.

- The San Francisco district office has a total of approximately $155,000 in outstanding salary advances, of which 146 advances totaling

$41,500 had been outstanding for more than 60 days as of June 30, 1986. On January 11, 1985, the State Controller reported that there were 715 salary advances outstanding over 60 days as of September 1984. The district office has significantly reduced the number of salary advances outstanding over 60 days and is recovering current salary advances promptly.

- As of June 6, 1986, the department had not prepared monthly bank reconciliations of its revolving fund checking account for the seven months from October 1985 to April 1986. Moreover, the travel, salary and expense advances reported by the headquarters and the San Francisco district office in their Revolving Fund Transactions Summary were less than the general ledger balances by approximately $1.6 million and $71,000, respectively. Conversely, the balances reported in the summaries for the Los Angeles, Stockton, and San Diego district offices were approximately $35,000, $1,700, and $139,000 greater, respectively, than the general ledger balances. On October 17, 1985, the Caltrans Audits Office reported that the department had not balanced the revolving fund since June 30, 1981.

- The department did not prepare a list to support the $9.7 million in revolving fund checks outstanding at June 30, 1986. We observed this same weakness during our audit for fiscal year 1984-85. In response to our management letter, the department concurred with our finding and stated that it would prepare a list for fiscal year 1985-86. However, as of October 31, 1986, it still had not done so.

Criteria: The State Administrative Manual, Section 8047, directs agencies to make every effort to prevent overdrafts in their checking accounts. In addition, the State Administrative Manual, Section 8110, limits the uses of the revolving fund to pay for compensation earned, for travel expenses, for travel expense advances, and to provide immediate payment when required. Moreover, the State Administrative Manual, Section 8118, requires agencies to collect salary advances from the subsequently issued payroll warrant for the period of the advance. The State Administrative Manual, Section 8060, requires state agencies to reconcile their bank accounts promptly at the end of each month. The State Administrative Manual, Section 8193, requires agencies to reconcile all revolving fund resources with the amount of cash advanced. Finally, the State Administrative Manual, Section 7967, requires agencies to support their bank reconciliations.

Recommendation: The department should comply with all requirements necessary to maintain adequate controls over and accountability for its revolving fund.

Item 2. Failure To Control Cash Deposits

Finding: Headquarters and the Los Angeles district office do not always deposit cash receipts promptly, and we found receipts totaling approximately $76,000 and $223,000, respectively, that remained undeposited for at least five working days. We estimate that because of the late deposits, headquarters and the Los Angeles district office lost at least $300 and $1,500 in interest earnings, respectively. Additionally, as of August 12, 1986, the San Francisco district office did not require a supervisor to verify the composition of its deposits. The Caltrans Audits Office reported a similar weakness that had permitted an embezzlement of cash at the San Diego district office to remain undetected for a prolonged period. Finally, headquarters and the San Francisco district office incorrectly accounted for cash by recording it on the date it was posted to the Cash State Form rather than on the date it was received. This would make it difficult for a supervisor to verify that all receipts were deposited intact.

Criteria: The State Administrative Manual, Section 8030.1, requires that daily collections in excess of $5,000 be deposited on the day of receipt or the next working day, that deposits totaling $50 or more not remain undeposited longer than 5 working days, and that no collection remain undeposited longer than 15 working days. In addition, the State Administrative Manual, Section 8030.5, requires that a supervisor verify that receipts have been deposited intact, and the State Administrative Manual, Section 8030.1, requires that the composition of a deposit be verified and signed by two department employees.

Recommendation: The department should require that collections be deposited daily, that the date entered on the Cash State Form be the date that cash is received, and that supervisors verify the composition of deposits.

Item 3. **Inadequate Control Over Disbursements**

Finding: Because of the large volume of vendor invoices, the headquarters' accounts payable unit does not research its manual file of payments to vendors to verify whether specific vendor invoices were previously paid. Instead, headquarters relies on its staff to remember whether such invoices were previously paid, and it relies on vendors to detect and refund duplicate payments. Consequently, the department failed to prevent and detect duplicate payments. Throughout the fiscal year, the department made at least ten duplicate payments totaling $2,107,300 to vendors that subsequently refunded the duplicate payment to the department. One of the payments alone was for approximately $2.1 million. If the department is relying on vendors to detect and voluntarily refund duplicate payments, it may not detect and recover all such payments. Moreover, by making duplicate payments, the department unnecessarily reduces the funds available for current operations.

Criteria: The State Administrative Manual, Section 8422.1, requires agencies to determine that payments have not already been made to a vendor before paying a vendor's invoice.

Recommendation: The department should require that vendor files be reviewed to verify that payments were not previously made to vendors before paying invoices. Moreover, it should automate its vendor payment files to allow the staff faster access to vendor files.

Item 4. **Inadequate Separation of Duties Over Cash**

Finding: At headquarters, we found that an employee who collects receipts and prepares collection reports also has access to the blank check stock, operates the check-signing machine, and controls the signature plate and key. At the Los Angeles district office, 13 accounting office employees have the combination to at least one of three safes that contain blank check stock, draft purchase orders, unclaimed salary warrants, undeposited receipts, and other assets. Further, the check-signing machine and keys are kept together and in close proximity to one of the safes. Eight of the 13 employees also have authority to sign revolving fund checks. In addition, the Caltrans Audits Office found that an employee at the Stockton district office collects and deposits receipts and also prepares checks. Two other employees who sign checks have access to the blank check stock, and one of these employees also maintains the general ledger. Because of these incompatible duties, an employee could divert receipts or issue an unauthorized disbursement that may not be detected.

Criteria: The State Administrative Manual, Section 8080, states that the person who operates the check-signing machine or manually signs checks should not have access to blank check stock. The State Administrative Manual, Section 8024, requires that the combinations to safes be known to as few persons as possible. Finally, the State Administrative Manual, Section 8081, requires that, when two keys are necessary for the operation of the check-signing machine, one key will be controlled by the operator and the other by the person whose signature is used. The operator is to promptly return the second key to the person who is responsible for controlling its use when the check-signing machine is not being used.

Recommendation: The department should separate incompatible duties regarding cash and should limit access to safes to as few individuals as possible.

Item 5. Failure To Reconcile Agency Trust Fund Cash Balance Promptly

Finding: The department had not reconciled its Agency Trust Fund Cash checking account to the bank statement on the centralized State Treasury System for five months. As of June 4, 1986, the most recent reconciliation available was for November 1985. Failure to reconcile bank accounts promptly may prevent the detection of errors or irregularities such as undeposited receipts or unauthorized disbursements.

Criteria: The State Administrative Manual, Section 8060, requires that all accounts be reconciled promptly at the end of each month.

Recommendation: The department should reconcile its Agency Trust Fund Cash checking account to the centralized State Treasury System promptly at the end of each month.

Item 6. **Incorrect Recording of Cash Transactions**

Finding: The department recorded certain cash transactions in the wrong month. For instance, the Los Angeles district office had $24,500 of General Cash receipts and $7,500 of Agency Trust Fund disbursements during June that were accounted as July transactions. Similarly, headquarters had Agency Trust Fund disbursements of approximately $13,000 during June that were accounted as July transactions. Finally, the San Francisco district office accounted for some June receipts and disbursements, totaling approximately $498,000 and $393,000 respectively, as July transactions. However, the district office subsequently increased its Agency Trust Fund Cash account by $104,000 to adjust the June 30 balance. Because of the incorrect recordings, the department understated its General Cash account by at least $24,500 and overstated its Agency Trust Fund Cash accounts by at least $21,500.

We observed this same weakness in the headquarters' General and Revolving Fund cash accounts during our audit for fiscal year 1984-85. In response to our management letter, the department reported that it had taken action to correctly record transactions. However, the weakness still existed as of June 30, 1986.

Criteria: The State Administrative Manual, Section 8093, requires agencies to record collections in a cash receipts register either directly or from reports of collections. The State Administrative Manual, Section 8094, requires agencies to record checks written each day in the cash disbursements register. The State Administrative Manual, Section 7222, requires state agencies to use books of original entry, such as the cash receipts or cash disbursements registers, to record and summarize all cash transactions occurring within each month.

Recommendation: The department should require that all receipts and disbursements be recorded in the month in which they occur.

Item 7. **Failure To Report Cash on Hand**

Finding: The department has not established a procedure to gather information regarding cash on hand that was received but not deposited as of June 30. Consequently, headquarters and the district offices did not report all cash on hand that was received but not deposited as of June 30. For example, headquarters did not report approximately $67,000 of Agency Trust Fund cash received but not deposited as of June 30. Similarly, the San Francisco district office did not report $12,500, $1,300, and $500 of General, Revolving, and Agency Trust Fund cash, respectively; the San Luis Obispo district office did not report $700, $1,100, and $2,000 for the same accounts; and the Los Angeles district office failed to report $636,300 and $147,900 of General and Agency Trust Fund cash, respectively. The Stockton district office failed to report $8,300 and $400 of General and Revolving Fund cash, respectively, and, the San Diego district office failed to report $88,900 and $700 of General and Revolving Fund cash, respectively. Failure to report cash on hand at June 30 resulted in an understatement of the department's cash by $967,600 as of June 30, 1986.

Criteria: The State Administrative Manual, Section 7620, requires state agencies to record undeposited receipts as cash on hand and to report these receipts in the year-end financial statements.

Recommendation: The department should establish procedures to provide for reporting cash on hand at June 30 in the year-end financial statements.

Item 8. **Failure To Close Out Completed Projects**

Finding: The department did not promptly submit final claims to the Federal Highway Administration (FHWA) to close out completed construction and local assistance projects. The department gave various reasons for its inability to close out completed projects promptly, including insufficient resources to prepare the final claims, not receiving expenditure information from local governments and district offices on time, and incomplete audits. We found 6,150 projects that had been completed but that had not had a final claim prepared as of June 30, 1986. The FHWA must review and approve these final claims before projects can be considered completed and closed. After a project is closed, the department can reallocate the unused balance of authorized funds for existing or future projects. Agency officials estimated that the department could have reallocated $14 million for construction projects and $24 million for local assistance projects if these projects had been closed promptly.

We reported a similar finding during our audits for fiscal years 1982-83 and 1984-85. In accordance with the department's response to our management letter for fiscal year 1984-85, the department added four employees in August 1986 to close out projects currently completed, and it hired a consultant to close out some of the older projects.

Criteria: The Federal Aid Highway Program Manual, Volume 1, Chapter 4, Section 6, Item 5, requires federal aid recipients to submit final claims promptly to the FHWA when projects are completed. In addition, the FHWA indicated in a letter to the department dated April 29, 1986, that, unless the department takes immediate steps to close out these completed projects, the FHWA would be forced to begin retaining a portion of federal funds on all current federal aid projects. Furthermore, a department memorandum dated May 20, 1986, requires district offices to prepare and submit to headquarters Final Reports of Expenditures within nine months after projects are completed. Finally, Office of Management and Budget Circular A-128 requires the department to ensure that locally administered projects be audited annually unless a constitutional or statutory requirement exists for less frequent audits.

Recommendation: The department should comply with all requirements necessary to close out completed federal aid projects promptly.

Item 9. **Failure To Adjust Service Center Rates**

Finding: The department had not reviewed and adjusted service center rates for the Electronic Data Processing (EDP) and Materials service centers since it developed these rates in fiscal year 1982-83. However, the department did adjust the Equipment service center rates during fiscal year 1985-86.

Service centers are units within the department that perform specific services that benefit individual projects and the department as a whole. The FHWA has allowed the department to charge the cost of the EDP, Materials, and Equipment service centers directly to federal aid projects. Because certain of these rates have not been reviewed and adjusted, the department is not maximizing federal reimbursements. For example, the department issued a report on May 14, 1986, showing approximately

$12.2 million in total unrecovered costs since the implementation of the EDP service center in fiscal year 1982-83.

We observed this same weakness during our audit for fiscal year 1984-85. In response to our management letter, the department indicated that it had established a work plan to update the rate review adjustment procedures for EDP services. Although the department has assigned the responsibility of monitoring service centers rates, as of October 1986, it has not developed all of the necessary reports or the specific procedures to review and adjust these rates properly.

Criteria: The Federal Aid Highway Program Manual, Volume 1, Chapter 4, Section 5, Paragraph 9, requires that service center rates charged to a project be of an average actual cost and that these rates be periodically reviewed and adjusted in each succeeding fiscal year to correct any overcharge or undercharge incurred in the preceding fiscal year.

Recommendation: The department should periodically review all service center rates and should adjust these rates annually.

Item 10. Delays in Requesting Federal Reimbursement

Finding: The department has not promptly requested federal reimbursement for inverse condemnation claims that result from taking or damaging property during highway construction. As of June 30, 1986, the department had approximately $5 million in claims that may be eligible for federal reimbursement. Some of these claims date from fiscal year 1977-78. Although the department has submitted approximately $850,000 in claims to the FHWA, the FHWA returned them to the department because of insufficient information. The department contends that the FHWA has not provided specific instructions on the type of information required before the claims will be approved and, therefore, has not continued to process these claims. As a result, the department may not recover that portion of the approximately $5 million in claims that are eligible for federal reimbursement.

Criteria: The Code of Federal Regulations, Title 23, Section 712.103(q), allows the reimbursement of inverse condemnation claims incurred on federal aid projects. Additionally, in a letter to the department dated January 17, 1985, the FHWA stated that federal reimbursement will be allowed for inverse condemnation claims that normally would have been eligible if approved before the taking or damaging of property.

Recommendation: The department should follow up with the FHWA and reach agreement on the specific information required to obtain FHWA approval for reimbursement of inverse condemnation claims.

Item 11. Delay in Audit of Local Assistance Projects

Finding: The department has not complied with the requirement to audit local assistance projects within one year after the completion of the project. The department's Caltrans Audits Office audits completed Railroad projects, while the State Controller audits completed Emergency Relief projects. However, 157 completed projects that the department scheduled to have audited more than one year ago still had not been completed as of June 30, 1986; 7 of these projects were assigned for audit as long ago as fiscal year 1980-81. Because audits of these projects have not been completed, the department is unable to close out the projects and reallocate any unused balance of authorized funds for use on other projects.

Criteria: The Office of Management and Budget Circular A-128 requires the department to ensure that local projects are audited annually unless a constitutional or statutory requirement exists for less frequent audits.

Recommendation: The department should ensure that audits of local projects are completed promptly.

Item 12. Failure To Submit Status Reports

Finding: The department failed to submit semi-annual program status reports for the Urban Mass Transportation Administration (UMTA) Transportation for Elderly and Handicapped Persons Program. The semi-annual status reports indicate the amount awarded to each nonprofit agency and the number and type of vehicles operated by each nonprofit agency. The semi-annual program status reports for the periods ending March 31, 1986, and September 30, 1986, had not been submitted to the UMTA as of November 13, 1986.

Criteria: The Urban Mass Transportation Administration Circular 9070.1A, Chapter V-7, requires the department to prepare and submit semi-annual status reports for each active grant. Further, the status report is due to the UMTA on April 30 for the period from October 1 to March 31, and on October 30 for the period from April 1 to September 30.

Recommendation: The department should prepare and submit to the UMTA the semi-annual status reports by the required due dates.

Item 13. **Failure To Properly Accrue Revenues**

Finding: Headquarters instructed district offices to accrue as revenue all interest on sales of excess lands expected to be collected in the next fiscal year, but it did not indicate that this interest should also be earned as of June 30. Consequently, some district offices did not accrue the correct amount of revenue. For instance, the San Francisco and Los Angeles district offices accrued as revenue approximately $541,000 and $490,000, respectively, in interest from the installment sales of excess land; this interest was not earned as of June 30, although it was expected to be collected in the subsequent fiscal year. In addition, the department failed to accrue as revenues certain amounts that it had earned as of June 30 and that it expected to collect within the next fiscal year. The Los Angeles district office, for example, did not accrue approximately $101,000 in revenue from four sales of excess land even though it had earned the interest as of June 30 and expected to collect it in the subsequent fiscal year. As a result, the department overstated its accounts receivable and revenue accounts by approximately $956,000 and $930,000, respectively. Further, it overstated its provision for deferred receivables account balance by approximately $26,000.

Criteria: The State Administrative Manual, Section 8776.2, requires agencies to accrue as revenue that portion of income earned as of June 30 and estimated to be collectible within the ensuing fiscal year.

Recommendation: The department should revise its instructions and require the district offices to accrue as revenue all amounts earned as of June 30 and estimated to be collectible within the ensuing fiscal year.

Item 14. **Failure To Control or Account for Accounts Receivable**

Finding: We found instances of poor control or accountability for certain accounts receivable at headquarters and at the Los Angeles and San Francisco district offices. As of October 31, 1986, headquarters had not attempted to collect approximately $174,000 due from cities and counties for signal and lighting service costs since January 1986; some of the accounts were over four years old. As a result, we believe that the department will not be able to collect some of these accounts.

At the San Francisco district office, we found five accounts included in the Accounts Receivable-Revenue account balance at June 30 totaling approximately $525,000 that were not valid receivables as of that date. Four of the five accounts represented sales of excess land for which the sales had been cancelled before June 30. The fifth account could not be substantiated by the district. At the Los Angeles district office, we found 41 accounts included in the Accounts Receivable-Revenue account balance at June 30 totaling approximately $1.5 million that were not valid receivables. These receivables were for cash sales of excess land that were paid, cancelled, or recorded twice before June 30.

Moreover, the Los Angeles district office did not reconcile its accounts receivable subsidiary ledger to the general ledger and failed to determine that differences existed. We found two accounts whose balances in the subsidiary ledger were as much as $10,600 greater than in the general ledger. Conversely, we found five accounts whose balances in the subsidiary ledger were as much as $4,000 less than those in the general ledger. The Los Angeles district office also did not record in either the subsidiary or the general ledger two receivables totaling approximately $75,000 from the sales of excess land. Finally, the San Francisco district office did not accrue abatement accounts receivable totaling approximately $395,000 that were due from third parties for costs of repairs for damage they caused to state property. Consequently, the department's accounts receivable account balances are misstated.

Criteria: The State Administrative Manual, Section 8710.1, requires agencies to implement collection procedures to ensure prompt follow up on receivables. The

State Administrative Manual, Section 7815, requires state agencies to remove paid receivables from the accounts receivable subsidiary ledger. The department's Accounting Manual, Chapter 9, Section 6.2.3, requires district offices to cancel receivables for the sale of excess land if the sale is defaulted. The State Administrative Manual, Section 7800, requires agencies to reconcile subsidiary ledgers to the general ledger on a monthly basis. Finally, the State Administrative Manual, Section 8776.2, requires agencies to accrue as revenue that portion of income earned as of June 30 that is not yet received but that is estimated to be collected within the ensuing fiscal year and to accrue abatements that were not previously accrued or billed but that are estimated to be collected within the ensuing fiscal year.

Recommendation: The department should require prompt follow up on accounts receivable and issue instructions to district offices to reconcile their accounts receivable subsidiary ledger to the general ledger each month. Moreover, it should estimate and accrue abatement accounts receivable that exist but are not yet billed as of June 30.

Item 15. Failure To Correct Error File

Finding: During our review of the Claims In Process account balance in the Transportation Revolving Account at June 30, we found a $1 million debit balance in an account that normally has a credit balance. Moreover, there were erroneous transactions in the error file that would have substantially reduced this debit balance if they had been corrected. Failure to clear these transactions from the error file caused an understatement of the Claims In Process and the Expenditure account balances by at least $1 million as of June 30.

Criteria: The Transportation Accounting and Management System Procedures Manual, Volume III, Chapter VI, Section 1, requires the department to clear the error file promptly to ensure the accuracy of the accounting transactions processed in the system.

Recommendation: The department should clear the error file promptly.

Item 16. **Improper Identification of Obligations and Encumbrances**

Finding: The department's local assistance unit did not adequately analyze accounts payable for local assistance projects to determine whether goods were received or services were provided before or after June 30. The local assistance unit did not include amounts for goods received by or services provided to the department as of June 30 and for which certain invoices had been received but were being processed or for which invoices had still not been received. Consequently, the actual obligations as of June 30, 1986, were understated by approximately $18 million, and encumbrances were overstated by a like amount. If the department does not properly identify the obligations and encumbrances in its financial statements, the State Controller's Office does not have sufficient information to prepare the State's financial statements in accordance with generally accepted accounting principles.

Criteria: The State Administrative Manual, Section 7952, requires agencies to report the amount of encumbrances applicable to their accruals in such a way that obligations can also be determined. This permits financial statements to be prepared in accordance with generally accepted accounting principles. Under generally accepted accounting principles, encumbrances are that portion of the accruals that represent goods received or services provided after June 30.

Recommendation: During year-end closing, the department should analyze its accruals to determine whether goods were received or services were provided before or after June 30 and report them appropriately as obligations or encumbrances.

Item 17. **Inadequate Payroll Procedures**

Finding: The department does not have adequate supporting documentation for leave taken, and it does not always have adequate separation of duties involving payroll. For example, the department did not require employees to prepare the Form 634, Absence Request, or a similar form when they were absent on sick leave. Instead, it relies on the timesheets certified by the employees and their supervisors as evidence of leave used. Further, the department requires timekeepers to maintain daily attendance reports as support and to reconcile their data to the certified timesheets. However, two of the five timekeepers that we tested at headquarters and two of five at the San Francisco district office did not maintain current attendance reports. Consequently, the department may not detect and correct errors and omissions in the employees' time sheets, and the department may pay employees for time not worked.

Furthermore, at the Los Angeles district office, 17 timekeepers who process attendance records also distribute salary warrants. The Caltrans Audits Office found a similar problem regarding 3 timekeepers at the San Diego district office. We observed a similar weakness at the San Francisco district office during our audit of fiscal year 1984-85. In response to our management letter, the department indicated that a reminder would be sent to all district offices to stress the importance of separating these payroll functions. However, the weaknesses still existed at the Los Angeles and San Diego district offices in September 1986. Unless these duties are separated, an employee could authorize an improper payment for personal use.

Criteria: The Personnel Transactions Manual, Section 605.13, requires state agencies to use the Absence Request to record sick leave taken, unless a similar form is approved by the Department of Personnel Administration for use in lieu of the Absence Request. In addition, the State Administrative Manual, Section 8580.1, requires that persons who receive salary warrants, distribute salary warrants to employees, or handle salary warrants for any other purpose should not also be authorized to process or sign payroll documents.

Recommendation: The department should require the use of the Absence Request to record leave taken. Also, it should require district offices to assign the duties of handling salary warrants to employees who do not process or sign payroll documents.

Item 18. **Inadequate Budgetary Control**

Finding: The department did not adequately monitor all the expenditures that the State incurred on behalf of the federal government for the Transportation Planning Program. The department is authorized to incur costs on behalf of the federal government and then request reimbursement from the federal government but only to the extent authorized by the Legislature. However, as of May 14, 1985, the department incurred approximately $3.4 million more in expenditures than had been budgeted for the program, and it received reimbursement from the federal government for the added expenditures. The department neglected to submit a budget revision to the Department of Finance to authorize it to incur additional expenditures on behalf of the federal government and to accept reimbursement from the federal government. On July 16, 1985, the department's accounting office formally requested that the budget unit submit the budget revision to the Department of Finance, but as of September 30, 1986, the department's budget unit still had not done so. Because the budget revision has not been submitted and approved, the department is unable to reimburse the fund that disbursed the monies for these expenditures incurred on behalf of the federal government.

Criteria: The State Administrative Manual, Section 6236.6, requires agencies to file a Section 28 budget revision with the Department of Finance when expenditures exceed the final budget or the previously approved Section 28 by 5 percent or $100,000, whichever is less.

Recommendation: The department should submit the Section 28 budget revision to the Department of Finance promptly and process all future budget revisions promptly.

DEPARTMENT OF WATER RESOURCES

Item 1. **Depreciation Records Not Reconciled**

Finding: The department does not reconcile the monthly change in the accumulated depreciation balance shown in the Depreciation Balances Report with the monthly change in the accumulated depreciation recorded in the general ledger account Automotive and Heavy Equipment. The Depreciation Balances Report is prepared by the Mobile Equipment Office, while the related general ledger account is maintained in the General Accounting Office. For 4 of the 12 months that we tested, the monthly entries on the Depreciation Balances Report differed from the monthly general ledger entries by an average of approximately $30,000. The annual change in the accumulated depreciation account totals approximately $250,000. Department personnel could not explain the differences. Not reconciling the Depreciation Balances Report to the general ledger could result in the misstatement of depreciation expense and accumulated depreciation in the financial statements.

Criteria: The State Administrative Manual, Section 7900, discusses the importance of making regular reconciliations. In addition, Section 6348.8 of the department's accounting manual states that the Depreciation Balances Report is to be used to reconcile depreciation balances as reported in the equipment accounting system with the general ledger accounts.

Recommendation: Each month the department should reconcile the depreciation expenses reported in the Depreciation Balances Report with the depreciation expenses recorded in the general ledger account.

Item 2. **Incorrect Depreciation Rates for Some Automotive and Heavy Equipment**

Finding: The department depreciates some automotive and heavy equipment over periods that exceed their estimated useful lives. During our review of the equipment account balance in the WRRF, we found that 12 pieces of equipment with estimated useful lives from 5 to 15 years were depreciated over 83 to 92 years. As a result, depreciation expense for the year ended June 30, 1986, was understated by approximately

$54,000, and accumulated depreciation was understated by approximately $172,000.

Criteria: The State Administrative Manual, Section 8600, states that property accounting procedures are designed to provide accurate records for the acquisition and control of state property. In addition, the State Administrative Manual, Section 8616, requires that an asset's depreciable cost be spread over the period benefited.

Recommendation: The department should review the depreciation tables of mobile and heavy equipment and make sure that all equipment is depreciated over its estimated useful life.

Item 3. Failure To Retain Depreciation Records

Finding: The department did not retain records supporting the estimated useful lives of equipment recorded in the Automotive and Heavy Equipment account before December 1985. In determining the annual depreciation of equipment, the department periodically adjusts the estimated useful lives of equipment based on the most recent experience. However, the department does not retain the records for the estimated useful lives of equipment acquired before the revision. Consequently, we cannot determine the accuracy of depreciation calculations for equipment purchased before December 1985.

Criteria: The Government Code, Section 13403, states that the elements of a satisfactory system of internal accounting and administrative control shall include a system of recordkeeping that is adequate to provide effective accounting control over assets, liabilities, revenues, and expenditures.

Recommendation: The department should retain documentation to support depreciation calculations for all equipment that has not been fully depreciated.

DEPARTMENT OF THE YOUTH AUTHORITY

The Department of the Youth Authority administers 2 of the 34 federal programs we reviewed. They are the U.S. Department of Agriculture grants, Federal Catalog Numbers 10.553 and 10.555.

Item 1. The Internal Audit Section Is Not Organizationally Independent

Finding: The internal audit section does not report to a sufficiently high level of administration to assure its independence from other sections within its own branch or from other branches. Currently, the department's internal audit section is organizationally a part of the Program Support Division within the Administrative Services Branch. Both the National School Breakfast and School Lunch programs' administrator and internal auditor report to the same level within the Program Support Division of the Administrative Services Branch. The organizational placement of the internal auditors within the Administrative Services Branch prevents them from being independent of the activities they audit because the chief of the Administrative Services Branch has the opportunity to influence audit plans and audit reports before they are received by the department director.

Criteria: The Government Code, Section 1236, requires the department to use the "Standards for the Professional Practice of Internal Auditing" (standards) established by the Institute of Internal Auditors, Inc. Section 110.01.1 of the standards requires the internal auditor to be responsible to an individual in the organization with sufficient authority to promote independence and to ensure broad unit coverage, adequate consideration of audit reports, and appropriate action on the recommendations.

Recommendation: The internal audit section should report directly to the chief deputy of the department.

Item 2. Failure To Follow Monitoring Policies

Finding: The department is not following its written policy for monitoring facilities to ensure that they are complying with the participation requirements of the National School Breakfast and School Lunch programs. The head of the Program Support Division attributes this deficiency to lack of funding for site visits.

Criteria: The department has a policy that the nutritionist of the Nutrition Services Bureau will visit sites and evaluate menus each quarter to ensure that the facilities are complying with federal regulation requirements.

Recommendation: The department should enforce its policy for monitoring facilities to ensure they are complying with the National School Breakfast and School Lunch programs' federal regulations.

Item 3. Inaccurate Meal Count Reports

Finding: Schools are not always reporting meal counts accurately. For the days we tested at each school site, we determined that the department did not include 118 eligible meals and included 217 ineligible meals in reimbursement claims filed between July 1, 1984, and September 30, 1985, for the National School Breakfast and School Lunch programs. These incorrect meal counts, which constitute substantially fewer than one percent of the meals tested, were primarily due to mathematical and clerical errors made at the facilities.

Criteria: The Code of Federal Regulations, Title 7 CFR 210.2, 210.10, and 220.8, provides the requirements that must be met for meals to be eligible for reimbursement. Only meals meeting these requirements should be included in ward counts.

Recommendation: The department and facilities should require supervisorial reviews of meal counts to verify the accuracy of the count data. Also, the department and facilities should ensure that personnel are familiar with the current code requirements relating to meal eligibility for reimbursement.

Item 4. Insufficient Documentation of Meal Content at Fred C. Nelles School

Finding: Fred C. Nelles School did not have worksheets that listed menus for 10 of the 15 breakfast meals and 11 of the 15 lunch meals we reviewed. The department's Special Funding Program Handbook requires that each facility prepare daily menu worksheets for each meal and retain these worksheets for a period of at least three years. Without these worksheets, the department has insufficient evidence to demonstrate that the meals served meet federal requirements. Food services personnel at Fred C. Nelles School believed that worksheets were required for only those days for which the department requested cost data.

Criteria: The Special Feeding Program Handbook, submitted to each facility by the department, requires facilities to prepare a daily menu worksheet for each meal and retain these worksheets for at least three years.

Recommendation: Fred C. Nelles School should prepare daily menu worksheets. The department should also implement procedures to ensure compliance with this requirement.

REPORT ON COMPLIANCE

WITH FEDERAL GRANT REQUIREMENTS

Telephone:
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STATE OF CALIFORNIA
Office of the Auditor General
660 J STREET, SUITE 300
SACRAMENTO, CA 95814

Thomas W. Hayes
Auditor General

Members of the Joint Legislative Audit Committee
State of California

We have examined the General Purpose Financial Statements of the State of California as of and for the year ended June 30, 1986, and have issued our report thereon dated December 19, 1986. Our examination was made in accordance with generally accepted auditing standards; the standards for financial and compliance audits contained in the Standards for Audit of Governmental Organizations, Programs, Activities, and Functions, issued by the U.S. General Accounting Office; the Single Audit Act of 1984; and the provisions of the U.S. Office of Management and Budget (OMB) Circular A-128, Audits of State and Local Governments. We accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The scope of our examination did not extend to programs administered by the University of California. The university contracts with independent certified public accountants for a financial and OMB Circular A-110 audit. Results of the OMB Circular A-110 audit of the university are not included in this report. In addition, our examination of charges made by subrecipients of federal funds was limited to a review of the State's system for monitoring these subrecipients. Some subrecipients, such as local school districts and certain cities and counties, have OMB Circular A-128 audits performed by independent auditors.

The management of state agencies is responsible for the State's compliance with laws and regulations. In connection with the examination referred to above, we selected and tested transactions and records from each major federal assistance program and certain nonmajor federal assistance programs. The purpose of our testing of transactions and records from those federal assistance programs was to obtain reasonable assurance that the State had, in all material respects, administered major programs and executed the tested nonmajor program transactions in compliance with laws and regulations, including those pertaining to financial reports and claims for advances and reimbursements, noncompliance with which we believe could have a material effect on the allowability of program expenditures.

Our testing of transactions and records selected from major federal assistance programs disclosed instances of noncompliance with those laws and regulations. We discuss those instances of noncompliance and present recommendations to correct them on pages 63 through 277 of our report. Management's comments regarding the recommendations appear on page 335 of this report. Specific responses to the instances of noncompliance identified at each state agency are on file with the Office of the Auditor General and the Department of Finance. The instances of noncompliance identified in the State's single audit report for fiscal year 1984-85 that have not been corrected are included in this report.

In our opinion, subject to the effect of the ultimate resolution of those instances of noncompliance referred to in the preceding paragraph, for the year ended June 30, 1986, the State administered each of its major federal assistance programs in compliance, in all material respects, with laws and regulations, including those pertaining to financial reports and claims for advances and reimbursements, noncompliance with which we believe could have a material effect on the allowability of program expenditures.

The results of our testing of transactions and records selected from nonmajor federal assistance programs indicate that, for the transactions and records tested, the State complied with the laws and regulations referred to in the third paragraph of our report, except as noted on pages 63 through 277. Our testing was more limited than would be necessary to express an opinion on whether the State administered those programs in compliance in all material respects with those laws and regulations noncompliance with which we believe could have a material effect on the allowability of program expenditures. However, with respect to the transactions and records that we did not test, nothing came to our attention to indicate that the State had not complied with the laws and regulations other than those laws and regulations for which we noted violations in our testing referred to above.

We present the Schedule of Federal Assistance on page 285. The OMB Circular A-128 and the Single Audit Act of 1984 require the Schedule of Federal Assistance to present total expenditures for each federal assistance program. However, the state accounting system identifies revenue only for federal assistance programs. As a result, we present the Schedule of Federal Assistance on a revenue basis. The schedule shows the amount of federal funds and commodities received by the State for the year ended June 30, 1986; it also indicates which grants we reviewed. The information in the schedule has been subjected to the auditing procedures applied in the examination of the General Purpose Financial Statements and, in our opinion, is fairly stated in all material respects in relation to the General Purpose Financial Statements taken as a whole.

In addition to the work we performed for the OMB Circular A-128 and Single Audit Act of 1984 audit, we performed other reviews related to federal programs. A schedule of the pertinent reports issued from July 1, 1985, through December 31, 1986, begins on page 311 of this report.

OFFICE OF THE AUDITOR GENERAL

CURT DAVIS, CPA
Deputy Auditor General

February 6, 1987

SCHEDULE OF FEDERAL ASSISTANCE
FISCAL YEAR ENDED JUNE 30, 1986

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received	
Department of Agriculture:			
Plant and Animal Disease and Pest Control	10.025	328,008	
Market News	10.153	22,215	
Federal-State Marketing Improvement Program	10.156	40,381	
Inspection Grading and Standardization	10.162	31,477	
Miscellaneous Federal Funds	10.199	114,193	
Farm Labor Housing Loans and Grants	10.405	1,983,425	
Meat and Poultry Inspection	10.477	145,488	
Food Distribution	10.550	59,478,652	A
Food Stamps	10.551	98,469,293	A O
School Breakfast Program	10.553	50,685,220	A
National School Lunch Program	10.555	318,883,042	A
Special Milk Program for Children	10.556	1,209,179	
Special Supplemental Food Program for Women, Infants, and Children	10.557	129,227,674	A
Child Care Food Program	10.558	47,338,198	A

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1985-86, OMB Circular A-128 compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1985, through December 31, 1986. See Appendix B for a description of these reports.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Department of Agriculture:		
Summer Food Service Program for Children	10.559	121,754
State Administrative Expenses for Child Nutrition	10.560	5,193,981
State Administrative Matching Grants for Food Stamp Program	10.561	7,712,396
Nutrition Education and Training Program	10.564	500,169
Commodity Supplemental Food Program	10.565	1,611,495
Temporary Emergency Food Assistance (Administrative Costs)	10.568	89,334,885 A
Cooperative Forestry Assistance	10.664	989,673
Schools and Roads--Grants to States	10.665	36,085,849 A
Schools and Roads--Grants to Counties	10.666	477,783
Agriculture Statistical Reports	10.950	3,100
Other--U.S. Department of Agriculture	10.992	2,232
Other--U.S. Department of Agriculture	10.994	2,835
Other--U.S. Department of Agriculture	10.999	992,064

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1985-86, OMB Circular A-128 compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1985, through December 31, 1986. See Appendix B for a description of these reports.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Department of Commerce:		
Economic Development--Support for Planning Organizations	11.302	162,640
Economic Development--State and Local Economic Development Planning	11.305	15,866
Special Economic Development and Adjustment Assistance Program--Sudden and Severe Economic Dislocation or Long-Term Economic Deterioration	11.307	322,998
Special Economic Development and Adjustment Assistance Program--Sudden and Severe Economic Dislocation	11.311	461,491
Anadromous and Great Lakes Fisheries Conservation	11.405	978,950
Commercial Fisheries Research and Development	11.407	104,883
Coastal Zone Management Program Administration Grants	11.419	839,419
Coastal Zone Management Estuarine Sanctuaries	11.420	142,906
Energy Impact--Formula Grants	11.421	53,771
Fisheries Development and Utilization Research and Development Grants and Cooperative Agreements Program	11.427	57,938
Public Telecommunications Facilities	11.550	9,263

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1985-86, OMB Circular A-128 compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1985, through December 31, 1986. See Appendix B for a description of these reports.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Department of Commerce:		
Minority Business Development--Management and Technical Assistance	11.800	47,886
Other--U.S. Department of Commerce	11.999	634,754
Department of Defense:		
Flood Plain Management Services	12.104	2,035
Flood Control Projects	12.106	45,504
Navigation Projects	12.107	73,444
Other--U.S. Department of Defense	12.991	5,538,232
Other--U.S. Department of Defense	12.992	98,625
Other--U.S. Department of Defense	12.999	478,155
Department of Health and Human Services:		
Food and Drug Administration--Research	13.103	388,881
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	13.116	204,700
Acquired Immunodeficiency Syndrome (AIDS) Activity	13.118	843,046
Alcohol Formula Grants	13.257	(328)

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1985-86, OMB Circular A-128 compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1985, through December 31, 1986. See Appendix B for a description of these reports.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received	
Department of Health and Human Services:			
Childhood Immunization Grants	13.268	1,027,800	
Centers for Disease Control--Investigations and Technical Assistance	13.283	91,187	
National Health Service Corps Scholarship Program	13.288	52,745	
State Health Planning and Development Agencies	13.293	1,702,953	
Biomedical Research Support	13.337	5,200	
Professional Nurse Traineeships	13.358	234,894	
Cancer Control	13.399	186,396	
Higher Education Instructional Equipment	13.518	(5,389)	
Administration for Children, Youth and Families--Child Welfare Research and Demonstration	13.608	42,772	
Administration on Developmental Disabilities--Basic Support and Advocacy Grants	13.630	3,575,712	O
Special Programs for the Aging--Title III, Parts A and B--Grants for Supportive Services and Senior Centers	13.633	61,759,198	A
Child Welfare Services--State Grants	13.645	19,294,717	
Work Incentive Program	13.646	30,777,090	A

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1985-86, OMB Circular A-128 compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1985, through December 31, 1986. See Appendix B for a description of these reports.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Department of Health and Human Services:		
Administration for Children, Youth and Families--Adoption Opportunities	13.652	9,169
Foster Care--Title IV-E	13.658	(8,617,632)
Adoption Assistance	13.659	32,608
Community Services Block Grant	13.665	41,623,424 A O
Social Services Block Grant	13.667	298,840,750 A
Special Programs for the Aging--Title IV--Training, Research and Discretionary Projects and Programs	13.668	25,819
Administration for Children, Youth and Families--Child Abuse and Neglect State Grants	13.669	416,384
Child Support Enforcement	13.679	93,489,939 A
Medical Assistance Program	13.714	2,481,216,458 A O
Health Financing Research, Demonstrations and Experiments	13.766	(94)
Medicare--Hospital Insurance	13.773	2,468,131
Medicare--Supplementary Medical Insurance	13.774	6,046,213
State Medicaid Fraud Control Units	13.775	4,209,551
State Health Care Providers Survey Certification	13.777	3,360,041

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1985-86, OMB Circular A-128 compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1985, through December 31, 1986. See Appendix B for a description of these reports.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received	
Department of Health and Human Services:			
Social Security--Disability Insurance	13.802	84,023,690	A
Supplemental Security Income	13.807	5,409	0
Assistance Payments--Maintenance Assistance	13.808	1,978,175,485	A 0
Assistance Payments--Research	13.812	242,529	
Refugee and Entrant Assistance--State Administered Programs	13.814	199,025,963	A
Low-Income Home Energy Assistance	13.818	106,890,239	A 0
Arthritis, Musculoskeletal and Skin Diseases Research	13.846	88,849	
Microbiology and Infectious Diseases Research	13.856	104,987	
Medical Facilities Construction--Formula Grant	13.887	168,950	
Preventive Health Services--Sexually Transmitted Diseases Control Grants	13.977	1,095,500	
Preventive Health Services--Sexually Transmitted Diseases Research, Demonstrations, and Public Information and Education Grants	13.978	94,100	
Health Programs for Refugees	13.987	1,465,000	
Cooperative Agreements for State-Based Diabetes Control Programs	13.988	310,100	

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1985-86, OMB Circular A-128 compliance audit.

0 - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1985, through December 31, 1986. See Appendix B for a description of these reports.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Department of Health and Human Services:		
Preventive Health and Health Services Block Grant	13.991	4,920,707
Alcohol and Drug Abuse and Mental Health Services Block Grant	13.992	51,143,137 A
Maternal and Child Health Services Block Grant	13.994	24,460,833 A
Other--Department of Health and Human Services	13.999	1,273,374
Department of Housing and Urban Development:		
Lower Income Housing Assistance Program	14.156	12,722,837
Comprehensive Planning Assistance	14.203	212,662
Community Development Block Grants/State's Program	14.228	22,440,758 A
Solar Energy and Energy Conservation Bank	14.550	2,792,181
Department of the Interior:		
Irrigation Systems Rehabilitation and Betterment	15.502	100,000
Small Reclamation Projects	15.503	1,063,818
Anadromous Fish Conservation	15.600	97,861
Fish Restoration	15.605	1,939,648

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1985-86, OMB Circular A-128 compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1985, through December 31, 1986. See Appendix B for a description of these reports.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Department of the Interior:		
Wildlife Restoration	15.611	3,724,291
Endangered Species Conservation	15.612	289,171
Geologic and Mineral Resource Surveys and Mapping	15.800	3,661
National Mapping, Geography and Surveys	15.803	20,984
Historic Preservation Grants-In-Aid	15.904	703,967
Outdoor Recreation--Acquisition, Development and Planning	15.916	10,638,912
Other--U.S. Department of the Interior	15.992	31,929
Other--U.S. Department of the Interior	15.993	40,000
Other--U.S. Department of the Interior	15.999	2,718,864
Shared Revenue--Potash/Sodium Lease	15.999	37,814,995 A
Outer Continental Shelf Lands Act Amendments of 1985	15.999	338,137,989 A
Department of Justice:		
Law Enforcement Assistance--Part F--Discretionary Grants	16.531	2,430,620
Juvenile Justice and Delinquency Prevention--Allocation to States	16.540	4,243,763

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1985-86, OMB Circular A-128 compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1985, through December 31, 1986. See Appendix B for a description of these reports.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Department of Justice:		
Justice Research and Development Project Grants	16.560	93,996
Corrections--Technical Assistance	16.603	19,229
Other--U.S. Department of Justice	16.993	5,773
Other--U.S. Department of Justice	16.999	373,421
Department of Labor:		
Labor Force Statistics	17.002	3,273,736
Employment Service	17.207	73,383,787 A
Job Corps	17.211	735,753
Unemployment Insurance	17.225	238,704,627 A
Comprehensive Employment and Training Programs	17.232	603,623
Senior Community Service Employment Program	17.235	5,304,352
Employment and Training Assistance--Dislocated Workers	17.246	17,214,725 A
Job Training Partnership Act	17.250	267,412,368 A
Occupational Safety and Health	17.500	15,464,998
Mine Health and Safety Grants	17.600	122,000
Disabled Veterans Outreach Program	17.801	8,380,344

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1985-86, OMB Circular A-128 compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1985, through December 31, 1986. See Appendix B for a description of these reports.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Department of Labor:		
Local Veterans Employment Representative Program	17.804	4,701,993
Department of Transportation:		
Boating Safety Financial Assistance	20.005	798,399
Airport Planning Grant Program	20.103	160,460
Highway Planning and Construction	20.205	868,739,510 A O
Motor Carrier Safety	20.217	767,457
Grants-in-Aid for Railroad Safety--State Participation	20.303	114,013
Local Rail Service Assistance	20.308	495,324
Urban Mass Transportation Capital Improvement Grants	20.500	32,638,873 A O
Urban Mass Transportation Technical Studies Grants	20.505	615,935
Public Transportation for Nonurbanized Areas	20.509	4,315,706
State and Community Highway Safety	20.600	12,541,467
Gas Pipeline Safety	20.700	43,389
State Marine Schools	20.806	510,695
Other--U.S. Department of Transportation	20.994	507,972

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1985-86, OMB Circular A-128 compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1985, through December 31, 1986. See Appendix B for a description of these reports.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received	
Department of Transportation:			
Other--U.S. Department of Transportation	20.999	28,898	
Department of the Treasury:			
Other--U.S. Department of Treasury	21.999	16,107	
Office of Personnel Management:			
Intergovernmental Mobility of Federal, State, and Local Employees	27.011	2,708	
Equal Employment Opportunity Commission:			
Employment Discrimination--State and Local Anti-Discrimination Agency Contracts	30.002	1,558,503	O
General Services Administration:			
Donation of Federal Surplus Personal Property	39.003	6,101,660	O
National Aeronautics and Space Administration:			
Aerospace Education Services Project	43.001	57,822	

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1985-86, OMB Circular A-128 compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1985, through December 31, 1986. See Appendix B for a description of these reports.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
National Foundation on the Arts and the Humanities:		
Promotion of the Arts--Dance	45.002	79,550
Promotion of the Arts--Artists-in-Education	45.003	323,400
Promotion of the Arts--State Programs	45.007	736,609
National Science Foundation:		
Biological, Behavioral, and Social Sciences	47.051	30,100
Small Business Administration:		
Management Assistance to Small Businesses	59.005	316,025
Veterans Administration:		
Veterans State Domiciliary Care	64.014	2,001,015
Veterans State Nursing Home Care	64.015	4,695,280
Veterans State Hospital Care	64.016	184,708
Veterans Educational Assistance	64.111	264,742
Other--U.S. Veterans Administration	64.999	1,163,329
Environmental Protection Agency:		
Air Pollution Control Program Grants	66.001	1,542,507

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1985-86, OMB Circular A-128 compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1985, through December 31, 1986. See Appendix B for a description of these reports.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Environmental Protection Agency:		
Air Pollution Control--Technical Training	66.006	38,300
Air Pollution Control--National Ambient Air and Source Emission Data	66.007	91,233
Construction Grants for Wastewater Treatment Works	66.418	217,291
Water Pollution Control--State and Interstate Program Support	66.419	3,337,200
Water Pollution Control--State and Local Manpower Program Development	66.420	28,919
State Underground Water Source Protection--Program Grants	66.433	347,000
Water Pollution Control--Lake Restoration Cooperative Agreements	66.435	294,584
Construction Management Assistance Grants	66.438	7,123,047
Water Quality Management Planning	66.454	1,083,745
Solid Waste Disposal Research Grants	66.504	139,184
Safe Drinking Water Research and Demonstration Grants	66.506	1,064,765
Toxic Substances Research Grants	66.507	99,714
Pesticides Enforcement Program Grants	66.700	167,957

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1985-86, OMB Circular A-128 compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1985, through December 31, 1986. See Appendix B for a description of these reports.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received	
Environmental Protection Agency:			
Hazardous Waste Management Financial Assistance to States	66.801	4,217,067	O
Hazardous Substance Response Trust Fund	66.802	3,618,479	
Other--U.S. Environmental Protection Agency	66.998	158	
Other--U.S. Environmental Protection Agency	66.999	1,114,825	
ACTION:			
Foster Grandparent Program	72.001	1,205,244	
Senior Companion Program	72.008	1,999	
Department of Energy:			
Research and Development in Energy Conservation	81.035	210,166	
State Energy Conservation	81.041	1,359,847	
Weatherization Assistance for Low-Income Persons	81.042	2,514,555	O
Energy Extension Service	81.050	466,229	
Energy Conservation for Institutional Buildings	81.052	203,604	
Renewable Energy Research and Development	81.087	71,307	

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1985-86, OMB Circular A-128 compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1985, through December 31, 1986. See Appendix B for a description of these reports.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
United States Information Agency:		
Other--U.S. Information Agency	82.999	289
Federal Emergency Management Agency:		
Flood Insurance	83.100	153,743
Emergency Management Institute--Field Training Program	83.403	171,560
State Assistance Program	83.501	14,855
Emergency Management Assistance	83.503	4,454,737
Other State and Local Direction, Control and Warning	83.504	49,680
State Disaster Preparedness Grants	83.505	99,471
Earthquake and Hurricane Preparedness Grants	83.506	557,026
Radiological Instrumentation	83.508	405,465
Facility Survey, Engineering and Development	83.509	207,391
Radiological Protection Program	83.511	90,156
State and Local Emergency Operating Centers	83.512	142,745
State and Local Warning and Communication Systems	83.513	44,548
Population Protection Planning	83.514	661,124
Disaster Assistance	83.516	17,856,903

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1985-86, OMB Circular A-128 compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1985, through December 31, 1986. See Appendix B for a description of these reports.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received	
Federal Emergency Management Agency:			
Other--U.S. Federal Emergency Management Agency	83.999	484,289	
Department of Education:			
Adult Education--State-Administered Program	84.002	8,378,238	
Bilingual Education	84.003	1,001,029	
Civil Rights Technical Assistance and Training	84.004	929,375	
Teacher Centers	84.006	(1,321)	
Supplemental Educational Opportunity Grants	84.007	7,574,896	
Education of Handicapped Children in State Operated or Supported Schools	84.009	1,415,081	O
Educationally Deprived Children--Local Educational Agencies	84.010	343,447,748	A
Migrant Education--Basic State Formula Grant Program	84.011	75,136,978	A
Educationally Deprived Children--State Administration	84.012	3,492,893	
Neglected and Delinquent Children	84.013	2,889,248	
Handicapped Early Childhood Education	84.024	62,262	
Deaf-Blind Centers	84.025	(43,945)	

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1985-86, OMB Circular A-128 compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1985, through December 31, 1986. See Appendix B for a description of these reports.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Department of Education:		
Handicapped Preschool and School Programs	84.027	101,665,871 A
Special Education Personnel Development	84.029	644,464
Higher Education Act Insured Loans	84.032	229,625,391 A O
College Work-Study Program	84.033	9,612,393
Public Library Services	84.034	6,447,317
Interlibrary Cooperation	84.035	1,727,517
National Defense/Direct Student Loan Cancellations	84.037	932,496
National Defense/Direct Student Loans	84.038	1,372,081
Strengthening State Educational Agency Management	84.043	(47,418)
Vocational Education--Basic Grants to States	84.048	52,637,156 A
Vocational Education--Consumer and Homemaker Education	84.049	2,619,105
Vocational Education--Program Improvement and Supportive Service	84.050	6,365,202
National Vocational Education Research	84.051	433,804
Vocational Education--Special Programs for the Disadvantaged	84.052	821,027

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1985-86, OMB Circular A-128 compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1985, through December 31, 1986. See Appendix B for a description of these reports.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Department of Education:		
Vocational Education--State Councils	84.053	229,000
Higher Education--Cooperative Education	84.055	59,200
Pell Grant Program	84.063	55,256,594 B
Higher Education--Veterans' Cost of Instruction Program	84.064	42,728
Indochina Refugee Children Assistance	84.068	(325)
Grants to States for State Student Incentives	84.069	11,749,536
National Diffusion Network	84.073	(6,220)
Career Education	84.074	(1,740)
Postsecondary Education Programs for Handicapped Persons	84.078	323,428
Education for Gifted and Talented Children and Youth	84.080	(331)
Community Education	84.081	589
Indian Education--Fellowships for Indian Students	84.087	1,804
Instructional Materials and School Library Resources	84.088	179

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1985-86, OMB Circular A-128 compliance audit.

B - This grant was audited by other independent auditors. The grant amount is not included in the total grants audited amount on page 306.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1985, through December 31, 1986. See Appendix B for a description of these reports.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Department of Education:		
Improvement in Local Educational Practice	84.089	(358)
Graduate and Professional Study	84.094	28,011
Emergency School Aid Act--State Agency Grants	84.110	12,262
Rehabilitation Services--Basic Support	84.126	86,201,854 A
Rehabilitation Services--Service Projects	84.128	549,453
Rehabilitation Training	84.129	13,692
Centers for Independent Living	84.132	192,001
Migrant Education--Interstate and Intrastate Coordination Program	84.144	298,808
Transition Program for Refugee Children	84.146	4,425,116
Improving School Programs--State Block Grants	84.151	47,241,745 A
Library Services and Construction Act--Construction	84.154	1,980,078
Secretary's Initiative to Improve the Quality of Chapter 1, ECIA Projects	84.157	7,471
Handicapped--Special Studies	84.159	52,549
Emergency Immigrant Education Assistance	84.162	14,150,847

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1985-86, OMB Circular A-128 compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1985, through December 31, 1986. See Appendix B for a description of these reports.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Department of Education:		
State Grants for Strengthening the Skills of Teachers and Instruction in Mathematics, Science, Foreign Languages, and Computer Learning	84.164	9,438,546
Other--U.S. Department of Education	84.999	1,728,312
Consumer Product Safety Commission:		
Other--U.S. Consumer Product Safety Commission	87.999	3,385
Miscellaneous Grants and Contracts:		
Shared Revenue--Flood Control	98.002	312,016
U.S. Department of Labor--Operating Reserve Guard Training	98.008	12,564,299
U.S. Department of Labor--Federal Unemployment Benefits and Allowances	98.010	6,533,391
U.S. Department of Housing and Urban Development--Interest Reduction Construction	98.013	1,271,810
U.S. Department of Agriculture--Fire Suppression Cost Recovery	98.014	738,092
Prevention and Suppression Agreement	98.015	28,658
Other--U.S. Department of Treasury	98.099	405,227

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1985-86, OMB Circular A-128 compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1985, through December 31, 1986. See Appendix B for a description of these reports.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Miscellaneous Grants and Contracts:		
Miscellaneous Federal Funds	98.999	305,370
Miscellaneous Receipts	99.999	456,171
Total Grants Received		9,547,302,944
Total Grants Audited for OMB Circular A-128		9,113,373,394

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1985-86, OMB Circular A-128 compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1985, through December 31, 1986. See Appendix B for a description of these reports.

WEAKNESSES IN COMPLIANCE WITH FEDERAL REGULATIONS
DISTRIBUTION BY GRANT

Federal Catalog Number	Grantor Agency/Program Title	Administering State Agency	Page Number	Item Number: Inadequate/ Late Reports	Item Number: Inadequate Support for Expenditures	Item Number: Inadequate Monitoring/ Auditing	Item Number: Early Draw/ Disbursement of Federal Funds	Item Number: Other
Department of Agriculture								
10.550	Food Distribution Program	Department of Education	131	28	39			
10.551	Food Stamps	Department of Social Services	232	13,17,18	19		14	12
10.551	Food Stamps	State Controller	246			6		
10.553	School Breakfast Program	Department of Developmental Services	121		8			
10.553	School Breakfast Program	Department of Education	131	2	27	3,4,19,20, 22,23,24, 25,26		
	School Breakfast Program	Department of Youth Authority	275		3,4	2		
10.555	National School Lunch Program	California School for the Deaf	92		7			
10.555	National School Lunch Program	Department of Developmental Services	121		8			
10.555	National School Lunch Program	Department of Education	131	2	27	3,4,19,20, 22,23,24, 25,26		
	National School Lunch Program	Department of Youth Authority	275		3,4	2		
10.557	Special Supplemental Food Program for Women, Infants, and Children	Department of Health Services	198		8			9
10.558	Child Care Food Program	Department of Education	131	2,28	27	3,4,19,20 21,22,23		
Department of Health and Human Services								
13.646	Work Incentive Program	Department of Social Services	232	13,15	19		14	
13.646	Work Incentive Program	Employment Development Department	163					12,13
13.646	Work Incentive Program	State Controller	246			6		
13.665	Community Services Block Grant	Department of Economic Opportunity	127			2		3
13.667	Social Services Block Grant	Department of Social Services	232		19		14	12
13.667	Social Services Block Grant	State Controller	246			6		
13.679	Child Support Enforcement	Department of Social Services	232	13,15	19		14	
13.679	Child Support Enforcement	State Controller	246			6		
13.714	Medical Assistance Program	Department of Health Services	198		7	11		

Federal Catalog Number	Grantor Agency/Program Title	Administering State Agency	Page Number	Item Number: Inadequate/ Late Reports	Inadequate Support for Expenditures	Inadequate Monitoring/ Auditing	Early Draw/ Disbursement of Federal Funds	Other
Department of Health and Human Services (Continued)								
13.802	Social Security--Disability Insurance	Department of Social Services	232	15			14	12
13.802	Social Security--Disability Insurance	State Controller	246			6		
13.808	Assistance Payments--Maintenance Assistance	Department of Social Services	232	13,15	19		14	12
13.808	Assistance Payments--Maintenance Assistance	State Controller	246			6		
13.814	Refugee and Entrant Assistance--State Administered Programs	Department of Social Services	232	13,15,20	19	16	14	12
13.814	Refugee and Entrant Assistance--State Administered Programs	State Controller	246			6		
13.818	Low-Income Home Energy Assistance	Department of Economic Opportunity	127				1	3,4
13.992	Alcohol and Drug Abuse and Mental Health Services Block Grant	Department of Alcohol and Drug Programs	79			1		2
13.992	Alcohol and Drug Abuse and Mental Health Services Block Grant	Department of Mental Health	216		8	6	7	
13.994	Maternal and Child Health Services Block Grant	Department of Health Services	198			12		
Department of Housing and Urban Development								
14.228	Community Development Block Grants/State Program	Department of Housing and Community Development	207	3,4			1,2	
Department of Labor								
17.225	Unemployment Insurance	Employment Development Department	163	7				13
17.250	Job Training Partnership Act	Employment Development Department	163	7		10,11	8,9	13
Department of Transportation								
20.205	Highway Planning and Construction	Department of Transportation	257	8	9	11		
20.500	Urban Mass Transportation Capital Improvement Grants	Department of Transportation	257	12				

Federal Catalog Number	Grantor Agency/Program Title	Administering State Agency	Page Number	Item Number				
				Inadequate/ Late Reports	Inadequate Support for Expenditures	Inadequate Monitoring/ Auditing	Early Draw/ Disbursement of Federal Funds	Other
Department of Education								
84.010	Educationally Deprived Children--Local Educational Agencies	Department of Education	131	2		3,4		
84.011	Migrant Education--Basic State Formula Grant Program	Department of Education	131	2		3,4,32,33	34	
84.027	Handicapped Preschool and School Programs	Department of Education	131	2,30		3,4,31		
84.032	Higher Education Act Insured Loans	Student Aid Commission	114	7		6		
84.048	Vocational Education--Basic Grants to States	Department of Education	131	2	35	3,4,37	36	
84.126	Rehabilitation Services--Basic Support	Department of Rehabilitation	231	1				
84.151	Improving School Programs--State Block Grants	Department of Education	131	2		3,4		

SCHEDULE OF AUDIT REPORTS INVOLVING FEDERAL GRANTS JULY 1, 1985 TO DECEMBER 31, 1986

From July 1, 1985, to December 31, 1986, the Office of the Auditor General issued reports on audits involving federal grants. The following schedule lists the reports issued and presents a summary of the report findings. The agencies' responses to these findings are included in each of the separate audit reports.

Agency Receiving Federal Funds	Federal Grant	Report Title and Description
Department of Developmental Services	Administration on Developmental Disabilities--Basic Support and Advocacy Grants	A Review of Allegations of Service Disruptions for Developmentally Disabled Clients of the San Gabriel Valley Regional Center (P-573, 5-30-86)
		(1) Services to some developmentally disabled clients in the San Gabriel Valley were disrupted after the Department of Developmental Services awarded the regional center contract to a new contracting agency, Inland Counties Regional Center. The service disruptions occurred when the new contractor introduced new systems and policies.
		(2) Claims that the Inland Counties Regional Center had drastically reduced or eliminated client services or had improperly sought to limit eligibility for program participation could not be substantiated.
		(3) According to a court decision, developmentally disabled clients are not adequately represented on the Inland Counties Regional Center's board of directors by residents of the area served. The court has ordered that the regional center be turned over to a locally controlled contracting agency by July 1, 1986.
Department of Economic Opportunity	Weatherization Assistance for Low-Income Persons	Estimates of the Number of Single-Family Houses That May Need Additional Ceiling Insulation (P-534, 2-10-86)
		(1) Weatherization programs are responsible for installing energy-saving measures in at least 1.39 million single-family houses in the State. Ceiling insulation was installed in 1.15 million of these single-family houses.
		(2) There may be as many as 3.49 million single-family houses constructed before 1975 that need some ceiling insulation to bring them up to R-19 standards.

Agency Receiving Federal Funds	Federal Grant	Report Title and Description
	Community Services Block Grant and Low-Income Home Energy Assistance	Audit of the Department of Economic Opportunity (F-511, 7-10-86)
		(1) The department is responsible for developing, coordinating, and implementing the Low-Income Home Energy Assistance Program and the Community Services Block Grant in California.
		(2) The community agencies through which the department provides the services of these program grants have a variety of internal control weaknesses. Audits of the community agencies do not meet federal requirements. Therefore, the department and the federal government cannot assess if funds were spent in accordance with federal and state regulations.
State Department of Education	Donation of Federal Surplus Personal Property	State Department of Education Surplus Property-Hardware Program Financial and Compliance Audit Report, Years Ended June 30, 1983 and 1984 (F-481, 8-13-85)
		(1) The Auditor General issued a disclaimer of opinion on the financial statements of the Surplus Property-Hardware Program because of problems in auditing transactions.
		(2) The State should maintain better control of participant eligibility and inventory of federal surplus property, should ensure that federal Quarterly Donation Reports reflect accurate and consistent information to the federal government, and should maintain adequate support for the account balances of the Hardware Program.
	Various Federal Programs	A Review of the State Department of Education's Administration of Child Development Programs (P-568, 6-6-86)
		(1) The State generally ensures that child care contractors comply with funding terms and conditions of their contracts. However, the department does not always ensure that contractors comply with state standards for program quality.
		(2) State-subsidized child care is not always immediately available to children who are at risk of being abused, neglected, or exploited because the programs for these children are full.

Agency Receiving Federal Funds	Federal Grant	Report Title and Description
	Education of Handicapped Children in State Operated or Supported Schools	A Review of High School Graduation Requirements for Special Education Students in Nine School Districts (P-627, 11-13-86) (1) During fiscal year 1985-86, special education programs received approximately $1.5 billion in funding. The nine school districts in our sample complied with the Education Code in establishing proficiency standards used for granting diplomas. (2) However, the proficiency standards varied among the districts.
Department of Fair Employment and Housing	Employment Discrimination--State and Local Anti-Discrimination Agency Contracts	A Review of the Department of Fair Employment and Housing (P-636, 10-2-86) (1) The system that the department uses for accepting, processing, and resolving complaints of discrimination complies with state law and has controls to ensure impartiality. (2) The department has correctly reported its rental and salary budgets.
Department of Health Services	Hazardous Waste Programs	The Department of Health Services' Involvement in the Cleanup of Hazardous Waste Sites (P-565, 8-20-85) (1) The Department of Health Services did not adequately document its involvement in the cleanup of 125 hazardous waste sites between March 1980 and April 1985. (2) The department did not accurately report the quantities of hazardous waste cleaned up at 55 of the 125 sites.
	Medical Assistance Program	Audit of the Medi-Cal Claims Processing System (P-521, 1-23-86) (1) Medi-Cal is a $4 billion program which is funded jointly by the State and the federal government. (2) Review of the program showed no evidence of a high claims processing error rate.

Agency Receiving Federal Funds	Federal Grant	Report Title and Description
		The Department of Health Services Could Increase Its Recovery of Medi-Cal Payments by $3 Million (P-566, 12-1-86) (1) By implementing a recent federal law and improving procedures for recovering Medi-Cal payments, the Department of Health Services could increase its recovery of Medi-Cal payments by an estimated $3 million annually. (2) The State has not executed offset authority against providers who have received Medi-Cal payments for services for which Medicare should have paid. (3) The State needs to identify beneficiaries with other health coverages. Presently, the department cannot ensure that Medi-Cal pays for only those services for which there is no other coverage. Also, the department is not using available information for identifying deceased beneficiaries who may leave recoverable assets in their estates.
	Hazardous Waste Management Financial Assistance to States	The Department of Health Services Needs Better Control of Hazardous Waste Contracts (P-582.1, 3-13-86) (1) The Department of Health Services is not contracting for toxics-related services in accordance with all state and federal requirements. (2) The State has paid for questionable and unreasonable costs, has made excessive payments, and has jeopardized federal funding because the Department of Health Services has not adequately procured and managed the State's contracts for toxics-related services. The State's Hazardous Waste Management Program has Improved in Some Areas; Other Areas Continue to Need Improvement (P-582.2, 5-13-86) (1) The State has improved its performance in issuing permits to hazardous waste facilities and encumbering Superfund monies to clean up toxic waste sites. (2) The State still needs improvement in following up on violations and taking enforcement actions, collecting fines, using its manifest tracking system to track shipments of toxic waste, inspecting all facilities on a regular basis, and expending Superfund monies to clean up toxic waste sites.

Agency Receiving Federal Funds	Federal Grant	Report Title and Description
		The State's Hazardous Waste Management Program Needs To Improve Its Personnel Practices and Community Relations (P-582.4, 8-21-86)
		(1) The State has inefficient personnel practices for its hazardous waste management program. Positions are allowed to remain vacant for an average of 2.8 months.
		(2) The State does not ensure that community relations plans are developed for all hazardous waste cleanup sites.
		(3) The State does not always comply with state law concerning access to information and departmental policies involving justification of trade secrets.
Department of Social Services	Supplemental Security Income	Recommendation for a Residential Care Rate Structure (P-574, 3-5-86)
		(1) The State should use basic living costs, indirect costs of facility operation, costs mandated by legislation or licensing requirements, and a reasonable proprietary return to establish a rate structure for residential care facilities.
		(2) If the State does not annually review residential care rates, it should adjust the rate by using an appropriate economic index.
	Assistance Payments--Maintenance Assistance (Aid to Families With Dependent Children-Foster Care)	California Needs Better Control Over the Out-of-State Placement of Delinquent Minors (P-535, 6-26-86)
		(1) California counties have spent more than $15 million in Aid to Families With Dependent Children-Foster Care (AFDC-FC) funds for approximately 500 minors placed in two out-of-state facilities.
		(2) Not all California minors in out-of-state facilities are protected by the standards and regulations that protect minors placed in licensed facilities within the State.
		The Department of Social Services Does Not Use Information From Its Audits to Adjust Rates for Group Homes That Receive Funds From the Aid to Families With Dependent Children-Foster Care Program (P-540, 8-20-86)
		(1) The department has not audited all group homes that receive funds from Aid to Families With Dependent Children-Foster Care (AFDC-FC), as is required by law.

Agency Receiving Federal Funds	Federal Grant	Report Title and Description
		(2) The department has not used its audits to verify the allowable costs or adjust rates for group homes. As a result, some group homes receive payments that exceed their allowable costs.
	Assistance Payments--Maintenance Assistance and Food Stamps	The Welfare Fraud Early Detection/Prevention Programs in Orange, Sacramento, and Tulare Counties (P-638, 12-18-86)
		(1) To detect and prevent fraud at the time an individual applies for Aid to Families With Dependent Children (AFDC) or food stamp benefits, the 1983 Budget Act established the Welfare Fraud Early Detection/Prevention (FRED) program and provided funding to counties that wanted to operate a FRED program.
		(2) As directed by the 1986 Budget Act, the Auditor General audited the administration and management of the FRED programs operated by at least three counties and reviewed the FRED programs in Orange, Sacramento, and Tulare counties.
State Controller's Office	Federal Land Payments	State of California Statement of Federal Land Payments October 1, 1983 Through September 30, 1984 (F-552, 7-19-85)
		(1) From October 1, 1983, through September 30, 1984, the State of California received $100.5 million under federal payment laws.
		(2) In accordance with state law, the State transferred $26.4 million to eligible local governments, transferred $67.8 million to school districts or county school service funds, and retained $6.3 million.
Student Aid Commission	Higher Education Act Insured Loans (Guaranteed Student Loans)	California Student Aid Commission, State Guaranteed Loan Reserve Fund, Years Ended June 30, 1984 and 1985 (F-556, 11-21-85)
		(1) The amount of defaults by student loan borrowers during fiscal year 1984-85 increased 33 percent over fiscal year 1983-84.
		(2) The fund balance for the Guaranteed Student Loan Program increased by $13.1 million during the year, resulting in an ending balance of $85.4 million at June 30, 1985.

Agency Receiving Federal Funds	Federal Grant	Report Title and Description
		California Student Aid Commission, State Guaranteed Loan Reserve Fund Financial Audit Report, Years Ended June 30, 1985 and 1986 (F-628, 11-20-86)
		(1) The State Guaranteed Loan Reserve Fund is supported by federal funds, investment earnings, and insurance premiums paid by student borrowers.
		(2) For fiscal year 1985-86 loan defaults totalled \$168.2 million as compared to \$126.3 million in the prior year. The federal government purchased \$156.2 million of that amount under a reinsurance agreement; as a result, the fund had to absorb \$12.0 million of the defaults.
Department of Transportation	Highway Funds	Review of the Department of Transportation's Contract of the I-580 Interchange in Castro Valley (P-523, 7-13-85)
		(1) While it appears that the Department of Transportation complied with both state and federal regulations in the award of the I-580 contract, one of the construction subcontractors that the department certified as a Woman Business Enterprise should be decertified and made ineligible for the competitive advantage provided to women-owned firms.
		(2) The contractor should make a "good faith" effort to replace the firm with a certified Woman Business Enterprise.
	Highway Planning and Construction, Urban Mass Transportation Capital Improvement Grants, and Miscellaneous Small Grant Funds	The Department of Transportation Has Mismanaged Employee Travel and Overtime (P-629.1, 6-25-86)
		(1) The Department of Transportation has not enforced the State's or its own travel and overtime policies.
		(2) As of June 13, 1986, the department's own internal reviews and our review had revealed over \$284,000 in inappropriate travel and overtime meal claims made by the department's employees. These inappropriate claims were primarily due to the department's travel policies being inconsistent with state regulations.
University of Southern California	Graduate Training in Family Medicine, Various Federal Contracts	Review of the State Federal Grants and Contracts Awarded to the University of Southern California for the Family Practice Residency Training Program (F-622, 8-14-86)
		(1) The University of Southern California has appropriate systems of internal controls.

Agency Receiving Federal Funds	Federal Grant	Report Title and Description
		(2) In addition, the university correctly charges the state and federal grants and contracts awarded to the state family practice residency training program, and the university complies with the specific requirements of the state and federal grants and contracts.

REPORT ON COMPLIANCE WITH STATE LAWS AND REGULATIONS

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STATE OF CALIFORNIA
Office of the Auditor General
660 J STREET, SUITE 300
SACRAMENTO, CA 95814

Thomas W. Hayes
Auditor General

Members of the Joint Legislative Audit Committee
State of California

We have examined the General Purpose Financial Statements of the State of California as of and for the year ended June 30, 1986, and have issued our report thereon dated December 19, 1986. Our examination was made in accordance with generally accepted auditing standards and the standards for financial and compliance audits contained in the Standards for Audit of Governmental Organizations, Programs, Activities, and Functions, issued by the U.S. General Accounting Office, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The management of state agencies is responsible for the State's compliance with laws and regulations. In connection with our examination referred to above, we selected and tested transactions and records to determine the State's compliance with laws and regulations, noncompliance with which could have a material effect on the General Purpose Financial Statements of the State. Listed below are the state requirements that we tested in order to determine whether the State maintains adequate control in these areas:

- The budget is controlled in accordance with the directions of the legislative body;

- Agency financial records reconcile to those of the State Controller;

- Money and credit held by the State Treasurer agrees with records of the State Controller;

- Securities purchased and held by the State are limited to those authorized by Government Code Sections 16430;

- The State Treasurer held securities as collateral for bank deposits as required by Government Code Section 16500;

- Procurement of materials, supplies, equipment, and services is made in accordance with the Public Contract Code;

- Investment income of the Pooled Money Investment Account is properly allocated to state funds and to local agencies investing through the Local Agency Investment Fund;

- School and Community College apportionments are made in accordance with Education Code sections;

- Sales tax collections are distributed to local governments in accordance with laws and contracts with local governments;

- Proceeds of state gasoline taxes are used for road construction, maintenance, and other specified purposes, as required by Article XIX of the State Constitution;

- Apportionments for costs of local health programs are made in accordance with provisions of the Welfare and Institutions Code;

- Trailer coach fees are apportioned to cities and counties in accordance with Revenue and Taxation Code Section 11003.3;

- Motor vehicle license fees are apportioned to cities and counties in accordance with Section 11005 of the Revenue and Taxation Code; and

- Resource revenues are apportioned to state funds in accordance with Section 6217 of the Public Resources Code and implementing legislation.

The results of our tests indicate that for the items tested, the State of California complied with those provisions of laws and regulations, noncompliance with which could have a material effect on the General Purpose Financial Statements, except as discussed in the following paragraph. Nothing came to our attention that caused us to believe that for the items not tested the State of California was not in compliance with laws or regulations, noncompliance with which could have a material effect on the State's General Purpose Financial Statements.

Our examination revealed some instances of noncompliance with provisions of those laws and regulations which we identified as having a potentially material effect on the General Purpose Financial Statements. We discuss the instances of noncompliance on pages 63 through 277 of our report. We also present recommendations to remedy the instances of noncompliance. Management's comments regarding the recommendations appear on page 335 of this report. Specific responses to the instances of noncompliance identified at each state agency are on file with the Office of the Auditor General and the Department of Finance. None of the instances of noncompliance actually had a material effect on the General Purpose Financial Statements.

OFFICE OF THE AUDITOR GENERAL

CURT DAVIS, CPA
Deputy Auditor General

February 6, 1987

APPENDIX A

REPORTS ISSUED BY THE OFFICE OF THE AUDITOR GENERAL JULY 1, 1985 THROUGH DECEMBER 31, 1986

DATE OF ISSUE	REPORT TITLE	REPORT NO.
1985		
Jul 15	Review of the Department of Transportation's Contract for the I-580 Interchange in Castro Valley	P-523
Jul 17	California's Automated Vehicle Registration System and Its Phone-Mail Appointment System Have Temporarily Inconvenienced Some Citizens	P-527
Jul 19	State of California, Statement of Federal Land Payments, October 1, 1983 Through September 30, 1984	F-552
Jul 29	1984/85 Annual Report	A-599
Aug 13	State Department of Education Surplus Property-Hardware Program Financial and Compliance Audit Report Years Ended June 30, 1983 and 1984	F-481
Aug 14	The State of California Could Better Protect Commercial Fishing Resources	P-488
Aug 20	The Department of Health Services' Involvement In The Cleanup of Hazardous Waste Sites	P-565
Sep 10	The State Is Incurring Unnecessary Costs Through Ineffective State Vehicle Management	P-461
Sep 12	The State Could Have More Effectively Managed The Sale and Repair of Surplus Residential Property	P-494
Sep 16	Follow-up Information on the Department of Social Services' Administration of Child Abuse Prevention Programs	P-265.2
Oct 08	Status Report: The State Loan to the Alameda County Office of Education	F-570

DATE OF ISSUE	REPORT TITLE	REPORT NO.
Oct 24	The Public Utilities Commission Could Trim Additional Millions From Telephone Company Rate Increase Proposals	P-356
Oct 28	Conversion of Bound Volumes in the State Library to Microform	P-513
Nov 07	A Review of the Public Utilities Commission's Regulation of Passenger Vehicle Operations	P-562
Nov 21	California Student Aid Commission State Guaranteed Loan Reserve Fund, Financial Audit Report, Years Ended June 30, 1984 and 1985	F-556
Nov 27	The Department of Fish and Game Is Not Collecting All Revenues Owed to the State	P-546
Dec 02	Better Administration at the Department of Veterans Affairs Can Improve Services to Veterans	P-548
Dec 13	The Short-Term General Fund Loan of the Unemployment Compensation Disability Fund	P-430.1
Dec 30	The Board of Osteopathic Examiners Improperly Spent State Money To Support Its Legal Action Against Seating Two Public Members	F-561
1986		
Jan 06	Review of the Architecture Revolving Fund Projected Cash Flow for Fiscal Year 1986-87	F-563
Jan 10	Lack of Management Controls and Self-Generated Revenue Has Led to the California Exposition and State Fair's Lack of Fiscal Independence	P-490
Jan 10	The State of California Needs To Improve the Management of Its Local Fairs Program	P-490.1
Jan 13	Review of the California Museum of Science and Industry	P-554
Jan 17	Report on the Financial Condition of the Peralta Community College District	F-579
Jan 23	Audit of the Medi-Cal Claims Processing System	P-521

DATE OF ISSUE	REPORT TITLE	REPORT NO.
Feb 10	Estimates of the Number of Single-Family Houses That May Need Additional Ceiling Insulation	P-534
Feb 21	The State's Role in the Regulation of the Western Community MoneyCenter	P-525
Feb 28	Some Pro-Rata Costs Could Be More Equitably Allocated	F-542
Mar 05	Recommendation for a Residential Care Rate Structure	P-574
Mar 11	A Comprehensive Review of Management Practices at Folsom State Prison--Report Summary	P-529 Vol. 1
Mar 11	A Comprehensive Review of Management Practices at Folsom State Prison	P-529 Vol. 2
Mar 13	The Department of Health Services Needs Better Control of Hazardous Waste Contracts	P-582.1
Apr 02	State of California, Financial Report, Year Ended June 30, 1985	F-500
Apr 02	The State of California Must Place Greater Emphasis on Improving the Control of Its Financial Operations	F-580
Apr 03	A Review of Management Practices at Folsom State Prison, the Deuel Vocational Institution, and the California Institution for Men	P-529.3
Apr 03	A Report on an Audit of Security Measures at Two California Prisons	P-529.4
Apr 07	A Review of Local Emergency Medical Services Systems	P-522
Apr 08	A Review of Contracts To Collect Entrance Fees at Folsom Lake State Recreation Area	P-515.1
Apr 08	State of California, Financial and Compliance Single Audit Report, Year Ended June 30, 1985	F-581
Apr 09	The State Needs To Improve Its Control of Consultant and Service Contracts	P-504

DATE OF ISSUE	REPORT TITLE	REPORT NO.
Apr 10	A Review of the Los Angeles City Harbor Department	P-545
May 08	State of California, Statement of Security Accountability of the State Treasurer, June 30, 1985	F-532
May 12	The Department of Insurance Should Be More Responsive to Consumer Complaints Against the Insurance Industry	P-575
May 13	The State's Hazardous Waste Management Program Has Improved in Some Areas; Other Areas Continue To Need Improvement	P-582.2
May 14	Results of the Plebiscite of Members of the State Bar of California	P-605
May 29	The Oakland Unified School District May Have a General Fund Deficit by June 30, 1986	F-572
May 30	A Review of Allegations of Service Disruptions for Developmentally Disabled Clients of the San Gabriel Valley Regional Center	P-573
Jun 02	The Department of Health Services' Handling of a Request To Test the Harmans' Soil for Toxic Substances	P-582.3
Jun 05	Public Reports of Auditor General Investigations Completed Between January 1, 1985 Through March 31, 1986	I-610
Jun 06	A Review of the State Department of Education's Administration of Child Development Programs	P-568
Jun 19	The Board of Medical Quality Assurance Has Made Progress in Improving Its Diversion Program; Some Problems Remain	P-576
Jun 25	The Department of Transportation Has Mismanaged Employee Travel and Overtime	P-629.1
Jun 26	California Needs Better Control Over the Out-Of-State Placement of Delinquent Minors	P-535
Jul 10	Audit of the Department of Economic Opportunity	F-511

DATE OF ISSUE	REPORT TITLE	REPORT NO.
Jul 23	The Department of Corporations' Administration of Conversions of Health Care Service Plans to For-Profit Status	F-606
Jul 25	The State of California Should Improve Its Internal Audit Capabilities	F-499
Jul 30	State Agencies Need To Improve Their Cash Management Procedures	F-506
Aug 4	1985-86 Annual Report	A-699
Aug 14	Review of the State and Federal Grants and Contracts Awarded to the University of Southern California for the Family Practice Residency Training Program	F-622
Aug 20	The Department of Social Services Does Not Use Information From Its Audits To Adjust Rates for Group Homes That Receive Funds From the Aid to Families With Dependent Children-Foster Care Program	P-540
Aug 21	The State's Hazardous Waste Management Program Needs To Improve Its Personnel Practices and Community Relations	P-582.4
Oct 02	A Review of the Department of Fair Employment and Housing	P-636
Oct 03	Evaluation of California's Plans, Policies, and Procedures for Developing and Managing Its Information and Telecommunications Systems	P-611
Oct 30	Hastings College of the Law Needs To Improve the Management of Its Real Property	P-624
Nov 13	A Review of High School Graduation Requirements for Special Education Students in Nine School Districts	P-627
Nov 20	California Student Aid Commission, State Guaranteed Loan Reserve Fund, Financial Audit Report, Years Ended June 30, 1985 and 1986	F-628
Dec 01	The Department of Health Services Could Increase Its Recovery of Medi-Cal Payments By $3 Million	P-566

DATE OF ISSUE	REPORT TITLE	REPORT NO.
Dec 02	A Review of the Department of Corrections' Selection of a Prison Site in Los Angeles County	P-655
Dec 10	Statewide Review of Overtime and Travel Controls	P-629.2
Dec 11	The Employment Development Department Needs To Improve Its Disability Insurance Program	P-430
Dec 16	Review of the Fiscal and Administrative Management of the California State University, Long Beach Foundation, and the California State University, Long Beach	F-633
Dec 18	The Welfare Fraud Early Detection/Prevention Programs In Orange, Sacramento, and Tulare Counties	P-638

SUMMARY OF VARIANCES FROM PROFESSIONAL STANDARDS
FOR INTERNAL AUDITORS
DISTRIBUTION BY STATE AGENCY
FISCAL YEAR 1985-86

		Performance of Audit Work						Professional Proficiency	
Agency	Independence	Scope of Work	Planning	Examining and Evaluating	Communicating Results	Following Up	Management	Training	EDP Capabilities
Full-Scope Reviews									
California State University, Trustees		X		X			X	X	
Consumer Affairs, Department of		X	X	X	X	X	X	X	X
Developmental Services, Department of		X		X			X	X	X
Education, State Department of				X			X		
Employment Development Department									
Equalization, Board of				X			X	X	X
Finance, Department of						X	X		
Food and Agriculture, Department of	X	X		X	X		X	X	X
General Services, Department of	X	X		X			X		
Justice, Department of	X	X	X	X			X		
Parks and Recreation, Department of		X	X	X	X		X	X	X
Rehabilitation, Department of	X		X	X		X	X	X	

<u>Limited-Scope Reviews*</u>	
Alcohol and Drug Programs, Department of	
Boating and Waterways, Department of	X
California Highway Patrol, Department of	
California State University, Chico	
California State University, San Diego	
California Student Aid Commission	
Corrections, Department of	
Industrial Relations, Department of	
Office of Criminal Justice Planning	
Public Employees' Retirement System	
State Compensation Insurance Fund	
State Teachers' Retirement System	
Youth Authority, Department of	X

*Limited-scope reviews conducted only for the "Independence" standard.

APPENDIX C

SCHEDULE OF ACTUAL AND POTENTIAL LOSSES
FISCAL YEAR 1985-86

	Lost Interest and Discounts	Uncollectible Receivables	Potentially Uncollectible Receivables
Administrative Office of the Courts	$ 4,800		
California State University, San Francisco	271		
Developmental Services, Department of	3,700		
Education, State Department of	245,000	$4,005,000	$4,372,000
Equalization, Board of	90,000		
Health Services, Department of	20,300		
Health Services, Department of, reported in Report P-566, issued by the Auditor General in December 1986			570,000
Justice, Department of	30,000		
Motor Vehicles, Department of	469,900		
Social Services, Department of	1,212,100		
Transportation, Department of	1,800		174,000
Various agencies, reported in Report F-506, issued by the Auditor General in July 1986	475,400	188,700	
Totals	$2,553,271	$4,193,700	$5,116,000

STATE OF CALIFORNIA | GEORGE DEUKMEJIAN, *Governor*

DEPARTMENT OF FINANCE
SACRAMENTO, CA 95814-4998

Thomas W. Hayes
Auditor General
660 J Street, Suite 300
Sacramento, California 95814

Dear Mr. Hayes:

REPORT F-644--THE STATE OF CALIFORNIA SHOULD FURTHER IMPROVE CONTROLS OVER FINANCIAL OPERATIONS--FEBRUARY 1987

I appreciate the opportunity to respond to the draft copy of the subject report which was prepared in connection with your examination of the State's general purpose financial statements for the fiscal year ended June 30, 1986. The draft includes your report on the study and evaluation of internal controls and your report on the compliance with Federal grant requirements, together with your summary of audit results. We all agree that the control of the State's financial operations is important and we feel steps have been taken to adopt various improvements. The fact that the cumulative findings do not adversely affect the State's general purpose financial statements is evidence that the operation is working.

REPORT ON THE STUDY AND EVALUATION OF INTERNAL CONTROL

The report on the study and evaluation of internal control disclaims an opinion on the State's system of internal accounting controls due to the limited nature of your examination. The report discloses only one weakness in accounting for fixed assets that could have a material effect on the State's general purpose financial statements and this condition was reported previously. While we again acknowledge it exists, we must also consider the cost/benefits associated with resolving this issue on a statewide basis, and to date, we feel there are higher priorities. This condition existed prior to the 1982-83 fiscal year, the first year the single audit report of the Auditor General was issued. We note that since the acquisitions and deletions would normally be tested during each subsequent audit, it could be reasonable for the report to qualify only the fixed asset balance as of June 30, 1982. As of now, we have no beginning balance basis upon which to establish the cost of the fixed assets, and there is no relevant method to assign a market value on the fixed assets. If the beginning balance could be established, then the qualification on the fixed assets could be eliminated.

The report also discloses certain other conditions requiring the attention of management. These conditions, as reported, do not have a material effect on the State's general purpose financial statements.

When considering the total State spending plan for the 1985-86 fiscal year of $ 59.7 billion as shown in Schedule 2 of the Governor's Budget for the 1987-88 fiscal year, I am most pleased that the State has an effective system of internal control in place and operative, albeit with some needed improvements. The system of internal control is under continuous review by our Financial and Performance Accountability (FPA) Unit, which examines and issues opinion reports on the system in the various State agencies on a two-year cyclical basis. Whenever necessary, these reports present findings and recommendations to improve internal controls, including accounting for general fixed assets. In addition, the FPA Unit performs quality control reviews on the internal control examinations required by Section 20010 of the State Administrative Manual which are made by State agency internal auditors.

REPORT ON COMPLIANCE WITH FEDERAL GRANT REQUIREMENTS

The report on compliance with Federal grant requirements gives a qualified opinion, due to your scope limitations, that the State complied with the terms and conditions of its grant awards and applicable federal regulations in all material respects for the transactions tested (positive assurance) and for transactions not tested (negative assurance). It also discloses instances of noncompliance requiring the specific attention of management. We understand that while these instances of noncompliance are not material in relation to the grant awards, the ultimate resolution of the instances of noncompliance may have an effect on the overall opinion of the State's compliance effort.

The report also gives an unqualified opinion on the schedule of Federal assistance for the fiscal year ended June 30, 1986. That is, it is fairly stated in all material respects in relation to the State's general purpose financial statements taken as a whole.

When considering the total State spending plan for the 1985-86 fiscal year, which includes $ 14.3 billion of Federal funds as shown in Schedule 2 of the 1987-88 fiscal year Governor's Budget, I am again pleased that the State has complied in most material respects with the many Federal requirements, albeit with some needed improvements.

SUMMARY OF AUDIT RESULTS

Your summary of audit results classifies those matters requiring the attention of management which do not have a material effect on the State's general purpose financial statements and the matters affecting the Federal grant awards, as applicable to financial reporting, revenue collections, expenditure controls, electronic data processing controls, internal audit standards, compliance with State regulations, Federal regulations, and the eligibility for the certificate of achievement.

Your 29 management letters, applicable to the 32 detailed reviews made within the total of 335 State agencies, have been received by those State agencies. They have either replied or are in the process of replying to the management letters. These letters are being monitored by the FPA Unit and replies will be received from all the affected agencies. A follow-up review regarding corrective actions will be made as a part of the continuous review made by FPA of internal controls and fiscal procedures in various State agencies.

Financial Reporting

I also am concerned regarding the timeliness of the State's financial reports. With the exception of 5 agencies, all of the State agency financial reports were submitted to the State Controller by September 17, 1986. All agencies had submitted their year-end reports as of September 30, 1986. I feel that real progress was made this year. As to the specific reports not prepared, I am reviewing the necessity of preparation of year-end financial reports not currently required by the State Administrative Manual and will determine their need.

I will also review those entities not presently included in the year-end general purpose financial statements, and determine the appropriateness of including them as operating entities of the State of California.

In determining the value of fixed assets, if we can determine the appropriate beginning balance as of June 30, 1982, and your staff as part of their subsequent annual single audits, would confirm the value of the acquisitions to and deletions from the fixed assets base, we should be able to develop an appropriate valuation for the fixed assets. The cost/benefit aspect of resolving the fixed asset problem generally precludes the expenditure of significant time and resources to research, inventory, appraise, and assign either a historic cost or a present value to the state's fixed assets. However, the Accounting Advisory Group, which includes a representative from the Auditor General's Office, is exploring alternatives to devise a system to accomplish this task without excessive expenditures.

Agency reconciliations of accounting information are an important control feature, and I am directing the FPA Unit to place increased emphasis in this area during their reviews.

Relative to the State's implementation of Generally Accepted Accounting Principles (GAAP), the Governor's Budget for the 1987-88 fiscal year highlights the continuing major effort which is in progress (refer to Appendix 14, Governor's Budget Summary). We will continue to carryout this conversion to GAAP until it is completed. However, this will be carried out in a manner which will cause the least amount of dislocation both in our budgeting and accounting activities.

Revenue Collections and Expenditure Controls

I share with you concerns about these areas where weaknesses exist within the various State agencies. We have identified many of the problems contained in your report in our reviews of the State agencies. I am directing the FPA Unit to place continued emphasis in this area.

Electronic Data Processing Controls

I am especially concerned regarding control problems in EDP systems and precedures. Guidelines are presently being developed by my staff regarding policies and audit procedures relating to personal computers. They will be issued following final review by both the FPA Unit and my Office of Information Technology.

Internal Audit Standards

As a consequence of the July 1986 report entitled "The State of California Should Improve Its Internal Audit Capabilities," Report F-499, I authorized the creation of the California State Internal Audit Forum (CSIAF). Management Memo 86-16, issued December, 1986, described the form and functions of the CSIAF. This forum should help to correct many of the weaknesses reported in Report F-499.

We are continuing in our role of coordinator of the internal audit units within the executive branch.

Certificate of Achievement

We recognize the desirability of the Certificate of Achievement, and are endeavoring to create the appropriate atmosphere necessary for the State of California to qualify for this award. Generally Accepted Accounting Principles (GAAP) are being adopted by the State in the most practical and timely manner possible. The proper accountability of fixed assets is dependent upon the establishment of a beginning balance and the certification of acquisitions and deletions thereafter. Finally, in order that the State Controller might issue the 1985-86 fiscal year-end statements within six months after the year end, all State agency year-end statements must be submitted timely. As of September 30, 1986, all State agencies had submitted their year end statements. We are continuing to emphasize this need and am sure the State agencies will continue to show improvement.

In closing, we appreciate your efforts in reviewing and reporting upon the financial operations of our State. Where weaknesses have been reported, we will make every effort to seek and effect corrective action. We are aware that many corrections are already in place at the agencies as a result of both your audit effort and of our own internal control reviews. We will continue to make improvements to our financial system and procedures since we all wish to provide to the citizens of California the best services possible.

Very truly yours,

JESSE R. HUFF
Director of Finance

cc: Curt I. Davis, CPA, Deputy Auditor General,
Office of the Auditor General

cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps