REPORT BY THE

# AUDITOR GENERAL

OF CALIFORNIA

## A REVIEW OF THE STATE'S PROGRESS IN IMPROVING CONTROLS OVER ITS FINANCIAL OPERATIONS

F-800

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Acting Auditor General

March 2, 1989

F-800

Honorable Elihu Harris, Chairman
Members, Joint Legislative
Audit Committee
State Capitol, Room 2148
Sacramento, California 95814

Dear Mr. Chairman and Members:

The Office of the Auditor General presents "A Review of the State's Progress in Improving Controls Over Its Financial Operations." Our report discusses the results of our review of the State's control of its financial activities and its compliance with federal grant requirements and state regulations. This review was made as part of our examination of the State's general purpose financial statements. This report fully meets the requirements of the 1984 Single Audit Act set forth by the United States Government as a condition of receiving over $10.5 billion in federal funds annually.

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, and do not manage cash to maximize benefits to the State. In addition, the State continues to have numerous shortcomings in its financial reporting system that need to be resolved by the State's financial leadership. For example, the State does not prepare its budget based on generally accepted accounting principles (GAAP) and does not have an accounting system that presents the financial condition of the State based on GAAP when reporting on the past execution of its budget. Instead, various state fiscal control departments report the financial condition of the State by using various accounting practices. This use of varying accounting practices can cause the State's financial decision makers to be confused about the State's true financial condition.

Respectively submitted,

KURT R. SJOBERG
Acting Auditor General

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# SUMMARY

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## 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 continue to 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.

For fiscal year 1987-88, each of the 18 agencies at which we reviewed internal controls had weaknesses in the controls over their financial activities. Amounts that we audited at these agencies represented approximately 60 percent of the State's revenues and approximately 63 percent of the State's spending. Further, other independent auditors audited approximately 33 percent of the State's revenues and approximately 22 percent of the State's spending. In addition, for fiscal year 1986-87, we audited the financial operations of 11 other agencies and institutions. We also reviewed selected internal control procedures at 3 agencies for fiscal year 1987-88; thus, in total, we reviewed internal control procedures at 32 state agencies and institutions.

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## ACTUAL AND POTENTIAL LOSSES

The State may have lost at least $1.5 million in foregone interest and discounts because the State did not promptly collect moneys owed to it or did not promptly pay invoices. Additionally, because the State does not always follow established collection procedures, it may have difficulty collecting some of approximately $9.1 million owed to it. Further, the State may have lost approximately $314,000 in revenues and may have incurred unnecessary expenditures of approximately $183,000. These amounts do not represent all the potential or actual losses the State may have incurred as the estimates were identified in a review of a sample of transactions. Appendix A presents a schedule of actual and potential losses listed by state agency.

Many of the weaknesses in internal control that we observed did not result in losses. However, if state agencies do not correct the weaknesses and provide proper controls over their operations, the opportunity exists for the State to suffer more serious losses in the future. For example, the Franchise Tax Board did not have procedures to promptly assess taxpayers for all the dishonored checks that it receives. At the time of our audit, the board was processing a five-month backlog of dishonored checks. As a result of the backlog, as of September 30, 1988, $8.3 million of taxes had not been reassessed to the taxpayers who had submitted dishonored checks. The delay in the processing of the dishonored checks lessens the chances of the State recovering the money owed to it.

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**STATEWIDE CONCERNS**

The State continues to have numerous shortcomings in its financial reporting system that need to be resolved by the State's financial leadership. The State does not prepare its budget based on generally accepted accounting principles (GAAP) and does not have an accounting system that presents the financial condition of the State based on GAAP when reporting on the past execution of its budget. Instead, various state fiscal control departments report the financial condition of the State by using differing accounting practices. For example, the State Controller's Office, the Department of Finance, the Legislative Analyst, and the Commission on State Finance each report on the financial condition of the State using various accounting practices. This use of varying accounting practices can cause the State's financial decision makers to be confused about the State's true financial condition. In addition, the State must make numerous adjustments to its financial statements to prepare them in accordance with GAAP. GAAP is the preferred method of accounting because it is a nationally recognized set of accounting principles that allows the State to be compared with other states and because it improves accountability since, under GAAP, costs are recognized when they occur, not when they are paid for.

Further, at the present time, the State does not recognize some liabilities when reporting on the past execution of the State's budget, including the cost of Medi-Cal services provided but not yet paid for, the cost of earned vacation for certain state faculty, and the cost of all lawsuits for which future funding has been provided. Furthermore, the State recognizes as revenues tax overpayments that will have to be refunded or applied to future years, as well as tax payments under appeal.

We also noted other weaknesses. For example, the State does not yet qualify for the Certificate of Achievement for Excellence in Financial Reporting, partly because it does not produce audited financial statements within six months of the fiscal year and partly because it does not properly account for billions of dollars of fixed assets. Further, the State does not require agencies to submit certain necessary reconciliations and reports, and it does not require the District Agricultural Associations to submit financial reports to be included in the State's financial statements. Finally, the State's accounting records and reporting procedures do not fully satisfy the needs of GAAP.

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## WEAKNESSES AT STATE AGENCIES

Many of the agencies that we audited had weaknesses in internal controls over revenues, expenses, and electronic data processing activities. Additionally, agencies did not comply with state regulations that could materially affect the State's financial statements and did not comply with all federal regulations for administering federal grants. Finally, several deficiencies in internal controls were common throughout the State.

### Weak Controls Over Financial Activities

Twenty-one of the agencies that we audited had weaknesses in internal controls over revenue activities. Problems that we found included failure to bill for and collect receivables, to follow proper procedures for recognizing revenue earned, and to deposit receipts promptly. These problems resulted in receivables that may be difficult to collect, inaccurate financial statements, and loss of interest revenue. For example, we estimated that the Department of Transportation lost approximately $490,000 in interest earnings by not billing the federal government promptly for money owed to it.

Further, problems involving expenditure activities existed at 26 of the agencies that we audited. The problems that we found included insufficient control over payroll, insufficient monitoring and control over revolving fund activities, improper separation of duties, and other weaknesses in control over disbursements. Weaknesses in controls over expenditures can result in the loss of state funds.

Finally, as part of our review of financial activities, we reviewed electronic data processing activities at selected state agencies. Of the 14 agencies at which we reviewed electronic data processing activities, 6 had internal control weaknesses, including improper control over input and output and insufficient system and security documentation. Failure to control electronic data processing activities can result in inaccurate processing of data. For example, the Board of Equalization currently has no access to off-site backup equipment that it can use if a major disaster renders its electronic data processing system unusable. A major shutdown of the board's electronic data processing system could result in processing delays and in the loss of revenues to the State and to local governments.

Lack of Compliance With State Regulations

Agencies did not comply with all state regulations that could materially affect the State's financial statements and that are intended to maintain control over budgeting, collecting, disbursing, and investing state moneys. Weaknesses exist in reconciling financial records with those of the State Controller's Office, apportioning moneys to schools, distributing sales and use tax collections to local governments, and purchasing materials, equipment, and services through contracts. Although these weaknesses did not have a material effect on the financial statements, the weaknesses could result in inaccuracies in the financial statements, improper amounts being paid to schools and local governments, and the State's interests being at risk because of improper contracting.

Lack of Compliance With Federal Regulations

In fiscal year 1987-88, the State received approximately $10.5 billion in federal grants. Many state agencies are not complying with all federal regulations for administering these federal grants. Adherence to these regulations is a condition of continued federal funding. The State did not fully comply with all federal regulations in 31 of the 34 grants that we reviewed.

These 34 grants represent approximately 95 percent of all federal moneys that the State received for fiscal year 1987-88, excluding the University of California. 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.

## INTRODUCTION

As part of our examination of the general purpose financial statements of the State of California for the fiscal year ended June 30, 1988, we studied and evaluated the State's systems of internal control. The purpose of our study of these systems 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 18 of the 334 state agencies required to submit financial reports.

Amounts that we audited at these agencies represented approximately 60 percent of the State's revenues and approximately 63 percent of the State's spending. Further, other independent auditors audited approximately 33 percent of the State's revenues and approximately 22 percent of the State's spending. In addition to this audit coverage, increased coverage resulted from centralized testing, that is, selecting items for review from the State as a whole rather than from the individual agencies. For example, we selected a sample of payroll warrants that the State processed through its payroll system. Moreover, we selected a sample of all warrants, other than payroll warrants, that the State processed through its claims payments system. We also reviewed electronic data processing activities at selected state agencies that have significant data processing operations.

In addition, for fiscal year 1986-87, we audited the financial operations of 11 operating departments and institutions. We issued the audit results of these 11 operating departments and institutions after we issued the State of California Comprehensive Financial and Compliance Audit Report for the Year Ended June 30, 1987, and thus, we are including these audit results in this report. We also reviewed selected internal control procedures at 3 agencies for fiscal year 1987-88; thus, in total, we reviewed internal control procedures at 32 state agencies and institutions.

We reviewed 30 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 sufficient control over budgeting, investing, collecting, and disbursing state moneys 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 257 federal grants that the State administers. These grants represent approximately 95 percent of the federal funds that the State received in fiscal year 1987-88, excluding moneys that the University of California received. 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.

Included in this report are the following reports that the United States Office of Management and Budget's Circular A-128 requires the State to issue each year. These reports state the specific scope of our audit.

- Report on the systems of internal control used in preparing the general purpose financial statements and in administering federal assistance programs (begins on page 67);

- Report on weaknesses and instances of noncompliance at state agencies (begins on page 93);

- 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 363); and

- Report on compliance with state laws and regulations (begins on page 405).

Between July 1, 1987, and December 31, 1988, the Office of the Auditor General issued 68 audit reports, many of which discussed improvements needed in the State's operations. These reports, listed in Appendix B, are available to the public.

## CHAPTER I

## STATEWIDE CONCERNS

The State of California continues to have numerous shortcomings in its financial reporting system that need to be resolved by the State's financial leadership. The State has inconsistently reported its financial condition, partly because it does not budget, and does not report on the past execution of the State's budget using nationally recognized accounting principles. Moreover, the State does not yet qualify for the Certificate of Achievement for Excellence in Financial Reporting, in part because of its inability to produce audited financial reports within six months of the end of the fiscal year. Additionally, the State does not account for its fixed assets properly and does not have a central record of state leases that contains all the information required by generally accepted accounting principles. Further, the State does not require agencies to submit certain reconciliations and reports, its method of accounting for federal assistance does not provide sufficient information on expenditures of federal moneys for each federal program, and it does not require the District Agricultural Associations to submit financial reports to be included in the State's financial statements. Finally, the State does not provide sufficient instructions to make an efficient and reliable conversion of the financial reports from their presentation in accordance with the State's budgetary provisions (budgetary basis) to a presentation in accordance with generally accepted accounting principles (GAAP).

## Inconsistent Financial Reporting

The State does not prepare its budget based on GAAP and does not have an accounting system that presents the financial condition of the State based on GAAP when reporting on the past execution of its budget. Instead, various state fiscal control departments report the financial condition of the State by using various accounting practices. For example, the State Controller's Office, the Department of Finance, the Legislative Analyst, and the Commission on State Finance each report on the financial condition of the State using various accounting practices. This use of varying accounting practices can cause the State's financial decision makers to be confused about the State's true financial condition. In addition, the State must make numerous adjustments to its financial statements to prepare them in accordance with GAAP. GAAP is the preferred method of accounting because it is a nationally recognized set of accounting principles that allows the State to be compared with other states and because it improves accountability since, under GAAP, costs are recognized when they occur.

Further, at the present time, the State does not account for expenses and revenues in accordance with GAAP when reporting on the past execution of its budget. The State does not recognize some expenses including the cost of Medi-Cal services provided but not yet paid for, cost of earned vacation for certain state faculty, and the cost of all lawsuits for which future funding has been provided. Also, the State has historically recognized some events as expenses even though no cost has been incurred. For example, the State reports loans from the State's General Fund to other funds as expenses rather than recognizing that the cash was lent to another fund but will be returned to the General Fund. Additionally, the State has historically reported as expenses certain orders to acquire goods and services even though the State could still cancel the order after June 30 and even though the goods or services did not benefit the State during the fiscal year because the goods or services would not arrive until the next fiscal year. In the Governor's Budget 1989-90, the governor proposed changing the method of reporting outstanding purchase orders and contracts to more closely conform to GAAP. Also, the State recognizes as revenue tax overpayments that will have to be refunded or applied to future years, as well as tax payments under appeal.

The following schedule displays the adjustments that were needed to present the fund balance of the State's General Fund (as reported by the State Controller's Office) in accordance with GAAP (in thousands).

| | |
|---|---|
| Total Fund Equity (Deficit) per the State Controller's Office | $ (82,859) |
| Medi-Cal services provided but not paid for | (549,676) |
| Earned vacation leave not paid for | (80,729) |
| Lawsuits for which future funding has been provided | (45,252) |
| Loans that will be repaid | 211,528 |
| Goods and services not received by June 30 | 383,736 |
| Tax overpayments | (206,931) |
| Tax payments under appeal | (219,619) |
| Total Fund Equity (Deficit) per audited GAAP report | $(589,802) |

Eligibility for Certificate of Achievement

The State does not yet qualify for the Certificate of Achievement for Excellence in Financial Reporting. The Certificate of Achievement Program of the Government Finance Officers Association exists to encourage and recognize excellence in financial reporting by governments. The State does not qualify for the certificate partly because it does not produce audited financial statements within six months of the fiscal year and partly because it does not properly account for fixed assets.

Problems With the State's Financial Reporting System

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. This requirement was established in 1980.

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

To address this concern, the Office of the Auditor General contracted with a consulting firm, Price Waterhouse, to evaluate the State's financial reporting system. The Office of the Auditor General issued Price Waterhouse's report entitled, "An Evaluation of the Financial Reporting System of the State of California," Report F-626 in May 1987. To provide a basis for its conclusions, Price Waterhouse surveyed over 75 persons in operating and control agencies and reviewed 16 representative state agencies, the State Controller's Office, and the Department of Finance. Price Waterhouse identified shortcomings throughout the State's financial reporting system and made corresponding recommendations. Among other suggestions, Price Waterhouse recommended that the State require state agencies to prepare monthly reconciliations within 30 days of the end of the month so that agencies could promptly complete their financial reports at the end of the fiscal year. Additionally, Price Waterhouse recommended that the State improve its training of employees assigned financial reporting responsibilities and suggested improvements in the project management process used by the State Controller's Office in producing the annual report.

In response to Price Waterhouse's recommendations, the committee responsible for improving the State's reporting system has initiated a pilot project to make financial reporting more accurate and prompt. The project involves the development of automated reconciliations of agency records with records of the State Controller's Office, a proposed reduction in the number of reports required from agencies, and a preliminary plan for the electronic reporting of year-end financial data to the State Controller's Office.

## Insufficient 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 sufficient 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's Office to present the general fixed assets account group in the State's general purpose financial statements, thus making the State ineligible for the Certificate of Achievement for Excellence in Financial Reporting.

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

In an attempt to resolve this ongoing problem, the State created a Fixed Asset Task Force, which includes representatives from various state agencies. The objective of the Fixed Asset Task Force is to provide recommendations that will allow the State, with minimal cost, to report general fixed assets in accordance with the law and generally accepted accounting principles. Further, legislation enacted in 1986 created Section 11011.15 of the California Government Code, which requires the Department of General Services to develop a complete and accurate statewide inventory of real property held by the State by January 1, 1989. The Department of General Services is also required to include a description of each major structure on the property in the statewide inventory. Although not required by the California Government Code, the Department of General Services also plans to include information on the cost of the real property and structures. Thus, the State would have a central listing of land and buildings that could be reconciled with state agency records and used as a source of information for the State's general purpose financial statements. As land and buildings comprise a major portion of the State's general fixed assets, this statewide inventory should contribute significantly to resolving the State's problems in reporting general fixed assets. Included in the budget act for fiscal year 1988-89 was funding to develop the statewide inventory of real property. However, the Department of General Services now estimates that the statewide inventory of real property will be completed by January 1990.

Insufficient Reporting
<u>of Leasing Information</u>

As we reported in fiscal year 1986-87, the State continues to spend unnecessary additional time and effort to prepare the financial statement disclosures required by GAAP for the State's lease commitments because the State does not have a central record of lease commitments that contains all the necessary information. The State's lease commitments totaled $3.1 billion in fiscal year 1987-88. GAAP requires the State, when it leases space or equipment from outside vendors, to disclose commitments for future minimum lease and rental payments in a summary that separates these future payments by fiscal year. Although the Department of General Services maintains space and equipment lease records for many lease commitments, it established these records for its internal management purposes and did not intend the records to be a complete listing of the State's leases that would meet GAAP requirements. Thus, the records do not provide all the necessary information.

For example, the records maintained by the Department of General Services disclose only the current year payment for each lease and do not indicate how the payment will change in future years. In addition, the records do not separate future minimum lease and rental payments by fiscal year. Further, the records do not include information on certain leases for which the Department of General Services does not have oversight responsibility. For example, because the Department of General Services is not required to approve the California State Lottery Commission's leases, the department's records do not include over $66 million in commitments that the California State Lottery Commission has entered into for its leasing of gaming terminals, data processing equipment, and space.

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

Failure To Require Agencies
To Submit Reconciliations
to the State Controller's Office

The State Administrative Manual, Section 7951, does not require agencies to prepare Report 15, Reconciliation of Agency Accounts With Transactions Per State Controller, for approximately 220 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 with records of the State Controller's Office. We reported a similar weakness in our audit for fiscal years 1986-87 and 1985-86.

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 processed properly and that the financial records are complete. The reconciliation with the records of the State Controller's Office is an important step in ensuring the accuracy of the agencies' financial statements.

Failure To Require Agencies
To Prepare a Report of Accruals

The State Administrative Manual, Section 7951, also does not require agencies to prepare Report 1, Report of Accruals to the Controller's Accounts, for funds numbered 500 to 699 and 800 to 999. Included among these funds are over 65 that had budget appropriations for fiscal year 1987-88. As a result of not preparing the report, 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. We reported a similar weakness in our audit for fiscal years 1986-87 and 1985-86.

The California Government Code, Section 12460, requires the State to present its financial position as closely as possible in accordance with GAAP. State agencies submit financial reports to the State Controller's Office, which then issues the financial report presenting the State's financial position. 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 the agencies' financial position and results of operations in accordance with GAAP.

Failure To Require Accounting
for Expenditures of Federal
Moneys by Each Federal Program

The State's method of accounting for federal assistance does not provide sufficient information on expenditures of federal moneys for each federal program. We reported a similar weakness in the last two fiscal years. 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 United States Office of Management and Budget Circular A-128. The schedule of federal assistance that we present, beginning on page 369, shows total receipts rather than expenditures.

The United States Office of Management and Budget Circular A-128 requires the State to submit an audit report on a schedule of federal assistance that shows 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 ensure that all revenues, expenditures, receipts, disbursements, resources, obligations, and property of the State are properly accounted for and reported.

## Improper Omissions From the State Reporting Process

District Agricultural Associations, which are organized to hold fairs and expositions, are not currently treated as part of the state reporting entity. Recently, to determine whether the District Agricultural Associations should be treated as part of the state reporting entity, we requested a legal opinion from the Legislative Counsel. The Legislative Counsel found that the District Agricultural Associations are state agencies and that moneys that they spend are state funds. Further, funds for support of the District Agricultural Associations are appropriated in the State's annual budget. For these reasons, the Legislative Counsel concluded that the State Controller's Office is required to include the financial information of the District Agricultural Associations in the State's general purpose financial statements. Currently, the District Agricultural Associations do not submit their financial reports to the State. As a result, the State's general purpose financial statements are incomplete.

Problems With the
State's Conversion to GAAP

The State Controller's Office issues the Annual Report of the State of California in conformance with the State's budgetary basis of accounting and issues the general purpose financial statements in conformance with GAAP. However, the Department of Finance has not provided sufficient instructions in the State Administrative Manual to make the conversion from the budgetary basis to the GAAP basis efficient and reliable. As a result, the financial information that agencies provide to the State Controller's Office is frequently insufficient.

In addition, some of the financial information required under the GAAP basis of accounting is more extensive than the information provided by the budgetary 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 budgetary basis to the GAAP basis in certain areas. The Department of Finance is currently rewriting the sections of the State Administrative Manual covering proprietary funds to bring them into conformance with GAAP. Further, the State's "Fund Manual" has been rewritten to bring it in conformance with GAAP. In addition, in the Governor's Budget 1989-90, the Department of Finance treated the State's General Fund encumbrances as a reservation of fund balance rather than expenditures. This treatment is consistent with GAAP in that encumbrances are obligations for which goods and services have not been received and should not be shown as expenditures. This could be considered one more step towards California's implementation of GAAP. 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 with those of other governmental entities and, therefore, acceptable to the investment community.

## CHAPTER II

## AUDIT HIGHLIGHTS BY AREA OF GOVERNMENT

The State of California continues to face unnecessary costs and reduced effectiveness of its operations because of weaknesses in its systems of internal control. Although the State has corrected some of the problems that we observed in previous years, the State can still significantly improve its accounting and administrative control systems.

Table 1, which begins on page 20, shows the distribution by state agency of weaknesses in control over financial activities. (The table does not include weaknesses in compliance with federal and state regulations. The table for federal compliance begins on page 387, and the table for state compliance begins on page 411.) The page number shown on the table provides the location of our management letter for the indicated state agency. The item number provides the location in the management letter of the discussion of the weakness identified.

Beginning on page 22, we present a summary of the most significant findings for each of the state agencies, which are organized by area of government. At the beginning of each area of government, we present additional information regarding audit work performed. Further, within each of these areas, we present those state agencies with the most significant findings first.

TABLE 1

WEAKNESSES IN INTERNAL CONTROL SYSTEMS

| Agency | Page Number | Item Number*: Financial Reporting Activities | Revenue Activities | Expenditure Activities | Electronic Data Processing Activities |
|---|---|---|---|---|---|
| BUSINESS, TRANSPORTATION AND HOUSING | | | | | |
| Alcoholic Beverage Control, Department of** | 97 | 1 | 1,2,3 | | |
| Corporations, Department of ** | 104 | | 1 | 2,3 | |
| Housing and Community Development, Department of | 107 | 4,6 | 5 | 3,5 | |
| Motor Vehicles, Department of | 112 | | 2 | 1 | |
| Real Estate, Department of** | 116 | | 1,2 | 3 | |
| Transportation, Department of | 119 | 4 | 3 | 5,6 | |
| EDUCATION | | | | | |
| California Community Colleges, Chancellor's Office | 129 | 5,11,12 | 13,14 | 3,4,6 | 7,8,9,10 |
| California State University | 142 | 1 | | 1,2,3,4 | |
| California Student Aid Commission** | 146 | 2 | 3 | | 1 |
| Education, State Department of | 156 | 6 | 1,5 | 5,7 | 9,10 |
| GENERAL GOVERNMENT | | | | | |
| Economic Opportunity, Department of | 183 | 3 | | | |
| HEALTH AND WELFARE | | | | | |
| Developmental Services, Department of | 210 | | | 1 | |
| Employment Development Department | 211 | 2 | 1 | | 1 |
| Health Services, Department of | 218 | 4,7 | 1,2,7,10 | 5,8,9,10 | |
| Mental Health, Department of | 234 | 4 | | 1,2,3 | |
| Atascadero State Hospital** | 238 | 1 | | 1 | |
| Social Services, Department of | 242 | 1,12 | 2,14 | 2,3,4,5,9,18 | |

* The item number identifies the location in the state agency's management letter (beginning on page 93) where the weakness is discussed.

** We audited the fiscal year 1986-87 financial operations of these agencies; however, we issued the audit results after we issued the State of California Comprehensive Financial and Compliance Audit Report, Year Ended June 30, 1987.

| Agency | Page Number | Item Number* Financial Reporting Activities | Revenue Activities | Expenditure Activities | Electronic Data Processing Activities |
|---|---|---|---|---|---|
| LEGISLATIVE, JUDICIAL, AND EXECUTIVE | | | | | |
| Equalization, Board of | 265 | 4,5 | | 6 | 1 |
| State Controller's Office | 273 | 4 | | 1 | |
| State Treasurer's Office | 280 | 1 | | | |
| RESOURCES | | | | | |
| Boating and Waterways, Department of** | 285 | 3,1 | 2,1 | 1 | |
| Water Resources, Department of | 289 | 1,2,3 | | 1,4 | |
| STATE AND CONSUMER SERVICES | | | | | |
| Fire Marshal, Office of the State** | 297 | | 1 | 2,4 | |
| Franchise Tax Board | 300 | | 1,2,3,4,5 | | |
| General Services, Department of | 304 | 2,3,4,6 7,8,10,11 | | 1,4,8,9 | 5 |
| YOUTH AND ADULT CORRECTIONAL | | | | | |
| Corrections, Board of | 325 | | 1 | 1 | |
| Corrections, Department of | 326 | 2 | 2 | 1,3 | |
| California Institution for Men** | 331 | | 2,3 | 1,4,5,6,7 | |
| California Men's Colony** | 336 | 4 | 1 | 1,2,3,5 | |
| Youth Authority, Department of the | 341 | 3 | | 1,2,6 | |
| Southern Reception Center-Clinic** | 351 | 3 | 2 | 1,2,6 | |
| Youth Training School** | 357 | 2 | 5 | 1,3,4,5 | |

* The item number identifies the location in the state agency's management letter (beginning on page 93) where the weakness is discussed.

** We audited the fiscal year 1986-87 financial operations of these agencies; however, we issued the audit results after we issued the State of California Comprehensive Financial and Compliance Audit Report, Year Ended June 30, 1987.

## BUSINESS, TRANSPORTATION AND HOUSING

In fiscal year 1987-88, the State spent over $3.7 billion, approximately 6 percent of the State's expenditures on programs in the Business, Transportation and Housing Agency. The agency oversees the operations of 18 departments and other budgeted activities. Our financial and compliance audit focused on the 6 departments listed below. Also, we have issued 13 special topic reports that include issues relating to Business, Transportation and Housing programs since July 1987. These special topic reports required our office to review the selected operations of 3 additional departments: the Department of Commerce, the Department of Savings and Loan, and the State Banking Department. Appendix B provides a listing of the reports that the Office of the Auditor General issued from July 1, 1987, through December 31, 1988.

We reported 23 weaknesses for 6 departments within the Business, Transportation and Housing Agency. In the following section, we discuss the most significant weaknesses that we reported for the 6 departments.

### Department of Transportation

We reported six weaknesses in internal control and in the administration of federal programs at the Department of

Transportation. The following are three of the most significant weaknesses that we noted:

- The department still did not promptly adjust the rates for its service centers, thus, undercharging the federal government for the federal share of the service center costs. Through service centers, the department can perform specific services that benefit individual projects and the department. After developing the rates for its materials and electronic data processing service centers in fiscal year 1982-83, the department did not update the rates for its materials service center until November 1987 and for its electronic data processing service center until July 1988. In addition, it updated rates for its equipment rental service center in February 1988 although it had not previously updated the rates since December 1985. As a result, the department estimated that it undercharged the federal government approximately $6 million for the federal share of the service center costs. The department expects to recover these undercharges over the next year. However, we estimate that the State will have lost approximately $736,000 in potential interest earnings by the date the department recovers the undercharges;

- The department did not promptly submit final claims to the Federal Highway Administration to close completed construction and local assistance projects. While the department has made considerable progress in reducing the number of unclosed completed projects, it still did not promptly submit final claims to close completed federal aid projects. As of June 30, 1988, the department had a backlog of more than 1,000 federal aid projects that had been completed for over two years but were not yet closed. As a result, the department could not reallocate approximately $8.2 million to other projects; and

- The department did not always ensure that it promptly billed the federal government for the federal government's share of project costs. During our review of district offices, we found three instances, totaling approximately $2.4 million, in which the district offices did not bill the federal government promptly. We estimated that the department lost approximately $490,000 in interest earnings by not billing the federal government promptly.

Department of Motor Vehicles

We reported two weaknesses in internal control at the Department of Motor Vehicles. The most significant weakness that we noted was that the department continued to have insufficient control over and accountability for its revolving fund. Four deficiencies existed in the department's use of the revolving fund. One deficiency was that the department did not promptly clear outstanding employee advances and vendor payments made from the revolving fund. For example, the department had a total of approximately $486,000 in outstanding travel advances. We examined travel advances totaling approximately $122,000; $68,000, or 56 percent, had been outstanding for more than 60 days at June 30, 1988. Failure to establish an effective system of internal accounting controls and failure to ensure that the controls are in place and functioning as prescribed could result in undetected errors or irregularities.

## Department of Housing and Community Development

We reported six weaknesses in internal control and in the administration of federal programs at the Department of Housing and Community Development. The most significant weakness that we noted was that the department still did not comply with all reporting requirements of the federal Community Development Block Grant. For example, in our review of 11 grantees of the Community Development Block Grant, 9 grantees were between 3 and 205 days late in submitting their quarterly financial reports. The department's noncompliance with the grant requirements may affect the State's receipt of federal funds.

## Department of Alcoholic Beverage Control

We reported three weaknesses in internal control at the Department of Alcoholic Beverage Control. The most significant weakness that we noted was that the department had deficiencies in its accountability for and control over its uncleared collections account. Uncleared collections is a temporary account used for recording collections when an agency has not yet determined to what account a receipt should be charged. The department had not reconciled its detailed list of uncleared collections in the Alcohol Beverage Control Fund to the general ledger account balance at June 30, 1987. In addition, by July 31, 1987, the department had not cleared at least $2.2 million of the account balance as of June 30, 1987. As a result of not performing the reconciliation, the department may not detect and correct errors in its records, and it may not detect irregularities promptly. The uncleared collections account contains amounts to be refunded or to be remitted to the State's General Fund. If the department does not promptly clear its uncleared collections account, people who are owed money may not receive their money promptly, if at all, or the money that has not been remitted to the General Fund will not be available for expenditure.

Department of Corporations

We reported three weaknesses in internal control at the Department of Corporations. The most significant weakness that we noted was that the department did not follow its written procedures for collecting receivables. We tested 29 invoices totaling approximately $205,000 that were over 30 days old. For 21 of those invoices, the department had no record of a follow-up procedure. Because the department failed to follow its written collection procedures, it diminished the control over its receivables and, thus, increased the risk that some receivables will become uncollectible.

Department of Real Estate

We reported three weaknesses in internal control at the Department of Real Estate. The most significant weakness that we noted was that the department did not promptly endorse or deposit checks received in the mail. The department did not endorse the 50 checks that we reviewed until an average of 2.3 working days after receipt, and it did not deposit these moneys until an average of 3.3 business days after receipt. When checks are not promptly endorsed, theft or loss may occur. In addition, we estimated that these late deposits resulted in a loss to the State of approximately $22,200 in interest earnings during fiscal year 1986-87.

EDUCATION

In fiscal year 1987-88, the State spent over $30.7 billion, approximately 46 percent of the State's expenditures, on education programs. This area of government consists of 16 departments and other budgeted activities. Our financial and compliance audit focused on the 4 departments listed below. Also, we have issued 16 special topic reports that include issues relating to education programs since July 1987. These special topic reports required our office to review the selected operations of 6 additional entities: the California Maritime Academy and five California campuses: University of California at Berkeley, University of California at Irvine, University of California at Los Angeles, University of California at San Francisco, and California State University, Bakersfield. Appendix B provides a listing of the reports that the Office of the Auditor General issued from July 1, 1987, through December 31, 1988.

We reported 53 weaknesses for 4 departments within the area of education. In the following section, we discuss the most significant weaknesses that we reported for the 4 departments.

State Department of Education

We reported 23 weaknesses in internal control and in the administration of federal programs at the State Department of Education. The following are some of the most significant weaknesses that we noted:

- The department still does not have a clearly defined system for monitoring and collecting delinquent accounts receivable. Various program units, as well as the accounting unit, perform some procedures related to accounts receivable and have developed their own policies, which differ from each other. In addition, these units do not apply their own policies consistently. For example, one program unit does not always follow its policy to immediately offset delinquent receivables with current disbursements. Because the department lacks a consistent policy and clear division of responsibilities among these units, inefficiencies and inconsistencies result;

- The department did not comply with provisions of the California Education Code when calculating one of the 12 school apportionments that we tested. In addition, the department did not provide sufficient documentation for the calculation of one apportionment, and it did not adequately monitor allocations in another apportionment that we tested. For example, the department did not monitor apportionments to participants in the Elementary Awareness Program. In the department's certification of acceptance of grant conditions, the department outlines the funding policies and reporting requirements for sponsors participating in the program. The certification of acceptance states that sponsors must submit budget expenditure reports and progress reports each quarter to receive funds the following quarter. For the three quarters that we reviewed in which reports were due, October 1987 through June 1988, 19 of the 36 reports required from the six sponsors were not submitted, were submitted late, or could not be located by the department. The department's failure to monitor the receipt of budget expenditure reports and progress reports may result in sponsors receiving funds in excess of actual expenditures or for inappropriate expenditures; and

- The department continues to make certain charges to federal grants based on undocumented or poorly documented estimates. For example, the department charged approximately $521,900 to the Improving School Programs block grant for administrative costs associated with two instructional support programs. The department based these costs on percentages that were used in past years. No other documentation was available to justify these percentages. In another instance, the department charged approximately $18,000 to the Vocational Education basic grant and approximately $54,100 to the Vocational

Education for Consumers and Homemaking grant for costs of administering Vocational Education programs. The department provided workload documentation that did not fully support the distribution of the charges between the two grants.

California Community Colleges, Chancellor's Office

We reported 14 weaknesses in internal control and in the administration of federal programs at the California Community Colleges, Chancellor's Office. In addition, during the audit, we were made aware of an alleged embezzlement of state funds. We are currently conducting a complete audit of the situation, and we plan to report the results of the audit in a separate report. The following are 3 of the most significant weaknesses that we noted:

- The Chancellor's Office continued to not always properly control the system for managing its federal vocational education funds. For instance, the Chancellor's Office did not limit the cash advances of its federal vocational education funds for fiscal year 1987-88 to the immediate needs of the college districts. As of December 17, 1987, the Chancellor's Office had already advanced to the college districts 90 percent, approximately $25.5 million of their 1987-88 entitlement, although the college districts had completed only 50 percent of their academic year. Because the

Chancellor's Office did not limit the cash advances to the college districts' immediate needs, the federal government lost potential interest earnings;

- The Chancellor's Office submitted its financial status report for fiscal year 1985-86 for the Vocational Education program in December 1988, nearly a year after the due date of December 31, 1987. In addition, we reviewed the financial status report before it was submitted to the State Department of Education and found that it contained various inaccuracies. For example, the Chancellor's Office did not include approximately $443,000 in expenditures and included an incorrect amount for administrative costs; and

- The Chancellor's Office lacks control over disbursements. In our review of 50 claims transactions, we found a total of 12 transactions lacking evidence that the Chancellor's Office had received the billed goods or services before paying for them. As a result, the Chancellor's Office may have paid for goods or services that it had not received.

California State University

We reported four weaknesses in internal control at the California State University. The following are two of the most significant weaknesses that we noted:

- California State University, Fullerton, did not submit accurate financial reports to the State Controller's Office. As a result, the State Controller's Office is not sure of the accuracy of the data that it uses to prepare financial statements for the State. One of the four deficiencies that we noted was that California State University, Fullerton, did not accurately prepare its Report of Accruals to the Controller's Accounts. Specifically, the total encumbrances reported by California State University, Fullerton, in its report of accruals were understated by $79,585, and its recorded expenditures were understated by $79,585. In addition, its accrual worksheet exceeded the amount shown in its report of accruals by $256,224; and

- California State University, Fullerton, did not follow state procedures that require warrants drawn for more than $15,000 to have two authorized signatures. We reviewed 30 warrant disbursements in fiscal year 1987-88 and found that 21 warrants issued in excess of $15,000 contained only one signature. The lack of signature control over warrants could result in the loss of state funds through improper payment.

California Student Aid Commission

We reported 12 weaknesses in internal control, in the administration of federal programs, and in our review of the internal audit unit at the California Student Aid Commission. Four weaknesses related to our audit for fiscal year 1986-87, 4 weaknesses related to our audit for fiscal year 1987-88, and the remaining 4 weaknesses related to our review of the internal audit unit. One of the weaknesses reported for fiscal year 1987-88 was an update of a weakness reported for fiscal year 1986-87. The most significant weakness of the 12 that we noted was that the commission did not promptly report to the federal government the federal government's share of collections from defaulted student loans. Specifically, during fiscal year 1987-88, the commission did not report to the federal government within the required 60 days at least $1.3 million of approximately $26.0 million in total collections. Noncompliance with the federal regulations could cause the federal government to take action against the commission's administration of the federal Higher Education Act Insured Loans program.

GENERAL GOVERNMENT

In fiscal year 1987-88, the State spent over $2.9 billion, approximately 4 percent of the State's expenditures, on general government. This area of government consists of 51 departments and other budgeted activities. Our financial and compliance audit included the department listed below. Also, we have issued 11 special topic reports that include issues relating to general government since July 1987. These special topic reports required our office to review the selected operations of 6 additional departments, 2 commissions, and one council: the Agricultural Labor Relations Board, the Board of Control, the California Horse Racing Board, the Office of Criminal Justice Planning, the Department of Food and Agriculture, the Department of Industrial Relations, the Native American Heritage Commission, the Public Utilities Commission, and the California Arts Council. Appendix B provides a listing of the reports that the Office of the Auditor General issued from July 1, 1987, through December 31, 1988.

We reported three weaknesses for the one department that we audited within the area of general government. In the following section, we discuss the most significant weakness that we reported for the one department.

Department of Economic Opportunity

We reported three weaknesses in the administration of federal programs at the Department of Economic Opportunity. One weakness was that the department did not follow its procedures for promptly conducting fair hearings requested by applicants who were denied assistance under the Home Energy Assistance Program, a component of the Low-Income Home Energy Assistance Program block grant. Our review of the department's records indicated that 179 of 190 cases filed between May 1988 and September 1988 did not receive a hearing within the required 90 days. For example, in 2 cases, the department did not conduct the hearings until 144 and 175 days after the department received the hearing request. In another 3 cases, the department has yet to conduct a hearing. As a result of the delays, some appellants may have difficulty paying their heating bills.

## HEALTH AND WELFARE

In fiscal year 1987-88, the State spent over $21.8 billion, approximately 33 percent of the State's expenditures, on programs in the Health and Welfare Agency. The agency oversees the operations of 17 departments and other budgeted activities. Our financial and compliance audit focused on the eight departments and one institution listed below. Also, we have issued 23 special topic reports that include issues relating to Health and Welfare Agency programs since July 1987. These special topic reports required our office to review the selected operations of an additional department, that is, the Office of Statewide Health Planning and Development. Appendix B provides a listing of the reports that the Office of the Auditor General issued from July 1, 1987, through December 31, 1988.

We reported 54 weaknesses for eight departments and one institution within the Health and Welfare Agency. In the following section, we discuss the most significant weaknesses that we reported for the eight departments and one institution.

### Employment Development Department

We reported five weaknesses in internal control and in the administration of federal programs at the Employment Development Department. The following are two of the most significant weaknesses that we noted:

- The department continued to have weaknesses in its control over employer tax accounts. Specifically, the department did not properly control employer tax accounts to ensure that all accounts were accurate and up-to-date. For example, we reviewed the accounts of 66 employers to whom the department owed tax refunds as of June 30, 1988. We found that 14 of the 66 accounts were inaccurate or contained amounts that the department did not know that it owed to the employers. The department's failure to sufficiently control these specific accounts caused the department to understate the revenues in its accounting records by approximately $1.7 million. In addition, the department unknowingly withheld for as long as two years approximately $834,000 in refunds owed to employers. The department's delay in issuing refunds may cause some employers unnecessary hardship.

  Further, the department could not reconcile its automated Tax Accounting System to its accounting records without making unsupported adjustments to its accounting records. The department made these adjustments to eliminate unidentified reconciling differences between the Tax Accounting System and the department's accounting records as of June 30, 1988. Specifically, the department increased total tax revenues by approximately $32.8 million. In addition, the department increased total refunds owed to employers by approximately $14.8 million and decreased total taxes owed by employers by approximately $16.2 million. Without these adjustments, the department could not reconcile the Tax Accounting System with its accounting records. The failure to properly control all tax accounts and to support all accounting adjustments reduces the department's ability to detect and prevent errors in the employer tax accounts and in the department's accounting records; and

- The department did not resolve questioned costs in 23 of 62 audit reports for subrecipients of the Job Training Partnership Act program within 180 days of the date of the report's issuance. 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.

Department of Health Services

We reported 16 weaknesses in internal control and in the administration of federal programs at the Department of Health Services. The following are 3 of the most significant weaknesses that we noted:

- The department did not analyze approximately $1.7 million in collections from third party health insurers. Specifically, at June 30, 1988, the department had not yet analyzed approximately $745,000 that it had collected from health insurers more than 12 months earlier. Further, at June 30, 1987, the department cleared from its uncleared collections listing approximately $1 million of collections from health insurers without determining if it should distribute any of the collections to Medi-Cal providers or health insurance policyholders. When the department does not promptly analyze collections from health insurers, it may improperly retain collections that it should distribute to Medi-Cal providers or health insurance policyholders. In addition, the department is unable to maintain accurate records of amounts due from health insurers;

- The department did not accurately estimate the receivables owed to the Health Care Deposit Fund at June 30, 1988, that it expected to collect in fiscal year 1988-89. The department estimated these receivables to be approximately $219 million at June 30, 1988. Our estimate of the receivables that the department would collect in the ensuing 12 months was approximately $81 million, $138 million less than the $219 million that the department estimated. The department overestimated the receivables because it has not developed a system that would enable it to properly estimate receivables; and

- The department still has not fully implemented a cost avoidance system to avoid paying Medi-Cal claims for beneficiaries who have other health-care coverage. Since May 1986, federal regulations require the department to determine the existence of third parties who may be liable for claims before the department makes payments. If any third parties are liable, the department should return the claim to the provider and instruct the provider to collect from the third parties first. In December 1986, the federal Department of Health and Human Services estimated that if the department implemented a cost avoidance system, the department would eliminate 25 personnel-years in operational costs with a savings of $650,000 annually, would save $46.9 to $70.4 million in Medi-Cal payments not then recovered, and would save interest then lost in the "pay-and-chase method" of payment. In response to the federal requirements, the department developed a three-phase plan to implement a cost avoidance system. The department completed the first phase in November 1986 and expected to complete the second phase by January 1989. However, as of September 30, 1988, the department was still making payments to providers for approximately 59 percent of the Medi-Cal beneficiaries who have other health-care coverage with nonmajor health insurers.

Department of Social Services

We reported 18 weaknesses in internal control and in the administration of federal programs at the Department of Social Services. The following are the most significant weaknesses that we noted:

- As of June 30, 1988, the department's California State Accounting and Reporting System's (CALSTARS) general ledger balance of cash in the state treasury for the department's share of the Federal Trust Fund was $28.8 million higher than the balance of the department's share as recorded by the State Controller's Office. The department has been aware of this problem since at least November 23, 1987, when the department learned the difference was $3.6 million at June 30, 1987. However, according to an accounting administrator, the department has not been able to determine the reason for the difference. For its financial statements for fiscal year 1987-88, the department adjusted its cash in the state treasury account and its due from other governments account so that the cash in the state treasury account agreed with the balance recorded by the State Controller's Office. Because the department is not able to account for the difference, we cannot be certain that the department's year-end balances for its cash in the state treasury account and its due from other governments account are correct. Further, we believe that the department's accounting procedures increase the risk of undetected errors;

- The department inaccurately calculated certain expenditure and liability accruals for the State's General Fund and the Federal Trust Fund. In addition, because the Federal Trust Fund expenditures are reimbursed by the federal government, inaccurate calculations in Federal Trust Fund expenditure and liability accruals result in corresponding inaccuracies in Federal Trust Fund revenue and asset accruals. Consequently, for fiscal year 1987-88, the General Fund expenditures and liabilities were understated by approximately $15.3 million. Moreover, the expenditures, liabilities, revenues, and assets of the Federal Trust Fund were overstated by approximately $14.4 million; and

- Although the department has resolved some of the weaknesses that we reported in previous years, it still does not always properly control its cash management system for the federal government's share of the department's expenditures. For example, the department did not ensure that federal funds were available before it submitted claim schedules to the State Controller's Office for payment. The State Controller's Office returned six claim schedules totaling approximately $27 million because of insufficient funds in the cash accounts of the department's Federal Trust Fund. As a result, the department delayed payment of these claim schedules for 7 to 218 days. In addition, the department did not promptly request approximately $2 million in federal funds to make a contract payment to the Employment Development Department. As a result, the State may have lost as much as $154,000 in interest income.

Department of Alcohol and Drug Programs

We reported five weaknesses in the Department of Alcohol and Drug Programs' administration of federal programs. The following are the most significant weaknesses that we noted:

- The department's Division of Drug Programs still did not adequately document its comprehensive reviews of county drug programs. For example, we reviewed 16 of the reports of the county administrative reviews completed by the division and found that 13 of the 16 reports did not contain complete documentary evidence to support all aspects of the program examined. In addition, the division has no standard procedures for following up on a county that has not issued a plan of corrective action within the 60-day deadline for responses. As a result, the department is unable to substantiate that it has complied with its own regulations for evaluating entities that receive federal funds; and

- As we reported last year, the department did not always reimburse county drug programs promptly. We reviewed the final reports of expenditures for fiscal year 1986-87 submitted by 15 county drug programs as claims for reimbursement. The department took an excessive amount of time to process all 15 claims from the date that the department received each claim to the date that each claim was scheduled for payment. As a result of the excessive delays, the county programs are without the federal funds to reimburse applicable program costs.

Department of Aging

We reported one weakness in the Department of Aging's administration of federal programs. The weakness that we noted was that the department's system of cash advances of federal funds to subgrantees did not always limit the disbursements of federal funds to the immediate cash needs of the subgrantees. For example, three of the ten subgrantees that we reviewed showed some excessive cash balances averaging between approximately $15,000 and $102,000. As a result of the department's excessive cash advances, the federal government lost interest that it could have earned on the funds that the department advanced too soon to subgrantees.

## Department of Developmental Services

We reported one weakness in internal control at the Department of Developmental Services. The weakness that we noted was that the department's accounting personnel did not accurately identify in their schedule of accounts payable which of the department's unliquidated encumbrances were obligations at June 30, 1988. In our review of a sample of accounts payable over $100,000 that totaled approximately $8.4 million, we found that the department had incorrectly identified 55 percent as encumbrances. Because the department did not properly identify encumbrances in its financial statements, it did not provide sufficient information to prepare the State's financial statements in accordance with generally accepted accounting principles.

## Department of Mental Health

We reported five weaknesses in internal control and in the administration of federal programs at the Department of Mental Health. The most significant weakness that we noted was that the department's process of requesting federal funds for the Alcohol and Drug Abuse and Mental Health Services Block Grant did not ensure that the requests were limited to the immediate needs of the department. During fiscal year 1987-88, we tested approximately $15 million of the block grant funds received by the department. In our review of the department's federal cash receipts and disbursements, we found that for 6 of the 21 claims that we reviewed, the interval between the date that the State Controller's Office received the funds and the date that it issued warrants ranged from 6 to 18 working days.

Department of Rehabilitation

We reported two weaknesses in the administration of federal programs at the Department of Rehabilitation. The most significant weakness that we noted was that the department inaccurately prepared the financial status report for June 30, 1988, that it submitted to the United States Department of Education. The department made three errors that overstated the federal share of expenditures by a net amount of approximately $63,000. The department's noncompliance with federal requirements may affect the State's receipt of federal funds.

Department of Mental Health
Atascadero State Hospital

We reported one weakness in internal control at Atascadero State Hospital. The weakness that we noted was that the hospital did not correctly prepare year-end financial reports for its portion of the State's General Fund. The hospital misclassified in its financial reports $870,977 of amounts due to other funds as accounts payable and $316,499 of expense advances as accounts payable. Additionally, the hospital incorrectly accrued in its financial reports $11,500 as due to other funds and as expenditures. As a result, the hospital's financial reports are not accurate.

## LEGISLATIVE, JUDICIAL, AND EXECUTIVE

In fiscal year 1987-88, the State spent over $1.1 billion, approximately 2 percent of the State's expenditures, on the legislative, judicial, and executive area of government. This area of government consists of 41 departments and other budgeted activities. Our financial and compliance audit focused on the 3 departments listed below. Also, we have issued four special topic reports that include issues relating to the legislative, judicial, and executive area of government since July 1987. These special topic reports required our office to review the selected operations of an additional department, that is, the Department of Justice. Appendix B provides a listing of the reports that the Office of the Auditor General issued from July 1, 1987, through December 31, 1988.

We reported 13 weaknesses for 3 departments within the legislative, judicial, and executive area of government. In the following section, we discuss the most significant weaknesses that we reported for the 3 departments.

### Board of Equalization

We reported seven weaknesses in internal control at the Board of Equalization. The following are the most significant weaknesses that we noted:

- The board currently has no access to off-site backup equipment for its electronic data processing system that it can use if a major disaster renders the computer equipment unusable. A major shutdown of the board's electronic data processing system could result in processing delays and in the loss of revenues to the State and to local governments; and

- The board's manual system for assigning and reviewing tax area codes to registered businesses still is not cost-effective and does not provide accurate data. When a business is registered, the district offices or the Local Tax Unit assign it a tax area code. The tax area code is important because it determines the amount of sales and use taxes that the board distributes to units of local government such as cities, counties, and transit districts. The assignment process is done manually, which is not cost-effective and has resulted in many errors in the past. For example, because of misallocations that resulted from an incorrect tax area code, one city is suing the board to regain approximately $139,000 in local sales taxes that the board erroneously distributed to the wrong city.

State Controller's Office

We reported five weaknesses in internal control, in the administration of federal programs, and in our review of the internal audit unit at the State Controller's Office. The most significant weakness that we noted was that the office's Division of Audits did not promptly submit audit reports to the Department of Social Services. The Department of Social Services contracts with the division to have the division audit county welfare departments and contract providers. We reviewed 14 of 122 audits that the division completed during fiscal year 1987-88. The division did not promptly submit audit reports to the Department of Social Services and the auditee for 5 of the 14 audits. These 5 reports, with disallowed costs totaling approximately $50,000, were for audits of three Refugee Resettlement Program contract providers, one Foster Care Program group home provider, and one In-Home Supportive Services contract provider. Delays in submitting the audit reports ranged from approximately 74 to 273 days after the date of the exit conference. Excessive delays in submitting audit reports contribute to delays in collecting disallowed costs with a resulting loss of potential interest earnings.

State Treasurer's Office

We reported one weakness in internal control at the State Treasurer's Office. The weakness that we noted was that the office did not promptly reconcile the eight bank accounts of the centralized

State Treasury System (CTS). State agencies deposit money into one of the eight CTS bank accounts, and the State receives credit for the deposit on the day that the bank records the deposit. We reviewed the office's reconciliations of the eight CTS bank accounts for 3 of the 12 months in fiscal year 1987-88 and found that the office was between 5 and 8 months late completing the reconciliations. Failure to reconcile the eight CTS bank accounts promptly may result in a bank or office error or in an illegal act committed by an agency employee that may go undetected for a prolonged period of time.

RESOURCES

In fiscal year 1987-88, the State spent over $1.8 billion, approximately 3 percent of the State's expenditures, on programs in the Resources Agency. The agency oversees the operations of 25 departments and other budgeted activities. Our financial and compliance audit focused on the 2 departments listed below. Also, we have issued nine special topic reports that include issues relating to programs in the Resources Agency since July 1987. These special topic reports required our office to review the selected operations of 5 additional departments: the Air Resources Board, the Department of Fish and Game, the Department of Forestry and Fire Protection, the Department of Parks and Recreation, and the State Water Resources Control Board. Appendix B provides a listing of the reports that the Office of the Auditor General issued from July 1, 1987, through December 31, 1988.

We reported seven weaknesses for 2 departments within the Resources Agency. In the following section, we discuss the most significant weaknesses that we reported for the 2 departments.

Department of Water Resources

We reported four weaknesses in internal control at the Department of Water Resources. The following are two of the most significant weaknesses that we noted:

- The department submitted inaccurate financial reports to the State Controller's Office for the Water Resources Revolving Fund. For instance, the department did not record in the Water Resources Revolving Fund approximately $100,000 due from four of the department's other funds for expenditures made on behalf of those funds. As a result of this error, at June 30, 1988, the department had understated the due from other funds account and transfers-in account balances in its Water Resources Revolving Fund; and

- In addition, the department did not reconcile mobile equipment and depreciation amounts on its Depreciation Balances Report with the related general ledger accounts for five months during fiscal year 1987-88. Further, the department did not resolve some differences identified in the seven reconciliations that it had performed. As of June 30, 1988, the cost of mobile equipment shown on the Depreciation Balances Report was about $631,000 less than the amount in the general ledger account. Further, the amount of accumulated depreciation shown on the Depreciation Balances Report was about $307,000 less than the amount in the general ledger account. The department's failure to reconcile the Depreciation Balances Report with the general ledger accounts and to resolve differences could result in misstatements in its financial reports.

Department of Boating and Waterways

We reported three weaknesses in internal control at the Department of Boating and Waterways. The most significant weakness that we noted was that the department did not prepare the year-end financial reports for the revolving fund in accordance with the State Administrative Manual and generally accepted accounting principles. We reported six deficiencies in the department's preparation of the revolving fund financial reports. As a result of these deficiencies and other deficiencies that we did not report, the revolving fund's retained earnings balance at June 30, 1986, was understated by approximately $140.1 million, and net income for fiscal year 1986-87 was understated by approximately $21.9 million.

STATE AND CONSUMER SERVICES

In fiscal year 1987-88, the State spent over $1.8 billion, approximately 3 percent of the State's expenditures, on programs in the State and Consumer Services Agency. The agency oversees the operations of 12 departments and other budgeted activities. Our financial and compliance audit focused on the 3 departments listed below. Also, we have issued five special topic reports that include issues relating to programs for the State and Consumer Services Agency since July 1987. These special topic reports required our office to review the selected operations of one additional department, the Department of Veterans Affairs, and one entity within the Museum of Science and Industry, that is, the California Afro-American Museum. Appendix B provides a listing of the reports that the Office of the Auditor General issued from July 1, 1987, through December 31, 1988.

We reported 20 weaknesses for 3 departments within the State and Consumer Services Agency. In the following section, we discuss the most significant weaknesses that we reported for the 3 departments.

Department of General Services

We reported 11 weaknesses in internal control at the Department of General Services. The following are 2 of the most significant weaknesses that we noted:

- The department reported liabilities for material purchases by the Office of State Printing at June 30, 1988, that contained significant errors. The department staff did not identify these errors because they did not reconcile the general ledger with a detailed listing. When we requested a detailed listing supporting the $970,000 reported in the financial statements, the accounting office provided us with an untotaled listing that supported approximately 50 percent of the reported amounts. The accounting office completed a revised listing and found that the amount that it had reported in the financial statements was overstated by approximately $650,000; and

- The department did not have sufficient controls over the disposal of state vehicles. As a result of these insufficient controls, the accounting office was not aware that 26 vehicles had been disposed of several years before. Moreover, because of a lack of sufficient records, the department cannot adequately explain what happened to 22 of the vehicles.

Franchise Tax Board

We reported five weaknesses in internal control at the Franchise Tax Board. The following are the most significant weaknesses that we noted:

- The board made erroneous adjustments totaling $818,499 to some taxpayer accounts. The adjustments were related to balancing individual tax years for these taxpayers and did not result in immediate assessments or refunds. However, the adjustments could have resulted in an assessment or refund to the taxpayers at a later date. As a result of these errors, the board understated its receivables in the financial statements of the Bank and Corporation Tax Fund at June 30, 1988; and

- The board does not have procedures to promptly assess taxpayers for all of the dishonored checks that it receives. At the time of our audit, the board was processing a five-month backlog of dishonored checks. As a result of the backlog, as of September 30, 1988, $8.3 million of taxes had not been reassessed to the taxpayers who had submitted dishonored checks. Delayed processing of the dishonored checks lessens the chances of collecting the money owed. In addition, during the past two years, the board did not assess charges for dishonored checks that may have totaled approximately $309,000.

Office of the State Fire Marshal

We reported four weaknesses in internal control at the Office of the State Fire Marshal. The most significant weakness that we noted was that the office did not promptly deposit cash and checks received. We examined 30 deposits that averaged $3,801 during fiscal year 1986-87. We found that the office took an average of 13.7 working days from the day that the cash and checks were received to deposit the cash and checks in the bank. When the office holds deposits for an excessively long period, an increased risk of loss exists from fire or theft, and the State loses interest earnings.

## YOUTH AND ADULT CORRECTIONAL

In fiscal year 1987-88, the State spent over $1.9 billion, approximately 3 percent of the State's expenditures, on programs in the Youth and Adult Correctional Agency. The agency oversees the operations of six departments and other budgeted activities. Our financial and compliance audit focused on the three departments, two institutions, and two facilities listed below. Also, we have issued six special topic reports that include issues relating to programs for the Youth and Adult Correctional Agency since July 1987. These special topic reports required our office to review the selected operations of one additional department, that is, the Board of Prison Terms. Appendix B provides a listing of the reports that the Office of the Auditor General issued from July 1, 1987, through December 31, 1988.

We reported 41 weaknesses for three departments, two institutions, and two facilities within the Youth and Adult Correctional Agency. In the following section, we discuss the most significant weaknesses that we reported for the seven departments, institutions, and facilities.

Department of Corrections

We reported five weaknesses in internal control and in our review of the internal audit unit at the Department of Corrections. The following are the most significant weaknesses that we noted:

- For its three construction funds, the department incorrectly identified and reported to the State Controller's Office accounts payable and amounts due to other funds as encumbrances. For example, in its 1986 Prison Construction Fund, we calculated that the department incorrectly reported $17,451,584 of accounts payable and $522,569 of due to other funds as encumbrances. If the department does not properly identify these amounts 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; and

- The department did not follow all of the procedures required by the State Administrative Manual for accounting for receivables. We reported four deficiencies in the department's accounting for receivables. One deficiency that we noted was that the department could not provide the supporting documentation for 26 of the 45 receivable items that we reviewed. Moreover, these 26 items, totaling $288,200, had been outstanding from three to seven years. As a result of this improper accounting, the department is unable to provide details to support its receivables at June 30, 1988. Additionally, the department is not collecting all of the amounts owed to it.

Department of the Youth Authority

We reported 12 weaknesses in internal control, in the administration of federal programs, and in our review of the internal audit unit at the Department of the Youth Authority. The following are the most significant weaknesses that we noted:

- For each of the last eight months of fiscal year 1987-88, the headquarters office overdrew its revolving fund by an average of $138,000 per month. These overdrafts were caused by the headquarters office not promptly scheduling expense advances for reimbursement and not recovering salary advances from the next payroll warrants issued. For example, as of June 30, 1988, approximately $277,000 (35 percent) of the total amount advanced from the revolving fund was outstanding for at least 60 days. When an agency overdraws its revolving fund, its overdrafts must be financed with moneys from other funds or cash receipts not yet accounted for in a fund. Financing overdrafts with moneys from other funds or cash receipts not yet accounted for weakens the controls over these moneys; and

- The department did not fully comply with certain federal requirements pertaining to the School Breakfast Program and National School Lunch Program. Specifically, the department requested reimbursement for more meals than it was entitled to claim because it received inaccurate and unsupported meal counts from two of its facilities. Also, one of the two facilities did not document the contents of all meals served and the quantities of meal contents. The department's noncompliance with federal requirements may affect the State's receipt of federal funds.

<u>Board of Corrections</u>

We reported one weakness in internal control at the Board of Corrections. The weakness that we noted was that the board's year-end financial reports for its three capital expenditure funds were inaccurate. Specifically, the Department of the Youth Authority, which performs the accounting for the board, did not record all of the transfers-in and transfers-out related to the first of two loans from the Pooled Money Investment Account. Consequently, the board's transfers-in and transfers-out accounts in the three capital expenditure funds were understated. For example, in the County Jail Capital Expenditure Fund-Bond Act of 1984, transfers-in were understated by $101,062,634 and transfers-out were understated by

$180,914,804. Failure to submit accurate financial reports delays the compilation by the State Controller's Office of the State's financial statements.

Department of Corrections
California Institution for Men

We reported seven weaknesses in internal control at the California Institution for Men. The most significant weakness that we noted was that the institution did not correctly record the payment of seven obligations totaling $310,100 and the institution did not disencumber the unused balances of six completed contracts and purchase agreements totaling $231,929. As a result, the institution overstated its June 30, 1987, liabilities and expenditures by $542,029 for the institution's portion of the State's General Fund.

Department of Corrections
California Men's Colony

We reported five weaknesses in internal control at the California Men's Colony. The most significant weakness that we noted was that the institution did not provide adequate separation of duties in its accounting department. For example, two employees who sign and review checks for proper support and authorization also have access to or control over the blank-check stock. Unless duties are properly separated, an employee could conceal irregularities, and the responsibility for errors may not be determined.

Department of the Youth Authority
Southern Reception Center-Clinic

We reported six weaknesses in internal control and in the administration of federal programs at the Southern Reception Center-Clinic. The following are the most significant weaknesses that we noted:

- Six deficiencies existed in the facility's use of the revolving fund. One deficiency was that, for 8 of the 35 revolving fund disbursements reviewed, the facility inappropriately made disbursements from the revolving fund to vendors who neither offered discounts nor required immediate payment. Another deficiency was that the facility did not properly separate duties related to cash. For example, the business manager had access to the blank-check stock and was authorized to sign checks. Failure to maintain proper separation of duties may result in material errors or irregularities that may go undetected; and

- The facility has not maintained complete records of meal counts and meal contents for the School Breakfast Program and the National School Lunch Program. The facility's inability to demonstrate compliance with federal regulations may place the State in jeopardy of fiscal sanctions by the federal government.

Department of the Youth Authority
Youth Training School

We reported five weaknesses in internal control at the Youth Training School. The most significant weakness that we noted was that the facility did not promptly collect reimbursement for salary payments paid from its revolving fund cash account. As a result, the facility filed claims with the State Board of Control to obtain reimbursement for approximately $67,000 for certain salary payments made from 1978 through April 1985. The facility is seeking reimbursement from the State Board of Control because the facility did not correctly file claims with the State Controller's Office within the three-year deadline allowed by state law to obtain reimbursement. Revolving fund moneys are not available for other uses when the facility does not promptly collect reimbursements for revolving fund payments. In addition, the facility may lose money if employees leave state service without repaying the facility.

REPORT ON THE STUDY AND EVALUATION

OF INTERNAL CONTROL

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STATE OF CALIFORNIA
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Kurt R. Sjoberg
Acting 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, 1988, and have issued our report dated December 16, 1988, except for the information in Note 26, for which the date is January 11, 1989. We did not examine the financial statements of the pension trust funds, which reflect total assets constituting 78 percent of the fiduciary funds. We also did not examine the financial statements of certain enterprise funds, which reflect total assets and revenues constituting 93 percent and 96 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 Standards for Audit of Governmental Organizations, Programs, Activities, and Functions, issued by the General Accounting Office; the Single Audit Act of 1984; and the provisions of the United States Office of Management and Budget Circular A-128, Audits of State and Local Governments. For this report, we classified the systems of internal control of the State into three areas: financial activities, including electronic data processing controls, 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 this 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, 1988, the State received 95 percent of its total federal assistance under major federal assistance programs. With respect to systems of internal control used in administering major federal assistance programs that we tested, 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 three categories of controls identified in the second paragraph. We also do not express an opinion on the systems of internal control used in administering the major federal assistance programs of the State. Further, our examination would not necessarily disclose material weaknesses in the systems of internal control used solely in administering nonmajor federal assistance programs. However, our evaluation disclosed a weakness in the State's 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 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's Office 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's Office 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 report, dated December 16, 1988, except for the information in Note 26, for which the date is January 11, 1989, 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 10, 1989

DETAILED DESCRIPTION OF WEAKNESSES AT STATE AGENCIES

# INDEX

## INDEX (Continued)

## INDEX (Continued)

## DEFICIENCIES COMMON TO VARIOUS AGENCIES

Certain deficiencies in internal control are common to more than one agency. For example, many state agencies do not comply with the California Public Contract Code in establishing and maintaining contracts with vendors. Additionally, many state agencies do not correctly calculate final payroll disbursements to employees who leave state service. Further, not all internal audit units that we reviewed fully complied with professional standards. Finally, not all state agencies comply with federal and state regulations for the Statewide Cost Allocation Plan.

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 that has general supervisory responsibility over all matters concerning the financial and business policies of the State. In the following paragraphs, we discuss the deficiencies that we found.

### Deficiencies in Administering State Contracts

State agencies do not always comply with the California Public Contract Code in establishing and maintaining contracts with vendors. During statewide testing at 15 agencies comprising a total of 150 contracts, we found 66 contracts that did not fully comply with provisions of the California Public Contract Code. For example, 24 contracts were not approved before the beginning of the contract work. As a result, the State may be liable for contracts that are not in the State's best interests. Additionally, 31 contract files did not contain a contractor evaluation form prepared within 30 days of completion of the contract, and 4 contracts lacked other documentation. Lack of contractor evaluations may cause the State to enter into contracts with unreliable vendors. Finally, 15 contracts failed to comply with other provisions of the California Public Contract Code. Table 2, on page 82, provides details of the test results.

In addition to the statewide testing discussed in the previous paragraph, the Office of the Auditor General recently conducted an indepth review of consultant contracts at one state agency. Our report, entitled "The Department of Health Services Did Not Comply With All Requirements for Awarding and Managing Consultant Contracts," Report P-753, October 1988, provided additional information regarding the preparation and review of contractor evaluations. In Report P-753, we stated that the Department of Health Services did not submit to the Department of General Services all of the required post evaluations of consultants and did not review post evaluations before awarding consultant contracts. Additionally, we concluded that the Department of General Services did not enforce the requirement that state agencies submit evaluations of contractors and approved contracts for which the department had not reviewed contractor evaluations.

Report P-753 included statements made by the chief counsel of the Department of General Services' legal office as to why the Department of General Services did not ensure that state agencies review contractor post evaluations. One of the reasons the chief counsel gave was that the California Public Contract Code did not expressly require the Department of General Services to take any action. In Report P-753, however, we concluded that Section 1203 of the State Administrative Manual requires the Department of General Services to meet its responsibilities in reviewing contracts and ensuring that state agencies comply with laws, rules, and regulations. We further concluded that this responsibility logically extended to ensuring that state agencies submit and review post evaluations before the Department of General Services approves a department's contract award to a consultant.

Sections 10295, 10335, 10360, and 10364 of the California Public Contract Code state that all state contracts, unless exempt under these sections, must contain the required documentation and are void unless and until approved. The State Administrative Manual, Section 1204, emphasizes the need for contract approval before the beginning of the contract work. Sections 10347(a) and 10369 of the California Public Contract Code require each state agency to conduct, within 30 days of completion of a contract, an evaluation of each contract awarded. Sections 10300 through 10334 and Section 10371 of the California Public Contract Code discuss other required state contracting provisions, such as competitive bidding procedures.

TABLE 2

DEFICIENCIES IN ADMINISTERING STATE CONTRACTS AT VARIOUS AGENCIES
FISCAL YEAR 1987-88

| Organization | Number of Contracts Tested | Number of Contracts Tested With at Least One Exception | Lack of Approval Before Start of Contract Work | Lack of Prompt Post-Contract Evaluations | Lack of Required Documentation (Except Evaluations) | Lack of Other Required Procedures |
|---|---|---|---|---|---|---|
| California Community Colleges, Chancellor's Office | 10 | 8 | | | 1 | 7 |
| Corrections, Department of | 10 | 1 | | 1 | | |
| Education, State Department of | 10 | 3 | 2 | 1 | | |
| Employment Development Department | 10 | 5 | | 2 | 3 | |
| Equalization, Board of | 10 | 4 | | 4 | | 1 |
| Franchise Tax Board | 10 | 7 | 5 | | | 3 |
| General Services, Department of | 10 | | | | | |
| Health Services, Department of | 10 | 8 | 5 | 5 | | |
| Mental Health, Department of | 10 | | | | | |
| Motor Vehicles, Department of | 10 | 5 | 2 | 3 | | |
| Social Services, Department of | 10 | 7 | 7 | | | 2 |
| State Controller's Office | 10 | 1 | 1 | | | |
| State Treasurer's Office | 10 | 2 | 2 | | | |
| Transportation, Department of | 10 | 8 | | 8 | | 1 |
| Youth Authority, Department of the | 10 | 7 | — | 7 | — | 1 |
| Total | 150 | 66 | 24 | 31 | 4 | 15 |

## Incorrect Calculations of Final Payroll for Employees Who Leave State Service

State agencies do not always correctly calculate final payroll disbursements for salary and unused vacation for employees who leave state service. We tested 260 disbursements to employees who left state service at 51 departments, related institutions, and offices and found that agencies had incorrectly calculated 70 (approximately 27 percent) of the disbursements. As a result, the State underpaid individuals a total of $20,625 and overpaid individuals a total of $3,351. Table 3, on the next page, provides details of the test results.

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

TABLE 3

INCORRECT CALCULATIONS OF FINAL
PAYROLL DISBURSEMENTS FOR EMPLOYEES WHO
LEAVE STATE SERVICE

| Agency | Number of Disbursements Tested | Number of Exceptions | Amount of Overpayments | Amount of Underpayments |
|---|---|---|---|---|
| California Conservation Corps | 5 | 3 | | $ 1,152 |
| California Exposition and State Fair | 5 | | | |
| California State University (Chancellor's Office and eleven campuses) | 60 | 10 | | 3,462 |
| Corrections, Department of (Eight institutions) | 40 | 16 | $1,792 | 3,167 |
| Developmental Services, Department of (Six hospitals) | 30 | 12 | 105 | 4,434 |
| Education, State Department of | 5 | | | |
| Fire Marshal, Office of the State | 5 | 3 | | 1,335 |
| Forestry, Department of | 5 | 3 | 43 | 3,946 |
| Housing and Community Development, Department of | 5 | | | |
| Justice, Department of | 5 | 2 | 100 | 73 |
| Mental Health, Department of (Headquarters and three hospitals) | 20 | 3 | 273 | 548 |
| Motor Vehicles, Department of | 5 | 1 | | 98 |
| Parks and Recreation, Department of | 5 | 1 | | 402 |
| Social Services, Department of | 5 | | | |
| Transportation, Department of (Headquarters and five districts) | 35 | 10 | 909 | 1,052 |
| Veterans Affairs, Department of (Veterans' Home of California) | 5 | 2 | | 378 |
| Water Resources, Department of | 5 | 2 | | 186 |
| Youth Authority, Department of the (Three institutions) | 15 | 2 | 129 | 392 |
| Total | 260 | 70 | $3,351 | $20,625 |

Variances From Internal Audit Standards

Five of the 14 internal audit units that we reviewed 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, Section 1236, requires internal audit units of state agencies to comply with these professional standards, which pertain to independence, management of the internal auditing department, performance of audit work, professional proficiency, and scope of work.

We reviewed the internal audit units of 14 state agencies for compliance with professional standards. For 5 of the agencies, we limited the scope of our review of the internal audit units to determining the scope of the internal audit work that they performed and the degree to which the internal audit units were independent of the activities that they audited. In addition, for the remaining 9 agencies, where the internal audit units may perform a portion of our testing for this financial and compliance audit, and we review their work to ensure that we can rely on it, we conducted full-scope reviews. The variances from compliance with professional standards are described in the following paragraphs and summarized on Table 4 on page 90.

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

Unless internal audit units comply with professional standards, management cannot be certain 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.

Independence Standard

Three of the 14 internal audit units that we reviewed were not organizationally independent of the activities they audit. The Department of the California Highway Patrol, the Department of Corrections, and the Department of the Youth Authority had no formal audit charter or similar document that at least outlined the unit's purpose or authority. The lack of an audit charter can result in misunderstandings between the auditees and the internal auditors. In addition, the organizational placement of the Department of the Youth Authority's internal audit unit impaired the unit's independence. If the unit is not independent of the areas that it audits, less assurance exists that the audits are conducted in an impartial and unbiased manner.

Management of the Internal
Auditing Department Standard

We reported seven weaknesses in compliance with the standard relating to management of the internal auditing department. Two of the weaknesses that we noted were that the Department of the California Highway Patrol and the Department of the Youth Authority had not established a quality assurance program that would ensure proper management of their internal audit units. For example, at the Department of the Youth Authority we found that the internal audit unit did not prepare audit plans or follow up on corrective action. Failure to follow up on corrective action leaves the management with less assurance that appropriate actions were taken.

Performance of Audit Work Standard

We reported five weaknesses in compliance with the standard relating to performance of audit work. Three of the weaknesses that we noted were that the California Student Aid Commission, the Department of Corrections, and the Department of the Youth Authority did not sufficiently support audit findings and recommendations. For example, at the Department of Corrections we found that, for the audit of the Deuel Vocational Institution, the internal auditors did not perform sufficient transaction tests to ensure that the system of internal control was working. Additionally, several pages of the audit program and other workpapers were missing. As a result, we were unsure whether the auditors had sufficient evidence to support audit conclusions. Failure to properly document evidence in the workpapers results in lack of management assurance that the audit results are complete and accurate.

Professional Proficiency Standard

We reported three weaknesses in compliance with the standard relating to professional proficiency. At the Department of the California Highway Patrol and the Department of the Youth Authority, we found that some workpapers were not reviewed by the supervisor. For example, the supervisor at the Department of the California Highway Patrol did not review the workpapers for the San Jose field office before the unit issued its audit report. Failure to review workpapers and to discuss the audit results with the officials in the field offices can result in inaccurate reports. In addition, at the Department of the California Highway Patrol, we found that not all auditors in the unit possess the proper qualifications or receive appropriate training to proficiently perform reviews of all internal controls and operations of the department. Specifically, three of the four auditors do not have the accounting or auditing education necessary to perform internal audits. Further, these auditors do not have auditing experience. Moreover, the department does not provide its internal auditors with sufficient training to improve their technical skills for conducting audits. Because they lack the necessary education, experience, and continued training, these auditors do not have the technical skills to effectively and efficiently perform audits of the department's internal controls and operations.

Scope of Work Standard

We reported three weaknesses in compliance with the standard relating to scope of work. At the Department of the California Highway Patrol and the Department of the Youth Authority, we found that the scope of the internal audit unit's work was insufficient to meet all of the unit's internal auditing responsibilities. For instance, the internal audit unit at the Department of the California Highway Patrol did not perform enough transaction tests for payroll and claims to ensure that the system of internal controls over expenditures was working. In addition, the unit did not review the separation of duties over cash and payroll at the field office level. Without sufficient reviews and transaction tests, the internal auditors may not detect departures from prescribed internal control procedures and practices.

TABLE 4

SUMMARY OF VARIANCES FROM PROFESSIONAL STANDARDS
FOR INTERNAL AUDITORS
DISTRIBUTION BY STATE AGENCY
FISCAL YEAR 1987-88

| Agency | Page Number | Independence | Professional Proficiency | Scope of Work | Performance of Audit Work | Management of Internal Auditing Department |
|---|---|---|---|---|---|---|
| Full-Scope Reviews | | | | | | |
| California Highway Patrol, Department of the | 100 | 1 | 2,3 | 4 | 5 | 1,3 |
| California Student Aid Commission | 146 | | | | 1,2 | 3,4 |
| Corrections, Department of | 326 | 1 | | | 2 | 1 |
| Franchise Tax Board | | | | | | |
| Health Services, Department of | | | | | | |
| Motor Vehicles, Department of | | | | | | |
| Transportation, Department of | | | | | | |
| Water Resources, Department of | | | | | | |
| Youth Authority, Department of the | 341 | 1,2 | 3 | 4 | 5 | 1,3 |
| Limited-Scope Reviews* | | | | | | |
| California Exposition and State Fair | | | | | | |
| Education, State Department of | | | | | | |
| Employment Development Department | | | | | | |
| General Services, Department of | | | | | | |
| State Controller's Office** | 273 | | | 5 | | |

* We conducted limited-scope reviews only for the "Independence" standard.

** This limited-scope review included a follow-up on the prior year's finding on the "Scope of Work" standard.

## Noncompliance With Regulations for the Statewide Cost Allocation Plan

State agencies do not always comply with federal and state regulations for the Statewide Cost Allocation Plan. The Statewide Cost Allocation Plan allocates those central service costs that the federal government may reimburse to agencies that receive central services. Central service costs are those amounts spent by central service agencies for overall administration of state government and for providing centralized services, such as financial, personnel, and legal support to state agencies.

We reviewed 6 of the 17 central service agencies and determined that one of the agencies reported expenditures of ineligible support services to the Department of Finance, the agency that prepares California's Statewide Cost Allocation Plan. Specifically, the Department of Justice reported approximately $17 million of ineligible costs. Reporting these ineligible costs could result in excess recoveries from the federal government of approximately $1.4 million.

All five state agencies that we reviewed for prompt transfer of Statewide Cost Allocation Plan recoveries were late in transferring the recoveries to the State's General Fund for at least one quarter of fiscal year 1987-88. When state agencies do not promptly transfer Statewide Cost Allocation Plan recoveries, the General Fund does not have the use of these moneys. Attachment 3 on page 197, lists the agencies that we reviewed for prompt transfer of Statewide Cost Allocation Plan recoveries. In addition, we determined that the Department of Finance needs to ensure that state agencies collect all Statewide Cost Allocation Plan recoveries and transfer the recoveries promptly to the General Fund.

The United States Office of Management and Budget Circular A-87 provides criteria for determining the allowable costs of programs administered by the State. The State Administrative Manual, Section 8753, specifies what costs should be included in the Statewide Cost Allocation Plan. The California Government Code, Section 13332.02, authorizes the director of the Department of Finance to determine whether a state agency promptly transfers Statewide Cost Allocation Plan recoveries to the General Fund.

MANAGEMENT LETTERS

BY AREA OF GOVERNMENT

## BUSINESS, TRANSPORTATION AND HOUSING

## DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL

We reviewed the financial operations and related internal controls at the Department of Alcoholic Beverage Control (department).

**Item 1. Insufficient Control Over Uncleared Collections**

Finding:

The department has significant weaknesses in its accountability for and control over its uncleared collections account. Uncleared collections is a temporary account used for recording collections when an agency has not yet determined to what account a receipt should be charged. The department has not reconciled its detailed list of uncleared collections in the Alcohol Beverage Control (ABC) Fund to the general ledger account balance at June 30, 1987. The department's detailed list totaled approximately $7.6 million while its general ledger account balance totaled approximately $9.0 million. In addition, the department failed to clear the items in its uncleared collections account promptly. By July 31, 1987, the department still had not cleared at least $2.2 million of the account balance as of June 30, 1987. Further, the department could not adequately explain the high balances in the uncleared collections account.

As a result of not reconciling its general ledger account balance with the subsidiary detailed list, the department may not detect and correct errors in its records. In addition, when the department does not reconcile these records, it may not detect irregularities promptly. Further, since the uncleared collections account contains amounts to be refunded or to be remitted to the State's General Fund, when the department does not promptly clear its uncleared collections account, people who are owed money may not receive their money promptly, if at all. Finally, money due to the State's General Fund that is not promptly remitted to the State Controller's Office is unavailable for expenditure.

The department does have controls to reduce the risk of irregularities such as unauthorized refunds or disbursements. However, those controls can be strengthened through reconciliations between the two records.

Criteria: The State Administrative Manual, Section 7900, stresses the importance of monthly reconciliations. Reconciliations are an important internal control because they provide an additional assurance that the transactions have been correctly recorded and that the financial statements are complete. Also, the State Administrative Manual, Section 10452, states that the purpose of the uncleared collections account is to show the amount of cash collections that are being reviewed to determine whether they are to be accepted for a fund in the State Treasury or are to be refunded.

Recommendation: Each month, the department should reconcile its detailed list of uncleared collections in the ABC Fund to the corresponding general ledger account balance. The department should also clear its collections promptly for remittance to the State Controller's Office.

**Item 2.** **Insufficient Controls Over Confiscated Cash**

Finding: The controls over cash confiscated as "seized evidence" are not sufficient to ensure that the cash is properly safeguarded. For example, according to the fiscal officer, an employee deposited confiscated cash in the amounts of $204 and $224 in his personal checking account and issued a check for those amounts. The department then did not deposit the personal checks for over 11 months and 6 months, respectively. The department also did not deposit other confiscated cash promptly. In 28 instances of cash confiscated as "seized evidence," which totaled approximately $6,700, the department held the cash an average of 198 days before making the deposit.

The conversion of cash into personal checks diminishes the department's control over cash. Also, the commingling of state funds with personal funds increases the risk that irregularities may occur. Further, the delays in depositing cash receipts result in the loss of interest revenue to the State.

Criteria: Prudent fiscal management dictates that state funds should not be commingled with personal funds. Also, the State Administrative Manual, Section 8030.1, requires agencies to deposit accumulated collections greater than $500 in cash or $5,000 in cash and checks on the day of receipt 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. Section 8030.1 further requires that no collection should remain undeposited for more than 15 working days.

Recommendation: The department should establish procedures over confiscated cash to ensure that the cash is sufficiently controlled. Also, the department should deposit accumulated collections over $500 in cash or $5,000 in cash and checks on the day of receipt or on the next working day. The department should not hold any undeposited collections for more than 15 working days.

**Item 3.** **Incorrect Cash Cutoff Procedures**

Finding: Two of the department's bank deposits in July 1987 contained checks that the department had received before the end of work on June 30, 1987. The department erroneously included these checks as July cash receipts rather than as June cash receipts. As a result, the department understated the cash balance on the financial reports of the department's general fund accounts for the fiscal year ended June 30, 1987, by approximately $24,000.

Criteria: The State Administrative Manual, Section 10507, describes the journal entry that agencies should make when they receive cash for deposit in the general cash account. The State Administrative Manual, Section 10536, describes the adjustment that is needed in the general ledger accounts to record undeposited receipts as of June 30.

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

## DEPARTMENT OF THE CALIFORNIA HIGHWAY PATROL

We reviewed the internal audit unit of the Department of the California Highway Patrol (department).

**Item 1.** **The Internal Audit Unit Lacks An Audit Charter**

Finding: The department has no formal audit charter or similar document that outlines the unit's purpose or authority. Although the department's administrative manual contains information on the operation of the unit, it does not describe the unit's position within the department and its line of reporting or the unit's authority to perform internal audits. The lack of an audit charter can result in misunderstandings between the auditees and the internal auditors.

Criteria: Sections 110.01.4 and 510.01 of the "Standards for the Professional Practice of Internal Auditing" (SPPIA) require the department to have a written audit charter for its unit. The audit charter should include the unit's position within the department, its scope of activities, and its authority for access to records, personnel, and physical properties necessary to perform internal audits.

Recommendation: The department should define, in a formal written document, the scope, authority, and responsibility of the unit and its placement within the organization.

**Item 2.** **Internal Auditors Do Not Always Possess the Proficiency To Perform Audit Work**

Finding: Not all auditors in the unit possess the proper qualifications or receive appropriate training to proficiently perform reviews of all internal controls and operations of the department. Specifically, three of the four auditors do not have the accounting or auditing education necessary to perform internal audits. Further, these auditors do not have auditing experience. Moreover, the department does not provide its internal auditors with sufficient training to improve their technical skills for conducting audits. For example, since July 1, 1986, three of the four auditors on staff at the time of our review received an average of

20 hours of training in auditing and accounting. Because they lack the necessary education, experience, and continued training, these auditors do not have the technical skills to effectively and efficiently perform audits of the department's internal controls and operations.

Without internal auditors who are properly trained and qualified, the department lacks assurance that its internal controls have been properly reviewed and evaluated. In addition, external auditors cannot rely on the work of the unit and, therefore, may duplicate the work of the internal auditors.

Criteria: The SPPIA, Section 220, states that the unit should possess the knowledge, skills, and disciplines essential to the performance of internal audits. The SPPIA, Section 270, states that the internal auditors should maintain their technical competence through continuing education.

Recommendation: The department should provide sufficient training to improve the knowledge and technical skills of its existing internal auditors. In addition, the department should establish appropriate minimum education and experience qualifications for hiring internal auditors in the future.

<u>Item 3</u>. <u>Lack of a Quality-Assurance Program</u>

Finding: The department has not established a quality-assurance program that would ensure proper management of the unit. In our review of internal audits of five field offices, we found that the internal auditors did not document the discussion of the audit findings with the officials in the field offices. We also found that the unit did not prepare budget and actual hours to review the progress of its audits. In addition, the supervisor did not review the workpapers for the San Jose field office before the unit issued its audit report. Failure to review workpapers and to discuss the audit results with the officials in the field offices can result in inaccurate reports. Failure to properly plan the audit can result in inefficient use of audit resources.

Criteria: Sections 230.01 through 230.05, 520.02, and 560 of the SPPIA require the unit to establish and implement a quality-assurance program that would ensure sufficient review of workpapers, adequate budgeting, and sufficient evidence to support audit findings.

Recommendation: The department should establish and implement a quality-assurance program that would monitor the progress and quality of the internal audits.

**Item 4.** **Insufficient Scope of Audit Work**

Finding: We found that the scope of the unit's work was insufficient to meet all of its internal auditing responsibilities. Specifically, although the department spends approximately $483 million annually, the unit did not perform enough transaction tests for payroll and claims to ensure that the system of internal controls over expenditures was working. We also found that the unit did not review the separation of duties over cash and payroll at the field office level. Without sufficient reviews and transaction tests, the internal auditors may not detect departures from prescribed internal control procedures and practices.

Criteria: The SPPIA, Section 300, requires that the scope of the unit include an examination and evaluation of the adequacy and effectiveness of the department's system of internal controls.

Recommendation: The department should require that the unit perform sufficient reviews and tests to evaluate the effectiveness of the internal control systems.

**Item 5.** **Deficiencies in Audit Reports**

Finding: The internal audit reports on the field-office activities do not present the purpose and scope of the audit properly, do not present the auditor's opinion when it might be appropriate, and do not address the appropriate level of management. As a result, users of the reports may not be able to determine the objectives of the audit, the scope of the work, the auditor's opinion, or the significance of the findings.

We also found that the unit has not issued nine reports for field-office reviews completed between August 1986 and May 1987. As a result, the officials in field offices may not be aware of problems. When the unit does not issue reports promptly, the management has less assurance that appropriate actions are taken.

Criteria: The SPPIA, Section 430.04, requires the unit to report its purpose, its scope, and the results of the audit, and, where appropriate, the reports should contain the auditor's opinion. The SPPIA, Section 430.01, requires the unit to issue a signed written report upon completion of an audit.

Recommendations: The unit should revise its report format to include the purpose and scope of the audit, and, where appropriate, the auditor's opinion. In addition, the department should ensure that the unit's reports address the appropriate level of management, including the commissioner, and that it issues reports promptly after the completion of the audit.

## DEPARTMENT OF CORPORATIONS

We reviewed the financial operations and related internal controls at the Department of Corporations (department).

**Item 1.** **Failure To Follow Written Procedures for Collecting Receivables**

Finding: The department did not sufficiently follow its written procedures for collecting the amounts billed to businesses for its cost of examinations. Our sample included 29 invoices totaling approximately $205,000 that were over 30 days old. For 21 of those invoices, the department had no record of a follow-up procedure, such as sending a notice of late payment to the debtor. The department documented sending one late notice to four debtors and two late notices each to two debtors. The accounting department referred one invoice to a special administrator for collection; however, it did not follow up further on this outstanding invoice. Because the department failed to follow its written collection procedures, it diminished the control over its receivables and, thus, increased the risk that some receivables will become uncollectible. The accounting officer stated that the staff sends out late notices promptly but that it failed to document such actions because of a heavy workload in the accounting department. Because of the lack of documentation, we are unable to determine whether the department sends late notices consistently and promptly.

Criteria: The department's written procedures require that late notices be sent to debtors 30 days after the invoice date if the entity fails to pay within the 30 days. A second late notice is to be sent to the debtor within 15 days of the first late notice and, after another 15 days, the account is to be turned over to a special administrator, the person responsible for collecting debts from the entities. The written procedures also require that the staff document its collection efforts on the applicable invoice by a stamp and the date of the collection effort. Further, the collection procedures require the accounting department, on a monthly basis, to follow up on any outstanding item that has previously been referred for collection.

Recommendation: The department should follow its written collection procedures and document its collection efforts.

**Item 2.** **Inadequate Separation of Duties Related to the Department's Revolving Fund**

Finding: The department does not adequately separate the revolving fund duties among its employees. Currently, one employee maintains the revolving fund ledger cards, prepares revolving fund checks, maintains the revolving fund and general cash disbursement registers, prepares the revolving fund bank deposits, and prepares the monthly accountability statement for the revolving fund. Without proper separation of duties, employees can conceal irregularities and management may be unable to determine the responsibility for errors. According to the accounting officer, the small size of the accounting office makes it difficult to completely separate all incompatible duties.

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

Recommendation: The department 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 the number of staff is not large enough to achieve proper separation of duties, or if such reassignment should cause operational difficulties, the department should obtain the Department of Finance's approval of an exemption from the requirement.

**Item 3.** **Lack of Evidence for Receipt of Goods**

Finding: On 4 out of 30 vendor invoices that we tested, we did not find evidence that the accounting office verified the receipt of goods before it submitted the invoices for payment. Unless the department obtains evidence of receipt of goods or services, the department may pay for goods or services that it did not actually receive.

Criteria: The State Administrative Manual, Section 8422.1, requires that agencies determine whether items listed on an invoice have been received before submitting a claim to the State Controller's Office for payment.

Recommendation: The department's accounting officer should ensure that the person receiving goods or services prepares a receiving report or provides other documentation of receipt before the accounting office submits the invoice to the State Controller's Office for payment.

## DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

We reviewed the Department of Housing and Community Development's (department) administration of the United States Department of Housing and Urban Development grant, Federal Catalog Number 14.228. In addition, we reviewed internal controls for selected cash procedures related to this federal grant.

**Item 1.** **Grantee Reporting Requirements Are Not Enforced**

Finding: In our review of 11 grantees of the Community Development Block Grant, nine grantees were between 3 and 205 days late in submitting their quarterly financial reports. In addition, we found that four of these grantees submitted their annual performance reports between 15 and 61 days late. Additionally, as of September 30, 1988, one of the grantees had not submitted its annual performance report that was due July 31, 1988. The department received late reports because it did not ensure that grantees promptly submit periodic reports. Reports that are late or not submitted reduce the department's control over the grantees' performance and could delay the State's annual performance report to the federal government.

We reported a similar weakness in our compliance audits for fiscal years 1985-86 and 1986-87. The department responded that it had implemented procedures to ensure that grantees comply with the reporting requirements. These procedures consist of withholding money until the grantees submit their reports, making a grantee's reporting history a factor in determining whether a grantee receives additional grants, and distributing grant management manuals to grantees. Although the department has implemented these procedures, it has not eliminated the problems of late grantee reports in fiscal year 1987-88.

Criteria: The Code of Federal Regulations, Title 24, Section 570.498, requires a state that administers Community Development Block Grant funds to submit an annual performance report in such a form and including such information as the State deems appropriate and sufficient. To prepare this report, the State requires subgrantees to submit information concerning their projects. Further, the California Code of Regulations, Title 25, Section 7108(e), requires that grantees file quarterly financial reports within 30 days after the end of the quarter. In addition, the department's Grant Management Manual requires grantees to submit their annual reports no later than July 31 of each year.

Recommendation: The department should continue its efforts to ensure that grantees submit their quarterly financial reports and annual performance reports by the required deadlines.

**Item 2.** **Performance Report Not Supported by Grantee Information**

Finding: The annual performance report prepared by the department contained expenditure information that was not supported by information received from grantees. Because of clerical errors, the department reported grant expenditure information that was $283,315 more than reported by six of ten grantees that we reviewed. As a result, the department overstated the amounts spent for this program in its report to the federal government.

Criteria: The Code of Federal Regulations, Title 24, Section 570.498, requires a state administering Community Development Block Grant funds to submit an annual performance report in such form and including such information as the State deems appropriate and sufficient. Good accounting practice dictates that this information be complete and accurate.

Recommendation: The department should prepare its annual performance report by using the appropriate information from grantee reports.

**Item 3.** **Insufficient Control Over the Revolving Fund**

Finding: We noted weaknesses in the department's administration of its revolving fund. For fiscal year 1987-88, we found the following specific deficiencies:

- The department overdrew its revolving fund an average of $326,473 in 3 of 12 months during fiscal year 1987-88 because it did not promptly submit to the State Controller's Office requests to reimburse its revolving fund;

- In our review of 28 travel expense claims, we found that the department did not promptly submit to the State Controller's Office requests for reimbursement for travel expenses. The requests for reimbursement were dated from approximately one to 18 months after the issuance of the revolving fund payments. As a result, the department did not receive prompt reimbursement for 25 of the 28 claims; and

- The department did not send letters to employees requesting confirmation of continuing travel advances during fiscal year 1987-88, as required by the State Administrative Manual.

Insufficient controls over and accountability for revolving fund activities can result in errors and irregularities that the department may not detect.

Criteria: The State Administrative Manual, Section 8047, directs agencies to make every effort to prevent overdrafts in their checking accounts, including account balances with the State Controller's Office. These efforts would include the department's submitting claim schedules promptly to the State Controller's Office to reimburse the department's revolving fund. In addition, the State Administrative Manual, Section 8116, requires the department to send letters to all employees holding continuing travel advances to confirm their liability or request the return of the advance.

Recommendation: The department should not make disbursements that will overdraw its available revolving fund balance. Also, the department should promptly prepare and submit claim schedules for reimbursement of the revolving fund. Additionally, the department should send letters to all employees holding continuing advances at the end of the fiscal year to confirm the amount of these advances.

**Item 4.** **Late Financial Reports**

Finding: The department did not submit the financial reports for its portion of the State's General Fund to the State Controller's Office until August 18, 1988, 18 days after the due date. In addition, because the department needed to revise its financial reports for its portion of the State's General Fund and

Federal Trust Fund, it did not submit these reports until September 22, 1988. The department has documented that the CALSTARS system problems contributed to the department's delay in producing year-end reports. Failure to submit accurate financial reports by the required deadline delays compilation by the State Controller's Office of the financial statements for the State and may delay the issuance by the State Treasurer's Office of the official statements that accompany bond issues.

Criteria: The State Administrative Manual, Section 7990, requires state agencies to submit to the State Controller's Office by July 31 the financial reports for their portion of the State's General Fund for the year ended June 30. In addition, they must submit the financial reports for all other funds by August 20.

Recommendation: The department should submit accurate financial reports to the State Controller's Office by the required due dates.

**Item 5.** **Insufficient Separation of Duties**

Finding: The department does not sufficiently separate duties over cash transactions. Specifically, one accounting office employee records cash transactions in the general ledger, compares checks to authorizations and supporting documents, and prepares bank deposits. Because of these incompatible duties, an employee could divert receipts or issue unauthorized disbursements that may not be detected.

Criteria: The State Administrative Manual, Section 8080, specifies that state agencies should separate functions so that no one person performs more than one of the following duties: receiving and depositing remittances, recording entries in the general ledger, and comparing machine-signed checks with authorizations and supporting documents.

Recommendation: The department should properly separate duties in the accounting office.

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| Item 6. | **Long-Outstanding Checks Not Cancelled** |
| Finding: | The department does not promptly cancel long-outstanding checks. As of June 30, 1988, the list of outstanding checks contained 44 checks, totaling approximately $2,700, that have been outstanding longer than two years. Failure to cancel checks creates additional accountability work for the department and delays the transfer of money to the State's Special Deposit Fund. |
| Criteria: | The State Administrative Manual, Section 8042, requires agencies to cancel general cash and revolving fund checks that have been outstanding for over two years and to remit the amount of such checks to the State's Special Deposit Fund. |
| Recommendation: | The department should cancel checks that have been outstanding for over two years and remit the money to the State's Special Deposit Fund. |

## DEPARTMENT OF MOTOR VEHICLES

We reviewed the financial operations and related internal controls at the Department of Motor Vehicles (department).

**Item 1.** **Insufficient Control Over and Accountability for the Revolving Fund**

Finding: The department has insufficient control over and accountability for its revolving fund. We found the following specific deficiencies:

- The department did not prepare monthly revolving fund accountability statements for the five months from July 1987 through November 1987. Although the department prepared the monthly revolving fund accountability statements for each of the months from December 1987 through June 1988, some of the statements contained mathematical errors;

- The department's headquarters staff made incorrect postings of approximately $6,410 to 9 of the 25 change funds that we reviewed. Further, the headquarters does not receive monthly accountability statements for a $75,000 sub-revolving fund accounted by one of the department's field offices;

- The department does not accurately account for its employee salary advances. Six of the 57 salary advance balances that we examined included duplicate entries. As a result, the department overstated these balances by a total of $5,832. Moreover, although the department knew of these duplicate entries, it did not adjust its records or its year-end financial statements; and

- The department does not promptly clear outstanding employee advances and vendor payments made from the revolving fund. The department had a total of approximately $380,000 in outstanding salary advances. We examined salary advances totaling approximately $84,000; approximately $37,000, or 43 percent, had been outstanding for more than 60 days as of June 30, 1988. Further, the department had a total of approximately $486,000 in outstanding travel advances. We examined travel advances totaling approximately $122,000; $68,000, or 56 percent, had been outstanding for more than 60 days at June 30, 1988. Finally, the department had a total of approximately $1.8 million in vendor payments that it had not scheduled for reimbursement by the State Controller's Office. We examined approximately $1.7 million of these vendor payments that the department had not scheduled for reimbursement by the State Controller's Office; approximately $70,000, or 4 percent, had been outstanding for more than 60 days as of June 30, 1988.

Failure to reconcile the revolving fund promptly can result in the misstatement of cash balances and can prevent the early detection of errors and irregularities. Also, failure to establish an effective system of internal accounting controls over field-office change funds and sub-revolving funds and failure to ensure that the controls are in place and functioning as prescribed could result in undetected errors or irregularities. Finally, failure to clear all outstanding employee advances and obtain prompt reimbursement from the State Controller's Office for vendor payments unnecessarily reduces funds available for other uses.

We reported a similar weakness in our financial audit for fiscal year 1986-87. In its April 8, 1988, response to our report, the department noted that it would install a new revolving fund system effective July 1, 1988. The department will not see the effects of this new system until the 1988-89 fiscal year.

Criteria:

The State Administrative Manual, Section 7964, requires agencies to prepare monthly revolving fund reconciliations. In addition, the State Administrative Manual, Section 8118, requires agencies to collect salary advances from the subsequently issued payroll warrant for the period of the advance. Moreover, the State Administrative Manual, Section 8116, requires agencies to submit claims to the State Controller's Office to reimburse the revolving fund when their employees submit their travel expense claims. Further, the State Administrative Manual, Section 8047, directs agencies to make every effort to prevent overdrafts in their checking accounts, including account balances with the State Controller's Office. These efforts would include the department's submitting claim schedules promptly to the State Controller's Office to reimburse the department's revolving fund.

Recommendation: The department should comply with all requirements necessary to maintain sufficient controls over and accountability for its revolving fund. Specifically, the department should correctly reconcile its revolving fund resources with the cash advanced to the revolving fund and, once reconciled, prepare monthly revolving fund reconciliations at the end of each month. In addition, the department should review all outstanding advances and vendor payments to determine whether they are collectible. The department should pursue collection or reimbursement of all collectible items. If collection efforts fail, the department should request from the State Board of Control discharge of accountability and reimbursement for the amounts it cannot collect.

<u>Item 2</u>. <u>Insufficient Support for Uncleared Collections</u>

Finding: The department is still unable to provide a complete detailed list of uncleared collections that supports the entire account balance for uncleared collections, which totaled $94 million as of June 30, 1988. The money that is in the uncleared collections account is unavailable for state expenditure or disbursement to local governments. Moreover, because the department cannot provide a complete detailed listing, we could not verify the uncleared collections account balance by testing transactions that support the total.

We reported a similar weakness in our financial audits of the last six fiscal years. To provide a complete detailed listing of uncleared collections, the department has now established an automated uncleared collections file for all of its field offices. Moreover, it anticipates converting the last major element of the uncleared collections account, the automatic license renewal program, to a compatible computer system by March 1989.

In addition to establishing the automated uncleared collections file, the department is attempting to reduce the number of transactions that affect the uncleared collections account. Legislation, which was approved in September 1986 and became effective in January 1987, reduced from four years to one year, the period that uncleared collections should remain outstanding. Therefore, money should remain in the uncleared collections account no longer than one year before it is considered revenue. Also, effective January 1, 1988, the department restricted the issuance of temporary permits. By restricting the number of temporary permits, the department has reduced the number of transactions that affect the uncleared collections account and, as a result, has reduced the uncleared collections account balance.

Criteria: The State Administrative 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 are correctly processed and that the financial records are complete.

In addition, the State Administrative Manual, Section 7951, requires that all agencies retain in their offices detail to support general ledger account balances as of June 30.

Recommendation: The department should continue to automate its uncleared collections file to provide a detailed record of the remaining contents of its uncleared collections file.

## DEPARTMENT OF REAL ESTATE

We reviewed the financial operations and related internal controls at the Department of Real Estate (department).

**Item 1.** **Checks Received Were Not Promptly Endorsed or Deposited**

Finding: The department did not promptly endorse or deposit checks received in the mail. The department did not endorse the 50 checks that we reviewed until an average of 2.3 working days after receipt. Also, the department did not deposit these monies until an average of 3.3 business days after receipt. According to the fiscal officer, the delays arose because of unfilled positions in the budget and fiscal section and because of the large volume of mail received. When checks are not promptly endorsed, theft or loss may occur. In addition, we estimate that these late deposits resulted in an average of $298,000 in undeposited checks and an estimated loss to the State of approximately $22,200 in interest earnings during fiscal year 1986-87.

Criteria: Section 8034 of the State Administrative Manual requires the department to endorse all negotiable instruments on the day received.

Section 8030.1 of the State Administrative Manual requires the department to deposit daily collections greater than $5,000 no later than the working day after receipt.

Recommendation: The department should endorse all checks on the day of receipt. In addition, if collections exceed $5,000, the department should deposit these checks no later than the next working day.

**Item 2.** **Late Transfer of Funds**

Finding: The department was late in notifying the State Controller's Office of monies that it received, deposited, and identified as belonging to the fund. For the 50 receipts that we reviewed, the department took an average of nearly nine business days to notify the State Controller's Office to transfer these receipts to the fund. This is nearly six business days later than required. When the department fails to promptly notify the State

Controller's Office, monies belonging to the fund are not available for the fund's investment or use. To earn interest income for the fund, the State Treasurer's Office, on order of the State Controller's Office, invests monies of the fund, in excess of immediate needs, in the Surplus Money Investment Fund. During fiscal year 1986-87, because the department was late in notifying the State Controller's Office to transfer these monies, we estimate that the State's General Fund earned about $46,300 in interest income that should have been earned by the fund.

Criteria: Section 8091 of the State Administrative Manual requires the department to notify the State Controller's Office of all monies determined to be revenue, reimbursements, abatements, and operating income by the first day of the week following the accumulation of $25,000 or more.

Recommendation: The department should promptly notify the State Controller's Office of all monies identified as belonging to the fund.

Item 3. Inadequate Identification of and Support for Payables and Encumbrances

Finding: The department did not adequately analyze its payables and encumbrances to determine whether it received goods or services before or after June 30. Also, fiscal personnel could not provide documentation for three estimates accrued at year end. These consisted of one estimate of a payable for $22,000 and two estimates of encumbrances totaling $33,000. We found these estimates to be inaccurate. Because of these factors, the department, at June 30, 1987, understated payables by more than $274,000 and overstated encumbrances by more than $207,000. If the department does not properly identify payables and encumbrances in its financial statements, the State Controller's Office does not have sufficient information to prepare the State's financial statements according to generally accepted accounting principles.

Criteria: A memorandum from the State Controller's Office dated April 3, 1987, instructed state agencies to report the amount of encumbrances in such a way that financial statements could be prepared in accordance with generally accepted accounting principles. Under generally accepted accounting principles, encumbrances are commitments that represent goods or services received or provided after June 30.

Recommendation: During year-end closing, the department should more carefully analyze its commitments to determine whether goods or services are received before or after June 30 and report them appropriately as payables or encumbrances.

## DEPARTMENT OF TRANSPORTATION

We reviewed the financial operations, internal controls, and administration of the United States Department of Transportation grant, Federal Catalog Number 20.205, at the Department of Transportation (department).

**Item 1.** **Service Center Rates Not Adjusted Promptly**

Finding: The department did not adjust the rates for its service centers promptly. Specifically, after developing the rates for its materials and electronic data processing (EDP) service centers in fiscal year 1982-83, the department did not update the rates for its materials service center until November 1987 and for its EDP service center until July 1988. In addition, it updated rates for its equipment rental service center in February 1988 although it had not previously updated the rates since December 1985. As a result, the department estimates that it undercharged the federal government approximately $6 million for the costs of materials, rental of equipment, and EDP. The department expects to recover these undercharges over the next year. However, the State lost approximately $736,000 in potential interest earnings.

Through service centers, the department can perform specific services that benefit individual projects and the department. The Federal Highway Administration allows the department to charge service center costs to federal aid projects for reimbursement to the State. Because the department delayed updating the rates, it undercharged the federal government. The department estimates that it undercharged the federal government approximately $1.2 million for costs of materials, $878,000 for costs of rental of equipment, and $3.8 million for EDP costs. The department expects to recover these undercharges over the next year. However, as a result of the EDP undercharges, we estimated that as of June 30, 1988, the State lost approximately $475,000 in potential interest earnings from July 1985 through June 1988; we estimate that it will lose an additional $171,000 interest from July 1988 through July 1989. The department will recover the costs of materials and equipment rental within a year after the update. However, we estimated that as of June 30, 1988, the State lost approximately $52,000 and $38,000, respectively, in potential interest earnings for one year.

We reported a similar weakness in our audits for fiscal years 1984-85, 1985-86, and 1986-87. As a result of our 1986-87 audit, the department developed a plan to update all of the rates for its service centers. The department has since updated the rates and expects to recover from the federal government all prior unclaimed costs over the next year.

Criteria: The Federal Aid Highway Program Manual, Volume 1, Chapter 4, requires that agencies periodically review and adjust their rates in each succeeding fiscal year to correct overcharges or undercharges incurred in the preceding fiscal year.

Recommendation: The department should continue to review periodically all of the rates for service centers and should adjust these rates annually. Moreover, the department should recover all prior undercharges as soon as possible.

**Item 2.** **Final Claims Not Filed Promptly**

Finding: The department did not promptly submit final claims to the Federal Highway Administration (FHWA) to close completed construction and local assistance projects. As of June 30, 1988, the department reported 3,525 completed projects that were not closed, including 1,076 projects completed over two years earlier. However, the department had not filed a final claim for any of the 1,076 projects. The FHWA will not consider a project closed until it reviews and approves a final claim. Moreover, until the project is closed, the department cannot reallocate the balance of authorized funds from completed projects for use on other projects. The department estimates that the unused portion of the expenditure authorization for the 1,076 projects totals approximately $8.2 million. The department gave several reasons for its inability to promptly submit final claims, including not receiving the Final Report of Expenditure from the district offices and the Final Detail Estimate Report from the local governments on time and not receiving audited information about local assistance projects promptly after the completion of the projects.

We reported a similar weakness in our audits for fiscal years 1984-85, 1985-86, and 1986-87. In August 1987, the department and the FHWA agreed to set a goal of preparing the final claim for a project within 24 months and thus reduce the total project backlog to 2,800 projects by July 1989. Further, the FHWA agreed to allow the department to process the final claims using the preliminary Report of Expenditures, rather than the Final Report of Expenditures. The department does not need to include disputed project costs and unresolved contractors' claims in the preliminary Report of Expenditures. Consequently, the department believes that the use of the preliminary report will expedite closing completed projects. The department has since reduced the number of completed projects that are not closed. As of June 30, 1988, the department stated that it was ahead of its schedule to achieve the agreed-upon goal of 2,800 projects by July 1989.

Criteria: The Federal Aid Highway Program Manual, Volume 1, Chapter 4, Section 6, requires federal aid recipients to submit final claims promptly to the FHWA when they complete projects. In addition, a department memorandum dated May 20, 1986, requires district offices to submit to headquarters the Final Report of Expenditures within nine months after completing a project. Finally, the Local Programs Manual, Section II-19, requires local governments to submit to department headquarters the Final Detail Estimate Report within 90 days after completing a project.

Recommendation: The department should submit final claims promptly to close completed federal aid projects.

**Item 3.** **Federal Reimbursement Not Always Billed Promptly**

Finding: The department does not always ensure that it promptly bills the federal government for the federal government's share of project costs. For example, we found that the San Diego district office did not promptly bill the federal government for one project amounting to approximately $1.9 million. This occurred because the department incorrectly coded the project costs as "undetermined" in August 1985 and did not follow up to determine whether the costs were eligible for federal reimbursement. Undetermined costs are those costs that the department cannot immediately identify as eligible or not eligible for reimbursement.

Also, in our review of transactions at the Los Angeles district office, we found two transactions, totaling approximately $500,000, for which the district office did not bill the federal government promptly. The district office delayed billing the federal government for these two transactions until at least 60 days after it had determined the federal share of the project costs eligible for reimbursement. The department generally bills the federal government for its share of project costs twice a month.

Although both of the district offices have implemented procedures to correct such problems, we estimate that the department lost a total of approximately $490,000 in interest earnings by not billing the federal government promptly.

Criteria: The State Administrative Manual, Section 8099, requires state agencies to bill the federal government promptly. Also, California Government Code, Section 13401, requires each agency to maintain effective systems of internal accounting and administrative control to minimize error.

Recommendation: The department should continue to review periodically projects with undetermined status and promptly bill the federal government for its share of project costs.

**Item 4.** **Lack of Reconciliation**

Finding: The department does not prepare a specific reconciliation that would help to detect errors between its accounting and billing systems. Specifically, the department did not reconcile the difference of $40 million that existed at June 30, 1988, between what it expects to recover from the federal government as recorded in the accounting system and what it expects to recover as reflected in the current billing system.

The department records expenditures in the accounting system, differentiating costs that are eligible for federal reimbursement from those that are not eligible. It passes only the project costs that are eligible for federal reimbursement to the current billing system. The department then uses the current billing system to bill the federal government for its share of the project costs. However, because the current billing system does not retain appropriation detail and project detail, the department has been unable to reconcile the two sets of records. Appropriation detail and project detail are necessary to trace the costs into the accounting records. Without a useful reconciliation, the department cannot be assured that its accounting records are accurate. The department believes that the $40 million difference occurred because the amount recorded in the accounting system is based on an estimate, while the amount billed to the federal government is the actual cost.

We reported a similar weakness in our audit for fiscal year 1986-87. During that period, the department hired a consultant to design a new system for billing the federal government that will provide sufficient detail to reconcile the current billing records to the accounting records. The department expects to implement the new system by July 1989.

Criteria: The State Administrative Manual, Section 7900, stresses the importance of reconciliations. Reconciliations are an important internal control because they indicate that transactions have been correctly recorded and that financial statements are complete.

Recommendation: The department should perform regular reconciliations to ensure that the federal government pay its full share of expenditures and to detect errors so that it can correct them.

**Item 5. Insufficient Controls Over and Accountability for the Revolving Fund**

Finding: The department has corrected some of the weaknesses that we reported in previous years. Specifically, the department is now able to reconcile its revolving fund and has a listing of outstanding checks. However, it needs to continue to strengthen its controls over and accountability for its revolving fund to prevent and detect errors and irregularities. For fiscal year 1987-88, we found the following specific deficiencies:

- The department overdrew its revolving fund in 8 of 12 months during fiscal year 1987-88, overdrawing an average of $4.6 million per month. We reported a similar weakness in our audits for fiscal years 1983-84, 1984-85, 1985-86, and 1986-87. In response to our management letter for fiscal year 1986-87, the department increased the revolving fund by $2 million. However, the department still overdrew its revolving fund during fiscal year 1987-88;

- Of 36 revolving fund disbursements that we reviewed at the department's headquarters, we found a payment made from the revolving fund that the State Controller's Office should have paid. The department inappropriately paid a vendor for a claim that neither offered a discount nor required immediate payment. The department's Audits and Internal Security (AIS) noted similar inappropriate payments at the Fresno district office. These payments to vendors in both headquarters and the Fresno district office were for approximately $48,000.

  We reported similar weaknesses at headquarters and the San Francisco and Los Angeles district offices in fiscal year 1985-86 and at headquarters and the San Diego district office in fiscal year 1986-87. In response to our management letter for fiscal year 1986-87, the department reported that it was monitoring the revolving fund for appropriate usage. However, the weaknesses still existed during fiscal year 1987-88; and

- The department did not always promptly reconcile the cash balance of its revolving fund with the cash balance in the centralized State Treasury System. We noted that the department took from 32 to 63 days to complete 9 out of 12 monthly reconciliations for fiscal year 1987-88. The department's failure to reconcile its revolving fund with the centralized State Treasury System promptly diminishes the department's ability to detect and prevent errors. The department states that it cannot prepare the reconciliations promptly because of the volume of transactions contained within the fund. On November 10, 1988, the department requested an exemption from the Department of Finance to allow the department to prepare the monthly reconciliations within 60 days rather than the required 30 days.

Criteria: The State Administrative Manual, Section 8047, directs agencies to make every effort to prevent overdrafts in their checking accounts. Section 8110 and Section 8113 state the appropriate uses of revolving funds, including paying for compensation earned, travel expenses and advances, immediate payment when required, and payment for vendor discounts. Section 7900 states that the revolving fund reconciliations should be prepared within 30 days after the end of the preceding month.

Recommendation: The department should maintain sufficient controls over and accountability for its revolving fund.

**Item 6.** **Insufficient Controls Over Disbursements**

Finding: The department lacks sufficient control over its system of disbursements. Because of this lack of sufficient controls, the department cannot be assured that all of its disbursements are proper. We found the following specific deficiencies:

- At the Fresno district office, the AIS noted six examples of invoices, totaling approximately $4,500, that were paid without evidence that the goods had been received. In addition, the person who was authorized to receive goods also purchased the goods. These two deficiencies increase the risk that the department may not detect errors and irregularities;

- The accounts payable unit at the headquarters office did not always research its vendor payment file to determine whether vendors had already been paid before the unit issued payments to vendors. We noted that during the nine-month period ending in March 1988, the department's headquarters office identified over 250 invoices, totaling approximately $40,000, that had been paid twice. In addition, the AIS noted that the Stockton district office had made 7 duplicate payments, totaling approximately $700, that the Los Angeles district office had made 23 duplicate payments, amounting to $2,319, and that the Redding district office had made 2 duplicate payments amounting to $107. As a result of not researching files before issuing payments, the department continues to sometimes pay vendors that have already been paid.

We reported a similar weakness in our audits for fiscal years 1985-86 and 1986-87. In response, the department implemented an automated system in July 1987 to identify vendors that may have been paid twice for the same invoice. However, the department does not use the new system regularly to identify duplicate payments. Moreover, when the department identifies vendors that were paid twice, it does not always bill the vendors promptly to recover the overpayments. For example, although the department had identified the 250 invoices noted above as of March 1988, it did not bill the vendors until July 1988; and

- The headquarters office did not always promptly pay vendors to take advantage of vendor discounts or to avoid late payment penalties. In our sample of 59 disbursements, the headquarters office did not take advantage of five discounts offered by five vendors. As a result, the department lost approximately $650 in vendor discounts. The department also owed three vendors $300 for late payment penalties because it did not submit claims to the State Controller's Office for payment within the time limit prescribed by law.

Criteria: The State Administrative Manual, Section 8422.1, requires agencies to determine that goods or services were received before making payments; agencies must determine that cash discounts have been taken before submitting claims to the State Controller's Office for payment; and agencies must determine that payments have not already been made to a vendor before paying a vendor invoice. In addition, the California Government Code, Section 926.17, requires agencies to submit these claims to the State Controller's Office for payment within 35 days of the postmark date of the invoice. Otherwise, the agency is responsible for interest penalty fees.

Recommendation: The department should implement procedures to avoid duplicating payments and to ensure that the goods or services have been received before making payments. In addition, the department should pay invoices promptly to avoid penalties, and it should take advantage of vendor discounts when available.

# EDUCATION

## CALIFORNIA COMMUNITY COLLEGES, CHANCELLOR'S OFFICE

We reviewed the financial operations, related internal controls, and administration of the United States Department of Education grant, Federal Catalog Number 84.048 at the California Community Colleges, Chancellor's Office (Chancellor's office)

### Item 1. Improper Control Over Cash Management

Finding: The Chancellor's Office did not always properly control the system for managing its federal vocational education funds. The Chancellor's Office acts as an intermediary in the allocation of these funds between the State Department of Education (SDE) and subrecipients organizations, including college districts. During our audit, we noted the following conditions:

- The Chancellor's Office did not limit the cash advances of its federal vocational education funds for fiscal year 1987-88 to the immediate needs of the college districts. As of December 17, 1987, the Chancellor's Office had already advanced to the college districts 90 percent, approximately $25.5 million of their 1987-88 entitlement, although the college districts had completed only 50 percent of their academic year;

- The Chancellor's Office delayed requesting from the SDE the federal vocational education funds for its fiscal year 1986-87 contract. The Chancellor's Office paid the college districts approximately $1.0 million between July 1, 1987, and April 1, 1988, before requesting reimbursement from the SDE on April 8, 1988. Similarly, the Chancellor's Office additionally paid approximately $1.4 million in the month of April 1988 and did not request reimbursement until June 6, 1988; and

- As we reported on February 3, 1988, for the fiscal year 1986-87 audit, the Chancellor's Office had $9.4 million in excess federal funds on hand at July 1, 1987, from its contract with the SDE for fiscal year 1985-86. During fiscal year 1987-88, the Chancellor's Office slowly disbursed these excess funds. However, at June 30, 1988, the end of the fiscal year, the

Chancellor's Office calculated that it would have to repay the SDE approximately $2.0 million of unused federal vocational education funds.

Because the Chancellor's Office did not properly control the system for managing its federal vocational education funds to ensure that funds were limited to its or the college districts' immediate needs, the federal government lost interest that it could have earned on these funds. The interest that the State lost because it requested funds late for fiscal year 1986-87 was offset by the interest that it earned on the excess federal funds from the previous year. However, the State could lose interest in future years if the Chancellor's Office continues to delay requesting reimbursement from the SDE.

Criteria: Circular 1075 of the federal Department of Treasury, Section 205.4, requires that cash advances be limited to the actual immediate cash 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 disbursement by the recipient organization. In addition, according to Section 8099 of the State Administrative Manual, state agencies making disbursements from a state fund must ensure that the State receive federal money by the time disbursements are made.

Recommendation: The Chancellor's Office should properly control its system for managing its federal vocational education funds to ensure that federal funds are limited to its and the college districts' immediate needs. Furthermore, when appropriate, the Chancellor's Office should ensure that it promptly request its federal money from the SDE.

**<u>Item 2</u>.** **<u>Late and Inaccurate Federal Financial Reports</u>**

Finding: The Chancellor's Office submitted its fiscal year 1985-86 financial status report (status report) for its vocational education program late. Further, the Chancellor's Office did not prepare an accurate status report, and it did not reconcile the status report with its accounting records until after we informed the Chancellor's Office that it should perform these reconciliations. During our audit, we noted the following conditions:

- The Chancellor's Office submitted its status report for its fiscal year 1985-86 vocational education program in December 1988, nearly a year after the due date of December 31, 1987. The Chancellor's Office submits the status report to the SDE, and the SDE submits the report to the federal government. The vocational education director of the Chancellor's Office explained that the SDE never informed the Chancellor's Office of the December 31, 1987, deadline;

- The Chancellor's Office did not correctly prepare the status report for its fiscal year 1985-86 contract with the SDE for the vocational education program. We reviewed the status report before the Chancellor's Office submitted it to the SDE, and we found that the status report contained various inaccuracies. For example, the Chancellor's Office failed to include approximately $443,000 in expenditures and included an incorrect amount for administrative costs. After we brought these errors to the attention of the director of the vocational education program, the errors were corrected before the Chancellor's Office submitted its status report to the SDE; and

- The Chancellor's Office did not reconcile its status reports with the accounting records. Failure to reconcile the status reports with the accounting records can cause the SDE to misstate its claims for reimbursement from the federal government. The failure to reconcile may also prevent the early detection of irregularities such as erroneous adjustments and nonreceipt of federal funds. In November 1988, after we had informed the Chancellor's Office that it should perform these reconciliations, it reconciled its status report for fiscal year 1985-86 with its accounting records. The Chancellor's Office found numerous posting errors in its accounting records, and it determined that it should have returned approximately $161,000 of additional vocational education funds to the SDE in June 1988.

Criteria: The Code of Federal Regulations, Title 34, Section 74.73(d), states that final status reports are due 90 days after the expiration or termination of grant support. In addition, Circular A-102, Attachment G, of the federal Office of Management and Budget requires financial management systems to provide accurate, current, and complete disclosure of each grant program. Further, the State Administrative Manual, Section 20014, requires agencies receiving federal funds to reconcile federal financial reports with the official accounting records and to retain all supporting schedules and worksheets for a minimum of three years.

Recommendation: The Chancellor's Office should ensure that it submit its status report on time. In addition, the Chancellor's Office should develop procedures to ensure that the status report is accurate and is reconciled with the official accounting records.

**Item 3.** **Lack of Control Over Disbursements**

Finding: Purchase documents do not always contain evidence that the Chancellor's Office has verified the receipt of billed goods or services. In our review of 50 claims transactions, we found a total of 12 transactions lacking evidence that the Chancellor's Office had received the billed goods or services before paying for them. As a result, the Chancellor's Office may have paid for goods or services that it has not received. In addition, the Chancellor's Office does not always prepare purchase documents before acquiring goods or services. Two of the 50 transactions that we reviewed were not supported by a contract or service request. If purchase documents are not prepared, the Chancellor's Office is not assured that all of its expenditures have been properly authorized and are, in fact, appropriate expenditures. Furthermore, the Chancellor's Office does not always promptly pay vendor invoices that offer discounts for prompt payment. The Chancellor's Office did not take advantage of discounts offered for prompt payment for two items that we reviewed. As a result, the Chancellor's Office paid more than necessary for these items. We reported a similar weakness in our audit for fiscal years 1986-87 and 1985-86.

Criteria: The California Government Code, Section 13403(a)(3), describes the elements of a satisfactory system of internal accounting and administrative control, including authorization and recordkeeping procedures that provide effective accounting control over expenditures. In addition, the State Administrative

Manual, Section 8422.1, requires each agency to determine that goods or services have been received before payment is made and to determine that invoices comply with the provisions of purchase orders, subpurchase orders, contracts, leases, service agreements, and similar documents. Further, the State Administrative Manual, Section 8422.1, requires facilities to determine that cash discounts have been taken before submitting claims to the State Controller's Office for payment.

Recommendation: The Chancellor's Office should ensure that someone verify the receipt of goods or services before paying for them and that its purchasing procedures comply with state requirements. In addition, the Chancellor's Office should pay vendor invoices promptly to take advantage of all discounts for prompt payment.

<u>Item 4.</u> <u>**Inaccurate Identification of Accounts Payable**</u>

Finding: The Chancellor's Office did not properly analyze and identify certain types of liabilities in its general fund and Higher Education Capital Outlay Bond Fund. We found the following specific conditions:

- The Chancellor's Office did not identify and record as obligations in its general fund the services that it had received on or before June 30 for its deferred maintenance contracts for fiscal year 1986-87. This occurred because the Chancellor's Office did not request this information from the college districts even though it had requested the information for its deferred maintenance contracts for fiscal year 1987-88;

- The Chancellor's Office incorrectly reported approximately $500,000 of accounts payable as encumbrances in its general fund. According to the accounting administrator, this occurred because the accounting personnel did not analyze three contracts with the community college districts and two interagency agreements to determine whether goods had been received or services had been provided on or before June 30; and

- The Chancellor's Office did not accrue in its Higher Education Capital Outlay Bond Fund amounts owed to college districts at

June 30, 1988. As a result, the Chancellor's Office understated its liability and expenditure accounts in this fund by approximately $800,000.

If the Chancellor's Office does not properly identify encumbrances and accounts payable in its financial statements, the State Controller's Office does not have sufficient information to prepare the State's financial statements in accordance with legal and regulatory requirements and in accordance with generally accepted accounting principals.

Criteria: The State Administrative Manual, Section 10544, requires agencies to analyze documents in order to accrue expenditures at the end of the fiscal year and to report the encumbrances that are still outstanding as of June 30.

Recommendation: The Chancellor's Office should ensure that it analyze all documents in order to accurately identify and record its liabilities at June 30.

**Item 5.** **Late Report to the Legislature**

Finding: The Chancellor's Office submitted to the Legislature its analysis of college districts' audit reports, which were prepared by independent auditors, approximately one and one-half months after its deadline of June 30. The review of the audits of the college districts is part of the State's process for monitoring subrecipients of federal grant money. Without this analysis, the Legislature is not promptly made aware of potential problems reported in the college districts' audits and analyzed by the Chancellor's Office.

According to the specialist of the Fiscal Services Unit of the Chancellor's Office, the Chancellor's Office chose to expand the report and include four new sections with information that it believed was pertinent to the use of the report. The four new sections discuss the audit results of average daily attendance, vocational education, and Extended Opportunity Programs and Services and the fiscal stability monitoring system. Developing these new sections required additional time that the staff of the Chancellor's Office did not anticipate, and, as a result, the report was late.

Criteria: The California Education Code, Section 84040.6, requires the Chancellor's Office to report to the Joint Legislative Audit Committee by June 30 of each year the results of its review of the annual audits of the college districts.

Recommendation: The Chancellor's Office should submit its analysis of the audit reports no later than June 30 of each year.

**Item 6.** **Delays in Reimbursing the Revolving Fund**

Finding: The Chancellor's Office does not request reimbursement for its revolving fund promptly. For example, the Chancellor's Office does not promptly request reimbursement for outstanding employee advances and vendor payments made from the revolving fund. Of approximately $100,000 in outstanding advances at June 30, 1988, approximately $72,000 represents employee advances and vendor payments that were at least two months old; approximately $37,000 of the $72,000 represents employee advances and approximately $26,000 of the $72,000 represents vendor payments that were at least four months old. Because the Chancellor's Office did not promptly reimburse the revolving fund, it overdrew its revolving fund during all 12 months in fiscal year 1987-88; in December 1987 alone, it overdrew its revolving fund by approximately $580,000. We reported a similar weakness in our audit for fiscal year 1986-87.

Criteria: The State Administrative Manual, Section 8170, explains the procedures that an agency should use for preparing claim schedules to reimburse the revolving fund. In addition, the State Administrative Manual, Section 8116, requires an agency to clear travel advances from the records when employees submit their travel-expense claims. Finally, the State Administrative Manual, Section 8118, requires agencies to collect from the next issued payroll warrant repayment for the salary advances for the period that the salary advance covers.

Recommendation: The Chancellor's Office should ensure that its revolving fund procedures comply with state requirements.

**Item 7.** **Lack of Procedures for CALSTARS Override Function**

Finding: The Chancellor's Office does not require employees to request authorization for or justify the use of fund and file control overrides. A fund and file control override can be used to bypass various computer edit controls for accounting transactions that are established in the CALSTARS masterfile. We observed that employees in the budget and accounting sections have used the override function for this purpose without seeking authorization or justifying its use. When the Chancellor's Office does not use an authorization and a justification process for overrides, the Chancellor's Office minimizes the effectiveness of the system's control mechanism.

Criteria: The California Government Code, Section 13403, establishes as one element of a satisfactory system of internal accounting control a system of authorization and recordkeeping that is adequate for the performance of duties and functions in each of the state agencies. Therefore, sound internal controls would require the Chancellor's Office to develop procedures to be followed when overriding fund and file control errors.

Recommendation: The Chancellor's Office should establish procedures that require employees to request authorization and justify the use of fund and file control overrides.

**Item 8.** **CALSTARS Reconciliation Not Consistently Prepared**

Finding: During fiscal year 1987-88, the Chancellor's Office did not prepare the CALSTARS' daily batch reconciliation for the periods of December 17, 1987 to February 2, 1988, and May 6 to June 12, 1988. The primary objectives of the daily batch reconciliation are to detect unauthorized data or erroneous updating of the system; to ensure all transactions submitted for processing are actually processed by the system; and to detect abnormal program interruptions or other data processing difficulties. Because the Chancellor's Office did not consistently perform this reconciliation, it may not have promptly detected unauthorized data entries, data entries from external sources, or lost transactions.

Criteria: The CALSTARS' Procedures Manual, Volume II, Chapter VII, states, "In order to ensure the proper submission and recordation of financial transactions, three types of reconciliations are required--daily batch reconciliations, report reconciliations, and State Controller's Office reconciliations."

Recommendation: The Chancellor's Office should consistently prepare a daily batch reconciliation for the CALSTARS.

**Item 9.** **Incomplete Documentation of the Electronic Data Processing Apportionment System**

Finding: The Chancellor's Office has not completely documented the electronic data processing (EDP) system that apportions approximately $1.2 billion to the community college districts. Insufficient documentation exists to describe the planning and testing of the EDP system and programs and to describe the creation and maintenance of the system and programs. The Chancellor's Office has prepared some preliminary documentation; however, it does not expect to complete this documentation until July 1989. Without system documentation, the Chancellor's Office has no basis for determining whether the system is working as intended. We have reported a similar weakness during our audits for the past three years.

Criteria: The California Government Code, Section 13403(a)(3), states that the elements of a satisfactory system of internal accounting and administrative control should include but are not limited to a system of authorization and recordkeeping procedures that effectively control assets, liabilities, revenues, and expenditures. In addition, the State Administrative Manual, Section 4820, requires that EDP systems be fully documented to satisfy the needs of nontechnical users, technical personnel, agency management, and outside auditors. A fully documented EDP system includes evidence of controls over system design, development, testing, and changes of the EDP system and programs.

Recommendation: The Chancellor's Office should continue to determine, establish, and ensure compliance with requirements for appropriate documentation of the EDP apportionment system.

**Item 10.** **CALSTARS Terminals Not Properly Secured**

Finding: The Chancellor's Office does not always use the external locks provided on each of the CALSTARS on-line terminals to secure the terminals during nonbusiness hours. Instead, the accounting and budgeting employees of the Chancellor's Office leave the keys in the locks at the end of the work day. As a result, unauthorized users could gain access to the CALSTARS.

Criteria: The CALSTARS Procedures Manual, Volume III, Chapter III, describes the various levels of security built into the CALSTARS system. Employees should use the external locks on each of the CALSTARS terminals to prevent unauthorized use. In addition, the Department of Finance issued a CALSTARS security guide entitled "CALSTARS Security System" that states, "Agency staff should lock their terminals when they are unattended for any period of time to prevent unauthorized access."

Recommendation: The Chancellor's Office should lock and remove the keys from the CALSTARS on-line terminals during nonbusiness hours.

**Item 11.** **Accounting Transactions Insufficiently Documented**

Finding: The Chancellor's Office was unable to identify or document and, therefore, could not resolve four reconciling items, totaling approximately $53,000, that were included on the June 30, 1988, reconciliation of its general checking account. Two of these items were outstanding for over two years. The largest unidentified reconciling item, approximately $34,000, is a receipt for which no cash appears to exist. Further, the Chancellor's Office had in its bank reconciliation four additional reconciling items, totaling approximately $20,000, that were outstanding for at least one year. Three of these items were outstanding for over two years. We reported a similar weakness in our financial audits for fiscal years 1986-87 and 1985-86. Failure to clear these reconciling items may result in the Chancellor's Office not promptly detecting errors or irregularities such as unauthorized cash disbursements or failure to deposit money.

Criteria: The State Administrative Manual, Section 7967, requires that an explanation of the nature of every reconciling item be made a part of the monthly bank reconciliation and every unusual reconciling item be traced by the person reconciling the bank statement to identify its nature.

Recommendation: The Chancellor's Office should identify and support all accounting transactions that it makes in its accounting records. Further, it should resolve all reconciling items in its general checking account.

**Item 12.** **Property Inventory Not Reconciled to Accounting Records**

Finding: As we have reported for the last five years, the Chancellor's Office has not reconciled its physical inventory of property with its accounting records for the last six years. In February 1983, the headquarters of the Chancellor's Office was severely damaged by fire. In fiscal year 1985-86, to update its property records, the Chancellor's Office initiated a comparison of the physical inventory completed in February 1985 to the property records it had before the February 1983 fire; however, it did not complete this comparison. According to the business services assistant, the Chancellor's Office initiated a second physical inventory during fiscal year 1987-88 but, as of January 5, 1989, had not yet completed it. The Chancellor's Office plans to complete the inventory in the next few months. Without accurate property records, the Chancellor's Office cannot reconcile the property records with the accounting records. Failure to reconcile the physical inventory counts with the accounting records can result in the failure to detect the loss or theft of state property.

Criteria: The State Administrative Manual, Section 8652, requires that agencies reconcile a physical inventory of property with accounting records at least annually.

Recommendation: The Chancellor's Office should complete the physical inventory and reconcile its property records with its accounting records.

**Item 13.** **Late Deposit of Collections**

Finding: The Chancellor's Office does not always deposit cash receipts promptly. Of 15 receipts that we reviewed, the Chancellor's Office did not deposit 4 receipts, each exceeding \$50, within five working days, and one receipt of approximately \$25,000 remained undeposited for two working days. The failure of the Chancellor's Office to deposit receipts promptly results in a loss of interest to the State.

Criteria: The State Administrative Manual, Section 8030.1, requires that agencies deposit accumulated collections totaling \$50 or more within five working days. This section also requires agencies to deposit collections of amounts greater than \$5,000 on the day that they are received unless they are received late in the day or another reason prevents their deposit, in which case they will be deposited the next working day.

Recommendation: The Chancellor's Office should promptly deposit all collections as required by the State Administrative Manual, Section 8030.1.

**Item 14.** **Late Remittance to the State Treasurer's Office**

Finding: The Chancellor's Office did not promptly remit money to the State Treasurer's Office. Of 12 cash receipts that we reviewed, the Chancellor's Office did not remit 5 receipts, totaling approximately \$82,000, to the State Treasurer's Office within 30 days following the collection date. If the Chancellor's Office did not remit money promptly to the State Treasurer's Office, these funds will not be recorded to a specific fund and, therefore, will not be available for their intended purposes. We reported a similar weakness during our financial audit of fiscal year 1986-87.

According to the accounting administrator, the late remittance to the State Treasurer's Office occurred during the time that the accounting staff were focusing on preparing the year-end financial statements, and remitting money to the State Treasurer's Office became a low priority.

Criteria: The State Administrative Manual, Section 8091, requires departments to remit to the State Treasurer's Office all money determined to be revenue, reimbursement, abatements, and operating income within 30 days following the date that the departments collect the money.

Recommendation: The Chancellor's Office should ensure that it remits all money to the State Treasurer's Office as required.

## CALIFORNIA STATE UNIVERSITY

We reviewed the financial operations and related internal controls at certain campuses of the California State University (CSU).

**Item 1.** **Inaccurate Financial Reports**

Finding: CSU Fullerton did not prepare year-end financial reports for the State's General Fund as required by the State Administrative Manual. As a result, the financial statements of CSU Fullerton are neither complete nor accurate, and the State Controller's Office is not sure of the accuracy of the data that it uses. We found the following specific deficiencies:

- CSU Fullerton did not accurately prepare its "report of accruals to controller's accounts." Specifically, the total encumbrances reported by CSU Fullerton in its report of accruals were understated by $79,585, and its recorded expenditures were understated by $79,585. In addition, its accrual worksheet exceeded the amount shown in its report of accruals by $256,224;

- CSU Fullerton also did not accurately prepare its report of "adjustments to controller's accounts" and its "reconciliation of agency accounts with transactions per state controller." The amount shown in the reconciliation report exceeded that shown in the report of adjustments by $487,725;

- CSU Fullerton did not accurately reconcile expenditure balances in its final budget report with the accounts of the State Controller's Office. The net appropriation balances of CSU Fullerton exceeded those recorded by the State Controller's Office by $683,316. In addition, CSU Fullerton did not prepare reports for several prior years' appropriation items to reconcile its appropriation balances with the accounts of the State Controller's Office; and

- In its "reconciliation of agency accounts with transactions per state controller," CSU Fullerton omitted balances of the State Controller's Office totaling $436,078 for two appropriation items.

Criteria: The State Controller's Office and the Department of Finance, in their letters dated May 20, 1988, and June 2, 1988, respectively, reminded agency officials of their responsibility for complete and accurate financial reports. Sections 7950 through 7979 of the State Administrative Manual describe the requirements for preparing accurate financial reports.

Recommendation: CSU Fullerton should prepare complete and accurate year-end financial reports as required by the State Administrative Manual.

**Item 2.** **Weakness in Control Over Warrant Disbursements**

Finding: CSU Fullerton did not follow state procedures that require warrants drawn for more than $15,000 to have two authorized signatures. We reviewed 30 warrant disbursements for CSU Fullerton in fiscal year 1987-88 and found that 21 warrants issued in excess of $15,000 contained only one signature. We also noted one warrant at CSU Hayward and one warrant at CSU Northridge that did not contain two signatures as required. The lack of signature control over warrants drawn for more than $15,000 could result in the loss of state funds through improper payment.

Criteria: The State Administrative Manual, Section 8001.2, requires that warrants drawn for more than $15,000 have two authorized signatures unless the warrant is payable to the State Treasurer's Office or another state agency or unless the Department of Finance has authorized the agency to disregard this requirement.

Recommendation: CSU Fullerton should ensure that warrants drawn for more than $15,000 have two authorized signatures before it releases the warrants.

**Item 3.** **Failure To Obtain Reimbursements Promptly for Revolving Fund Advances**

Finding: CSU Northridge and CSU Fullerton did not promptly obtain from the State Controller's Office reimbursements for some revolving fund advances. We found these specific deficiencies:

- At June 30, 1988, CSU Northridge had not obtained reimbursement from the State Controller's Office for approximately $60,000 in vendor payments that had been outstanding for at least 3 to more than 12 months;

- CSU Northridge had not obtained travel expense claims from employees or reimbursement from the State Controller's Office for approximately $76,600 in travel and payroll advances that were outstanding for more than three months as of June 30, 1988; and

- CSU Fullerton had not obtained travel expense claims from employees or reimbursement from the State Controller's Office for approximately $17,300 in travel and payroll advances that were outstanding for more than three months as of June 30, 1988.

Failure to obtain reimbursement promptly for revolving fund advances can result in loss of state funds if improper disbursements to vendors are not detected immediately or if employees leave state service before repaying the advances.

We reported similar weaknesses at other campuses for fiscal years 1985-86 and 1986-87.

Criteria: The State Administrative Manual, Section 8047, requires that agencies schedule claims for reimbursement of office revolving funds promptly to prevent overdrawing the revolving fund. In addition, the State Administrative Manual, Section 8116, provides for agencies to reimburse, and therefore clear travel advances from the records, when employees submit their travel expense claims. Further, the State Administrative Manual, Section 8118, requires agencies to collect payroll advances from payroll warrants issued for the period covered by the advance.

Recommendation: CSU Northridge and CSU Fullerton should submit vendor claims to the State Controller's Office and collect travel and payroll advances promptly as required by the State Administrative Manual.

**Item 4. Inaccurate Analysis and Reporting of Payables and Encumbrances**

Finding: CSU Northridge and CSU Fullerton did not accurately analyze and report payables and encumbrances at June 30, 1988. Of its portion of the State's General Fund, CSU Northridge overstated encumbrances and understated payables by $748,000. CSU Fullerton understated encumbrances and overstated payables by $277,000. These misstatements occurred because CSU

Northridge and CSU Fullerton did not thoroughly analyze their commitments to determine whether they had received the goods or services before or after June 30.

Failure to analyze and report payables and encumbrances accurately to the State Controller's Office reduces the ability of the State Controller's Office to prepare the State's financial statements accurately and in accordance with generally accepted accounting principles.

We reported a similar weakness at the Chancellor's Office for fiscal year 1986-87 and other campuses for fiscal year 1985-86.

Criteria: The State Administrative Manual, Section 10544, requires agencies to analyze their obligations and encumbrances at June 30 and to determine whether they received the goods or services before or after June 30. In addition, a State Controller's Office memorandum, dated May 20, 1988, requires agencies to accurately report in their financial statements the amount of encumbrances.

Recommendation: CSU Northridge and CSU Fullerton should analyze their commitments to determine whether they received the goods or services before or after June 30 and appropriately report the commitments as payables or encumbrances.

## CALIFORNIA STUDENT AID COMMISSION

We issued three reports for the California Student Aid Commission (commission). For fiscal year 1986-87, we reviewed the commission's financial operations, related internal controls, and administration of the United States Department of Education grant, Federal Catalog Number 84.032 (items 1-4). For fiscal year 1987-88, we reviewed the commission's administration of Federal Catalog Number 84.032 (items 5-8), and we reviewed the commission's internal audit unit (items 9-12).

**Item 1.** **Insufficient Controls Over Service Contractor**

Finding: The commission did not sufficiently control its service contractor, the Electronic Data Systems Corporation (EDS), which processes student loan information for the commission. The recently expired contract between the EDS and the commission did not require that the EDS provide the commission with documentation of the programs and data files that the EDS used in the processing of student loans. During fiscal year 1986-87, the EDS extensively reorganized its data files and programs. When we discovered that this reorganization had taken place and wanted to write new computer-assisted audit programs, the commission was unable to provide us with the documentation needed to write the programs. In addition, the EDS deleted some information from the master file that we needed to verify premium revenue. After considerable efforts to ascertain all the facts, we had to abandon the attempt to verify premium revenues through a computer-assisted audit program. Furthermore, these difficulties resulted in the delay of our audit report of the State Guaranteed Loan Reserve Fund by over three months. Officials of the commission explained that the new service contract stipulates that the EDS provide the commission with documentation of the data files but not the programs.

Criteria: The California Government Code, Section 13403(a)(3), states that the elements of a satisfactory system of internal accounting and administrative control should include, but is not limited to, a system of authorization and recordkeeping procedures that effectively control assets, liabilities, revenues, and expenditures. As a first step in exercising the control, the commission should require that the EDS provide it with the programs and data files that the EDS uses in the processing of student loans.

Recommendation: The commission should ensure that it receives the documentation of the programs and data files that the EDS uses in the processing of student loans.

**Item 2.** **Lack of Separation of Duties Relating to Property**

Finding: The commission does not separate the duties related to property. We found that one employee receives incoming equipment, has custody of unassigned equipment, maintains the property ledger, is in charge of the physical inventory, and reconciles the physical inventory to perpetual inventory records. The business services officer indicated that he does not have sufficient staff to properly separate the duties related to property. The commission's failure to provide for adequate separation of duties can result in the loss of equipment without the commission becoming aware of the loss. We reported a similar weakness in our audit for fiscal year 1985-86.

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

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

**Item 3.** **Late Deposit of Collections**

Finding: The commission does not promptly deposit collections. Of the 70 receipts that we reviewed, the commission did not deposit 6 receipts, each of which exceeded $50, within 5 working days, and it did not deposit one receipt of less than $50 within 15 working days. In addition, we found two receipts for $67,354 and $22,774 that the commission did not deposit for 12 and 16 working days, respectively. The commission's failure to promptly deposit collections results in a loss of interest to the State.

Criteria: The State Administrative Manual, Section 8030.1, stipulates that agencies deposit accumulated collections totaling $50 or more within 5 working days and must not hold any collections longer than 15 working days. This section also requires agencies to deposit collections of amounts greater than $5,000 on the day that they are received unless they are received late in the day or another reason prevents their deposit.

Recommendation: The commission should promptly deposit all collections as required by the State Administrative Manual, Section 8030.1.

**Item 4.** **Late and Possibly Inaccurate Federal Quarterly Reports**

Finding: The commission's federal quarterly report for the quarter of April through June 1987 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, the commission's 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 quarter ending December 31, 1986, the commission did not file its federal quarterly report within 60 days as required.

We reported a similar weakness in our audit for fiscal years 1985-86 and 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: Circular A-128 of the Office of Management and Budget requires that federal reports contain information that is supported by the agency's accounting records. Federal instructions for the guaranteed student loan programs 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.

**Item 5.** **Delays In Reporting Collections From Defaulted Student Loans**

Finding:

The commission did not promptly report to the federal government the federal government's share of collections from defaulted student loans. Specifically, during fiscal year 1987-88, the commission did not report to the federal government within the required 60 days at least $1.3 million of approximately $26.0 million in total collections. For this review, we considered all collections received throughout a month to have been received on the last day of the month; therefore, the commission may not have promptly reported more than the $1.3 million that we identified. The federal government reduces the amount that it reimburses the commission by the amount of the collections that the commission reports. Because the commission did not promptly report the federal government's share of collections, the federal government may have provided the commission with money before the commission was entitled to receive the money. Noncompliance with the federal regulations could cause the federal government to take action against the commission's administration of the federal Higher Education Act Insured Loans program.

According to a loan program manager, during fiscal year 1987-88, the commission implemented new collection and processing procedures that should have reduced the number of collections that the commission did not report within the required 60 days. Further, the manager stated that the commission will have to research each receipt to determine the reason for the reporting delays.

Criteria:

The Code of Federal Regulations, Title 34, Section 682.404(e)(1) and (4), requires that the commission pay to the federal government within 60 days the federal government's share of any collections that the commission receives from defaulted student loans. The commission reports to the federal government the federal government's share of collections and the amount that the federal government owes the commission for defaulted student loans. In turn, the federal government receives its payment for its share of collections through a reduction of the amount that it owes by the amount of the collections.

Recommendation: The commission should determine why it delays reporting collections from defaulted student loans and consider implementing changes to its collection and processing procedures to ensure that it reports the federal government's share of collections within the required 60 days.

**Item 6.** **Failure To Ensure That Defaulted Student Loans Met Federal Requirements For Reimbursement**

Finding: The commission did not ensure that all of the defaulted student loans that it submitted to the federal government met the federal requirements for reimbursement. During fiscal year 1987-88, the federal government reimbursed the commission for approximately 45,000 defaulted student loans, totaling approximately $112 million. We reviewed 44 of these loans and found that 17, approximately 40 percent, did not meet all of the federal requirements for reimbursement. Specifically, for 6 of the loans, the commission did not pay the lender within 90 days of the date that the lender filed the claim; for 9 of the loans, the commission requested payment from the federal government earlier than 90 days following default; and for 2 of the loans, the lender did not file a claim within 90 days of default. As a result, the federal government reimbursed the commission approximately $45,000 for the 17 defaulted student loans that did not meet the federal requirements for reimbursement. The federal government could require the commission to repay the funds that it has received for these defaulted student loans. In addition, the federal government could take action against the commission's administration of the federal Higher Education Act Insured Loans program.

Criteria: The Code of Federal Regulations, Title 34, Section 682.406, lists the conditions that a defaulted student loan must meet in order to qualify for federal reimbursement. These conditions include the following: the commission must pay the lender's claim for the loan within 90 days of the date that the lender filed the claim; the commission must submit a request for payment of the loan to the federal government no earlier than 90 days following the default of the loan; and the lender must file a claim for the loan within 90 days of default.

Recommendation: The commission should ensure that the defaulted student loans it submits to the federal government meet the federal requirements for reimbursement.

**Item 7.** **Lack of Documentation For Some Disability Claims**

Finding: The commission could not always provide the necessary documents to show that the disability claims that it had submitted to the federal government were eligible for reimbursement. During the fiscal year 1987-88, the commission submitted to the federal government 421 disability claims totaling approximately $1.1 million. The commission submits a disability claim for federal reimbursement when an individual who received a student loan becomes totally and permanently disabled. A completely disabled student does not have to repay the loan.

We examined a sample of 48 claims resulting from loans that were forgiven, including 12 disability claims. According to a physician's certification, in 7 of the 12 disability claims, the students were disabled when they applied for the loans. If this type of loan is to qualify for federal reimbursement, the student's condition must have substantially deteriorated since the student originally applied for the loan. However, for 4 of the 7 disability claims that we reviewed, the commission could not provide us with documentation showing that the student's condition had substantially deteriorated. The commission received federal reimbursement of approximately $9,800 for the 4 disability claims. The federal government could require the commission to repay the funds that it received for these 4 disability claims. In addition, the federal government could take action against the commission's administration of the federal Higher Education Act Insured Loans program.

Criteria: The Code of Federal Regulations, Title 34, Section 682.402(c) and (h), states that the federal government is not required to pay the commission for disability claims when the student's disability existed before he or she applied for the loan unless the commission documents that the student's condition has substantially deteriorated since that time.

Recommendation: In instances when a student's disability existed before the student applied for a loan, the commission should ensure that it has documentation showing that the student's condition has substantially deteriorated before it submits a disability claim to the federal government for reimbursement of the student's loan.

Item 8. **Federal Quarterly Reports Not Reconciled**

Finding: The commission's federal quarterly report for the quarter of April through June 1988 contained information that does not reconcile with the commission's accounting records and may have been inaccurate. The commission prepares the quarterly reports and the accounting records using computer-generated information from the data base maintained by the Electronic Data Systems Corporation, the commission's service contractor. However, we were unable to reconcile this computer-generated information with the commission's accounting records. Specifically, the commission reported $200,950 more in collections received and $18,864 more in lender claims paid on the quarterly report than it recorded in its accounting records. In addition, we were unable to ascertain whether the quarterly report, accounting records, or both were inaccurate.

We reported a similar weakness in our audit for fiscal years 1984-85, 1985-86, and 1986-87. The commission responded that its internal audit and the contract management staff were aware of this problem and were working to correct the matter. Noncompliance with federal reporting requirements could cause the federal government to take action against the commission's administration of the federal Higher Education Act Insured Loans program.

Criteria: Circular A-128 of the Office of Management and Budget requires that federal reports contain information that is supported by the agency's accounting records.

Recommendation: The commission should reconcile computer-generated data used for the quarterly reports with its accounting records before preparing its federal quarterly reports.

**Item 9.** **Internal Audit Workpapers Lack Sufficient Evidence To Support Audit Conclusions**

Finding: Audit workpapers do not sufficiently support audit findings and recommendations. For one of the two internal audits that we reviewed, we found that the workpapers lacked sufficient evidence. For purposes of our review, we examined the unit's audit of the Electronic Data Systems (EDS), a private corporation that processes claims for the commission. We found that the audit report issued in June 1987 contained information that was not supported by the workpapers. We also found that the audit program was not completely referenced to the supporting workpapers or initialed to indicate that the audit procedures were performed. Finally, we noted that the auditors did not always include the criteria and recommendations in their summaries of audit findings. Failure to properly document evidence in the workpapers prevents management from being assured that the audit results are complete and accurate.

Criteria: The "Standards for the Professional Practice of Internal Auditing" (SPPIA), Section 420.01.5, requires the internal auditors to document in the workpapers the information that they obtain and their analyses. This section also requires that workpapers support the findings and recommendations that the auditors report.

Recommendation: The commission should provide training to improve the internal auditors' technical skills in preparing workpapers and in gathering and documenting sufficient, competent, and relevant evidence.

**Item 10.** **Insufficient Communication of Audit Findings**

Finding: The unit did not discuss its audit findings and recommendations with the appropriate levels of management at the EDS or commission before issuing its June 4, 1987, final report. The chief of the unit stated that the unit did not hold an exit conference before issuing the EDS audit report. Further, we did not find workpapers to support that an exit conference was held to discuss audit findings and recommendations. The purpose of discussing audit findings and recommendations with the auditee is to ensure that a report is fair, complete, and objective.

Criteria: The SPPIA, Section 430.02, requires the internal auditors to discuss their audit findings and recommendations with appropriate levels of management before issuing final reports.

Recommendation: The unit should discuss its audit findings with the appropriate level of management to ensure that internal audit reports are fair, complete, and objective.

**Item 11.** **Lack of Accountability for Audit Personnel Hours**

Finding: The unit did not properly monitor its audit personnel hours. We found that the unit did not account for all audit hours spent by its two auditors. Specifically, for fiscal year 1986-87, the unit could account for only approximately 2,100 hours of an estimated 3,600 hours available.

Although the chief of the unit was unsure what the unaccounted 1,500 hours were used for, he felt that they were for work performed for external auditors, administrative time, and training. However, without effective monitoring of all staff resources, the commission is not assured that it uses its internal audit resources efficiently.

Criteria: The SPPIA, Section 500.01, requires the management of the unit to use its audit resources efficiently.

Recommendation: The commission should establish a quality assurance program to ensure that the unit, through proper planning, uses its audit resources efficiently.

**Item 12.** **Lack of Personnel Performance Evaluations**

Finding: We found that the unit has not performed annual staff evaluations for its current internal audit staff. The primary objectives of staff performance evaluations are to appraise staff performance, to identify training needs, and to promote audit staff. Without annual staff performance evaluations, the internal personnel unit may not be aware of the auditors' training needs and professional development.

Criteria: The SPPIA, Section 540.01.4 requires the chief of the unit to appraise each internal auditor's performance at least annually.

Recommendation: The commission should require its unit to evaluate the internal auditors' performance annually.

## STATE DEPARTMENT OF EDUCATION

We reviewed the financial operations, related internal controls, and administration of ten federal programs at the State Department of Education (department). These programs are the United States Department of Agriculture grants, Federal Catalog Numbers 10.550, 10.553, 10.555, and 10.558, the United States Department of Labor grant, Federal Catalog Number 17.250, and the United States Department of Education grants, Federal Catalog Numbers 84.010, 84.011, 84.027, 84.048, and 84.151.

**Item 1.** **Inconsistent Policy for Accounts Receivable**

Finding:

The department does not have a consistent policy for monitoring and collecting delinquent accounts receivable. Various program units, as well as the accounting unit, perform procedures related to accounts receivable. However, because the department lacks a consistent policy and clear division of responsibilities among these units, inefficiencies and inconsistencies result.

For example, two program units do duplicate work because both units have accounts receivable from the same contractors. For one contractor with outstanding receivables that we reviewed, the two program units and the accounting unit each handled the contractor's delinquent accounts differently. One program unit requested an asset check on the contractor, the other program unit planned to reduce future disbursements to the contractor, and the accounting unit requested permission from the Board of Control to write off one of the contractor's delinquent accounts with the department. We observed a similar weakness during our financial audit for fiscal year 1986-87.

Furthermore, the department does not have a consistent policy for dealing with delinquent accounts receivable. Certain program units have developed their own policies, which differ from each other. In addition, units that have developed their own policies do not apply their own policies consistently. For example, one program unit does not always follow its policy to immediately offset delinquent receivables with current disbursements. Furthermore, the department also has not required a small program unit to monitor its delinquent accounts receivable. One of the items that we reviewed was a delinquent account receivable from a small program within the department. This program had not monitored the status of the receivable.

Finally, the department does not consistently charge interest on delinquent accounts receivable. Four of the 14 accounts receivable that we reviewed included an interest charge. The department could not explain why some accounts receivable had interest charges and others did not.

Criteria: The California Government Code, Section 13403, requires agencies to ensure that a satisfactory system of internal accounting and administrative controls is in place to provide effective accounting control over assets, liabilities, revenues, and expenditures.

Recommendation: The department should establish a clear policy for monitoring and collecting accounts receivable. As a minimum, this policy should include the following:

- An explicit delineation of duties between the program units and the accounting unit that prevents duplication of effort and provides for thorough monitoring of all receivables;
- A list of procedures for collecting outstanding receivables;
- A list of conditions under which recipients of program money can continue to receive money when the recipients owe the department money; and
- A specific definition of conditions under which the department will charge interest on receivables.

<u>Item 2</u>. <u>Lack of Monitoring of the Apportionment for the Elementary Awareness Program</u>

Finding: The department does not monitor apportionments to participants in the Elementary Awareness Program. Apportionments in the Elementary Awareness Program provide funds that help make nonhandicapped pupils aware of special problems encountered by handicapped persons. The department developed a certification of acceptance that outlines funding policies and reporting requirements for sponsors participating in the program. The sponsor must sign a certification of acceptance before it can receive grant money.

The certification of acceptance states that sponsors must submit budget expenditure reports and progress reports each quarter to receive funds the following quarter.

One of the sponsors that received apportionments for the Elementary Awareness Program did not submit a signed certification of acceptance before receiving a grant advance. In addition, for the three quarters that we reviewed in which reports were due, October 1987 through June 1988, 19 of 36 reports required from six sponsors were not submitted, were submitted late, or could not be located by the department. Department failure to monitor receipt of budget expenditure reports and progress reports may result in sponsors receiving funds in excess of actual expenditures or for inappropriate expenditures.

Criteria:

The California Education Code, Section 56463, states that the superintendent must develop a process for evaluating and monitoring the Elementary Awareness Program established in selected districts.

Recommendation:

The department should follow the guidelines that it developed in the certification of acceptance to ensure that sponsors submit budget expenditure reports and progress reports before receiving funds in the Elementary Awareness Program.

<u>Item 3</u>. <u>Insufficient Documentation for the Project Work-Ability I Apportionment</u>

Finding:

The department does not sufficiently document the calculation for the apportionment of Project Work-Ability I funds. The Project Work-Ability I apportionment provides funds for job training and placement. The department has developed its own formula for apportioning Project Work-Ability I funds to local educational agencies (LEAs). However, the funding formula for fiscal year 1987-88 was based on the prior-year apportionment calculations, and, in fiscal year 1986-87, we reported that the department could not provide sufficient documentation of the 1986-87 apportionment calculations. According to the assistant to the director of Special Education, determining how the Project Work-Ability I apportionments for fiscal year 1986-87 were calculated would be too time-consuming and not cost-effective.

The department is developing a new funding formula that is not based on prior-year calculations. The department intends to have the funding formula approved and in effect for new Work-Ability I sites in fiscal year 1988-89. In addition, it intends to inform currently participating sites of their estimated Work-Ability I apportionments calculated under the new formula and to implement the new formula for these sites in fiscal year 1991-92. The department has delayed implementing the new formula for existing sites because it wants to allow sites that will receive decreased funding under the new formula the opportunity to find other sources of funding.

Criteria: The California Government Code, Section 13403, requires agencies to ensure that a satisfactory system of internal accounting and administrative control, including a system of authorization and recordkeeping procedures, is in place to provide effective accounting control over assets, liabilities, revenues, and expenditures. The California Education Code, Section 56471 (c), states that the superintendent shall develop criteria for awarding grants.

Recommendation: The department should fully implement its plan to apportion Project Work-Ability I funds for current and new sites.

<u>Item 4</u>. <u>Incorrect Calculation of Entitlements for the School Improvement Program</u>

Finding: The department did not calculate entitlements for the School Improvement Program for fiscal year 1987-88 in accordance with state statutes. In three of the ten entitlement items that we reviewed for fiscal year 1987-88, 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 1986-87. However, according to our legal counsel's interpretation of the California Education Code, the department should have based its calculations of the funding for the school improvement program for fiscal year 1987-88 on the California Education Code, Section 52046(b)(1) and (2), which adjusts the previous year's funding by the student attendance figures. If the department maintains district entitlements at the funding level for fiscal year

1986-87, school districts with declining attendance would not have a decrease in entitlement.

We reported a similar weakness in our financial audits for fiscal years 1984-85, 1985-86, and 1986-87. The department attempted to have legislation approved to amend these code sections; however, the governor vetoed this legislation on September 30, 1986. The department's attempt to clarify the intent of the code sections through explanatory language in the budget bill for fiscal year 1988-89 also was disallowed.

Criteria: The California Education Code, Section 52046(b)(1) and (2), requires that, from funds appropriated, the superintendent is to make allowances to school districts 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; and

- $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 seek the attorney general's opinion for interpretation of the California Education Code, Sections 52048 and 52046(b)(1) and (2).

<u>Item 5.</u> <u>Insufficient Controls Over Cash and Cash Receipts</u>

Finding: The department did not maintain sufficient controls over certain areas of cash and cash receipts. We noted the following specific deficiencies:

- For cash receipts other than federal grant money deposited directly with the State Treasurer's Office, the department was late in notifying the State Treasurer's Office which fund to credit with the department's receipts. For receipts received from July through January that we reviewed, the department notified the State Treasurer's Office 16 to 75 working days after the month of collection. However, by the end of the fiscal year, the department had significantly improved its notification process. When the department does not notify the State Treasurer's Office which fund to credit for money that it receives, it cannot use the money to pay current obligations. According to the supervising accounting officer, the department's staff position responsible for notifying the State Treasurer's Office was unfilled for part of the year. This vacancy caused a backlog and delayed the processing of the receipts between July and December 1987;

- The department did not reconcile the checks-written log with the checks-signed log for general cash checks. During our review of the logs, we noted two series of checks entered in the checks-signed log but not in the checks-written log. As a result, the department could not be certain that it could completely account for the blank-check stock. We reported a similar weakness during our financial audit for fiscal year 1986-87; and

- The department was unable to locate 4 voided general cash checks of the 45 voided checks that we reviewed. As a result, we were unable to determine if the department properly voided these 4 checks. The remaining 41 voided checks were properly defaced.

Criteria: The State Administrative Manual, Section 8091, requires the department to notify the State Treasurer's Office which fund to credit within 30 days of collection and, for receipts of $25,000 or more, requires the department to send notification no later than the first day of the week following the accumulation of that amount. The State Administrative Manual, Section 8081, requires the department to reconcile the checks-written log with the checks-signed log each month to ensure that the department accounts for all checks. Furthermore, the State Administrative Manual, Section 8041, requires state agencies to retain copies of all voided checks for audit purposes.

Recommendation: The department should comply with the provisions of the State Administrative Manual, Sections 8081, 8091, and 8041.

**Item 6.** **Lack of Documentation for Reclassifications of Accounts Payable**

Finding: The department did not sufficiently document reasons for reclassifications of accounts payable to other liability accounts in the department's portion of the State's General Fund. The department's original reclassification was $140,229 more than the amount in the report used to prepare the reclassification, and the department could not provide documentation to explain the difference. In addition, corrections to the original reclassification did not take these differences into account. Finally, the report used to prepare the correcting reclassification was a preliminary report that recorded $424,637 more than the final report that supports the department's financial statements. Therefore, certain liability accounts reported on the financial statements that the department submitted to the State Controller's Office as of June 30, 1988, were incorrect. However, liabilities in total were correctly reported.

Criteria: The California Government Code, Section 13403, requires agencies to ensure that a satisfactory system of internal accounting and administrative control, including a system of recordkeeping procedures, is in place to provide effective accounting control over assets, liabilities, revenues, and expenditures.

Recommendation: The department should document adjustments made to supporting records that it uses to prepare year-end financial statements.

**Item 7.** **Revolving Fund Advances and Expenditure Claims Not Cleared Promptly**

Finding: The department does not promptly clear outstanding revolving fund advances and expenditure claims. Fifteen of the revolving fund advances and expenditure claims that we reviewed have been outstanding a longer period than allowed. For example, four salary advances have been outstanding for approximately three to four years. According to a senior accounting officer, the department has been continuously working to resolve long-outstanding revolving fund balances, but the remaining advances and claims are complex, delaying resolution. In addition, the accounting office has been unable to clear outstanding salary advances because the personnel office has not ordered warrants to reimburse the revolving fund.

Criteria: The California Government Code, Section 13403, requires agencies to ensure that a satisfactory system of internal accounting control is in place to provide effective accounting control over assets, liabilities, revenues, and expenditures. In addition, the State Administrative Manual, Section 8116, provides for an agency to reimburse and, therefore, clear travel advances from the records when employees submit their travel-expense claims. If the advance exceeds the employee's travel-expense claim, the employee is required to reimburse the revolving fund promptly unless it is known that the employee will travel in the near future. Also, the State Administrative Manual, Section 8118, requires agencies to collect repayment for a salary advance from the next issued payroll warrant for the period that the salary advance covers.

Recommendation: The department should ensure that the responsible units promptly resolve and clear revolving fund advances and expenditure claims.

**Item 8.** **Late Transfers of SWCAP Recoveries**

Finding: The department did not promptly transfer to the State's General Fund the reimbursements representing the federal government's share of service costs provided by central service agencies. These costs are calculated under the statewide cost allocation plan (SWCAP), which is the plan that each state agency uses to pay for its share of the State's costs for central services. The reimbursements are to be transferred to the State's General Fund each quarter.

On April 29, 1988, the department transferred to the State's General Fund $1,301,101 of its total SWCAP costs of $1,336,039 for fiscal year 1987-88. The remaining $34,938 was not transferred until November 1988 because federal funds were unavailable to reimburse the State's General Fund until that time. As a result of the delay in transferring SWCAP recoveries, money was not available for disbursement from the State's General Fund as soon as required. We observed a similar weakness during our financial audit for fiscal year 1986-87.

According to the manager of the department's federal funds unit, the department delayed transferring SWCAP recoveries because a new system that it had developed to calculate the SWCAP recoveries in fiscal year 1987-88 was not in effect until late in the fiscal year. The department had begun using a personal computer rather than its automated California State Accounting and Reporting System (CALSTARS) system to calculate SWCAP recoveries, but, because of heavy workloads, this system was not in place until March 1988.

Criteria: Section 13332.01 of the California Government Code requires agencies to recover SWCAP costs from the federal government. Although no deadline is expressly mandated, the State Administrative Manual, Section 8755.2, intimates that a transfer of SWCAP recoveries to the State's General Fund within 30 days of the end of each quarter would be appropriate.

Recommendation: The department should follow the State Administrative Manual and transfer its SWCAP recoveries to the State's General Fund within 30 days of the end of each quarter.

**Item 9.** **Insufficient Control Over Changes in Employee Access to the CALSTARS**

Finding: The department did not consistently change access to the CALSTARS when staffing changes occurred. On February 1, 1988, the department changed its security officer and on February 15, 1988, the department changed one of its accounting supervisors. However, the department did not follow required procedures to protect the security of the CALSTARS. Specifically, in both instances, the department did not submit to the CALSTARS EDP security supervisor at the Department of Finance the forms that indicate the changes in access to the system. Also, the department's new security officer did not submit a signature sheet to the CALSTARS EDP security supervisor at the Department of Finance. When the department does not follow these procedures, employees may have access to certain CALSTARS features that are not within their responsibility or that are in violation of requirements for internal control or separation of duties. According to the manager of the responsible unit, the effect of this finding is mitigated by frequent changes to passwords that are also necessary for access.

Criteria: The CALSTARS Security System General Description and Instructions Manual issued by the Department of Finance states that a CALSTARS security form, which assigns a user identification name and identifies the user's access to the system, must be submitted to the CALSTARS EDP security supervisor at the Department of Finance whenever personnel are reassigned within an agency. In addition, the security officer of each agency is required to complete and submit a signature sheet to the CALSTARS EDP security supervisor at the Department of Finance. Agencies must resubmit a signature sheet whenever the security officer has been changed.

Recommendation: The department should ensure that it follows proper CALSTARS security procedures by submitting security forms to the CALSTARS EDP security supervisor at the Department of Finance whenever employees leave or are reassigned or when some other change would affect an employee's access to the CALSTARS. Also, the department should ensure that the current security officer submit a signature sheet to the CALSTARS EDP security supervisor.

**Item 10. Incorrect Processing of the Cost Allocation Cycle**

Finding: The department's CALSTARS system did not correctly perform its cost allocation cycle for allocating the department's indirect costs to the state library program. Each month the cost allocation cycle allocates the department's indirect costs to programs based on salary and wage estimates. Because the CALSTARS did not correctly perform the cost allocation in November 1987, December 1987, and January 1988, the cost allocation cycle did not allocate a total of $58,672 of the department's indirect costs that should have been allocated to the state library program. Although the department corrected the error by adjusting the amounts allocated to reflect actual costs incurred at year end, the state library uses the monthly allocation amounts for budgeting to ensure that it has enough funds to cover actual expenditures at year end. The department was unaware that the cost allocation cycle was processing incorrectly and could not provide a reason for this error. The department's

CALSTARS documentation showed that the department performed correct procedures for initiating the cost allocation process for the three months in which the error occurred.

Criteria: The State Administrative Manual, Section 8752, requires all departments to recover full costs whenever goods or services are provided. The full cost of goods or services includes all costs attributable directly to the activity and a fair share of indirect costs. The State Administrative Manual, Section 8752.1, requires that department indirect costs be accumulated and assigned periodically to the programs or organizational units that benefit from the activity. The State Administrative Manual, Section 4841, requires each agency to provide for the accuracy and completeness of automated information produced or used in agency operations.

Recommendation: The department should try to determine why the allocation system did not process correctly. If the department cannot determine the reason for the error, it should notify the Department of Finance of the error.

**Item 11.** **Undocumented or Poorly Documented Charges to Federal Grants**

Finding: The department made certain charges to federal grants during fiscal year 1987-88 based on undocumented or poorly documented estimates. We noted the following specific deficiencies:

- The department charged approximately $4,800 to the Adult Education grant based on percentages that were used in past years. No other documentation was available to justify these percentages. We reported a similar weakness during our financial audit for fiscal year 1986-87;

- The department charged approximately $59,400 to the Educationally Deprived Children grant and approximately $15,800 to the Improving School Programs block grant for administrative costs associated with the categorically funded programs unit. Initially, the department based these costs on percentages that were undocumented workload estimates. The department began documenting actual workload for this unit in January 1988. The department used this actual workload information and estimates of other charges to analyze total charges for the unit. This analysis showed that the department should have been charging slightly less to the Educationally Deprived Children grant and more to the Improving School Programs block grant. We reported a similar weakness during our financial audits for fiscal years 1984-85 and 1986-87;

- The department charged approximately $18,000 to the Vocational Education basic grant and approximately $54,100 to the Vocational Education for Consumers and Homemakers grant for costs of administering Vocational Education Programs. The department provided workload documentation that did not fully support the distribution of the charges between the two grants. We reported a similar weakness during our financial audits for fiscal years 1984-85 and 1986-87; and

- The department charged approximately $521,900 to the Improving School Programs block grant for administrative costs associated with two instructional support programs. The department based these costs on percentages that were used in past years. No other documentation was available to justify these percentages.

Documentation of the bases for the distribution of these costs is insufficient because not all staff who work on federal programs maintain time sheets that indicate the amount of time that they work on each federal program.

Criteria: The federal Office of Management and Budget Circular A-87 states that, to be allowable under a grant program, costs must be necessary and reasonable for the proper and efficient administration of grant programs. In addition, Circular A-87 states that allocation of joint costs must be supported by formal accounting records that will substantiate the propriety of eventual charges.

Recommendation: Unless the department can get federal approval of its allocation of joint costs or approval for alternative procedures, the department should require all staff whose salary costs are charged to federal programs to maintain time sheets indicating the amount of time they work on each federal program. The department should use these records of actual workloads to charge federal programs.

**Item 12.** **Inconsistency in Resolving Instances of Noncompliance With Federal Laws and Regulations**

Finding:

The department is not consistently identifying and requiring resolution of instances of noncompliance with federal laws and regulations identified in audit reports of subrecipients. A "subrecipient" is any person, government department, or establishment that receives federal financial assistance to carry out a program through a state government but is not a direct beneficiary of such a program.

We reviewed 108 audit reports for subrecipients' compliance with federal laws and regulations. Thirty-six of these audit reports identified instances in which subrecipients did not comply with federal laws and regulations. Of these 36, 4 reported an instance of noncompliance that had not been properly resolved.

Two of the 4 instances that were not properly resolved related to audits of local educational agencies (LEAs) for fiscal year 1985-86. Although the department identified instances of noncompliance, it did not identify these as instances requiring corrective action and as a result, did not require the LEAs to correct the instances of noncompliance. The audit reports for fiscal year 1986-87 again identified these instances of noncompliance.

For the other 2 instances of noncompliance that required corrective action, the department identified the necessary corrective action but then did not require the subrecipients to correct the instances of noncompliance.

Without proper follow-up on instances of noncompliance with federal laws and regulations reported in audits of subrecipients, the department cannot be certain that subrecipients are complying with federal laws and regulations.

Criteria:

The federal Office of Management and Budget Circular A-128 requires that state or local governments receiving federal financial assistance and providing $25,000 or more of it in a fiscal year to a subrecipient ensure that subrecipients correct instances of noncompliance with federal laws and regulations.

Recommendation: The department should ensure that subrecipients correct instances of noncompliance with federal laws and regulations identified in audits of subrecipients.

**Item 13.** **Late Submittal of the Federal Indirect Cost Rate Proposal**

Finding: The department submitted its provisional indirect cost rate proposal (ICRP) for fiscal year 1987-88 to the United States Department of Education (USDOE) in June 1988, approximately 18 months after it was due. The department submitted its provisional ICRP for fiscal year 1988-89 in July 1988, approximately seven months after it was due. Because the department prepared the ICRP late, it did not use the ICRP to enter indirect cost rates in the CALSTARS cost allocation table. However, the department includes actual costs in its final report to the federal government, which is submitted after the end of the fiscal year. The federal government uses the ICRP to determine whether the distribution of indirect costs to federal grant programs is reasonable.

We reported a similar weakness during our financial audit for fiscal year 1986-87. At least since fiscal year 1982-83, the USDOE had not notified the department of its approval or disapproval of the ICRP. However, in March 1988, the USDOE notified the department that the department's ICRP for fiscal year 1986-87 had not been approved.

According to the budget office manager, the department delayed preparing the ICRP for fiscal year 1987-88 because the budget office's staff had a heavy workload and employee turnover. The department could not prepare the ICRP for fiscal year 1988-89 until after it had completed the ICRP for fiscal year 1987-88. The department submitted the ICRP for fiscal year 1988-89 within one month after submitting the ICRP for fiscal year 1987-88.

Criteria: The federal Office of Management and Budget Circular A-87 requires the State to prepare a plan for the allocation of joint and indirect costs related to grant programs.

The State Administrative Manual, Section 8756.1, requires state agencies to submit their ICRPs to the responsible federal agency at least six months before the start of the fiscal year to which the ICRP applies.

Recommendation: The department should submit its ICRP at least six months before the start of the fiscal year.

**Item 14.** **Incorrect Calculation of Entitlements for the Handicapped Education Program**

Finding: The department incorrectly calculated fiscal year 1987-88 entitlements to Special Education Local Plan Areas (SELPAs), participants in the handicapped education program. When it calculated the entitlement per student based on information reported by each SELPA, the department incorrectly included students who were over 21 years old. By including students over 21 years old, the department incorrectly calculated the per-student entitlement, resulting in an overpayment of $16,710 to the 65 SELPAs that reported students over 21 years old and an underpayment of the same amount to the 45 SELPAs that did not report students over 21 years old. The department has corrected this problem for the entitlements for fiscal year 1988-89.

Criteria: The Code of Federal Regulations, Title 34, Section 300.122(a), requires the State to ensure that a free, appropriate public education is available for all handicapped children aged 3 through 21.

Recommendation: The department should allocate funds from the handicapped education program only to handicapped children aged 3 through 21.

**Item 15.** **Procedures for Monitoring Eligibility of Migrant Students Not Completed**

Finding: The department does not ensure that consultants complete all procedures for monitoring the eligibility of migrant students for the migrant education grant. For one of the program's operating agencies, a consultant did not complete 20 of 49 items that he selected for monitoring certificates of eligibility and records of the migrant student record transfer system. For the same operating agency and another operating agency, the same consultant did not present findings to management in a finding letter.

Criteria: The California Plan for the Education of Migrant Children submitted to the United States Department of Education requires the department to conduct periodic reviews of each operating agency to determine how accurately the identification and recruitment process is being implemented. To accomplish this, the department has developed procedures for periodically monitoring the records of each operating agency's certificates of eligibility and migrant student transfer system.

Recommendation: The department should complete all of its monitoring procedures for the 18 operating agencies. It should review all sample items selected and report findings to all operating agencies that it reviews.

**Item 16.** **Lack of Prompt Follow-up on Fiscal Reviews for the Migrant Education Program**

Finding: The department does not follow up until the subsequent annual fiscal review, on problems that it reports during its fiscal reviews of the operating agencies for the migrant education program. The department completed fiscal reviews of all of the 18 operating agencies for the program between October 1987 and June 1988. Seventeen of these reviews reported problems, but only two operating agencies responded to the reviews, and these two responses were voluntary. Without prompt follow-up, the department cannot ensure that the operating agencies are correcting problems identified in the fiscal reviews.

Criteria: The federal Office of Management and Budget Circular A-128 requires the State to determine whether subrecipients are spending federal grant money in accordance with applicable laws and regulations. We interpret this to include prompt follow-up on problems noted during the review process.

Recommendation: The department should require the operating agencies to submit plans of corrective action for problems noted during the department's annual fiscal review.

**Item 17.** **Weaknesses in Administration of the Migrant Child Care Program**

Finding:

Weaknesses exist in the department's administration of the migrant child care program, which provides services to preschool-age children of migrant parents. The Office of Migrant Education in the Categorical Support Programs Division (division) administers the K-12 migrant education program. The division has entered into an interdivision agreement with the Child Development Division (CDD) to define the responsibilities of the CDD and the division in the administration of the migrant child care program. The CDD contracts with 20 agencies to administer the program at the local level.

Although it has improved its compliance with the provisions of the interdivision agreement, the CDD did not comply with all of the provisions. First, the CDD did not promptly follow up on problems that it had identified during its reviews of contracts with the 20 agencies. Specifically, for 13 of the 18 agencies with identified problems, the CDD did not follow up within the 45 days specified in the interdivision agreement. In some of these cases, the agencies themselves did not respond to the CDD's notification of findings within the 30 days specified in the notification. Moreover, when one agency did not respond at all, the CDD failed to conduct a case conference as required.

Second, the CDD did not promptly follow up on problems that it identified during its program quality reviews. In total, for five out of seven agencies with identified problems, the CDD did not follow up within the 45 days specified in the interdivision agreement. Two of these agencies were late in submitting their responses.

Finally, the CDD made errors in the final status report that it sends to the division. The CDD listed 2 of the 20 agencies as having corrected all problems identified in reviews when, in fact, corrections of the problems were still pending.

Criteria:

The federal Office of Management and Budget Circular A-128 requires the State to determine whether subrecipients are spending federal grant monies in accordance with applicable laws and regulations.

The interdivision agreement for the administration of migrant child care programs between the division and the CDD, for July 1, 1987 through June 30, 1988, requires the CDD to follow up within 45 days on instances of noncompliance that it identifies in reviews. The notification of findings sent to a non-compliant agency requires the agency to respond to findings within 30 days. If an agency fails to respond, the interdivision agreement requires the CDD to conduct a case conference. The agreement also requires the CDD to inform the division of the status of each migrant child care agency by submitting a semiannual status report.

Recommendation: The CDD should comply with all of the provisions of the interdivision agreement to ensure that the migrant child care program meets all legal and program quality requirements.

**Item 18. Late Federal Reports for the Vocational Education Program**

Finding: The department did not submit vocational education reports to the federal government on time. We noted the following specific deficiencies:

- The department submitted the annual performance report for fiscal year 1986-87 approximately six months after the due date of December 31, 1987;

- The department submitted federal cash transactions reports for fiscal year 1987-88 up to two weeks late;

- The department submitted the civil rights annual compliance report for fiscal year 1987-88 over one month after the due date of July 1, 1988; and

- The department submitted the second preliminary financial status report for fiscal year 1985-86 and the first preliminary financial status report for fiscal year 1986-87 approximately five months after the due date of December 31, 1987. In addition, as of December 5, 1988, the department had not yet submitted its final financial status report for fiscal year 1985-86. The department's vocational education administrator attributed this delay to the late transmittal of necessary data from the California Community Colleges, Chancellor's Office, which administers 45 percent of the program's money, and to a legal issue regarding the refund of funds to the Chancellor's Office.

Also, according to the vocational education administrator, the department submitted late financial status reports to the federal government because the local educational agencies (LEAs) did not submit their final expenditure reports to the department on time. Of the 30 LEAs that we reviewed, 9 had not submitted their final expenditure reports for the vocational education program for fiscal year 1987-88 as of October 23, 1988. We observed a similar weakness during our financial audits for fiscal years 1983-84, 1984-85, 1985-86, and 1986-87.

Criteria:

The Code of Federal Regulations, Title 34, Section 74.82(b), states that annual performance reports shall be due 90 days after the grant year.

The Code of Federal Regulations, Title 34, Section 74.74(d), states that federal cash transactions reports shall be due no later than 15 working days following the end of each quarter.

The Code of Federal Regulations, Title 34, Section 100.3(a), provides that no person in the United States shall, on the ground of race, color, or national origin be excluded from participation in, be denied the benefits of, or be otherwise subjected to discrimination under any program to which this part applies. This code section applies to vocational education grants. The Code of Federal Regulations, Title 34, Section 100.4(b), states that a state agency must provide or be accompanied by a method of administration to give reasonable assurance that recipients comply with discrimination prohibitions. The department's methods of administration require that the report be submitted to the federal government by July 1.

The Code of Federal Regulations, Title 34, Section 74.73(d), states that, when required on an annual basis, financial status reports are due 90 days after the grant year.

The Code of Federal Regulations, Title 34, Section 76.722, states that a state may require a subrecipient to furnish reports that a state needs to carry out its responsibilities under the program. The department established a deadline of September 30, 1988, for submitting the reports without penalty for expenditure reports of the prior fiscal year.

Recommendation: The department should ensure that local educational agencies submit expenditure reports on time. In addition, the department should submit required federal reports on time.

**Item 19. Inconsistent Data on Processing Inventory Reports**

Finding: The department reports inconsistent data on processing inventory reports, for the Food Distribution program, that it submits to the United States Department of Agriculture each quarter. These reports record the inventory balances and the amount of donated foods processed by contractors that have processing agreements with the State. The report for the quarter ending December 1987 contained data for inventory balances and processing activities from July 1986 through January 1988 instead of from October 1987 through December 1987. The reports are inconsistent for two reasons. First, the department does not ensure that processors submit their monthly inventory reports promptly so that complete data are included in the report for the appropriate quarter. Second, according to the processing unit manager, the department reports the most current information available at the date on which the quarterly reports are due. He stated that this has been the department's approach for several years, and the United States Department of Agriculture has not informed the department that this approach was inappropriate.

Criteria: The Code of Federal Regulations, Title 7, Section 250.15(o), states that the quarterly reports should contain the processing activity during the quarter and the inventory balances at the close of the quarter for the federal fiscal quarter for which the department is reporting.

Recommendation: The department should comply with the requirements of the Code of Federal Regulations, Section 7, Part 250.15(o). In addition, the department should ensure that the processors submit their monthly inventory reports promptly.

**Item 20.** **Insufficient Monitoring of Subrecipients and Contractors That Participate in the Food Distribution Program**

Finding: The department does not sufficiently monitor subrecipients and contractors that participate in the Food Distribution program. For example, it does not promptly follow up on the compliance reviews that it has conducted on subrecipients of the Food Distribution program. At the time of our review, the Food Distribution Unit had not received plans for corrective action for 4 of the 20 subrecipients that it reviewed. The unit completed the reviews 8 to 13 months before our review. In addition, the Child Nutrition Services Unit did not require 4 of the 21 subrecipients that we reviewed to propose corrective action for instances of noncompliance noted during the unit's compliance reviews. Because the department does not immediately follow up on noncompliance issues noted during compliance reviews, the department cannot ensure that the subrecipients have promptly corrected instances of noncompliance. We reported a similar weakness during our financial audit for fiscal year 1986-87.

In addition, the department does not consistently perform compliance reviews of commercial processors. The State enters into contracts with commercial processors to process foods received through the Food Distribution program. The department has not performed compliance reviews of these commercial processors since April 1987. In addition, the department cannot provide documentation of compliance reviews performed from January through March 1987. As a result, the department cannot ensure that commercial processors are complying with federal and departmental regulations.

Criteria: The California Government Code, Section 13402, requires state agencies to establish and maintain a system of administrative controls. According to the California Government Code, Section 13403, these administrative controls should be adopted to safeguard assets, promote operational efficiency, and encourage adherence to prescribed managerial policies. We interpret these codes to require the department to have prudent monitoring procedures that include prompt follow-up on areas of noncompliance noted during compliance reviews and periodic reviews of participants in the programs that it administers.

In addition, the federal Office of Management and Budget Circular A-102, Attachment I, requires grantees to constantly monitor performance under grant-supported activities to ensure that time schedules are being met, projected work units by time periods are being accomplished, and other performance goals are being achieved.

Recommendation: The department should develop prudent monitoring procedures to ensure that participants in the programs that it administers are complying with federal and departmental regulations.

**Item 21.** **Late Closing Reviews for the School Lunch and Breakfast Programs**

Finding: The department did not perform closing reviews for the school lunch and breakfast programs within 90 days of the exit conference dates, as required. For 4 of the 19 items that we reviewed for fiscal year 1987-88, the department allowed up to approximately a month and a half beyond the 90 days to elapse before performing the closing review. In addition, for 15 of the 25 administrative reviews that we reviewed for the four fiscal years prior to 1987-88, the department also did not meet the 90 day requirement.

Criteria: The Code of Federal Regulations, Title 7, Section 210.18(i)(6)(iii), states that a corrective action plan shall be written, signed by the proper official of the school food authority, and submitted to and approved by the state agency within 60 days following the exit conference of a review. State agencies may extend this deadline to 90 days.

Recommendation: The department should ensure that it completes administrative closing reviews for the school lunch and breakfast programs within 90 days of the exit conference date.

Item 22. **Late Final Status Report for the Job Training Partnership Act Program**

Finding:

The department did not complete on time its final status report for the Job Training Partnership Act program. The department administers a portion of the Job Training Partnership Act program for the Employment Development Department through an interagency agreement. The Employment Development Department requires the department to submit the final status report within 60 days after receiving the instructions and other reporting information from the Employment Development Department. The department should have submitted the report by September 15, 1988, but it did not require the program's subrecipients to submit their expenditure reports and other year-end reports until September 30, 1988. Subrecipients' expenditure reports and other year-end reports include information necessary for the department's final status report. The department completed the final status report on January 19, 1989. As a result, the Employment Development Department could not include final expenditure amounts in the financial status report that it submitted to the federal government on September 30, 1988.

According to the administrator of the department's Employment Preparation Unit, the department did not submit the report within 60 days because it was unclear whether the department was required to report within 60 days of receipt of the instructions and reporting information or within 90 days of the end of the grant period. The interagency agreement is not specific about reporting deadlines. In addition, the administrator of the Employment Preparation Unit said that deadlines for completing the final status report are not reasonable because, based upon a directive from the Employment Development Department, subrecipients are not required to submit their information to the department until 90 days after the end of the grant period.

Criteria:

The Code of Federal Regulations, Title 20, Sections 629.35 and 629.36, establishes reporting requirements for the Job Training Partnership Act. An addendum to the Job Training Partnership Act directive, Number 86-2, issued by the Employment Development Department, requires the department to submit the final status report within 60 days after the department receives instructions and other reporting information from the Employment Development Department. In addition, the interagency agreement with the Employment Development Department requires the department to make every effort to collect reports from subrecipients on time and submit its own reports to the Employment Development Department on time.

Recommendation: The department should attempt to include in the interagency agreement with the Employment Development Department specific reporting deadlines that the department believes are reasonable.

**Item 23.** **Lack of Authorization for Expenditures for the Job Training Partnership Act Program**

Finding: The department did not always ensure that expenditures for the Job Training Partnership Act program had proper authorization before disbursing program funds. For 7 of the 30 disbursements that we reviewed for the program, the department's program unit submitted to the accounting unit expenditure claims that did not have proper authorization. The accounting unit did not require the program unit to provide the necessary authorization before it submitted the claims to the State Controller's Office for payment. As a result, the department could not be certain that the expenditures were appropriate. The supervisors in the program and accounting units were not aware that their units were processing claims without proper authorization. They told us that their staff inadvertently did not follow their established authorization procedures.

Criteria: The State Administrative Manual, Section 8422.1, requires the department to determine that claims are appropriate for submission to the State Controller's Office for payment. In addition, Section 84522.1 of the State Administrative Manual requires the department to determine that proper authority exists for obtaining goods and services. Effective internal control requires written authorizations for expenditures.

Circular A-102, Attachment G, of the federal Office of Management and Budget requires recipients of grant money to maintain procedures for determining that costs are reasonable and allowable. Attachment G further states that recipients are to have effective control over accountability for all assets and must ensure that these assets are used solely for authorized purposes.

Recommendation: The department should ensure that the program unit has properly authorized all disbursements for the Job Training Partnership Act before submitting the program claims to the State Controller's Office for payment.

# GENERAL GOVERNMENT

## DEPARTMENT OF ECONOMIC OPPORTUNITY

We reviewed the Department of Economic Opportunity's (department) administration of two federal programs. They are the United States Department of Health and Human Services grants, Federal Catalog Numbers 13.789 and 13.792. In addition, we noted that the department did not promptly submit its financial reports.

**Item 1.** **Excessive Delays in Home Energy Assistance Program Appeals**

Finding: The department did not follow its procedures for promptly conducting fair hearings requested by applicants denied assistance under the Home Energy Assistance Program, a component of the Low-Income Home Energy Assistance Program (LIHEAP) block grant. Our review of the department's records indicated that 179 of 190 cases did not receive a hearing within the required 90 days. We reviewed 5 of the 190 requests for a hearing. In two cases, the department did not conduct the hearings until 144 and 175 days after the department received the hearing request. In the three other cases, the department had yet to conduct a hearing. As of November 1988, these three appellants had already been waiting five to six months for their hearings. As a result of the delays, some appellants may have difficulty paying their heating bills.

We reported a similar weakness in our audit for fiscal year 1985-86. The department corrected this weakness during fiscal year 1986-87.

Criteria: Public Law 97-35, Section 2605(b)(13), requires the State to agree to provide an opportunity for a fair hearing to individuals denied assistance under the LIHEAP block grant. The state plan, which the department submitted to the United States Department of Health and Human Services, requires the department's Fair Hearing Unit to hold a hearing within 90 days after the receipt of an appellant's request for a hearing.

Recommendation: The department should develop a schedule for each appeal to allow an appellant to receive a hearing within the 90-day period stipulated in the LIHEAP block grant state plan.

**Item 2.** **Requests For Federal Funds Exceeded Immediate Needs**

Finding: The department does not always limit its request for monies from the federal treasury to the immediate needs of the Community Services Block Grant (CSBG) and LIHEAP programs. For approximately half of the 54 claims that we examined, the department held federal funds for over a week before the State Controller's Office paid the claims. Those claims amounted to approximately $20 million. The department's manager of financial services told us that the department did not put a high priority on cash management because the department did not have enough trained staff in its accounting office. Also, the manager said that the department's system of matching cash requirements with cash needs did not operate effectively. Maintaining excessive cash may result in the termination of advance funding by the federal government.

Criteria: The Code of Federal Regulations, Title 31, Section 205.4, stipulates, in part, that cash advances must be timed to meet the actual immediate needs of the recipient organization.

Recommendation: The department should implement cash management procedures to limit its request for monies from the federal treasury to its immediate needs. Also, the department should assign trained staff to monitor its cash management procedures.

**Item 3.** **Late Financial Reports**

Finding: The department did not promptly submit its financial reports to the State Controller's Office. The department did not submit financial reports for its portion of the State's General Fund until October 26, 1988, or 89 days after the due date. In addition, the department did not submit its Federal Trust Fund reports until November 10, 1988, or 83 days after the due date. Failure to submit financial reports by the required deadlines delays the State Controller's Office in compiling the financial statements for the State and may delay the State Treasurer's Office from issuing official statements that accompany bond issues.

We reported similar delays in our audit for fiscal year 1986-87. The department responded to that report that it had hired staff with experience in the California State Accounting and Reporting System (CALSTARS) and that it anticipated no continuing delays.

Criteria: The State Administrative Manual, Section 7990, requires state agencies to submit their General Fund financial reports for the year ended June 30 to the State Controller's Office by July 31 and to submit the financial reports of all other funds by August 20. Department of Finance Management Memo 88-07, dated June 2, 1988, revised the due dates for fiscal year 1987-88 reports to July 29 for General Fund reports and August 19 for all other funds.

Recommendation: The department should submit its financial reports to the State Controller's Office by the required due dates.

## DEPARTMENT OF FINANCE

We reviewed the Department of Finance's (department) compliance with federal and state regulations in administering the Statewide Cost Allocation Plan (SWCAP) and state regulations in administering the Prorata Allocation Plan.

**Item 1.** **Insufficient Review of Support Services Costs**

Finding: Thirteen executive agencies, the Department of Justice, the Legislature, the Office of the Auditor General, and the State Library provide various support services to other state agencies. These entities, called "central service agencies," provide services such as financial, personnel, and legal support. (Attachment 1 lists the agencies performing support services during fiscal year 1987-88 and identifies the six agencies that we reviewed.) The department did not sufficiently review support services to determine if the agencies had submitted all allowable and only allowable expenditures for the SWCAP and the prorata allocations. The SWCAP is the plan that each state agency uses to pay for its federal programs' share, if any, of the State's costs for central services. The prorata is the plan that each state agency uses to pay for its special funds' share, if any, of the State's costs for central services.

For fiscal year 1987-88, the department estimated that SWCAP expenditures would be approximately $257.9 million and the prorata expenditures would be approximately $316.1 million. The department estimated that the State would recover approximately $21.4 million (8.3 percent) of the SWCAP expenditures from the federal government and approximately $104.4 million (33.0 percent) of the prorata expenditures from the special funds.

One of the six central service agencies that we reviewed, the Department of Justice, included expenditures of ineligible support services for the SWCAP allocations. The Department of Justice reported as central service expenditures approximately $17 million of ineligible costs related to its noncentral support services, such as enforcing the State's antitrust laws and operating its Crime Prevention Center. Reporting expenditures for ineligible costs could result in excess recoveries from the federal government of approximately $1.4 million. This error occurred because the department did not sufficiently review the support services to determine if the expenditures should or should not be included in the SWCAP allocations.

We reported a similar weakness in our audit for fiscal year 1986-87. In February 1988, the department responded that it would determine the changes to its instructions that would be necessary for identifying eligible support services. Also, the department stated that it would review current support services provided by central service agencies to determine adjustments that would be necessary.

In January 1989, the federal Department of Health and Human Services, Division of Cost Allocation, notified the department of the Division of Cost Allocation's understanding of the agreement regarding the resolution of the unallowable Department of Justice costs included in the SWCAP for fiscal year 1986-87. Under the agreement, the department will adjust the fiscal year 1989-90 SWCAP for unallowable Department of Justice costs included in the SWCAP for fiscal year 1986-87. Further, according to a department memorandum to the Department of Justice dated February 3, 1989, the department intends to review the central service costs of the Department of Justice to determine what portion, if any, were actually central service costs. If the Division of Cost Allocation and the department agree that some of these costs were in fact central service costs, then the department will be allowed to recapture the unallowed costs in a subsequent SWCAP.

Criteria: The federal Office of Management and Budget Circular A-87, provides principles for determining allowable costs of programs administered by the State. The State Administrative Manual, Section 8753, designates the department as the agency responsible for preparing the SWCAP and administering the prorata. Further, Section 8753, states that the SWCAP contains only those costs that the federal government allows for federal funding purposes.

Recommendation: The department should periodically review support services provided by the central service agencies and related expenditures to ensure that all allowable costs are included in the SWCAP and that only allowable costs are included. Also, until the department receives approval from the Division of Cost Allocation to include the unallowable Department of Justice central service costs, these costs should be excluded from the SWCAP.

<u>Item 2</u>. **<u>Inaccurate Workload Data Used in the SWCAP and Prorata Allocation</u>**

Finding: The department made errors in calculating the workload amount that it used in the SWCAP and prorata allocations for several state agencies. We noted that the department used an incorrect workload amount in determining the SWCAP and prorata allocations for the following four agencies: the Department of Fish and Game, the Department of Housing and Community Development, the Department of Boating and Waterways, and the Energy Resources Conservation and Development Commission.

As a result of these errors, the Department of Fish and Game, the Department of Boating and Waterways, and the Energy Resources Conservation and Development Commission were overcharged approximately $124,000, $4,200, and $6,500 respectively, in prorata costs. Further, the Department of Housing and Community Development was undercharged approximately $14,500 in prorata costs. These errors could result in a net over-collection from the federal government of approximately $200.

Criteria: The federal Office of Management and Budget Circular A-87, states that federal programs should bear their fair share of costs recognized under Circular A-87, except where restricted or prohibited by law. The State Administrative Manual, Sections 8753 and 8755, requires the department to use actual workload measures for each department in calculating the SWCAP and prorata allocations.

Recommendation: The department should ensure that it uses the correct workload measures to calculate the SWCAP and prorata allocations. In addition, the department should adjust the SWCAP and prorata allocation for the errors that we identified above.

**Item 3.** **Insufficient Record of Indirect Cost Rate Proposals**

Finding: The department does not maintain sufficient records of those agencies required to submit indirect cost rate proposals (ICRP) for review. Further, the department does not maintain records of those agencies that may submit cost allocation plans (CAP) instead of ICRPs. For fiscal year 1987-88, 51 agencies were budgeted to receive federal funds. However, as of November 8, 1988, only 21 of the 51 agencies had submitted their ICRPs for review. (See Attachment 2 for a list of the state agencies that had not submitted their ICRPs or CAPs.) As a result, the State may not recover from the federal government all of the SWCAP reimbursements that it is entitled to receive, or the State may recover too much.

We reported a similar weakness in our audit for fiscal year 1986-87. In February 1988, the department responded that it would revise its procedures that require agencies receiving federal funds to submit ICRPs and CAPs and update its recordkeeping and control process for submitted plans.

Criteria: The federal Office of Management and Budget Circular A-87, requires the State to prepare a plan for the allocation of joint and indirect costs related to grant programs. The State Administrative Manual, Section 8755.2, requires each state agency receiving federal funds to submit its ICRP or CAP to the department for review before sending it to the responsible federal agency for approval.

Recommendation: The department should establish procedures to ensure that all agencies receiving federal funds submit their ICRPs or CAPs to the department for review before sending them to their responsible federal agencies for approval.

**Item 4.** **Late Filing of ICRPs or Filing of ICRPs Before the Department's Approval**

Finding: For fiscal year 1987-88, the department did not receive the ICRPs from 30 of 51 agencies that were required to submit ICRPs or CAPs. For the remaining 21 agencies, the department did not approve the ICRPs until after the required deadline. (See Attachment 2 for the agencies that did not submit an ICRP or CAP.) As a result, these agencies were late in submitting their ICRPs to the federal government or they sent their ICRPs to the federal government before obtaining the department's approval.

Criteria: The federal Office of Management and Budget Circular A-87, requires the State to prepare a plan for the allocation of joint and indirect costs related to grant programs. The State Administrative Manual, Section 8755.2, requires each state agency receiving federal funds to submit its ICRP or CAP to the department for review before sending it to the responsible federal agency for approval. Also, the State Administrative Manual, Section 8756.1, requires each state agency to file its ICRP with the responsible federal agency at least six months before the start of the fiscal year to which the ICRP applies.

Recommendation: The department should establish procedures to ensure that each agency receiving federal funds submit its ICRP or CAP to the department for review before sending it to the responsible federal agency for approval. Also, the department should ensure that each agency submit its ICRP or CAP in advance of the deadline for filing it with the responsible federal agency.

**Item 5. Insufficient Monitoring of SWCAP Recoveries**

Finding: The department does not sufficiently monitor SWCAP recoveries. For recovery of the prorata costs, the department calculates prorata costs for all funds. The State Controller's Office transfers from the special funds to the State's General Fund the amounts calculated by the department. However, to recover the SWCAP costs, the department relies on the individual state agencies, as required in the State Administrative Manual, to transfer SWCAP recoveries to the State's General Fund. All five state agencies that we reviewed for the prompt transfer of SWCAP recoveries were late for at least one quarter in transferring SWCAP recoveries to the State's General Fund. (See Attachment 3 for a list of the state agencies that we reviewed for transfer of SWCAP recoveries during fiscal year 1987-88.) Until the agencies transfer their SWCAP recoveries to the State's General Fund, the SWCAP recoveries are not available for expenditures from the State's General Fund.

We reported a similar weakness in our audit for fiscal year 1986-87. In February 1988, the department responded that, with its current level of staffing, it would continue to rely upon state audit groups to review federal grant recoveries.

Criteria: The California Government Code, Section 13332.01, requires agencies to recover SWCAP costs from the federal government. Although no deadline is expressly mandated, the State Administrative Manual, Section 8755.2, intimates that a transfer of SWCAP recoveries by state agencies to the State's General Fund within 30 days of the end of each quarter would be appropriate. Further, a department memorandum dated November 6, 1986, states that the department's budget analysts are responsible for ensuring that a fair share of SWCAP costs are budgeted, recovered, and returned to the State's General Fund.

Recommendation: The department should ensure that agencies collect all SWCAP recoveries available to the State from the federal government and transfer the recoveries to the State's General Fund within 30 days of the end of each quarter.

<u>Item 6</u>. <u>Lack of Justification for SWCAP Budgets</u>

Finding: The department's Fiscal Systems and Consulting Unit (FSCU) provides written instructions to its own budget analysts for calculating the SWCAP budgets. Of the 21 agency SWCAP budgets that we recalculated using the department's methodology, 11 amounts differed from our calculations. Moreover, the FSCU did not receive from the department's own budget analysts justification for the deviations. Attachment 2, which lists the state agencies receiving federal funds during fiscal year 1987-88, shows the 21 agencies that we reviewed and identifies the 11 agencies whose SWCAP calculations differed from our calculations. We contacted 5 of the 11 agencies. We found that 2 agencies, the Employment Development Department and the State Department of Education, could explain their methods for calculating their SWCAP budgets. However, the other 3 agencies, the Department of Health Services, the Department of Rehabilitation, and the State Water Resources Control Board, could not explain how their SWCAP budgets were calculated. As a result, for the Department of Health Services, the Department of Rehabilitation, and the State Water Resources Control Board, the SWCAP collections proposed in the Governor's Budget 1987-88 may be understated by at least $4.3 million.

We reported a similar weakness in our audit for fiscal year 1986-87. In February 1988, the department responded that it would review its process for budgeting SWCAP recoveries to determine if any changes are necessary.

Criteria: The federal Office of Management and Budget Circular A-87, states that federal programs should bear their fair share of costs recognized under Circular A-87, except where restricted or prohibited by law. A department memorandum, dated November 6, 1986, states that the department's budget analysts are responsible for ensuring that a fair share of SWCAP costs are budgeted, recovered, and returned to the State's General Fund.

Recommendation: The department's own budget analysts should document the methodology used to calculate the SWCAP budgets of other state agencies, and the analysts should justify any deviation from the department's recommended methodology. Also, the FSCU should review the information submitted by the department's budget analysts to ensure that the amount budgeted is appropriate and correctly computed.

**ATTACHMENT 1**

**AGENCIES PERFORMING CENTRAL SUPPORT SERVICES FISCAL YEAR 1987-88**

| Agency Name | Reviewed by the Office of the Auditor General |
|---|---|
| Department of Finance | X |
| Department of Justice | X |
| Department of Personnel Administration | |
| Health Benefits For Retired Annuitants | X |
| Legislature | |
| Office of Administrative Law | |
| Office of the Auditor General | |
| Secretary of the Business, Transportation and Housing Agency | |
| Secretary of the Health and Welfare Agency | |
| Secretary of the Resources Agency | |
| Secretary of the State and Consumer Services | |
| Secretary of the Youth and Adult Correctional Agency | |
| State Board of Control | |
| State Controller's Office | X |
| State Library | X |
| State Personnel Board | |
| State Treasurer's Office | X |

ATTACHMENT 2

## AGENCIES RECEIVING FEDERAL FUNDS
## FISCAL YEAR 1987-88

| Agency Name | SWCAP Budgets Reviewed by the Office of the Auditor General | SWCAP Calculations Different From the Office of the Auditor General | ICRPs and CAPs Not Submitted to Department of Finance as of November 8, 1988 |
|---|---|---|---|
| Air Resources Board | | | X |
| California Arts Council | | | |
| California Coastal Commission | | | X |
| California Community Colleges, Chancellor's Office | X | | X |
| California Maritime Academy | | | X |
| California Occupational Information Coordinating Committee | | | X |
| California Postsecondary Education Commission | | | X |
| California State Council on Vocational Education | | | X |
| California State University | | | X |
| Commission on Aging | | | X |
| Department of Aging | X | X | |
| Department of Alcohol and Drug Programs | X | X | |
| Department of Boating and Waterways | | | X |
| Department of the California Highway Patrol | X | | |
| Department of Commerce | | | |
| Department of Conservation | | | X |
| Department of Corrections | X | | X |
| Department of Developmental Services | X | | X |
| Department of Fair Employment and Housing | | | X |
| Department of Fish and Game | | | |
| Department of Food and Agriculture | | | |
| Department of Forestry | | | |
| Department of General Services | X | | X |
| Department of Health Services | X | X | X |

| Agency Name | SWCAP Budgets Reviewed by the Office of the Auditor General | SWCAP Calculations Different From the Office of the Auditor General | ICRPs and CAPs Not Submitted to Department of Finance as of November 8, 1988 |
|---|---|---|---|
| Department of Housing and Community Development | X | | |
| Department of Industrial Relations | | | X |
| Department of Justice | X | X | X |
| Department of Mental Health | X | X | |
| Department of Parks and Recreation | | | X |
| Department of Rehabilitation | X | X | |
| Department of Social Services | X | | X |
| Department of Transportation | X | | |
| Department of Water Resources | X | | |
| Department of the Youth Authority | X | X | |
| Emergency Medical Services Authority | | | X |
| Employment Development Department | X | X | |
| Energy Resources Conservation and Development Commission | | | |
| Military Department | | | |
| Office of Criminal Justice Planning | | | |
| Office of Emergency Services | | | X |
| Office of Planning and Research | | | |
| Office of Statewide Health Planning and Development | | | X |
| Office of Traffic Safety | | | X |
| Public Utilities Commission | | | X |
| Seismic Safety Commission | | | X |
| State Controller's Office | X | | |
| State Council on Developmental Disabilities | | | X |
| State Department of Education | X | X | |

| Agency Name | SWCAP Budgets Reviewed by the Office of the Auditor General | SWCAP Calculations Different From the Office of the Auditor General | ICRPs and CAPs Not Submitted to Department of Finance as of November 8, 1988 |
|---|---|---|---|
| State Water Resources Control Board | X | X | X |
| Student Aid Commission | X | X | X |
| Veterans' Home of California | | | X |
| Totals | 21 | 11 | 30 |

**ATTACHMENT 3**

## AGENCIES THAT WE REVIEWED FOR PROMPT TRANSFER OF SWCAP RECOVERIES FISCAL YEAR 1987-88

| Agency Name | Agencies Late in Transferring SWCAP Recoveries to the State's General Fund |
|---|---|
| Department of Economic Opportunity | X |
| Department of Health Services | X |
| Department of Justice | X |
| Department of Social Services | X |
| State Department of Education | X |

# HEALTH AND WELFARE

## DEPARTMENT OF AGING

We reviewed the Department of Aging's (department) administration of two federal programs. These programs are the United States Department of Agriculture grant, Federal Catalog Number 10.550, and the United States Department of Health and Human Services grant, Federal Catalog Number 13.633.

| Item | Excessive Cash Advances to Subgrantees |
|---|---|
| Finding: | The department's system of cash advances of federal funds to subgrantees does not always limit the disbursements of federal funds to the immediate cash needs of the subgrantees. For example, three of the ten subgrantees that we reviewed showed some monthly cash balances in excess of the three-day cash reserve guideline established under federal regulations. During fiscal year 1987-88, the three subgrantees had excessive cash balances averaging between approximately \$15,000 and \$102,000; at one subgrantee, the excessive cash balance corresponded to 26 days' needs. We reported a similar weakness in our audit for fiscal year 1986-87. Part of the department's ineffectiveness in limiting cash balances of subgrantees to their immediate cash needs is because some subgrantees and their service providers do not promptly report actual expenditures.<br><br>As a result of the department's excessive cash advances, the federal government lost interest that it could have earned on the funds that the department advanced too soon to subgrantees. If the department does not limit the disbursements of federal funds to the subgrantees' immediate cash needs, the federal government may require grantees to report the amount of cash advances in excess of three-days' needs in the hands of their subgrantees and the actions the department has taken to reduce the excess balances. |
| Criteria: | Code of Federal Regulations, Title 31, Section 205.4(a), requires that the timing and the amount of cash advances be as close as is administratively feasible to the actual disbursement by the recipient organization. |

Recommendation: The department should ensure that it limits advances of federal funds to the subgrantees' immediate cash needs. To accomplish this, the department should require its subgrantees and service providers to report monthly actual expenditures promptly.

## DEPARTMENT OF ALCOHOL AND DRUG PROGRAMS

We reviewed the Department of Alcohol and Drug Program's (department) administration of the United States Department of Health and Human Services grant, Federal Catalog Number 13.992.

**Item 1.** **Late Reports on County Alcohol Program Reviews**

Finding: The department's division of alcohol programs does not issue the reports of its reviews of county alcohol programs promptly. We reviewed 14 reports of these reviews. As the table below indicates, 7 of the 14 reports were not issued within the division's schedule of 90 working days from the exit conference at the end of the site visit.

| Number of Days | Number of Reports |
|---|---|
| Less than 90 | 7 |
| 91 - 120 | 3 |
| 121 - 140 | 3 |
| Greater than 140 | 1 |

The manager of the program management branch of the department's division of alcohol programs explained that one cause of the department's not meeting the 90-day deadline is that each preliminary report is reviewed twice, once by a peer reviewer, a county alcohol administrator independent of the program, and once by the administrator of the county alcohol program that is being reviewed.

We observed a similar weakness during our compliance audit of fiscal year 1986-87. The department responded that it would monitor procedures to ensure that it issues reports within 90 days. However, the department has not monitored its procedures successfully. The manager of the program management branch of the division of alcohol programs informed us that the division will be implementing deadlines to enable the department to issue its final reports within 90 working days from the exit conference.

Criteria: 42 United States Code, Section 300w-4(c)(2), requires that the State agree to establish reasonable criteria to evaluate the effective performance of entities that receive funds from the State under this code. Further, the California Health and Safety Code, Section 11825, states that the department may establish reasonable criteria to evaluate the performance of programs. Finally, the department's County Administrative Review Procedures Manual states that the reports should be issued 90 days after the department's review of the county program.

Recommendation: The department should monitor its procedures to verify that it is meeting the 90-day deadline that it has established.

__Item 2__. __Incomplete Documentation of County Alcohol Program Reviews and Insufficient Follow-up Procedures__

Finding: The department's division of alcohol programs does not adequately document its comprehensive reviews of county alcohol programs. In addition, the division does not adequately implement its follow-up procedures to ensure that it receives all required plans for corrective action from counties. As a result, the department is unable to substantiate that it has complied with its own regulations for evaluating entities that receive federal funds. We reviewed 14 of the reports completed by the division and found the following specific deficiencies:

- The administrative review files for 3 of the 14 reports did not contain the checklists that support all aspects of the program examined. Therefore, there was no evidence to support the findings reported;

- One of the 14 reports did not present documentary evidence that the county alcohol administrator had been allowed to comment on the report before the division issued the final report. In addition, one of the 14 reports did not present documentary evidence that the peer reviewer had been allowed to comment on the report before the division issued the final report; the manager of the program management branch of the division of alcohol programs explained that the peer reviewer did not comment on the report because the peer reviewer was unable to participate in the review of the county alcohol program; and

- Although five reports should have contained the county's plan to correct deficiencies, two did not. However, the division did not follow-up to ensure that the two counties submitted the required plans.

Criteria: 42 United States Code, Section 300w-4(c)(2), requires that the State agree to establish reasonable criteria to evaluate the effective performance of entities that receive funds from the State under this code. Further, the California Health and Safety Code, Section 11825, states that the department may establish reasonable criteria to evaluate the performance of programs. The criteria are defined in the division of alcohol programs' County Administrative Review Procedures Manual. In our opinion, reasonable criteria for the evaluation of the performance of entities that receive federal funds includes complete documentation of the review, timely reports, and adequate follow-up on the findings reported.

Recommendation: The department should completely document its reviews, follow up on its recommendations, and comply with its own manual and management objectives.

**Item 3. Late Reports on County Drug Program Reviews**

Finding: The department's division of drug programs does not issue the reports of its reviews of county drug programs within its deadline of ten working days after the department's exit conference. We reviewed 16 of the reports of county administrative reviews completed by the division. As the table below shows, none of the 16 reports were issued within the division's deadline.

| Number of Days | Number of Reports |
|---|---|
| Less than 11 | 0 |
| 11 - 20 | 6 |
| 21 - 50 | 2 |
| 51 - 100 | 1 |
| Greater than 100 | 7 |

We observed a similar weakness during our compliance audit of fiscal year 1986-87.

Criteria: 42 United States Code, Section 300w-4(c)(2), requires that the State agree to establish reasonable criteria to evaluate the effective performance of entities that receive funds from the State under this code. Further, the California Health and Safety Code, Section 11997, requires that the review of county programs be based on the department's standards. These standards are identified in the Manual for Monitoring County Operations. In addition, the department had additional criteria stating that the reports should be issued within ten working days after the department's exit conference at the end of a site visit.

Recommendation: The department should monitor its procedures to verify that it is meeting the ten-day deadline that it has established.

**Item 4. Incomplete Documentation of County Drug Program Reviews and Insufficient Follow-up Procedures**

Finding: The department's division of drug programs does not adequately document its comprehensive reviews of county drug programs. In addition, the division has no standard procedures for following up on a county that has not issued a plan of corrective action within the 60-day deadline for responses. As a result, the department is unable to substantiate that it has complied with its own regulations for evaluating entities that receive federal funds. We reviewed 16 of the reports of the county administrative reviews completed by the division and found the following specific deficiencies:

- Thirteen of the 16 reports did not contain complete documentary evidence to support all aspects of the program examined. Specifically, the division's drug program analysts did not completely fill out the Manual for Monitoring County Operations for the 13 reports. In addition, the drug program analysts did not provide support for the findings reported in 4 of the 13 reports;

- Two of the 16 reports did not present documentary evidence that the county drug administrator had been allowed to comment on the report before the division issued the final report. The division of drug programs now requires the addition of a list of exit conference participants to the final report; and

- Although 12 reports should have contained the counties' plans to correct deficiencies, 5 did not. However, the division did not follow up to ensure that the 5 counties submitted the required plans. Further, one of the 12 reports was not submitted within the 60-day time allowed for response.

We observed a similar weakness during our compliance audit of fiscal year 1986-87. The department responded that all aspects of the review of county programs would be documented and a formal supervisory review process would be established. However, the department has not successfully implemented this action.

Criteria:

42 United States Code, Section 300w-4(c)(2), requires that the State agree to establish reasonable criteria to evaluate the effective performance of entities that receive funds from the State under this code. Further, the California Health and Safety Code, Section 11997, requires that the review of county programs be based on standards developed by the department. These standards are identified in the division of drug program's Manual for Monitoring County Operations. In our opinion, reasonable criteria for the evaluation of the performance of entities that receive federal funds includes complete documentation of the review, timely reports, and adequate follow-up on the findings reported.

Recommendation: The department should completely document its reviews, follow up on its recommendations, and comply with its own manual and management objectives.

**Item 5.** **County Drug Programs Not Reimbursed Promptly**

Finding: The department does not always reimburse county drug programs promptly. We reviewed the final reports of expenditures for fiscal year 1986-87 submitted by 15 county drug programs as a claim for reimbursement. The department took an excessive amount of time to process all 15 claims from the date that the department received each claim to the date that each claim was scheduled for payment, as shown in the table below:

| | Number of Claims | |
|---|---|---|
| Number of Days | Medi-Cal Counties | Non Medi-Cal Counties |
| 1 - 60 | 0 | 0 |
| 61 - 90 | 2 | 1 |
| 91 - 120 | 1 | 1 |
| 121 - 180 | 0 | 4 |
| Over 180 | 5 | 1 |
| Totals | 8 | 7 |

The manager of the program review branch of the department's division of drug programs explained that some delays in processing the claims of county drug programs are a result of the late submission of Medi-Cal claims by counties that receive Medi-Cal funds. However, we also found delays in processing claims from counties that do not receive Medi-Cal funds. As a result of the excessive delays, the county programs are without the federal funds to reimburse applicable program costs.

We observed a similar weakness for both the alcohol and drug program divisions during our compliance audit of fiscal year 1986-87. The department responded that it would establish and monitor procedures for reviewing and settling claims to ensure that counties are reimbursed promptly. However, the department's monitoring of these procedures for the division of drug programs has not been effective.

Criteria: The Code of Federal Regulations, Title 31, Section 205.4(a), requires that the timing and amount of cash advances or reimbursements be as close as is administratively feasible to the timing and amount of actual disbursements by the recipient organization for applicable program costs. In addition, the department's memorandum dated July 24, 1987, states that, with the exception of counties that receive Medi-Cal funds, it should take no longer than 60 days after receipt to review and approve claims submitted by the counties.

Recommendation: The department should monitor its new procedures to ensure that counties are reimbursed promptly.

## DEPARTMENT OF DEVELOPMENTAL SERVICES

We reviewed the procedures for reporting liabilities at June 30, 1988, at the Department of Developmental Services (department). We also reviewed the department's administration of the United States Department of Agriculture grants, Federal Catalog Numbers 10.553 and 10.555.

| Item | Improper Identification of Encumbrances |
|---|---|
| Finding: | The department's accounting personnel did not accurately identify in their schedule of accounts payable which of its unliquidated encumbrances are obligations at June 30, 1988. The items under $100,000 in the department's schedule of accounts payable totaled approximately $8.4 million. In our review of a sample of these items, we found that the department had incorrectly identified 55 percent (11 of the 20 reviewed items) as encumbrances. This represents approximately 64 percent ($12,769 of the $19,833 sample) of the dollar value of the sample that we reviewed. The misstatement occurred because the department did not thoroughly analyze the accounts payable to determine whether goods were received or services provided after June 30. We reported a similar weakness in our audit for fiscal year 1986-87.<br><br>Because the department did not properly identify encumbrances in its financial statements, it did not provide sufficient information to prepare the State's financial statements in accordance with generally accepted accounting principles. |
| Criteria: | The State Administrative Manual, Section 7952, requires state agencies to disclose the portion of accounts payable that represents encumbrances in their financial statements. Under generally accepted accounting principles, encumbrances are that portion of the accounts payable that represents goods or services received or provided after June 30. |
| Recommendation: | During year-end closing, the department should analyze its accounts payable to determine whether goods were received or services provided before or after June 30 and report them appropriately as liabilities or encumbrances. |

## EMPLOYMENT DEVELOPMENT DEPARTMENT

We reviewed the financial operations, internal controls, and administration of three federal programs at the Employment Development Department (department). These programs are the United States Department of Labor grants, Federal Catalog Numbers 17.207, 17.225, and 17.250. We also performed a limited review of the department's administration of the United States Department of Health and Human Services grant, Federal Catalog Number 13.790.

**Item 1.** **Weaknesses in Control Over Employer Tax Accounts**

Finding:

The department has weaknesses in its control over employer tax accounts. Specifically, the department did not properly control employer tax accounts to ensure that all accounts were accurate and up-to-date. In addition, the department could not reconcile its automated Tax Accounting System (TAS) with its accounting records without making unsupported adjustments to its accounting records. The failure to properly control all tax accounts and to support all accounting adjustments reduced the department's ability to detect and prevent errors in the employer tax accounts and in the department's accounting records.

We observed similar weaknesses during our financial audit of the department for fiscal year 1986-87. In response to our recommendations, the department implemented a corrective action plan to improve its control over employer tax accounts. For example, the department established procedures to prevent erroneous billings to employers and implemented programming changes in the TAS to produce a report of financial activity each month. However, more improvement is needed to correct the following specific deficiencies.

- Inaccurate and Mishandled Employer Tax Accounts

  The department did not properly control all employer tax accounts. Specifically, we found that some employer tax accounts were inaccurate or contained amounts that the department should have refunded to employers.

  We reviewed the accounts of 66 employers to whom the department owed tax refunds as of June 30, 1988. We found that 14 of the 66 accounts were inaccurate or contained amounts that the department did not know that it owed to the employers. The department's failure to control these specific accounts sufficiently caused the department to understate the revenues in its accounting records by approximately $1.7 million. In addition, the department unknowingly withheld for as long as two years approximately $834,000 in refunds owed to employers. The department's delay in issuing refunds may cause some employers unnecessary hardship.

We also reviewed the accounts of 92 employers who owed taxes to the department as of June 30, 1988. We found that 3 of the 92 accounts were inaccurate. Specifically, department employees incorrectly increased the amount of taxes owed by these employers. As a result of these incorrect adjustments, the department billed two of the employers for approximately $4.9 million of payroll taxes that the employers already had paid. In addition, the department overstated taxes owed by employers by approximately $5.1 million in the department's accounting records.

The department did not sufficiently control these employer tax accounts because it had no procedures for reviewing and approving adjustments to employers' accounts that increase taxes owed by employers. In addition, the department did not have procedures to identify and review employer tax accounts with long-outstanding balances to determine whether refunds owed to employers are accurate. Finally, programming deficiencies in the TAS prevent the department from identifying and, thus, determining whether all tax refunds owed to employers are valid.

As a result of our audit and the department's own reviews, the department has developed procedures to correct these weaknesses in control over employer tax accounts. In addition, the department continues to identify and correct programming deficiencies in the TAS to ensure the validity and accuracy of employer tax accounts.

- <u>Unsupported Adjustments Used To Reconcile the TAS With Accounting Records</u>

  The department could not reconcile the TAS with its accounting records without making unsupported adjustments to its accounting records for the Unemployment Fund, Unemployment Compensation Disability Fund, Personal Income Tax Fund, Employment Development Department Contingent Fund, Employment Training Fund, and School Employees' Fund. The department made these adjustments to eliminate unidentified reconciling differences between the TAS and the department's accounting records as of June 30, 1988. Specifically, the department increased total tax revenues for those funds by approximately $32.8 million. In addition, the department increased total refunds owed to employers by approximately $14.8 million and decreased total taxes owed by employers by approximately $16.2 million. Without these adjustments, the department could not reconcile the TAS with its accounting records; however, these adjustments only represented the difference between the two systems and did not result from specific transactions.

  The unidentified reconciling differences between the TAS and the department's accounting records exist because the TAS did not initially process tax transactions as the department had intended. Specifically, the financial activity reports generated by the TAS did not reflect accurately the activity in the TAS. In addition, other problems in the TAS caused the total amount of payments applied to accounts to differ from the total amount of payments recorded. To prevent future discrepancies between the TAS and its accounting records, the department has developed procedures to reconcile the TAS with the department's accounting records each month. In addition, the department continues to identify and correct all of the TAS programming problems that cause the differences.

Criteria: The California Government Code, Section 13403 (a) (3), requires each department to maintain a system of authorization and recordkeeping procedures that provide effective accounting control over assets, liabilities, revenues, and expenditures.

Recommendation: To ensure the accuracy of the employer tax accounts and the department's accounting records, the department should review for accuracy all significant adjustments that increase taxes owed by employers. In addition, the department should review employer tax accounts with long-outstanding balances to determine if refunds owed to employers are accurate and should be refunded to employers. Further, the department should identify and support all reconciling differences between the TAS and its accounting records each month. Finally, the department should continue to identify and correct all system problems in the TAS.

**Item 2.** **Insufficient Support for Bank Reconciliations**

Finding: The department did not sufficiently support amounts reported on its bank reconciliations. Specifically, the department could not support $167,845 and $32,285 reported in benefit payment account numbers 810 and 820 for unemployment insurance. In addition, the department could not support a $59,382 item reported in benefit payment account number 600 for disability insurance. The amounts in benefit payment account numbers 600, 810, and 820 represent the difference between the actual cash deposited from the collection of overpayments of unemployment and disability insurance benefits and the overpayments as recorded in the computer system. The department's failure to support amounts in its bank reconciliations may prevent the detection of cash shortages, errors, or intentional distortions of records.

We reported a similar weakness during our financial audit for fiscal year 1986-87. The department reports that, when the Automated Benefit Accounting System is fully implemented, it will be able to support the reconciliation of these benefit payment accounts.

Criteria: The State Administrative Manual, Section 7967, requires the department to support every unusual reconciling item between the bank records and its own records and to include an explanation of the reconciling item.

Recommendation: The department should identify and support all reconciling items contained in its bank reconciliations.

**Item 3.** **Late Resolution of Audit Reports for Subrecipients of the Job Training Partnership Act**

Finding: The department did not resolve questioned costs in 23 of 62 audit reports for subrecipients of the Job Training Partnership Act program within 180 days of the report's issuance. 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 time.

We reported a similar weakness during our financial audits for fiscal years 1984-85, 1985-86, and 1986-87. The department reports that, because of past staffing problems, it was unable to resolve all of the audit reports within the required time. The department has since established a new unit within its Job Training Partnership Division to resolve audit reports for the subrecipients of the Job Training Partnership Act program.

Criteria: The Code of Federal Regulations, Title 20, Section 629.42(b), requires that the State promptly resolve questioned costs. Policy and procedures bulletin 84-13, dated July 13, 1984, of the Job Training Partnership Office, requires the department to resolve audit reports for the subrecipient no later than 180 days after the subrecipient's receipt of the final audit report.

Recommendation: The department should resolve all subrecipients' audit reports within 180 days after the issuance of the reports.

**Item 4.** **Unsupported Financial Transactions for Unemployment Insurance**

Finding: The department could not sufficiently support certain transactions that it reported in its Unemployment Insurance Financial Transaction Summary reports for each month of fiscal year 1987-88. Specifically, the department could not support the amounts that it reported as reimbursable benefit payments owed by state governments, local governments, and nonprofit organizations.

State governments, local governments, and nonprofit organizations pay for unemployment insurance on a reimbursement basis. The department pays the unemployment insurance benefits to qualified ex-employees on behalf of these reimbursable employers. The department then bills the employers for the unemployment insurance benefits paid. The department relies on its Tax Accounting System (TAS) to identify reimbursable employer transactions. However, the department has not yet developed the necessary programming that will allow the TAS to report these transactions separately as reimbursable benefit payments owed from state governments, local governments, and nonprofit organizations. Consequently, the department records the transactions for reimbursable benefit payments on the Unemployment Insurance Financial Transaction Summary report based on approximate percentages from information for fiscal year 1985-86. As a result, the department is reporting to the federal government reimbursable benefit transactions that are inaccurate.

We reported this same weakness during our financial audit of the department for fiscal year 1986-87. The department reports that it is developing programming to correct this reporting deficiency. By February 1989, the department expects to generate from its TAS accurate reports for reimbursable employer transactions.

Criteria: The Office of Management and Budget, Circular A-102, Attachment G, requires the department to maintain accounting records that are supported by source documentation.

Recommendation: The department should complete the necessary TAS programming that will allow it to accurately report reimbursable benefit payment transactions to the federal government.

**Item 5.** **Late Federal Financial Reports**

Finding: The department did not submit Unemployment Insurance Financial Transaction Summary reports to the federal government within the required time for any of the months during fiscal year 1987-88. The department stated that it cannot submit these reports on time because it cannot summarize the information within the required time limit. Failure to submit these reports on time may place the department in jeopardy of fiscal sanctions imposed by the federal government.

We reported a similar weakness during our financial audits for the four previous fiscal years. The department reports that, once it has fully implemented the Automated Benefit Accounting System and the Single Client Data Base, it will be able to submit the Unemployment Insurance Financial Transaction Summary report within the required time. The department estimates that it will have fully implemented the Automated Benefit Accounting System in March 1990 and the Single Client Data Base by December 1990.

Criteria: The Employment Security Manual, Part V, Section 9320, requires the department to submit the Unemployment Insurance Financial Transaction Summary report within ten business days after the end of each month.

Recommendation: The department should submit the Unemployment Insurance Financial Transaction Summary report by the prescribed due date.

## DEPARTMENT OF HEALTH SERVICES

We reviewed the financial operations, related internal controls, and administration of three federal programs at the Department of Health Services (department). These programs are the United States Department of Agriculture grant, Federal Catalog Number 10.557 and the United States Department of Health and Human Services grants, Federal Catalog Numbers 13.714 and 13.994.

**Item 1.** **Failure To Analyze Collections From Health Insurers**

Finding:

The department did not analyze approximately $1.7 million in collections from third party health insurers. State regulations require the department to determine if it should distribute to Medi-Cal providers or health insurance policyholders any amounts collected. During fiscal year 1987-88, the department's health insurance unit collected over $11.1 million and distributed $612 thousand or 5.5 percent of the collections to Medi-Cal providers or health insurance policyholders.

Specifically, at June 30, 1988, the department had not yet analyzed approximately $745,000 that it had collected from health insurers more than 12 months earlier. Further, at June 30, 1987, the department cleared from its uncleared collections listing approximately $1 million of collections from health insurers without determining if it should distribute any of the collections to Medi-Cal providers or health insurance policyholders. Finally, for the collections that it had not analyzed, the department could not reduce its amounts due from health insurers.

The chief of the department's health insurance unit said that the department did not analyze all collections from health insurers because it assigned a low priority to analyzing older collections. In addition, the chief said that the unit did not have sufficient staff to analyze the older collections and also perform its current work.

When the department does not promptly analyze collections from health insurers, it may improperly retain collections that it should distribute to Medi-Cal providers or health insurance policyholders. In addition, the department is unable to maintain accurate records of amounts due from health insurers.

Criteria: Title 22 of the California Code of Regulations, Section 50769, requires the department to distribute certain of the amounts collected to Medi-Cal providers or health insurance policyholders. Generally, the State Administrative Manual, Sections 10401 and 10452, require agencies to analyze their uncleared collections account and clear the account at least once each month.

Recommendation: The department should analyze its staff requirements to be sure that it can promptly analyze its collections and reduce its amounts due from health insurers. In addition, the department should determine if it should distribute to Medi-Cal providers or health insurance policyholders any amounts collected.

**Item 2.** **Inaccurate Estimate of Receivables**

Finding: The department did not accurately estimate the receivables owed to the Health Care Deposit Fund at June 30, 1988, that it expected to collect in fiscal year 1988-89. The department estimated these receivables to be approximately $219 million at June 30, 1988. However, the department included in its estimate all receivables it expected to collect rather than only those receivables that it expected to collect in the ensuing 12 months. The State Controller in his financial statements prepared in accordance with generally accepted accounting principles, reports receivables that are measurable and available within the ensuing 12 months. As a result, the amount of receivables that the department reported to the State Controller's Office as of June 30, 1988, was higher than it would collect in the ensuing 12 months.

Our estimate of the receivables that the department would collect in the ensuing 12 months was approximately $81 million, $138 million less than the $219 million that the department estimated. The department overestimated the receivables because it has not developed a system that would enable it to properly estimate receivables. Specifically, the department does not maintain records of collections of receivables by the fiscal year that the department established the receivables.

Criteria: The California Government Code, Section 12460, requires each department to maintain its accounting system to make it possible to present its financial position in accordance with generally accepted accounting principles. The Governmental Accounting Standards Board prescribes generally accepted accounting principles for state governments. In its Governmental Accounting and Financial Reporting Standards, Section 1100.108, the Governmental Accounting Standards Board requires states to report receivables that are measurable and available.

Recommendation: The department should report at year end only receivables that it expects to collect in the ensuing 12 months. In addition, the department should record collections of receivables by the fiscal year that the department established the receivables.

**Item 3.** **Delay in Implementing a System To Avoid Paying Medi-Cal Claims to Beneficiaries Who Have Other Health Care Coverage**

Finding: The department has not fully implemented a cost avoidance system to avoid paying Medi-Cal claims for beneficiaries who have other health care coverage. As a result, the department continues to pay some claims that third parties are liable for.

Since May 1986, federal regulations require the department to determine the existence of third parties who may be liable for claims before the department makes payments. If any third parties are liable, the department should return the claim to the provider and instruct the provider to collect from the third parties first. Then, the department can pay the balance up to the maximum amount allowed. In December 1986, the federal Department of Health and Human Services estimated that if the department implemented a cost avoidance system, the department would eliminate 25 person-years in operational costs with a savings of $650,000 annually, would save $46.9 to $70.4 million in Medi-Cal payments not then recovered, and would save interest then lost in the "pay-and-chase method" of payment.

In response to the federal requirements, the department developed a three-phase plan to implement a cost avoidance system. During the first phase, the department included in its cost avoidance system

Medi-Cal beneficiaries enrolled in prepaid health plans and health maintenance organizations. The department completed the first phase in November 1986. In the second phase, the department plans to expand the system to include Medi-Cal beneficiaries who have health insurance coverage similar to Medi-Cal with other health insurance carriers. The department expected to complete the second phase by January 1989. In the third phase, the department plans to complete the system by including Medi-Cal beneficiaries who have limited health care coverage. This group includes beneficiaries who have insurance with small carriers or who are the dependents of insured persons. Additionally, in the third phase, the department plans to implement federal cost avoidance exclusions and to provide more-specific billing and coverage information to Medi-Cal providers.

On July 13, 1988, the department provided to the federal Health Care Financing Administration a quarterly status report on its progress in implementing a cost avoidance system. In the report, the department stated that it had saved over $4 million during the quarter ending June 30, 1988, using its cost avoidance system. The department further reported that it had saved over $11.6 million for fiscal year 1987-88. As of September 30, 1988, the department was using its cost avoidance system for eight major health insurers. These eight insurers provide health insurance coverage to approximately 41 percent of the Medi-Cal beneficiaries who have other health care coverage.

However, as of September 30, 1988, the department was still making payments to providers for approximately 59 percent of the Medi-Cal beneficiaries who have other health care coverage with nonmajor health insurers. The department's Recovery Branch identifies those beneficiaries after the department pays a claim and then attempts to recover monies by billing the health insurance carriers that are liable for the services. This is the "pay-and-chase" method.

Specifically, 7 of 160 claims that we examined involved Medi-Cal services to beneficiaries who had other health care coverage. In each of the seven cases, the third party health insurers may be legally liable for all or part of the medical costs. In 5 of the 7 cases, the department paid the claims before it identified the existence of third parties and could return the claims to the providers for collection from appropriate third parties. We reported a similar weakness during our financial audit for fiscal year 1986-87.

Criteria: Title 42 of the Code of Federal Regulations, Section 433.139, requires the department to implement by May 12, 1986, a cost avoidance system to reject and return to providers claims for which third parties are liable. The providers must collect from the third parties first, then determine the unpaid amount, if any, and submit these claims to the department for payment.

Recommendation: The department should fully implement its cost avoidance system for Medi-Cal payments.

**Item 4. Receivable Reconciliation Not Performed**

Finding: The department has not reconciled with its supporting detail records its receivable balance for advance payments to providers of Medi-Cal services as of June 30, 1988. Without this reconciliation, the department lacks assurance that it has correctly recorded its transactions and that its financial records are complete.

Specifically, as of November 1, 1988, the department's Medi-Cal contractor reported approximately $4 million more in advance payments to providers than the department had recorded in its general ledger at June 30, 1988. Agency officials told us that the supporting detail records provided by the contractor and the department's own records both include inaccurate information.

Criteria: The State Administrative Manual, Section 7900, stresses the importance of reconciliations. Reconciliations are important to internal control because they indicate that the department has correctly recorded its transactions and that the financial records are complete.

Recommendation: The department should reconcile its accounts receivable balance with the supporting detail records to ensure that it records all transactions correctly.

**Item 5.** **Overpayments to Medi-Cal Providers Because of Incorrect Determination of Beneficiaries' Ages**

Finding: The department overpaid to providers certain claims for office visits by Medi-Cal beneficiaries because the department's computer system did not properly determine the beneficiaries' ages. The system rounded the age of each beneficiary to the nearest year rather than determining the exact age of each beneficiary on the date of service. As a result, the department paid providers for some office visits at higher rates than allowed. The overpayments occurred whenever a beneficiary's age was within six months of the beneficiary's next birthday, when a rate increase would occur. Rate increases occur for office visits whenever a beneficiary's age reaches 1, 5, 12, or 18 years. For example, in one claim that we examined, the department paid at the next higher rate the claim for an initial office visit by a child who was less than one year old. Instead of determining the exact age of the beneficiary on the date of service and paying the provider at the rate for a beneficiary 0-1 years old, the system rounded the age of the beneficiary to the nearest year. In this case, the department paid the provider $27.60 for the office visit rather than $23 that the department should have paid, $4.60 more than allowed.

Criteria: Title 22 of the California Code of Regulations, Section 51503(a), establishes the maximum reimbursement rates that the department must pay for physician services covered by Medi-Cal.

Recommendation: The department should identify overpayments to providers caused by incorrectly determining beneficiaries' ages. In addition, the department should report the errors to the federal government and recommend appropriate correction.

**Item 6.** **Price Changes for Drugs Not Promptly Implemented**

Finding: The department did not promptly implement price changes for some drugs provided to Medi-Cal beneficiaries. The department did not fully implement, until November 4, 1987, a price change that it should have implemented July 1, 1987. Also, in March 1988, the department granted its new Medi-Cal contractor permission to postpone implementing some drug price changes. The department authorized the delay so that the new

Medi-Cal contractor could convert from using manual drug price updates to using automated drug price updates. The department has not determined the financial effect of these delays in implementing drug price changes.

Criteria: Title 42 of the Code of Federal Regulations, Section 447.331, requires the State to make payments for drugs at the lowest established limit. Additionally, Title 22 of the California Code of Regulations, Section 51513 (a)(13), requires the department to update the cost of a drug to reflect the most current information available.

Recommendation: The department should identify overpayments or underpayments to providers caused by not promptly implementing price changes for drugs. In addition, the department should report the errors to the federal government and recommend appropriate corrections. Further, the department should implement drug price changes promptly so that it uses the most current information for payment of pharmacy claims.

**<u>Item 7.</u>** **<u>Weaknesses in Controls Over Cash</u>**

Finding: The department has weaknesses in its controls over cash. We noted the following specific weaknesses:

- The department's headquarters office did not promptly prepare 7 of the 12 monthly bank reconciliations for fiscal year 1987-88. Specifically, the headquarters office completed the 7 monthly bank reconciliations between 61 and 118 days after the end of the month. Failure to reconcile bank accounts promptly may result in misstatement of cash balances and can prevent early detection of errors or intentional distortions of cash balances;

- The department's cashiering units at headquarters and the recovery branch do not record the date that they receive cash. Instead, the headquarters cashiering unit records the date that it deposits cash for the two units. As a result, the department is unable to determine if it deposits cash receipts promptly and intact. For fiscal year 1987-88, the department deposited approximately $169 million in its bank account; and

- The headquarters cashiering unit does not endorse checks when it receives them. Instead, the unit endorses checks as it prepares them for deposit. Failure to endorse checks promptly upon receipt of the checks makes the department more vulnerable to loss of the checks.

Criteria: The State Administrative Manual, Section 8060, requires agencies to reconcile their bank accounts promptly at the end of each month. In addition, the State Administrative Manual, Section 8092, requires the department to record the date of receipt for each collection. Furthermore, the State Administrative Manual, Section 8030.5, requires the department to be sure that it deposits receipts promptly and intact. Finally, the State Administrative Manual, Section 8023, requires agencies to endorse checks, money orders, and warrants no later than the end of the day of receipt.

Recommendation: The department should prepare bank reconciliations promptly at the end of each month. In addition, the department should record the date of receipt for each collection so that the department can be sure that it deposits receipts promptly and intact. Finally, the department should endorse checks, money orders, and warrants no later than the end of the day of receipt.

**Item 8. Weaknesses in Control Over the Revolving Fund**

Finding: The department has weaknesses in its control over its revolving fund. We noted the following deficiencies:

- For seven months during the fiscal year, the department did not reconcile the revolving fund resources with cash advanced to the revolving fund. As of June 30, 1988, the department had a $2 million revolving fund cash advance. Failure to reconcile revolving fund resources with the cash advanced may prevent the department from detecting and correcting errors or intentional distortions of the accounting records;

- The department does not promptly collect outstanding salary advances. As of June 30, 1988, the department reported outstanding salary advances of approximately $117,000. Of this amount, 96 advances totaling approximately $48,000 had been outstanding for over 120 days; 30 of these advances, totaling approximately $14,000 had been outstanding since June 30, 1987. Failure to clear advances due from employees may result in 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 advances are not promptly repaid. We reported a similar weakness in our audit for fiscal year 1986-87. In response, the department reported that it would implement a formal collection plan by April 15, 1988. However, as of October 1988, the department had not yet implemented a formal collection plan; and

- The department did not confirm with its employees its permanent travel advances outstanding at year end. As of June 30, 1988, the department had permanent travel advances outstanding with over 200 employees. These advances totaled approximately $100,000. Failure to confirm with employees permanent travel advances outstanding at year end may prevent early detection of errors or intentional distortions of the accounting records.

Criteria: The State Administrative Manual, Section 8193, requires agencies to prepare a monthly reconciliation of revolving fund resources with cash advanced to the revolving fund. In addition, the State Administrative Manual, Section 8118, requires the department to collect salary advances from subsequently issued payroll warrants for the period covered by the salary advance. Finally, the State Administrative Manual, Section 8116, requires agencies to confirm directly with its employees permanent travel advances outstanding at the end of the fiscal year.

Recommendation: The department should prepare revolving fund reconciliations promptly at the end of each month. In addition, the department should promptly recover salary advances from subsequently issued payroll warrants. If this collection effort fails, the department should take other actions as specified in the State Administrative Manual. Finally, the department should confirm permanent travel advances directly with its employees at the end of the fiscal year.

**Item 9.** **Incorrect Calculations of Payments**

Finding: The department does not correctly calculate some amounts that it pays providers in its California Childrens Services/Genetically Handicapped Persons Program (CCS/GHPP). Total expenditures for the department's CCS/GHPP in fiscal year 1987-88 were approximately $7.8 million. Errors by the department in the 25 claims valued at $9,906 that we reviewed amounted to only $151 in total. However, we found calculation errors in 20 percent of the claims we reviewed. Three providers were overpaid a total of $144, and two providers were underpaid a total of $7. For 3 of the 5 claims, the department used incorrect rates when determining the amounts to pay. For the other 2 claims, the department was not able to explain how it calculated the amounts that it paid.

Criteria: The California Health and Safety Code, Section 344, requires the department to establish a rate structure and reimburse providers accordingly.

Recommendation: The department should be sure that it uses the correct rates when paying providers.

**Item 10.** **Inaccurate Financial Reports**

Finding: Because of accounting errors, the department did not initially prepare accurate financial reports for its Federal Trust Fund and Public Health Federal Fund for the year ended June 30, 1988. In the Federal Trust Fund, the department incorrectly reported approximately $3 billion as operating transfers in and operating transfers out, and it incorrectly classified approximately $3 billion of expenditures as operating transfers out. In the Public Health Federal Fund, the department overstated revenues and expenditures by approximately $25 million and $32 million, respectively.

In November 1988, more than two months after agencies are required to submit financial statements to the State Controller's Office, the department submitted revised financial reports to the State Controller's Office to correct these errors in its financial reports for the Federal Trust Fund and the Public Health Federal Fund. Failure to promptly prepare accurate year-end financial reports delays the State Controller's Office in preparing the State's financial statements.

Criteria: A Department of Finance management memorandum dated June 2, 1988, reminded agency officials of their responsibility for preparing accurate year-end financial reports. The State Administrative Manual, Sections 7950 through 7979, describe the requirements for preparing accurate financial reports.

Recommendation: The department should carefully review its year-end financial reports before submitting them to the State Controller's Office to be sure that it has prepared them in accordance with requirements in the State Administrative Manual.

**Item 11.** **Inaccurate Federal Reports**

Finding: The department made numerous errors in preparing its Medicaid Eligibility Quality Control report for the Medical Assistance Program for the period April 1987 through September 1987. In this report the department includes results of its semi-annual sample and review of Medi-Cal claims and reports errors it finds in the claims. The department incorrectly reported the total "number of cases" and the total "dollar value" of state Medicaid payments for the period April 1987 through September 1987. In addition, the department reported 18 incorrect amounts out of a total of 996 amounts for "number of cases"; it also reported 14 incorrect amounts out of a total of 870 amounts for "dollar value" of cases. Finally, the department developed four incorrect computer spreadsheet formulas to calculate totals and subtotals. The department used these incorrect amounts and formulas to calculate additional information to include in the report. Consequently, the department reported an additional 446 incorrect amounts out of a total of 1,866 reported amounts relating to the "number of cases" and "dollar value" of cases.

The department did not perform an independent review of the report before sending it to the federal Health Care Financing Administration. The Health Care Financing Administration uses the data in the report to analyze the State's Medicaid error rate to identify where the State needs to take corrective action. Incorrect information in this report may adversely affect the federal government's evaluation of the effectiveness of the State's corrective actions.

Criteria: Title 42 of the Code of Federal Regulations, Section 431.800(f)(4), requires the department to sample and review its Medi-Cal claims every six months and to report its findings to the Health Care Financing Administration.

Recommendation: The department should establish procedures to be sure that it submits accurate Medicaid Eligibility Quality Control reports to the federal government.

**Item 12.** **Late Federal Reports**

Finding: The department was late in submitting to the Health Care Financing Administration its semi-annual Medicaid Eligibility Quality Control reports for the four most-recent reporting periods. Specifically, the department submitted its September 1986 report due May 31, 1987, 39 days late; its March 1987 report due November 30, 1987, was 43 days late, and its September 1987 report due May 31, 1988, was 63 days late. In addition, as of January 11, 1989, the department had not submitted its March 1988 report due on November 30, 1988. The chief of the Medi-Cal Quality Control section could not explain why the department submitted late reports for September 1986 and March 1987. However, he attributed the delay in submitting the September 1987 report to a staff shortage; he attributed the delay in submitting the March 1988 report to delays in obtaining detail claim information from its files and to computer failure. Failure to submit these reports on time may adversely affect the federal government's evaluation of the State's corrective actions.

Criteria: Title 42 of the Code of Federal Regulations, Section 431.800, requires the department to submit its Medicaid Eligibility Quality Control reports by November 30 for the October through March sampling period and by May 31 for the April through September sampling period.

Recommendation: The department should establish procedures to be sure that it submits its Medicaid Eligibility Quality Control reports by the deadlines required by the federal government.

**Item 13.** **Food Vouchers Not Reconciled Promptly**

Finding:

The department was late in reconciling about 18 percent of "food vouchers issued" with "food vouchers redeemed" in fiscal year 1987-88. Federal regulations require the reconciliation within 150 days of the date on which a food voucher is issued.

Specifically, the department's monthly reconciliations indicate that in fiscal year 1987-88, an average of approximately 300,000 food vouchers redeemed each month were issued more than 150 days before the reconciliations were prepared. The department redeemed approximately 20 million food vouchers in fiscal year 1987-88. During the first nine months of the fiscal year, monthly reconciliations indicate that an average of only approximately 150,000 food vouchers redeemed each month were issued more than 150 days before the monthly reconciliations were prepared. However, for the last three months of the fiscal year, the monthly reconciliations indicate that an average of approximately 750,000 food vouchers redeemed each month were issued more than 150 days before the monthly reconciliations were prepared. This average for the last three months was significantly higher than for the first nine months.

The chief of the department's Special Supplemental Food Program for Women, Infants, and Children said that the increase in the number of food vouchers redeemed more than 150 days before the reconciliations were prepared was caused by machine failure. The department was unable to promptly prepare its file of food vouchers issued to match with the file of food vouchers redeemed. Consequently, the department was unable to provide the information necessary to prepare the monthly reconciliations for the last three months of the fiscal year as promptly as it did for the first nine months.

Although the department ultimately reconciles all of the food vouchers redeemed with the food vouchers issued, failure to promptly reconcile each food voucher issued to food vouchers redeemed may delay detection of irregularities such as redemption of food vouchers that the department did not issue.

Criteria: Title 7 of the Code of Federal Regulations, Section 246.12(n)(1), requires the department to reconcile each food voucher issued with food vouchers redeemed within 150 days of the issue date of the food voucher.

Recommendation: The department should develop procedures to ensure that it reconciles each food voucher issued with food vouchers redeemed within 150 days of the issue date of the food voucher.

**Item 14. Suspension of Procedures for Detecting and Resolving Dual Enrollment**

Finding: In July 1987, the department suspended its use of reports to detect participants who may enroll in the Special Supplemental Food Program for Women, Infants, and Children at more than one location (dual enrollment). Federal regulations require the department to have procedures to detect participant abuse such as dual enrollment.

In 1984, the department implemented a system to provide information to identify dual enrollments. However, the system did not operate as intended and produced inaccurate dual enrollment reports. In July 1987, the department suspended using reports from the system. In October 1988, the department contracted with the state Department of General Services to conduct a feasibility study of the system to determine whether the system can be modified to produce more-accurate dual enrollment reports.

The department's suspension of procedures to identify dual enrollments may decrease the department's ability to detect and resolve participant abuse of the program.

Criteria: Title 7 of the Code of Federal Regulations, Section 246.12(k), requires the department to establish procedures designed to detect and resolve participant abuses.

Recommendation: The department should continue its efforts to re-establish procedures to detect dual enrollments.

**Item 15.** **Food Vouchers Not Always Endorsed by Vendors**

Finding: The department has not developed procedures to ensure that all food vouchers that it redeems are endorsed by vendors. We noted that 7 of 66 food vouchers that we examined that were redeemed by the department were not endorsed by vendors. Federal regulations require the department to be sure that it can identify redeemed food vouchers to specific vendors. Vendor endorsements provide the department a means to analyze the redeemed vouchers and identify vendors that may not be authorized to redeem food vouchers and vendors that may not be complying with all provisions of the program.

Criteria: Title 7 of the Code of Federal Regulations, Section 246.12(s), requires the department to ensure that it can identify redeemed food vouchers to specific vendors. Section 246.12(e) states that only authorized vendors may redeem food vouchers.

Recommendation: The department should remind vendors to endorse food vouchers.

**Item 16.** **Delay in Transferring Recoveries of SWCAP Costs**

Finding: The department did not promptly transfer approximately $548,000 of cumulative first, second, third, and fourth quarter reimbursements for the federal share of service costs provided by central service agencies. The State recovers these costs as part of its Statewide Cost Allocation Plan (SWCAP). On average, the department transferred reimbursements for the federal share of SWCAP costs to the State's General Fund 86 days after the end of each quarter.

We reported a similar weakness during our financial audit for fiscal year 1986-87. In response to our audit report, the department stated in March 1988 that it would transfer recoveries of SWCAP costs to the State's General Fund within the 30 days following the close of each quarter as required by state guidelines. However, the department consistently made late transfers of recoveries of SWCAP costs to the State's General Fund throughout fiscal year 1987-88.

Failure to promptly transfer recoveries of SWCAP costs may result in a delay in use of these monies by the State's General Fund.

Criteria: The California Government Code, Section 13332.01, requires agencies to recover SWCAP costs from the federal government. Although no deadline is expressly mandated, the State Administrative Manual, Section 8755.2, intimates that a transfer of SWCAP recoveries by state agencies to the State's General Fund within 30 days of the end of each quarter would be appropriate.

Recommendation: The department should ensure that it identifies and transfers the correct recoveries of SWCAP costs to the State's General Fund within 30 days of the end of each quarter.

## DEPARTMENT OF MENTAL HEALTH

We reviewed the financial operations, internal controls, and administration of one federal program at the Department of Mental Health (department). This program is the United States Department of Health and Human Services grant, Federal Catalog Number 13.992.

**Item 1.** **Improper Identification of Encumbrances**

Finding: The accounting personnel of the department did not accurately identify which of its unliquidated encumbrances were payables at June 30, 1988. As a result, $4.4 million of payables were incorrectly classified as outstanding encumbrances. If the department does not properly identify encumbrances, 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 state agencies to disclose the portion of payables that represents encumbrances in their financial statements. Under generally accepted accounting principles, encumbrances are commitments for goods or services to be received in the future, and accounts payable are commitments for goods or services that have been received.

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

**Item 2.** **Incomplete Reconciliation for Revolving Fund Accountability and Lack of Follow Up on Outstanding Advances**

Finding: The department has insufficient accountability for the revolving fund. We found the following specific deficiencies:

- The detail listing of advances for salary, travel, and expenses did not agree with the balances reported on the revolving fund reconciliation. The balance on the reconciliation for salary and travel advances is $3,803 less than the balance on the detail listing. In addition, the listing includes approximately $2,200 of adjustments that are not supported. The balance on the reconciliation for expense advances is $2,635 less than the balance on the detail listing;

- The department is not following up on long-outstanding advances promptly. As of November 1988, 38 travel advances, outstanding on June 30, 1988, had been outstanding for over 120 days. These outstanding travel advances totaled $6,524. Also, the department is not completing the confirmation of permanent travel advances. As of November 1988, 4 of the 17 confirmation letters for permanent travel advances that we reviewed had not been received from employees; and

- The department reduced the balance of the claims filed account by the amount of $50,369. The department contends that this adjustment was for claims filed that had been paid by the department's revolving fund as of June 30, 1988. However, the department did not provide a list of the specific claims paid or a list of the revolving fund checks that paid the claims. Therefore, we are unable to verify the correctness of the adjustment.

Criteria: The State Administrative Manual, Section 7964, states that the agencies will reconcile their revolving fund accounts at the end of each month. An inaccurate reconciliation will not satisfy this requirement. Good internal control requires that long-outstanding advances be followed up promptly to ensure the accuracy of the revolving fund reconciliation.

Recommendation: The department should ensure that its reconciliation of revolving fund accountability is accurate, and it should follow up on long-outstanding advances promptly.

**Item 3.** **Poor Internal Controls Caused by Lack of Separation of Duties for Revolving Fund Disbursements**

Finding: The department lacks sufficient separation of duties for employees who process revolving fund disbursements. Specifically one employee, the Accounting Officer, authorizes disbursements, compares checks with supporting documents, and has access to the blank check stock. Without proper separation of duties, irregularities may go undetected and management may be unable to determine the responsibility for errors.

Criteria: The State Administrative Manual, Section 8080, prescribes the separation of duties in agencies where accounting systems have manual processes. Section 8080 specifies that one person should not perform more than one of such duties as authorizing disbursements, comparing machine-signed checks with authorization and supporting documents, and having access to or control over blank check stock.

Recommendation: The department should separate the duties of persons who authorize disbursements, compare checks with supporting documents, and have access to blank check stock.

**Item 4.** **Property Records Not Properly Reconciled**

Finding: The department does not maintain adequate control over property accounting. Specifically, the department does not reconcile the balance of the property records to the control accounts, and does not reconcile physical inventories with property records.

Since property records are not properly reconciled, the department lacks assurance that the balance in the property account is accurate. Failure to maintain property records as required may result in an undetected loss of state property.

Criteria: The State Administrative Manual, Section 8650, requires departments to keep records of all property and related information to serve as the subsidiary record to support the general fixed assets. Therefore, the individual property records must agree with the general ledger control account to satisfy this requirement. The State Administrative Manual, Section 8671, illustrates the journal entries that departments should make to record the purchase of the equipment. The State Administrative Manual, Section 8652, requires departments to make a physical count of all property and reconcile the count with accounting records at least once every year.

Recommendation: The department should maintain accurate records of all property. Specifically, the department should reconcile the balance of property records to the control accounts and also reconcile physical inventories with the accounting records.

**Item 5.** **Excessive Lag Between Receipt and Disbursement of Federal Funds**

Finding: The department's process of requesting federal funds for the Alcohol and Drug Abuse and Mental Health Services Block Grant does not ensure that the requests are limited to the immediate needs of the department. During fiscal year 1987-1988, we tested approximately $15 million of block grant funds received by the department. In our review of the department's federal cash receipts and disbursements, we found that for 6 of the 21 claims that we reviewed, the interval between the date that the State Controller's Office received the funds and the date that it issued warrants ranged from 6 to 18 working days.

Criteria: The Department of Treasury, Circular 1075, Section 205.4, stipulates that cash advances be limited to the minimum amounts needed and be timed to be in accord only with the actual immediate cash requirements of the recipient organization in carrying out the purpose of the approved program.

Recommendation: The department should request federal funds for the block grants at the time the State Controller's Office issues the warrants.

## DEPARTMENT OF MENTAL HEALTH
## ATASCADERO STATE HOSPITAL

We reviewed the financial operations and related internal controls at the Atascadero State Hospital (hospital).

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| **Item** | **Inaccurate Year-End Financial Reports** |
| Finding: | The hospital did not correctly prepare year-end financial reports for its portion of the State's General Fund in accordance with the State Administrative Manual. As a result, the hospital's financial reports are not accurate. We found the following specific deficiencies:<br>- The hospital misclassified in its financial reports $870,977 of amounts due to other funds as accounts payable;<br>- The hospital misclassified in its financial reports $316,499 of expense advances as accounts payable; and<br>- The hospital incorrectly accrued in its financial reports $11,500 as due to other funds and as expenditures. These amounts were already paid and recorded as expenditures before year end. As a result of the incorrect accrual, the hospital overstated expenditures and due to other funds by $11,500. |
| Criteria: | The State Administrative Manual, Section 7620 through Section 7680, describes the purpose and nature of the State's general ledger accounts. The State Administrative Manual, Section 10537, describes the process for recording expense advances at fiscal year end. |
| Recommendation: | The hospital should prepare accurate year-end financial reports in accordance with the State Administrative Manual. |

# DEPARTMENT OF REHABILITATION

We reviewed the Department of Rehabilitation's (department) administration of the United States Department of Education grant, Federal Catalog Number 84.126.

**Item 1.** **Inaccurate Federal Financial Report**

Finding: The department inaccurately prepared the financial status report for June 30, 1988, that it submitted to the United States Department of Education. The department made three errors that overstated the federal share of expenditures by a net amount of approximately $63,000. We found the following specific deficiencies:

- As a result of clerical errors, the department overstated the federal share of expenditures by approximately $70,000. The department made an error in transferring total program expenditures from a manually prepared worksheet to the financial status report;

- The department incorrectly included as direct costs up to $87,000 of purchase costs for communications equipment. Indirect costs chargeable to federal programs are a percentage of allowable direct costs. Thus, an incorrect base of direct costs results in an incorrect calculation of indirect costs. According to the authorized indirect cost rate agreement with the United States Department of Education, the department should exclude from allowable direct costs all equipment that costs more than $300 per unit. As a result of its error, the department overstated the federal share of expenditures for this program by as much as $7,000; and

- The department incorrectly excluded up to 20 percent of the expenditures and encumbrances relating to grants for establishing rehabilitation facilities (establishment grants) when it calculated indirect costs chargeable to federal programs for fiscal year 1987-88. In calculating indirect costs, the department used expenditure figures recorded in the allotment-expenditure ledger. However, the allotment-expenditure ledger reflects only 80 percent of the expenditures for establishment grants because the remaining 20 percent of expenditures consists of matching funds provided by individual facilities. In January 1989, the department recalculated the allowable cost base for determining indirect costs applicable to its establishment grants as of June 30, 1988. From this recalculation, we determined that the department had understated the federal share of expenditures applicable to its establishment grants by approximately $14,000. The department's establishment grants totaled approximately $6 million for fiscal year 1987-88.

Criteria: The federal Office of Management and Budget Circular A-102, Attachment G, requires that federal financial reports contain accurate and reliable information.

Recommendation: Before the department submits its financial status reports, it should review the calculations used to determine program costs. In addition, the department should prepare its December 1988 federal financial report to include the correction of establishment grant expenditures.

**Item 2.** **Late Submittal of the Federal Indirect Cost Rate Proposal**

Finding: The department submitted its indirect cost rate proposal (ICRP) for fiscal year 1987-88 to the United States Department of Education on March 16, 1987, 16 days after the revised due date of February 28, 1987, and 15 days before the State Department of Finance approved it. As a result of the late ICRP, the department did not know how much of its indirect costs the federal government would pay. The chief of the department's budget unit attributes the delay to unclear instructions from the United States Department of Education.

Criteria: The State Administrative Manual, Section 8756.1, requires state agencies to submit their ICRPs to the responsible federal agency at least six months before the start of the fiscal year for which the ICRP applies. In addition, the State Administrative Manual, Section 8756.1, requires agencies to send their ICRPs to the Fiscal Systems Control Unit of the Department of Finance for review before sending the proposal to the responsible federal agency for approval.

Recommendation: The department should submit its ICRP to the United States Department of Education in accordance with the mandated deadlines, which include sufficient time for the State Department of Finance to approve the ICRP.

## DEPARTMENT OF SOCIAL SERVICES

We reviewed the financial operations, related internal controls, and administration of nine federal programs at the Department of Social Services (department). These programs are the United States Department of Agriculture grants, Federal Catalog Numbers 10.551, 10.561, and 10.568 and the United States Department of Health and Human Services grants, Federal Catalog Numbers 13.658, 13.667, 13.780, 13.783, 13.787, and 13.802.

**Item 1.** **Unidentified Difference of Cash in State Treasury**

Finding: As of June 30, 1988, the department's California State Accounting and Reporting System (CALSTARS) general ledger balance of cash in the state treasury for the department's share of the Federal Trust Fund was $28.8 million higher than the balance of the department's share as recorded by the State Controller's Office. The department has been aware of this problem since at least November 23, 1987, when the department learned that the difference was $3.6 million at June 30, 1987. However, according to an accounting administrator, the department has not been able to determine the reason for the difference.

The accounting administrator said that the department does not use the CALSTARS balance. Instead, during the year, the department maintains a manual record of its federal receipts and disbursements. For its financial statements for fiscal year 1987-88, the department adjusted its cash in the state treasury account and its due from other governments account so that the cash in the state treasury account agreed with the balance recorded by the State Controller's Office. Because the department is not able to account for the difference between its CALSTARS records and records of the State Controller's Office, we cannot be certain that the department's year-end balances for its cash in the state treasury account and its due from other governments account are correct. Further, we believe that the department is increasing the risk of undetected errors.

In a memo to my staff, dated December 1, 1988, the department said that the problem was related to the posting of transactions to various CALSTARS files. The department plans to implement new procedures for recording transactions affecting these files. Also, the department plans to reconcile the department's cash in the state treasury account balance with the account balance of the State Controller's Office.

Criteria: The State Administrative Manual, Section 20003, requires state agencies to maintain recordkeeping procedures adequate to provide effective accounting control over assets, liabilities, revenues, and expenditures.

Recommendation: The department should resolve differences among its CALSTARS files. Also, the department should ask the State Controller's Office for assistance in resolving the difference between the department's accounting records and the records of the State Controller's Office.

**Item 2.** **Misstatement of Account Balances**

Finding: The department inaccurately calculated certain expenditure and liability accruals for the State's General Fund and the Federal Trust Fund. In addition, because the Federal Trust Fund expenditures are reimbursed by the federal government, inaccurate calculations in Federal Trust Fund expenditure and liability accruals result in corresponding inaccuracies in Federal Trust Fund revenue and asset accruals. Consequently, for fiscal year 1987-88, the General Fund expenditures and liabilities were understated by approximately $15.3 million. Moreover, the Federal Trust Fund expenditures and liabilities and revenues and assets were overstated by approximately $14.4 million. During our audit, we found the following errors related to accruals of assets, liabilities, revenues, and expenditures:

- The department understated an expenditure and liability accrual for the General Fund by approximately $4.4 million. This understatement occurred because the department did not include in its accruals all counties' expenditures for the Adoption Assistance program;

- The department understated an expenditure and liability accrual for the General Fund by approximately $10.9 million. This understatement occurred because the department incorrectly recorded the State's share of expenditures as a reimbursement from the federal government;

- The department overstated an accrual of expenditures and liabilities and revenues and assets for the Federal Trust Fund by approximately $8.8 million. This overstatement occurred because the department incorrectly included in its calculation of accruals a total of $5.1 million for two contracts that had expired and a total of $3.7 million for two other contracts for which the department did not expect to incur future expenditures. The contracts were with the Department of Health Services, which provides services on behalf of the department's Refugee Assistance program;

- The department overstated an accrual of expenditures and liabilities and revenues and assets for the Federal Trust Fund by approximately $4.5 million. This overstatement occurred because the department incorrectly twice recorded the same accrual for the balance of a contract with the County of Los Angeles under the Refugee Assistance Services program; and

- The department overstated an accrual of expenditures and liabilities and revenues and assets for the Federal Trust Fund by approximately $1.1 million. This overstatement occurred because the department incorrectly recorded as $1.1 million an accrual of $1,118 for the Foster Care-Refugee Resettlement program.

We reported similar weaknesses in our audits for fiscal years 1984-85, 1985-86 and 1986-87. The department responded to our audit for fiscal year 1986-87 that it was continuing to improve the year-end accrual process.

Criteria:

The State Administrative Manual, Section 10544, requires agencies to accrue expenditures at the end of the fiscal year and determine that the amounts are the most accurate that can be determined. In addition, the California Government Code, Section 13403, states that the systems of internal accounting and administrative control are to include authorization and recordkeeping procedures to provide effective accounting control over assets, liabilities, revenues, and expenditures.

Recommendation: The department should review available financial information to ensure that amounts it accrues are as accurate as possible.

**Item 3.** **Improper Cash Management**

Finding: Although the department has resolved some of the weaknesses we reported in previous years, it still does not always properly control its cash management system for the federal government's share of the department's expenditures. As a result, the department was unable to promptly honor all claims, may have affected the receipt of federal funds, and lost potential interest income. During our audit, we noted the following deficiencies:

- The department did not ensure that federal funds were available before it submitted claim schedules to the State Controller's Office for payment. This weakness occurred because the department did not coordinate the receipt and disbursement of federal funds before submitting claims to the State Controller's Office for payment. The State Controller's Office returned six claim schedules totaling approximately $27 million because of insufficient funds in the cash accounts of the department's Federal Trust Fund. As a result, the department delayed payment of these claim schedules for 7 to 218 days and created additional work for both the State Controller's Office and the department. We reported similar weaknesses in our audits for fiscal years 1984-85, 1985-86, and 1986-87. The department responded that the returned claim schedules cited in our audit for fiscal year 1986-87 represent only 0.2 percent of the schedules submitted to the State Controller's Office;

- The department requested federal funds in excess of the department's immediate needs. Of 60 requests that we reviewed, the department held one request valued at approximately $368,000 for 14 days and another request valued at approximately $595,000 for 30 days before it incurred the related expenditures. Maintaining excess cash may result in the termination of advance financing by the federal government. We reported a similar weakness in our audits for fiscal years 1984-85, 1985-86 and 1986-87. The department responded to our audit for fiscal year 1986-87 that it estimates monthly the amount of federal funds to request; and

- The department did not promptly request approximately $2 million in federal funds to make a contract payment to the Employment Development Department. According to department accounting staff, the department did not have sufficient federal grant funds to pay the Employment Development Department; however, the department could not support this statement. As a result, the State may have lost as much as $154,000 in interest income.

Criteria: The State Administrative Manual, Section 0911.4, requires state agencies to secure prompt reimbursement from grant funds for goods and services provided. In addition, the California Government Code, Section 13401, requires each agency to maintain effective systems of internal accounting and administrative control to minimize error. Circular 1075, Section 205.4 of the federal treasury stipulates that the timing and amount of federal cash advances be as close as administratively feasible to the actual disbursement by the recipient organization.

Recommendation: The department should verify the availability of funds before it submits claim schedules to the State Controller's Office for payment, and it should promptly request federal funds only in amounts that the department immediately needs.

__Item 4__. __Ineffective Monitoring of the State Supplementary Program Payments__

Finding: Although the department has resolved some of the weaknesses we reported in previous years, it still did not completely monitor the State Supplementary Program (SSP). The State provides supplementary payments to the federal Social Security Administration for aged, blind, or disabled persons who meet the SSP's income and resource requirements. The Social Security Administration determines the eligibility of applicants, computes grants, and disburses monthly payments to the recipients. However, the department did not resolve a net difference of $100,000, the difference between $4.7 million in credits and $4.6 million in charges, between the financial accountability statement for the SSP program and the supporting financial accounting exchange file that includes detailed information on payments and collections. As a result, the department cannot be certain that it is paying its proper share of the SSP program.

We reported a similar weakness in our audits for fiscal years 1985-86 and 1986-87. The department responded to our audit for fiscal year 1986-87 that its staff members are working to improve the reconciliation process. We found that the department is currently working with the Division of Audits of the State Controller's Office to perform the reconciliation and expects to complete the reconciliation during fiscal year 1988-89.

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.

Recommendation: The department should resolve all differences between the financial accountability statement and financial accounting exchange file.

**Item 5.** **Lack of Control Over and Accountability for the Revolving Fund**

Finding: The department does not always maintain control over and accountability for its revolving fund. During our audit, we found the following deficiencies:

- The department overdrew its revolving fund in 10 of the 12 months of fiscal year 1987-88 by a monthly average of $179,000. The department overdrew its revolving fund by amounts ranging from $51,000 to $327,000 during fiscal year 1987-88. We reported a similar weakness in our audit for fiscal year 1986-87. To solve this problem the department assigned additional staff to process claims and reimbursements and increased its revolving fund advance from $900,000 to $1.2 million;

- The department did not prepare reconciliations of its revolving fund promptly. Reconciliations for July 1987 through March 1988 were prepared quarterly rather than monthly. Reconciliations for the remainder of the year were not prepared within 30 days of the end of the preceding month. In addition, the revolving fund reconciliations do not show the name of the reviewer or the date of review;

- The department did not prepare its year-end "Analysis and Reconciliation of Revolving Fund Accountability Report" in accordance with requirements of the State Administrative Manual. Specifically, the department misclassified salary and expense advances to employees. As a result, expense advances and accounts payable were understated on the year-end financial reports;

- The department did not promptly collect outstanding revolving fund advances. As of June 30, 1988, expense advances of approximately $68,000, salary advances of approximately $29,700, and temporary travel advances of approximately $77,900 were outstanding for more than 120 days;

- The department did not reimburse the revolving fund promptly. Of the 30 transactions that we examined, two disbursements totaling $1,505 were not submitted to the State Controller's Office for reimbursement. The first disbursement, an expense advance, was outstanding for nine months. The second, a travel advance, was outstanding for five months, and two subsequent advances were issued before clearing the first travel advance; and

- The department did not always obtain proper authorization for payments for travel expense advances and travel expense claims. Of the 30 transactions that we examined, 7 disbursements were authorized by personnel not empowered to do so.

Insufficient controls over and accountability for revolving fund activities can result in undetected errors and irregularities and unnecessarily reduce funds available for other uses.

Criteria: The State Administrative Manual, Section 8047, directs agencies to make every effort to prevent overdrafts in their checking accounts, including account balances with the State Controller's Office. These efforts would include promptly submitting claim schedules to the State Controller's Office to reimburse the department's revolving fund. The State Administrative Manual, Section 7900, requires agencies to prepare reconciliations within 30 days of the end of the preceding month. Further, the State Administrative Manual, Section 7908, requires that reconciliations show the names of the preparer and reviewer and the dates of preparation and review.

The State Administrative Manual, Section 7965, describes the format and classifications of the Analysis and Reconciliation of Revolving Fund Accountability. The State Administrative Manual, Sections 8116, 8117, and 8118, describes the required procedures for reimbursing the revolving fund for travel advances, travel expenses, and salary expenses, respectively. In addition,the State Administrative Manual, Section 8710.1, requires the department to develop collection procedures that will assure prompt follow-up on receivables.

The State Administrative Manual, Section 8116, provides for an agency to reimburse and, therefore, clear advances from the records when employees submit their travel expense claims. If the advance exceeds the employee's travel expense claim, the employee is required to reimburse the revolving fund promptly, unless it is known that the employee will travel in the near future. The State Administrative Manual, Section 8422.1, requires an agency to determine that authority existed to obtain goods and services.

Recommendation: The department should continue to monitor its revolving fund balance and not exceed the authorized revolving fund balance. In addition, the department should prepare its Analysis and Reconciliation of Revolving Fund Accountability promptly and in accordance with the format required by the State Administrative Manual. Further, the department should monitor all revolving fund advances and collect long-outstanding advances. The department should also review all travel advances and vendor payments made from the revolving fund and pursue prompt reimbursement. Finally, the department should maintain adequate procedures to ensure that revolving fund disbursements are authorized.

Item 6. **Inaccurate and Undocumented Time-Reporting Summaries**

Finding: The department did not maintain sufficient supporting documentation for time-reporting summaries. Because of incomplete employee time reports, we could not verify the accuracy of a time-reporting summary that the Language Services Bureau submitted. Moreover, the Quality Control Branch submitted a time-reporting summary that it prepared using incorrect percentages for group activities. In addition, a time-reporting summary that the Statewide Systems Program Management Bureau submitted did not agree with the employees' time reports. Excluding the inaccurate time-reporting summary from the Statewide Systems Program Management Bureau, which the department subsequently corrected in August 1988, these inaccurate and unsupported time-reporting summaries resulted in aggregate charges to state and federal programs of approximately $767,000. Because of inaccurate and undocumented time-reporting summaries, the department is not complying with federal regulations regarding cost allocation, and the federal government may withhold additional grant monies.

We reported similar weaknesses in our audits for fiscal years 1984-85, 1985-86, and 1986-87. In response to our audit for fiscal year 1986-87, the department stated it was evaluating the various time-reporting procedures used throughout the department, and it was updating the Time Reporting Handbook. The updated Time Reporting Handbook was released on June 7, 1988. It requires reporting units to keep copies of supporting employees' time reports and emphasizes management's responsibility for accurate time-reporting summaries.

Criteria: Circular A-87, Attachment B (10)(b) of the federal Office of Management and Budget requires that salaries and wages chargeable to more than one grant, program, or other cost objective be supported by appropriate time-reporting summaries. The department's Time Reporting Handbook states that it is the supervisor's responsibility to collect, review, correct when necessary, sign, and submit time reports for all employees in his/her unit (including absent employees). In signing employee time reports, supervisors are certifying the accuracy of all data reported.

Recommendation: The department should maintain accurate time-reporting summaries to support personnel expenditures of time charged to federal programs.

**Item 7.** **Deficiencies in Administering State Contracts**

Finding: The department did not comply with the California Public Contract Code and the State Administrative Manual in establishing and maintaining contracts with vendors. Of the ten contracts that we examined for approximately $9.8 million in goods and services, the department had not approved seven of the contracts before the work began. For example, although the contract period for one of the seven contracts was from October 1, 1987 to December 31, 1989, the department had not approved the contract as of June 27, 1988. In addition, the contract period for another of the seven contracts was from December 9, 1987 to June 30, 1988, but the department had not approved the contract as of June 27, 1988. As a result of lack of timely approvals of contracts, the State may be liable for invalid contracts.

We reported similar weaknesses in the department's contracting procedures in our statewide management letter for fiscal years 1985-86 and 1986-87.

Criteria: The California Public Contract Code, Section 10295, states that identified state contracts must contain specific documentation and are void unless and until they are approved by the Department of General Services. Additionally, the State Administrative Manual, Section 1204, emphasizes the need to have contracts approved before the beginning of the contract work.

Recommendation: The department should follow the requirements of the California Public Contract Code and the State Administrative Manual in establishing and maintaining contracts with vendors.

Item 8. Delays in Collecting Disallowed Costs

Finding: The department did not promptly collect disallowed costs from the county welfare departments. The department contracts with the Division of Audits of the State Controller's Office to conduct "post audits" of the records of county welfare departments. 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 federal Department of Health and Human Services and the department. The State Controller's Office is also responsible for reporting the fiscal effects 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 $863,000 in disallowed costs, for seven audits that we reviewed, ranged from 8 to 31 months after allowing time for an appeal process. Of this $863,000 amount, $344,000 represents funds owed to the State. The remaining $519,000 represents amounts owed to the federal government. 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 $32,000.

We reported similar weaknesses in our audits for fiscal years 1985-86 and 1986-87. The department responded to our audit for fiscal year 1986-87 that it had significantly reduced the number of audits for which recovery of disallowed costs was pending and that it had also reduced the time elapsed until recovery of disallowed costs from 51 months in July 1987 to an average of less than 6 months as of February 1988.

Criteria: Circular 1075, Section 205.4, of the federal treasury states that cash advances to a recipient organization shall be limited to the minimum amounts needed. In addition, the Code of Federal Regulations, Title 45, Section 74.61(h), requires the State to follow a systematic method to assure prompt and appropriate resolution of audit findings and recommendations. Good business practice dictates that the State promptly collect money owed to it.

Recommendation: The department should promptly offset the disallowed costs of the county welfare departments against current county claims to ensure that excess funds are not held by the county welfare departments. The department should also establish time frames for processing disallowed costs, and it should monitor compliance with established procedures.

**Item 9.** **Delays in Submitting Audit Reports**

Finding: The department contracts with the State Controller's Office to have the State Controller's Office audit county welfare departments and contract providers. We reviewed 14 of 122 audits that the Division of Audits of the State Controller's Office completed during fiscal year 1987-88. The Division of Audits did not promptly submit audit reports to the department and the auditee in 5 of the 14 audits. These 5 reports were for audits of three Refugee Resettlement Program contract providers, one Foster Care Program group home provider, and one In-Home Supportive Services contract provider. Delays in submitting the audit reports ranged from approximately 74 to 273 days after the date of the exit conference. Excessive delays in submitting audit reports contribute to delays in collecting disallowed costs with a resulting loss of potential interest earnings.

The department has established a procedure for monitoring the status of audits of county welfare departments and contract providers performed by the State Controller's Office. The State Controller's Office must now provide the department with quarterly reports of the status of its audits. We also reported this finding in our letter to the State Controller's Office.

Criteria: The interagency agreement between the department and the State Controller's Office, dated July 1, 1987, requires the State Controller's Office to submit to the department and the auditee copies of final audit reports within 60 days after the date of the exit conference.

Recommendation: The department should enforce the terms of the interagency agreement to ensure that the State Controller's Office submits final audit reports to the department and the auditee within 60 days of the exit conference.

**Item 10.** **Insufficient Review and Monitoring of Independent Audit Reports**

Finding: The department's Refugee and Immigration Programs Branch (branch) failed to properly review independent audit reports of subrecipients and monitor the submission of such reports for fiscal year 1987-88. Federal regulations require that states determine whether audits of subrecipients address fiscal and compliance issues and that states monitor these audits. During our audit, we found the following deficiencies:

- We reviewed six independent audit reports received from refugee program subrecipients and found that they were not prepared according to requirements of the U.S. Comptroller General's Standards for Audit of Governmental Organizations, Programs, Activities, and Functions (Comptroller General's standards). The audit reports did not include a statement of positive assurance on items of compliance that it tested or a statement of negative assurance on items of compliance that it did not test. In addition, five audit reports did not include a report on the study and evaluation of internal control, and two did not include a statement that the examination was made in accordance with generally accepted governmental auditing standards for financial and compliance audits. Without proper audits, the department cannot be certain that sponsors are complying with applicable federal rules and regulations;

- The branch evaluated five of the six audit reports tested for corrective action only and not for proper scope and content. As a result, the branch cannot be certain that subrecipients are complying with federal grant requirements; and

- Of the six independent audit reports that we reviewed, four were not recorded in the monitoring system as having been received. As a result, the branch is unable to adequately monitor reports due from subrecipients.

We reported similar weaknesses in our audit for fiscal years 1984-85, 1985-86, and 1986-87. The department responded to our audit for fiscal year 1986-87 that the branch would verify that the audit reports contain the required assurances and that it would establish a monitoring system in January 1988. However, we found that the branch had not completely evaluated all the audit reports for compliance with the Comptroller General's standards. In addition, the branch did not completely comply with the Comptroller General's standards, and the branch's monitoring system was not operating as intended.

Criteria: The Code of Federal Regulations, Title 45, Section 74.62 (b), requires the State to determine whether private, nonprofit subrecipients are in compliance with Circular A-110 of the federal Office of Management and Budget. Circular A-110 requires the State to determine whether these audits include an examination of the subrecipient's compliance with the terms and conditions of the federal grants and other agreements.

Recommendation: The branch should review independent audit reports to ensure that the reports are in compliance with the Comptroller General's standards. Additionally, the branch should follow its procedures for monitoring independent audit reports of subrecipients.

**Item 11.** **Federal Financial Reports Not Reconciled to Accounting Records**

Finding: The department did not reconcile its federal financial reports with departmental accounting records for fiscal year 1987-88 for the following programs: the Food Stamp Program, the Temporary Emergency Food Assistance (Administrative Costs) Program, the Foster Care--Title IV-E Program, the Child Support Enforcement Program, the Assistance Payments--Maintenance Assistance Program, and the Refugee and Entrant Assistance--State Administered Programs. Failure to reconcile federal financial reports with the accounting records can result in misstatements of claims that may go undetected.

We reported similar weaknesses in each of our annual audits beginning in fiscal year 1982-83. The department responded to our audit for fiscal year 1986-87, that it was seeking a redirection of staff to implement the reconciliation.

Criteria: The Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments, Subpart C, Section 20 (b)(1), of the federal Office of Management and Budget, requires grantee financial management systems to provide accurate, current, and complete disclosure of each grant program. Further, the State Administrative Manual, Section 20014, requires agencies receiving federal funds to reconcile federal financial reports with the official accounting records and retain all supporting schedules and worksheets for a minimum of three years.

Recommendation: The department should ensure that federal reports are reconciled with the department's official accounting records.

**Item 12. The Department Does Not Prepare Bank Reconciliations Promptly**

Finding: Of the 12 bank reconciliations prepared during fiscal year 1987-88, 9 reconciliations were prepared from 18 to 63 days late, and one did not show the name of the reviewer and two did not show the date of review. When bank reconciliations are not prepared promptly, and preparers and reviewers do not sign and date bank reconciliations, the department cannot be certain that reconciliations are prepared correctly and reviewed promptly.

We have reported a similar weakness in two of our last three financial audits of the department. The department responded that it reviewed its bank reconciliation procedures and considered them appropriate to ensure compliance with state requirements. The department cited staff vacancies as the reason for not preparing bank reconciliations promptly.

Criteria: The State Administrative Manual, Section 7900, requires agencies to prepare reconciliations within 30 days of the end of the preceding month. Further, the State Administrative Manual, Section 7908, requires that reconciliations show the names of the preparer and reviewer and the dates of preparation and review.

Recommendation: The department should prepare bank reconciliations within 30 days of the end of the preceding month. Also, the bank reconciliations should show the names of the preparer and reviewer as well as the dates prepared and reviewed.

**Item 13. Late Reports of Federal Quarterly Statement of Expenditures**

Finding: The department was from 26 to 117 days late in submitting reports of federal quarterly statement of expenditures for the Foster Care--Title IV-E Program and the Family Support Payments to States--Assistance Payments during fiscal year 1987-88. Failure to comply with federal requirements can affect the state's receipt of federal funds.

We reported similar weaknesses in our audits for fiscal years 1984-85, 1985-86, and 1986-87. The department responded to our audit for fiscal year 1986-87 that it had been given verbal, but not written, latitude by the federal government for submitting these reports late. At the time of our review of the reports of quarterly statement of expenditures, the department had not received written authority exempting it from the reporting requirements of the federal government.

Criteria: The Code of Federal Regulations, Title 45, Section 74.73 and Section 201.5(a), states that quarterly federal financial status reports are due 30 days after the reporting period.

Recommendation: The department should prepare the required statements promptly or obtain written evidence of any deadline extensions granted by the federal Department of Health and Human Services.

**Item 14. Late Remittance of Monies to the State Treasury**

Finding: The department did not promptly remit monies to the State Treasury. Of the 30 remittance transactions that we reviewed, 11 were 5 to 39 days late. The 11 transactions were valued at approximately $4,300.

Failure to promptly remit monies to the State Treasury prevents the monies from being used for their intended purposes.

We reported a similar weakness in our audits for fiscal years 1985-86 and 1986-87. In response to our audit for fiscal year 1986-87, the department stated that it had established procedures to remit monies at the end of every calendar month. During fiscal year 1987-88, the department reduced to 29 days the maximum period that any report was late (in fiscal year 1986-87, the maximum period was 81 days). Additionally, the department indicated that the delays occurred because of problems in the automated cash control system installed in August 1986.

Criteria: The State Administrative 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.

<u>Item 15</u>. <u>Late Submission of Food Stamp Program Reports</u>

Finding: The department did not ensure that counties promptly submit their Food Stamp Program reports to the department and to the United States Department of Agriculture-Food and Nutrition Service (USDA-FNS). Failure to comply with the Food Stamp Act may affect the state's receipt of federal funds. During our audit, we found the following late reports:

- Of the 232 Status of Claims Against Households reports that we examined, 98 reports were not submitted promptly to the department: 72 reports were one to 10 days late, 16 reports were 11 to 20 days late, 6 reports were 21 to 40 days late, and 4 reports were 52 to 115 days late. We reported a similar weakness in our audits for fiscal years 1985-86 and 1986-87;

- Of the 200 Food Stamp Mail Issuance reports that we examined, 35 reports were not submitted promptly to the department: 29 reports were one to 10 days late, 3 reports were 11 to 20 days late, and 3 reports were 22 to 73 days late. We reported a similar weakness in our audits for fiscal years 1984-85, 1985-86, and 1986-87;

- Of the 116 Food Coupon Accountability Reports that we examined, 13 reports were not submitted promptly: 11 reports were one to 10 days late, and 2 reports were 11 to 15 days late; and

- Of the 66 Food Stamp Reconciliation reports that we examined, 1 report was 9 days late.

Criteria: The department's Manual of Policies and Procedures, Section 63-801.821, requires counties to submit to the department a completed Status of Claims Against Households report no later than 30 days after the end of each calendar quarter. In addition, the Code of Federal Regulations, Title 7, Section 274.8, states that quarterly Food Stamp Mail Issuance reports are due within 45 days after the end of the quarter reported upon, monthly Food Coupon Accountability reports are due within 45 days after the end of the month reported upon, and monthly Food Stamp Reconciliation Reports are due within 90 days after the end of the month.

Recommendation: The department should ensure that the counties promptly submit Food Stamp Program reports to the department and the United States Department of Agriculture-Food and Nutrition Service as required.

**Item 16. Noncompliance With Refugee Resettlement Monitoring Requirements**

Finding: The department's Refugee Program Operations Bureau (bureau) did not comply with federal regulations for monitoring subrecipients of Refugee Resettlement grants. We reviewed ten files of direct providers of Refugee Resettlement Program services; six of these files did not contain required quarterly self-evaluation reports. In addition, the department did not prepare annual review reports of any of the ten direct providers for fiscal year 1987-88. Without the monitoring reports, we could not determine if the department is complying with federal monitoring requirements. Failure to comply with federal regulations for monitoring subrecipients of refugee resettlement grants could affect the state's receipt of federal funds for refugee resettlement programs.

Criteria: The Code of Federal Regulations, Title 45, Sections 74.20 and 74.21, require the bureau to retain all financial and program records, supporting documents, statistical records, and other records that must be maintained by the terms of a Health and Human Services grant or are reasonably considered pertinent to a Health and Human Services grant. Moreover, the state's monitoring plan for the Refugee Resettlement Program requires direct providers to submit quarterly self-evaluation reports to the bureau. In addition, the plan requires the bureau to conduct annual reviews of direct providers' activities.

Recommendation: The department should comply with federal regulations for monitoring subrecipients of refugee resettlement grants.

**Item 17. Noncompliance With Reporting Requirements for Refugee/Entrant Unaccompanied Minor**

Finding: The department's Refugee Program, Policy and System Bureau (bureau) did not always comply with federal requirements to track and report on unaccompanied refugee minors. For example, of the six reports that we reviewed regarding the placement of minors, two were submitted late. One report was 127 days late, and the other was 71 days late. Further, of the ten case files that we reviewed, three did not contain an annual progress report. Finally, of the three change-of-status reports that we reviewed, one was submitted six days late. These instances occurred because the bureau does not always ensure that counties submit reports required by federal regulations. Failure to comply with the federal reporting requirements could affect the department's receipt of federal funds for refugee child welfare services.

Criteria: The Code of Federal Regulations, Title 45, Section 400.120, requires the State to submit to the federal Office of Refugee Resettlement an initial placement report within 30 days of the minor's placement in the State, a progress report every 12 months beginning with 12 months from the date of the initial placement report, and a change-of-status report within 60 days of the date that the minor's placement is changed or legal responsibility of any kind for the minor is established or transferred.

Recommendation: The department should ensure the county welfare departments promptly submit the required reports so that the department can comply with the federal reporting requirements for tracking and reporting unaccompanied minors.

**Item 18. County Claim Requirements Not Enforced**

Finding: The department did not ensure that counties promptly submit claims for public assistance and administrative costs. During our review of the 58 counties, we noted that 13 counties were late in submitting 149 of 1,724 assistance claims. Of the 149 late assistance claims, 80 were from one to 45 days late and 69 were from 47 to 162 days late. At the time of our review, one other county had submitted only one assistance claim since March 1987. We also found that 12 counties, including 3 of the counties that submitted late, or failed to submit, assistance claims, submitted 21 of their 236 administrative claims from one to 45 days late. No county submitted an administrative claim more than 45 days late.

The department told us that it is working with the county welfare directors to improve the promptness of submitting claims. Prompt claims from counties are necessary to ensure prompt monthly advances of federal monies to the counties. Moreover, when a county does not file its assistance or administrative claim on time, the department cannot file accurate federal reports and may advance excess money to the county.

Criteria: The department's Fiscal Management and Control Handbook, Section 25-770, requires that all aid claims that counties file with the department be received no later than the eighth working day of the month immediately following the month or quarter of claim.

Recommendation: The department should implement procedures to ensure that counties submit their assistance and administrative claims on time.

## LEGISLATIVE, JUDICIAL, AND EXECUTIVE

## BOARD OF EQUALIZATION

We reviewed the financial operations and related internal controls at the Board of Equalization (board).

**Item 1.** **Insufficient Backup Procedures for Electronic Data Processing**

Finding: The board currently has no access to off-site backup equipment for its electronic data processing (EDP) system that it can use if a major disaster renders the computer equipment unusable. The board has been working on a disaster recovery plan to resolve this problem. Such a plan requires facilities with data processing equipment that is compatible with the board's equipment and that can process the board's volume of work. However, no facilities that satisfy these requirements exist in Sacramento. Further, the board has no contract with a facility outside of the Sacramento area for off-site backup equipment. A major shutdown of the board's EDP system could result in processing delays and in the loss of revenues to the State and to local governments.

Criteria: The State Administrative Manual, Section 4909.8, requires departments that have critical EDP systems involving the collection of income to ensure that backup procedures are in place.

Recommendation: The board should ensure that backup procedures are in place for its EDP system.

**Item 2.** **Inefficient and Ineffective System for Assigning and Reviewing Tax Area Codes**

Finding: The board's manual system for assigning and reviewing tax area codes to registered businesses is not cost effective and does not provide accurate data. As a result, the board wastes staff resources and has no assurance that it distributes the correct amount of sales and use taxes to local governments.

When a business is registered, the district offices or the Local Tax Unit (LTU) assign it a tax area code. The tax area code is important because it determines the amount of sales and use taxes that the board distributes to units of local government such as cities, counties, and transit districts.

The assignment process is done manually, which is not cost effective and has resulted in many errors in the past.

For example, because of misallocations that resulted from an incorrect tax area code, one city is suing the board to regain approximately $139,000 in local sales taxes that the board erroneously distributed to the wrong city.

In addition, to follow up on the current manual assignment process, four staff members in the LTU review the assigned tax codes to make sure that the field offices make the corrections. The board has studied the problem and has analyzed the cost benefits of converting its assignment process to a computerized system. The analysis shows that a computerized assignment process would be more accurate and that the initial investment in the new process would pay for itself in three years.

The current assignment and review processes occupy so much time that the board staff cannot perform other control activities such as following up on whether the district offices have corrected the identified errors. We reviewed 60 registration cards with errors that the LTU had identified. As of November 9, 1988, 27 of those cards still had incorrect tax area codes that the LTU had identified as erroneous five or more months earlier.

We reported a similar weakness during our financial audits for fiscal years 1985-86 and 1986-87. In response, the LTU requested in March 1988 that the board's Information Management Division automate the process for assigning tax area codes. However, as of November 1988, the Information Management Division had not begun to implement the request.

Criteria: The California Government Code, Section 13403, requires that the elements of a satisfactory system of internal accounting and administrative control include a system of recordkeeping that is adequate to provide effective accounting control over assets, liabilities, revenues, and expenditures. In addition, the contracts between the board and the local governments require the board to distribute to the local governments the amounts to which they are entitled.

Recommendation: The board should automate its process for assigning tax area codes as soon as possible.

**Item 3.** **Insufficient Controls Over Allocations of Sales and Use Taxes**

Finding: The board does not have sufficient controls to ensure that all of the sales and use taxes that it collects are properly allocated between various jurisdictions. When the board receives sales and use tax returns from businesses with multiple locations, which include all large retail chain stores, the board must manually enter into the computer the allocation of sales and use taxes for the various jurisdictions identified on the returns. The only control the board uses over this procedure is to reconcile the total amount of sales and use taxes received from the taxpayer with the total amount of sales and use taxes allocated based upon information provided by the taxpayer. This procedure would not detect misallocations to various jurisdictions as long as the total amount allocated to all jurisdictions is correct. In our review of 100 sales and use tax returns, we identified 11 that had multiple locations. Of these 11, one contained an error that resulted in the underallocation of $3,300 in sales and use taxes to one city and the overallocation of $3,300 to two other cities.

The board's LTU corrected the allocation to the cities after we brought the error to its attention.

Criteria: The California Revenue and Taxation Code, Section 7204, requires that all sales and use taxes collected by the board for cities and counties be properly allocated.

Recommendation: The board should consider additional controls to ensure that all of the sales and use taxes that it collects are properly allocated.

**Item 4.** **Weak Internal Controls Over Property**

Finding: We found several weaknesses in the board's internal controls over property. For example, the board does not sufficiently separate duties for the accounting, reconciliation, custody, and disposition of property. Two employees have exclusive control over the inventory of equipment because they maintain the property ledger, reconcile the physical inventory to the property records, and have custody of the unassigned equipment. In addition, these same two employees dispose of unneeded automobiles.

We also found a problem with the board's survey reports, which are the records of property dispositions. Specifically, the board could not support its disposition of property for the month of June 1988. The board's accounting administrator indicated that a fire in an employee's car destroyed the survey reports for that month.

Finally, the board could not provide evidence that it took the annual physical inventory because it could not locate the records of the physical inventory that it took in December 1987. Consequently, the board also could not provide evidence that it had reconciled and adjusted its property records to the physical inventory.

Failure to sufficiently separate duties over property may result in the loss of equipment and in dispositions of property that do not comply with management policies. Further, since the board could not support its physical inventory for December 1987 or provide its survey reports for June 1988, we could not determine whether it had made all inventory adjustments properly.

We reported similar weaknesses in our financial audit for fiscal year 1986-87. The board responded that it had properly reestablished a separation of duties, that it would review property disposal procedures for compliance, and that it would provide appropriate documentation for adjustments to property records. However, at the time of our review, we found that the board had not corrected all of the weaknesses that we reported for the prior year.

Criteria:

The State Administrative Manual, Section 8652, requires that the custodian of property records not exclusively control the physical inventory of property. In addition, the California Government Code, Section 13403, requires that the elements of a satisfactory system of internal accounting and administrative control include a system of recordkeeping that is adequate to provide effective accounting control over assets. Finally, the State Administrative Manual, Section 1671, requires the board to maintain physical inventory records for four years or until an audit is completed, whichever occurs first.

Recommendation: The board should reassign some of the duties of the property personnel to provide for an adequate separation of duties. In addition, the board should properly safeguard its survey reports and the records of its annual physical inventory.

**Item 5.** **Insufficient Follow-up of Cash Deposit**

Finding: The board did not promptly follow up on an outstanding deposit that it had identified in its bank reconciliations for several months. Specifically, on June 24, 1988, the board made a bank deposit of approximately $225 million, which the State Treasurer's Office did not promptly add to the board's bank balance. The board identified this amount as an outstanding deposit in its bank reconciliations for the months of June, July, August, and September. However, the board did not request the State Treasurer's Office to investigate this outstanding deposit until October 27, 1988. Although the State received credit for the $225 million deposit promptly, the State Treasurer's Office did not credit the deposit to the board until November 1988. This occurred because the board's deposit slip was misplaced, so the State Treasurer's Office did not know which agency should receive credit for the $225 million deposit. By not promptly investigating outstanding deposits, the board may not promptly detect errors or irregularities that may have occurred.

Criteria: The California Government Code, Section 13403, requires that the elements of a satisfactory system of internal accounting and administrative control include a system of recordkeeping that is adequate to provide effective accounting control over assets, liabilities, revenues, and expenditures. Further, the board's procedures require staff to follow up within one month on all outstanding deposits that exceed one million dollars.

Recommendation: The board should promptly follow up on all long outstanding deposits.

**Item 6.** **Insufficient Control Over Check-out Procedures for Employees Who Leave the Board's Service**

Finding: The board did not always complete employee clearance forms for employees who left the board's service. We reviewed the records of 20 employees who left the board's service between April and June 1988. Four of those employees did not have the required employee clearance form on file before leaving the board's service. When the board does not complete these forms, it lacks assurance that employees leaving its service have repaid outstanding advances and returned state-owned property.

We have reported a similar weakness in five of our last six financial audits of the board. In response to our management letter for fiscal year 1986-87, the board's executive director issued a memorandum in March 1988 stressing the need for promptly completing the clearance form and placing the responsibility for compliance on each payroll unit's administrators, managers, and supervisors. Further, the memorandum established a new procedure requiring administrators, managers, and supervisors to certify on a Report of Separation that the employee's final warrant will not be released until the accounting office has approved the clearance form. However, at the time of our review in August 1988, the board had not corrected the deficiency in its check-out procedures.

Criteria: The State Administrative Manual, Section 8580.4, requires agencies to ensure that employees who leave their service pay any outstanding salary and travel advances. This section also suggests that agencies should ensure the repayment of all advances and the return of state-owned property through the use of a general check-out list.

Recommendation: The board should delay release of the final salary payment to employees who leave its service until it has a completed clearance form on file. The form should indicate that the board has collected all outstanding travel and salary advances and recovered all state-owned property.

**Item 7. Deficient Contracting Procedures**

Finding: The board did not follow all contracting procedures required by the California Public Contract Code. Specifically, the board did not request or review contract evaluation forms before awarding consulting contracts. Further, the board did not require the submission of completed resumes from each major contractor who had not previously had a state contract. Finally, for four of five contracts over $1,000 that we reviewed, the board did not complete contract evaluation forms and submit them to the Department of General Services within 30 days. Failure to adhere to prescribed procedures of the California Public Contract Code may result in the award of contracts to unreliable contractors.

Criteria: The California 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. Further, Sections 10367 and 10369 require that contract evaluation forms be prepared and submitted to the legal office of the Department of General Services within 30 days after the completion of every contract of $1000 or more.

Recommendation: The board should meet all contracting requirements stated in the California Public Contract Code before approving consulting services contracts. Further, the board should prepare and submit contract evaluation forms to the Department of General Services within 30 days after the completion of every contract of $1000 or more.

## DEPARTMENT OF JUSTICE

We reviewed the Department of Justice's (department) compliance with federal and state regulations for the Statewide Cost Allocation Plan (SWCAP).

| Item | Late Transfers of SWCAP Recoveries |
|---|---|
| Finding: | The department did not promptly submit its requests for transfers to the State's General Fund of reimbursements representing the federal government's share of costs for services provided by central service agencies. The State calculates the costs under the SWCAP. The SWCAP is the plan that each state agency uses to pay for its federal programs' share, if any, of the State's costs for central services.<br><br>For fiscal year 1987-88, the department submitted three of its four requests for transfers of SWCAP recoveries from approximately one month to four months late. The resulting transfers were made from approximately two months to five months late. Because of these delays, approximately $170,000 was not available for disbursement from the State's General Fund as soon as possible.<br><br>We reported a similar weakness in our audit for fiscal year 1986-87. In its response to our report, the department stated it would make every effort to transfer SWCAP recoveries to the State's General Fund within the time suggested by the State Administrative Manual, Section 8755.2. |
| Criteria: | The California Government Code, Section 13332.01, requires agencies to recover SWCAP costs from the federal government. Although no deadline is expressly mandated, the State Administrative Manual, Section 8755.2, intimates that a transfer of SWCAP recoveries to the State's General Fund within 30 days of the end of each quarter would be appropriate. |
| Recommendation: | The department should submit its requests for transfers promptly so that SWCAP recoveries can be transferred to the State's General Fund within 30 days of the end of each quarter. |

## STATE CONTROLLER'S OFFICE

We reviewed the financial operations, related internal controls, and administration of the United States Department of Agriculture grant, Federal Catalog Number 10.665 and the United States Department of the Interior grant, Federal Catalog Number 15.999 at the State Controller's Office. Additionally, we tested the review of audit reports and county cost allocation plans conducted by the State Controller's Office. Further, we performed a limited review of the internal audit unit at the State Controller's Office.

**Item 1.** **Delays in Submitting Audit Reports**

Finding: The Division of Audits (division) of the State Controller's Office did not promptly submit audit reports to the Department of Social Services.

The Department of Social Services contracts with the division to have the division audit county welfare departments and contract providers. We reviewed 14 of 122 audits that the division completed under contract with the Department of Social Services during fiscal year 1987-88. The division did not promptly submit audit reports to the Department of Social Services and the auditee in 5 of the 14 audits. These 5 reports, with disallowed costs totaling approximately $50,000, were for audits of three Refugee Resettlement Program contract providers, one Foster Care Program group home provider, and one In-Home Supportive Services contract provider. Delays in submitting the audit reports ranged from approximately 74 to 273 days after the date of the exit conference. The division's officials explained that the division's audit support unit, which is responsible for reviewing and processing the audit reports, experienced some staffing problems. In addition, the audit support unit was relocated to a new site causing further delays in processing the audit reports. Excessive delays in submitting audit reports contribute to delays in collecting disallowed costs with a resulting loss of potential interest earnings.

The Department of Social Services has established a procedure for monitoring the status of audits of county welfare departments and contract providers performed by the State Controller's Office. The State Controller's Office must now provide the department with quarterly reports of the status of its audits. We reported a related finding in our letter to the Department of Social Services.

Criteria: The interagency agreement between the Department of Social Services and the State Controller's Office, dated July 1, 1987, requires the State Controller's Office to submit to the Department of Social Services and the auditees copies of final audit reports within 60 days after the date of the exit conference.

Recommendation: The State Controller's Office should submit final audit reports to the Department of Social Services and the auditees within 60 days of the exit conference.

**Item 2.** **Insufficient Reviews of County Cost Allocation Plans**

Finding: The Bureau of County Cost Plans (bureau) of the State Controller's Office did not perform field reviews to determine whether costs reported in the county cost allocation plans for fiscal year 1987-88 were reasonable, allowable, or properly allocated. Instead, the bureau performed desk reviews of the 58 cost allocation plans submitted by the counties. However, the chief of the bureau informed us that the bureau will complete at least ten field reviews during fiscal year 1988-89. If the bureau does not perform field reviews, it has limited assurance that counties are properly claiming indirect and central support service costs related to state and federally funded programs.

We reported similar weaknesses in our audits for fiscal years 1984-85, 1985-86, and 1986-87. The bureau responded to our audit for fiscal year 1986-87 that it could not perform field reviews of the county cost allocation plans each year because its requests for additional staff positions had been rejected by the Department of Finance.

Criteria: The Code of Federal Regulations, Title 45, Section 74.61(f), requires the bureau to determine that costs are reasonable, allowable, and properly allocated in accordance with applicable cost principles.

Recommendation: The State Controller's Office should conduct field reviews to ensure the adequacy and accuracy of the county cost allocation plans.

Item 3. **Single Audit Reports That Lacked Complete Schedules of Federal Assistance Were Accepted**

Finding:

The Division of Audits (division) of the State Controller's Office accepted 8 single audit reports that we believe included materially misstated schedules of federal assistance contrary to the auditor's opinions on these schedules. Of the 50 school district and county offices of education reports that we reviewed, the division identified 7 reports that omitted one or more federal programs from the schedule of federal assistance which we believe were significant omissions. Two of these reports omitted a major federal program from the schedule. A major federal program for these districts is a program that received more than $300,000 in federal funds during fiscal year 1986-87. The remaining reports omitted programs for which the districts had received at least $20,000. These omissions amounted to between 15 and 39 percent of the federal revenue reported on the general purpose financial statements. In addition to the above 7 reports, the division accepted the single audit report for the Center Unified School District that reported $958,000 less federal revenue on the schedule of federal assistance than was reported on the general purpose financial statements. This difference represents approximately 77 percent of the district's federal revenue reported on the general purpose financial statements and indicates that one or more major federal programs may have been omitted from the schedule of federal assistance.

Although these 8 reports had deficient schedules of federal assistance, the auditor's opinion, in each instance, reported that the schedule was fairly stated. The division noted these deficient schedules during its review of the single audit reports, yet, based upon its criteria, it accepted the 8 reports without requiring the reports to be corrected. The division assigns a point value to each audit report deficiency noted and rejects audit reports that exceed a predetermined point value. The division chose not to assign point values that would result in the automatic rejection of reports containing an incomplete schedule of federal assistance because the division did not feel that this was a significant deficiency. The division believes that it has designed its report review process to accept audit reports that substantially comply with the federal reporting standards, and it believes that a stricter application of the reporting requirements would result in the rejection of more audit reports. Increased rejections would require additional staff time to ensure that revised reports are issued and reviewed. The division believes that the benefit of rejecting these audit reports would not justify the additional staffing costs.

Single audit reports must include a schedule of federal assistance as part of the supplemental information. Independent auditors' opinions on the supplemental information report that the information presented in the schedule of federal assistance is fairly stated in all material respects in relation to the financial statements taken as a whole. However, contrary to the independent auditor's opinion, a schedule of federal assistance that omits a major federal program or excludes a significant portion of total federal revenues may be materially misstated. Because the school boards, the county offices of education, the State Department of Education, and federal agencies are not notified of the deficiencies, the users of these reports may rely on information that is not accurate and may be unaware of the deficiencies. In addition, an audit report without a complete and accurate schedule of federal assistance may not contain all information needed by subsequent users including federal agencies and state agencies responsible for monitoring federal funds that they disburse to local agencies. Further, acceptance of incomplete audit reports may result in the perpetuation of substandard reporting because local agencies may believe their reports meet federal reporting requirements when they do not.

Criteria:

The State Administrative Manual, Section 20050, requires the State Controller's Office to review and monitor the audit reports issued by independent auditors for local governments and to determine whether the audit reports conform to the <u>Standards for Audit of Governmental Organizations, Programs, Activities, and Functions</u>, published by the U.S. General Accounting Office, and to the compliance guide issued by the Department of Finance.

The California Education Code, Section 14504, requires the State Controller's Office to review and monitor annually the audit reports prepared by independent auditors and to determine whether the audit reports conform to the reporting provisions of the school district audit guide of the State Controller's Office. The audit guide indicates that audit reports must conform with the requirements of the Office of Management and Budget Circular A-128.

Circular A-128 requires an independent auditor's report to include a schedule of federal assistance showing the total expenditures for each federal assistance program as identified in the Catalog of Federal Domestic Assistance. In addition, Section 424 of the Standards and Procedures for Audits of California K-12 Local Education Agencies, published by the State Controller's Office, requires independent auditors to express opinions on supplemental information. This section also requires the supplemental information to include a Schedule of State and Federal Financial Assistance.

Recommendation: When a single audit report contains a required schedule that appears to be materially misstated, the division should notify the school board, county office of education, State Department of Education, the Certified Public Accountant, and the appropriate federal agencies.

**Item 4. Failure To Reconcile the State Payroll Revolving Fund Promptly**

Finding: The Division of Accounting, the Division of Disbursements, and the Personnel/Payroll Services Division of the State Controller's Office maintain records for the State Payroll Revolving Fund. The State uses this fund to account for payroll expenses, which, in fiscal year 1987-88, totaled $7.7 billion. The Division of Accounting has assumed responsibility for reconciling monthly the total amount transferred from state agencies to the State Payroll Revolving Fund with the total amount disbursed from the fund. However, the Division of Accounting did not complete the reconciliations for August 1987 through November 1987 until June 1988. In addition, as of October 31, 1988, the Division of Accounting had not begun the reconciliations for December 1987 through July 1988, even though the division's records indicate differences between the amounts transferred to the State Payroll Revolving Fund and amounts disbursed from the fund. These differences ranged from $584 to $1,106,106. Failure to promptly reconcile the records maintained for the State Payroll Revolving Fund may prevent prompt detection and correction of errors.

According to the State Controller's Office, it submitted to the Department of Finance a budget change proposal requesting additional staff positions for the Division of Accounting. According to officials of the Division of Accounting, this would allow them to devote more time to the reconciliation. However, the Department of Finance has denied the request for additional staff.

Criteria:

Since January 1, 1988, the State Administrative Manual, Section 7900, has required monthly 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 Division of Accounting should promptly reconcile the State Payroll Revolving Fund records each month to ensure that the amounts processed, received, and disbursed for the State's payroll are recorded correctly in the accounting records.

Item 5. Inadequate Internal Audit Cycle

Finding:

The Management Audits and Review Section of the State Controller's Office does not review each division of the State Controller's Office every two years as required by the State Administrative Manual. Because of limited staff in the Management Audits and Review Section, the State Controller's Office has chosen to review the agency's divisions on a three-year cycle. By auditing on a three-year cycle, the Management Audits and Review Section can concentrate its limited staff resources on areas that they believe will provide the greatest assurance on the adequacy of internal controls and financial compliance.

According to the State Controller's Office, it has submitted to the Department of Finance a budget change proposal requesting additional staff positions for the Management Audit and Review Section; however, the Department of Finance has denied the request.

Because the Management Audit and Review Section does not audit each division every two years, the State Controller's Office's report on the adequacy of its internal control systems is not supported by audit work that was performed entirely during the two year reporting period.

Criteria: The State Administrative Manual, Section 20010, requires that agencies with internal audit activities review their agencies' systems of internal control every two years and report to the Department of Finance on the adequacy of the internal control system.

Recommendation: The Management Audit and Review Section of the State Controller's Office should perform the audit work necessary to support the report on the adequacy of the internal controls in the State Controller's Office within each two-year reporting period.

## STATE TREASURER'S OFFICE

We reviewed the internal controls over the central treasury functions at the State Treasurer's Office (office).

**Item** — **Centralized State Treasury System's Bank Accounts Not Reconciled Promptly**

Finding:

The office is not promptly reconciling the eight bank accounts of the centralized State Treasury System (CTS). State agencies deposit money into one of the eight CTS bank accounts, and the State receives credit for the deposit on the day that the bank records the deposit. State agencies deposited approximately $8.8 billion into the eight CTS bank accounts during the months of September 1987, December 1987, and June 1988. We reviewed the office's reconciliations of the eight CTS bank accounts for these months and found that the office was between five and eight months late completing the reconciliations.

Failure to reconcile the eight CTS bank accounts promptly may result in a bank or office error going undetected for a prolonged period. In addition, state agencies rely on the office to provide them with monthly statements verifying that the bank, as well as the office, received and correctly recorded all of its deposits. Consequently, late reconciliations by the office may result in a state agency's receiving a monthly statement that will not include all of its deposits for that month. If the statements do not include all of the deposits for each month, an error in the agency's records or an illegal act committed by an agency employee could go undetected for a prolonged period of time.

According to the office's chief of administration, the office did not promptly reconcile the bank accounts because it did not have staff available in the bank reconciliation unit to perform the monthly bank reconciliations. The chief of administration also stated that incomplete or unavailable deposit information from either the banks or state agencies complicates and thus delays the bank reconciliation unit from completing a bank reconciliation promptly. However, the chief of administration believes that, by using the staff that is now available in the bank reconciliation unit and by working with the banks and state agencies to provide detailed and complete deposit information, the office can begin reconciling the eight CTS bank accounts promptly.

Criteria: The State Administrative Manual, Section 8060, requires state agencies to promptly reconcile all bank accounts at the end of each month.

Recommendation: The office should promptly reconcile the eight CTS bank accounts.

# RESOURCES

## DEPARTMENT OF BOATING AND WATERWAYS

We reviewed the financial operations and related internal controls at the Department of Boating and Waterways (department).

**Item 1.** **Inaccurate Year-End Financial Reports**

Finding: The department does not prepare the year-end financial reports for the revolving fund in accordance with the State Administrative Manual and generally accepted accounting principles (GAAP). GAAP requires the use of the accrual basis of accounting for enterprise funds. In addition, the department does not have special manuals or instructions memoranda from the fiscal systems and consulting unit of the Department of Finance that prescribe the use of the accrual basis of accounting. As a result, the financial reports are not accurate. The following are examples of deficiencies that we found:

- The department inappropriately reported approximately $45.3 million of unliquidated encumbrances for goods, services, and commitments for grants and loans as liabilities. Thus, the department overstated its total liabilities for accounts payable and due to other governments as of June 30, 1987, by approximately $45.3 million. This occurred because the department's accounting officer did not accurately analyze the accounts to determine whether goods and services were received or grants were provided before or after June 30. As a result, the department also understated its retained earnings at June 30, 1987, by approximately $45.3 million. If the department does not properly separate encumbrances from obligations, the State Controller's Office does not have accurate information to prepare the financial statements in accordance with GAAP;

- The department overstated its expenses for fiscal year 1986-87 because it recorded loans totaling approximately $1.2 million as operating expenses in addition to recording them as additions to loans receivable. The department also overstated its revenues by recording loan principal repayments totaling approximately $2.0 million as operating revenues in addition to recording them as deductions from loans receivable;

- The department understated its interest revenue from loans. The department has agreements that allow borrowers to defer paying interest until future dates. The department did not recognize as revenue the interest that is added to borrowers' outstanding loan principal although the interest revenue had been earned. As a result, the interest revenue from loans for fiscal year 1986-87 was understated by approximately $2.2 million;

- The department did not record as fixed assets a total of approximately $583,000 used for the construction of boating facilities;

- The department overstated operating expenses for fiscal year 1986-87 by approximately $18,000 for the cost of additions to boating facilities and by approximately $41,000 for equipment purchased during the year; and

- The department does not depreciate its fixed assets. We determined that the unrecorded accumulated depreciation on fixed assets at June 30, 1986, was approximately $543,000. The depreciation expense for fiscal year 1986-87 that the department did not include in operating expenses was approximately $63,000.

As a result of the deficiencies discussed in the proceeding paragraphs and other deficiencies that we have not discussed in this report, the revolving fund's retained earnings balance at June 30, 1986, was understated by approximately $140.1 million, and net income for fiscal year 1986-87 was understated by approximately $21.9 million.

Criteria: The Governmental Accounting and Reporting Standards, Section 1600(b), provides that enterprise funds should recognize revenues and expenses on the accrual basis. Secondly, State Administrative Manual, Section 13400, provides that to properly show the financial status and operation of certain enterprise funds, it has been necessary for the fiscal systems and consulting unit of the Department of Finance to prescribe in special manuals or special instructions memoranda the use of all or some commercial accounting principles such as accruing expenses on the basis of goods used and services received, accruing operating income earned regardless of when collectible, and accounting for all assets and depreciating them. In addition, the State Administrative Manual, Section 8613, states that improvements to assets will be recorded as fixed assets. Finally, Section 8616 states that depreciation expense should be recorded for enterprise funds.

Recommendation: The department should contact the fiscal systems and consulting unit of the Department of Finance and obtain the special manuals or instructions memoranda that prescribe the use of commercial accounting principles to properly show the financial status and operations of the revolving fund. Also, the department, with the help of the Department of Finance, should develop appropriate guidelines for the year-end accrual of liabilities.

**Item 2.** **Delays in Requesting Reimbursements From the Federal Trust Fund**

Finding: The department is losing interest earnings because it does not promptly request reimbursement from the Federal Trust Fund for expenses of the Boating Safety Financial Assistance Program (program). We reviewed the reimbursements for these expenses for fiscal year 1986-87 and determined that the department delayed in requesting reimbursements for periods ranging from approximately 90 to 200 days from the end of the calendar quarter in which the expenditures for the program were incurred. As a result, the department lost potential interest earnings of at least $21,000.

Criteria: Prudent fiscal management requires the department to ensure that federal monies are received from the Federal Trust Fund to promptly reimburse the revolving fund after disbursements are made.

Recommendation: The department should promptly request reimbursement for expenses of the Boating Safety Financial Assistance Program from the Federal Trust Fund.

**Item 3.** **Insufficient Accountability for Property**

Finding: The department did not reconcile its equipment account in the general ledger to its property ledger. As a result, the department did not detect errors in its property records. We audited the additions to equipment during fiscal year 1986-87 and found the following specific deficiencies:

- The department did not record in its property ledger the cost of two equipment items totaling approximately $12,000. In addition, the department did not tag these items with identification numbers to identify them as state property; and

- The department did not record the full invoice cost of equipment items purchased during fiscal year 1986-87. The department understated the amount of equipment purchases recorded in the property ledger by approximately $4,000 because the department did not record tax, the cost of delivery, and the costs of some components of equipment.

The department's failure to maintain sufficient accountability for its property prevents the prompt detection of errors and exposes state property to increased risk of loss.

Criteria: The State Administrative Manual, Section 7969, requires that agencies reconcile the current year's equipment expenditures with additions of major property to the property ledger at the end of each quarter. In addition, Section 8650 requires that a department's property accounting system provide sufficient information to support the account balances of all capitalized property. Finally, Section 8651 states that when practical, all state property will be tagged after acquisition with an identification number to identify assets belonging to the State.

Recommendation: The department should regularly reconcile its property ledger to the general ledger control account, tag all state property with an identification number, and record all equipment purchases at the correct amount.

## DEPARTMENT OF WATER RESOURCES

We reviewed the financial operations and related internal controls at the Department of Water Resources (department).

**Item 1.** **Inaccurate Financial Reports**

Finding: The department did not prepare accurate year-end financial reports for the Water Resources Revolving Fund in accordance with the requirements of the State Administrative Manual. As a result, six of the department's accounts were misstated by amounts ranging from $79,000 to $130,000. We noted the following specific deficiencies in the department's year-end financial reports:

- The department did not record in the Water Resources Revolving Fund approximately $100,000 due from four of the department's other funds for expenditures made on behalf of those funds. As a result of this error, at June 30, 1988, the department had understated the due from other funds account and transfers-in account balances in its Water Resources Revolving Fund;

- Before issuing its financial reports for fiscal year 1987-88, the department did not perform a year-end analysis and reconciliation of the cash in transit to the state treasurer account. As a result, the department did not detect that, at June 30, 1988, it had overstated the cash in transit to the state treasurer account by approximately $79,000, and it had understated the uncleared collections account by the same amount; and

- The department did not record as an expenditure all of its prepaid insurance premiums that expired before June 30, 1988. As a result, the department overstated its prepaid expenses and understated its expenditures by approximately $130,000 each as of June 30, 1988.

Criteria: The State Administrative Manual, Sections 7950 through 7979, describes the procedures that agencies must follow to prepare accurate financial reports.

Recommendation: The department should prepare accurate year-end financial reports in accordance with the requirements of the State Administrative Manual.

**Item 2.** **Mobile Equipment and Depreciation Records Not Reconciled**

Finding: The department did not reconcile mobile equipment and depreciation amounts on its Depreciation Balances Report with the related general ledger accounts for five months during fiscal year 1987-88. Further, the department did not resolve some differences identified in the seven reconciliations that it had performed. As of June 30, 1988, the cost of mobile equipment shown on the Depreciation Balances Report was about $631,000 less than the amount in the general ledger account. Further, the amount of accumulated depreciation shown on the Depreciation Balances Report was about $307,000 less than the amount in the general ledger account. The department's failure to reconcile the Depreciation Balances Report with the general ledger accounts and to resolve differences could result in misstatements in its financial reports.

We reported a similar weakness in our audit for fiscal year 1985-86. As a result of our recommendation at that time, the department began reconciling the Depreciation Balances Report with the general ledger account. According to the department's accounting administrator, the monthly reconciliations identified recurring differences. The accounting administrator stated that because the department already identified the differences and experienced a heavy year-end workload, it did not perform the reconciliation for five months during fiscal year 1987-88.

Criteria: The State Administrative Manual, Section 7900, discusses the importance of making regular reconciliations. In addition, the Department of Water Resources Accounting Manual, Section 6348.8, states that the department should use the Depreciation Balances Report to reconcile balances reported in the equipment accounting system with the general ledger accounts.

Recommendation: The department should perform monthly reconciliations of the cost of mobile equipment and the amount of accumulated depreciation shown in the Depreciation Balances Report with the amounts recorded in the general ledger accounts, and it should resolve any differences that it identifies.

**Item 3. Outdated Equipment Accounting System and Incorrect Accounting for Mobile Equipment**

Finding: The department did not accurately account for its mobile equipment or properly calculate its depreciation expense because of staff and equipment accounting system errors. The department's equipment accounting system maintains the detail for the $39 million equipment inventory reported in the Water Resources Revolving Fund. The effect of these errors, some of which offset each other, is that the department overstated its mobile equipment account by approximately $232,000, overstated its depreciation expense by approximately $18,200, and overstated its accumulated depreciation by approximately $202,300. According to the chief of the Mobile Equipment Office, error correction is difficult because the system does not easily accommodate adjustments to equipment accounting records. During our review, we found the following specific deficiencies:

- A one-month delay exists between the time that the department disposes of equipment and the time that the equipment accounting system posts the disposition in the accounting records. As a result of the delay, the department overstated the equipment account for the year ended June 30, 1988, by approximately $232,000 and overstated accumulated depreciation by approximately $190,000;

- The department continued to depreciate approximately $116,000 of equipment that it had already fully depreciated. As a result, the department overstated depreciation expense by approximately $40,000 in years before fiscal year 1987-88 and by approximately $5,400 for the year ended June 30, 1988, and it overstated accumulated depreciation by approximately $52,000;

- The department did not depreciate approximately $303,000 in depreciable equipment. Because of this error, the department understated depreciation expense by approximately $11,000 in years before fiscal year 1987-88 and by approximately $18,000 for the year ended June 30, 1988. In addition, the department understated the accumulated depreciation for this equipment by approximately $29,000;

- The department did not promptly record equipment deletions from its accounting records. For 42 of the 68 equipment deletions that we reviewed, the department did not record the deletion in its accounting records within 30 days of the disposition of the equipment. As a result, the department overstated both depreciation expense and accumulated depreciation about $700 for the year ended June 30, 1988;

- The department used an incorrect useful life for 12 of the 68 equipment acquisitions that we reviewed. As a result, the department understated both depreciation expense and accumulated depreciation on these 12 items by about $16,700 for the year ended June 30, 1988; and

- The department did not always begin depreciating equipment at the time that the department acquired the equipment and put it into service. The department began depreciating 22 of the 68 equipment acquisitions that we reviewed one month early and delayed depreciating 3 items from one to two months. The net result of these errors is that the department overstated both depreciation expense and accumulated depreciation by about $5,300 for the year ended June 30, 1988.

As a result of these deficiencies, the financial reports of the Water Resources Revolving Fund are inaccurate.

We reported a similar weakness in our audit for fiscal year 1986-87. On February 10, 1988, in its response to our report, the department stated that it was studying its equipment accounting system in conjunction with an overall update of the accounting system. The department stated that the estimated implementation date of the new system was two years away.

Criteria: The California Government Code, Section 13403, states that a satisfactory system of internal accounting and administrative control includes a system of recordkeeping that provides effective accounting control over assets, liabilities, revenues, and expenditures. In addition, the State Administrative Manual, Section 8621, requires agencies to remove equipment from their records when they dispose of the equipment. Finally, the State Administrative Manual, Section 8616, states that agencies should calculate depreciation based on an asset's actual cost or other basis, less the estimated residual value, distributed over the life of the equipment.

Recommendation: The department should continue its efforts to improve its equipment accounting system. In addition, the department should record dispositions of equipment in accordance with the requirements of the State Administrative Manual. Finally, the department should calculate depreciation on all its depreciable equipment based on the equipment's proper estimated useful life.

<u>Item 4</u>. <u>**Weaknesses in Control Over Disbursements**</u>

Finding: The department has weaknesses in control over its process of authorizing, reviewing, and paying for goods and services. We reviewed 60 disbursements and found the following deficiencies:

- The department does not always take advantage of cash discounts offered by vendors. In our review of 60 disbursements, we identified nine instances in which vendors offered cash discounts. In these nine instances, the department did not take advantage of the cash discounts on 33 of the 51 invoices offering discounts. The lost discounts totaled $362. We reported a similar weakness in our audit for fiscal year 1986-87. On February 10, 1988, in its response to our report, the department stated that it was reorganizing the accounts payable unit with the addition of a new supervisory position and a redistribution of the workload. The department stated that the reorganization would help resolve the problem of lost discounts; and

- The department does not always obtain evidence that it has received goods or services before authorizing payments. In our review of 60 disbursements, we identified two instances in which the department did not obtain evidence that it had received services before authorizing payment. If the department does not obtain evidence that it has received services, it may pay for services that it has not received.

Criteria: The State Administrative Manual, Section 8422.1, requires agencies to determine that they have taken cash discounts and that they have received goods and services before submitting invoices for payment.

Recommendation: The department should take advantage of available vendor discounts. In addition, the department should obtain evidence that it has received goods and services before submitting invoices for payment.

# STATE AND CONSUMER SERVICES

## OFFICE OF THE STATE FIRE MARSHAL

We reviewed the financial operations and related internal controls at the Office of the State Fire Marshal (office).

**Item 1.** **Late Deposit of Cash Receipts**

Finding: The office does not promptly deposit cash and checks received. We examined 30 deposits that averaged $3,801 during fiscal year 1986-87. We found that the office took an average of 13.7 working days from the day that the cash and checks were received to deposit the cash and checks in the bank. When the office holds deposits for an excessively long period, an increased risk of loss exists from fire or theft, and the State loses interest earnings.

Criteria: The State Administrative Manual, Section 8030.1, requires the office to deposit collections of $50 or more within five working days after the money is received. Additionally, Section 8030.1 requires the office to deposit collections of over $500 in cash or $5,000 in cash, checks, money orders, and warrants on the day that the money is received or on the next day.

Recommendation: The office should take action to process collections of $50 or more within five working days or, when appropriate for larger amounts, on the day received.

**Item 2.** **Weak Control Over Revolving Fund Activities**

Finding: The office has weaknesses in its control over the activities of its revolving fund. We noted the following specific deficiencies:

- The office did not confirm its 50 permanent travel advances totaling over $19,000 at year end;
- The office did not promptly reimburse its revolving fund. Specifically, seven temporary advances of travel and expense pay totaling $1,721 had been outstanding for periods of seven months or more as of June 30, 1987. Further, the office did not reimburse its

revolving fund for over one year for eight expenditures that totaled approximately $3,300;

- The office did not maintain sufficient control over its blank-check stock. Because the office did not maintain sufficient control over blank checks, the office could not be certain that good accounting of blank checks existed; and

- Checks that had been outstanding for more than two years were not cancelled to allow for remittance of funds to the Special Deposit Fund for unclaimed monies. As of June 30, 1987, 11 checks totaling $1,559 had been outstanding for more than two years.

Criteria:

The State Administrative Manual, Section 8116, requires the office to send annual letters to all employees holding permanent advances requesting that they confirm the liability.

In addition, the State Administrative Manual, Section 8047, requires the office to reimburse the revolving fund promptly.

Further, the State Administrative Manual, Section 8080, requires the office to maintain accountability records of check stock.

Finally, the State Administrative Manual, Section 8042, requires the office to cancel revolving fund checks that have been outstanding for over two years and remit the amount of the checks to the Special Deposit Fund as unclaimed monies.

Recommendation:

To improve its controls over the revolving fund, the office should take the following actions:

- Confirm permanent travel advances to employees at least annually;

- Reimburse the revolving fund promptly;

- Maintain a record of blank checks; and

- Cancel checks that have been outstanding for more than two years and remit the appropriate amount to the Special Deposit Fund.

Item 3. **Incorrect Payment to Employees Who Left the Office's Service**

Finding: The office did not correctly calculate the lump-sum separation payments for accumulated vacation hours when employees left the office's service. Because the office did not give the former employees proper credit for holidays that occurred during the period that the employees' vacation hours were being extended following their separation, three of the five lump-sum vacation payments that we tested were incorrect. As a result, the office underpaid the three employees a total of $1,335.

Criteria: The State Personnel Transactions Manual, Section 623, details the procedures for calculating the lump-sum vacation payments to employees who leave an agency's employment.

Recommendation: The office should follow the correct procedures for lump-sum payment calculations and correct the payments that it incorrectly calculated.

Item 4. **Failure To Record Amounts Owed to Vendors and Other State Agencies**

Finding: The office omitted some of its obligations from the financial reports that it submitted to the State Controller's Office. Specifically, the office did not record obligations of $5,000 that it owed to commercial vendors and obligations of $78,269 that it owed to other state government agencies as of June 30, 1987. As a result, the office understated its liabilities by $83,269 at the end of fiscal year 1986-87.

Criteria: The State Administrative Manual, Section 7630, requires the office to use the "accounts payable" account to show the amount due to private persons or organizations. In addition, Section 7630 requires the office to use the "due to other funds or appropriations" as a summary account of payables due to other funds.

Recommendation: The agency should properly record all of its obligations when it prepares its financial reports at the end of the fiscal year.

## FRANCHISE TAX BOARD

We reviewed the financial operations and related internal controls at the Franchise Tax Board (board).

**Item 1.** **Erroneous Adjustments To Taxpayers' Accounts**

Finding: The board made erroneous adjustments to some taxpayers' accounts. For example, the board increased taxpayer liability by $142,665; in another example the board decreased taxpayer liability by $675,834. The adjustments were related to balancing individual tax years for these taxpayers and did not result in immediate assessments or refunds. However, the adjustments could have resulted in an assessment or refund to the taxpayers at a later date. Also, because of these errors, the board understated its receivables in the financial statements of the Bank and Corporation Tax Fund at June 30, 1988.

The board did not detect these erroneous adjustments because the board's policy was to review certain types of adjustments only when they exceeded certain limits. In April 1988, the board lowered those limits substantially, so the problem should be minimized.

Criteria: The California Government Code, Section 13403(a)(3), states that the elements of a satisfactory system of internal accounting and administrative control should include authorization and recordkeeping procedures that effectively control assets, liabilities, revenues, and expenditures. A satisfactory system should also include an effective system of internal review.

Recommendation: The board should review and approve adjustments before it applies the adjustments to taxpayers' accounts.

**Item 2.** **Charges For Dishonored Checks Not Assessed**

Finding: The board did not assess charges for dishonored checks on taxpayers' accounts when banks returned the taxpayers' checks. The check charges for the 15,000 dishonored checks that it received in fiscal year 1987-88 may have totaled approximately $150,000. The charges for the 15,900 dishonored checks that it received in fiscal year 1986-87 may have totaled approximately $159,000. Collected check charges would partially offset the costs of processing dishonored checks.

Criteria: The State Administrative Manual, Section 8043.1, allows the State to assess a dishonored check charge not to exceed $10.

Recommendation: The board should partially offset the costs of processing dishonored checks by assessing a $10 charge on dishonored checks.

**Item 3.** **Delayed Assessment of Accounts With Dishonored Checks**

Finding: The board does not have procedures to promptly assess taxpayers for all of the dishonored checks that it receives. At the time of our audit, the board was processing a five-month backlog of dishonored checks. As a result of the backlog, as of September 30, 1988, $8.3 million of taxes had not been reassessed to the taxpayers who had submitted dishonored checks. Delayed processing of the dishonored checks lessens the chances of collecting the money owed.

Currently, the board is concentrating its efforts on reducing the backlog of dishonored checks. Further, the board is reviewing its procedures for dishonored checks and hopes to automate the system by March 1989.

Criteria: The State Administrative Manual, Section 8710.1, requires that each department develop collection procedures to assure prompt follow up on receivables, which include dishonored checks.

Recommendation: The board should continue its plans to automate dishonored-check processing.

**Item 4.** **Failure to Correctly Compute Interest and Penalties**

Finding: The board does not always compute interest and penalties correctly on bank and corporation taxpayers' accounts. Of the 99 taxpayers' accounts that we reviewed, the board had assessed interest and penalties on 36 accounts. On 5 of those accounts, the board failed to correctly compute the interest and penalties. In addition, the board failed to compute the interest that it owed to another 6 of the 99 taxpayers. Although the dollar amount of the errors was not significant, our review covered only a small portion of the bank and corporation taxpayers' accounts.

Criteria: The California Revenue and Taxation Code, Sections 25901 through 25905, provides the requirements for the proper computation of interest and penalties by the board. Further, Sections 26080 through 26080.5, require the board to pay interest on overpayments of bank and corporation taxes that are not refunded within 90 days after the return was filed or the due date of the return, whichever is later.

Recommendation: The board should correctly compute interest and penalties that it assesses or interest that it owes to bank and corporation taxpayers.

**Item 5.** **Delayed Payment of Tax Refunds**

Finding: The board did not consistently issue tax refunds promptly. Of the 230 tax refunds that we reviewed, the board did not process 15 refunds within the required number of days. Of these 15 refunds, 11 were owed to bank and corporation taxpayers, while 4 were owed to personal income taxpayers. The board delayed issuing 14 of these refunds from between 3 months and nearly 24 months. The other refund has not yet been issued after over 5 months. As a result of these delays, taxpayers are not receiving their refunds within a reasonable time period. Further, the board is required by law to pay interest on overpayments of taxes that it does not refund within the required number of days.

Criteria: The California Revenue and Taxation Code, Sections 19062 and 19062.11, requires the board to pay interest on overpayments of personal income tax that it has not refunded within 45 days after the return was filed or the due date of the return, whichever is later, or within 90 days, if the return was filed solely to claim the renter's credit. In addition, Sections 26080 and 26080.5, require the board to pay interest on overpayments of bank and corporation taxes that it has not refunded within 90 days after the return was filed or the due date of the return, whichever is later.

Recommendation: The board should ensure that it issues tax refunds promptly before interest begins to accrue.

## DEPARTMENT OF GENERAL SERVICES

We reviewed the financial operations and related internal controls at the Department of General Services (department).

**Item 1.** **Incorrect Reporting of Office of State Printing Liabilities**

Finding:

The department reported liabilities for Office of State Printing (OSP) material purchases at June 30, 1988, that contained significant errors. The staff did not identify these errors because they did not reconcile the general ledger with a detailed listing. When we requested a detailed listing supporting the liability of more than $970,000 reported in the financial statements, the accounting office provided us with an untotaled listing that supported approximately 50 percent of the reported amount. When the accounting office completed a revised listing approximately three weeks later, it found that the amount that it had reported in the financial statements was overstated by approximately $650,000. The accounting office submitted the necessary corrections to the State Controller's Office. We reported a similar weakness during our financial audit for fiscal year 1986-87 when we stated that the accounting office did not provide a detailed listing to support the amount owed for material purchases.

Additionally, at the end of the fiscal year, the accounting office did not analyze other amounts that it had recorded as liabilities throughout the year to determine if the amounts were as accurate as possible. As a result of not analyzing the recorded amounts, the accounting office overstated its liabilities by approximately $77,000. For example, the accounting office reported liabilities for amounts that had already been paid and for balances for purchase-orders and contracts that the department did not plan to use.

Criteria:

The State Administrative Manual, Section 10544, requires state agencies to review their records to ensure that they have accurately recorded all amounts owed to others. In addition, 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 properly recorded and that the financial records are complete.

Recommendation: The department should ensure that the accounting office maintains an accurate listing of amounts owed to others for material purchases and should reconcile the general ledger with the listing. Further, at the end of the fiscal year, the accounting office should analyze amounts recorded as liabilities to ensure that they are as accurate as possible.

**Item 2. Insufficient Reconciliation for the Work in Process Account**

Finding: The department continues to have problems reconciling the OSP's work in process account in the general ledger with the subsidiary records. To bring the general ledger and the subsidiary records into agreement, the accounting office adjusted the general ledger account by approximately $272,500 at the end of the fiscal year. In doing so, the accounting office had assumed that the general ledger and the subsidiary records did not agree because of an error in the general ledger, but it could not provide detail supporting the difference. During our financial audit for fiscal year 1986-87, we reported a similar weakness when we reported that the accounting office did not prepare the final reconciliation until nearly two months after preparing its financial reports for the fiscal year. In its reconciliation, it discovered errors in its financial statements. Although this year the accounting office prepared the final reconciliation before preparing its financial statements, the accounting office did not properly prepare the reconciliation because it did not research the $272,500 difference that it identified.

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 properly recorded and that the financial records are complete.

Recommendation: The department should ensure that the accounting office researches differences identified during reconciliations of the general ledger with the subsidiary records to ensure that it has properly recorded transactions.

**Item 3.** **Lack of Necessary Authorizations for Disposals of Property**

Finding: The department continues to dispose of OSP equipment without all of the necessary authorizations. We reviewed 25 disposals and found that 23 did not have all the necessary approvals. Although the OSP had a property survey form for each of the items disposed, which was an improvement over previous years, the property survey forms were not approved by the property reutilization unit, and in one case, the property survey report was prepared after the disposal.

Additionally, the OSP retired from service eight video terminals, and staff have been using parts from these terminals to repair other terminals. One of the retired video terminals is a fully depreciated asset, and the other seven are being depreciated over the remaining useful life originally estimated. The department did not have a completed property survey report on file for any of the terminals, and it had not removed the terminals from the financial records. Failure to write off equipment retired from service overstates the equipment account and related depreciation accounts. In addition, failure to obtain proper authorizations before disposing of property may result in disposals that are not in accordance with management policies. We reported similar weaknesses during our financial audit for fiscal years 1985-86 and 1986-87.

Criteria: The State Administrative Manual, Section 8640, requires that state agencies prepare a property survey report whenever they dispose of equipment. In addition, this section requires that agencies obtain approval from the property reutilization unit at the Department of General Services before disposing of property. The State Administrative Manual, Section 8621, requires agencies to remove equipment from their records after the agencies have disposed of the equipment.

Recommendation: The department should ensure that the OSP obtain all of the necessary approvals before disposing of property. In addition, the accounting office should remove from the records all equipment that has been disposed.

**Item 4.** **Improper Accounting for Equipment and Related Acquisitions**

Finding: The department continues to make errors when depreciating OSP equipment and continues to make incorrect decisions regarding the need to capitalize equipment-related acquisitions. We reviewed 16 equipment acquisitions and found that the department's accounting office did not depreciate 2 of the 16 pieces of equipment according to the department's schedule of estimated useful lives. For example, the accounting office depreciated over a ten-year period office furniture with an estimated useful life of eight years. During our fieldwork, we brought these errors in depreciation to the attention of the accounting office, which made the necessary corrections before preparing the financial statements for the fiscal year. We noted a similar weakness during our financial audit in fiscal year 1986-87 when we reported that the department's accounting office used the wrong schedule of estimated useful lives to depreciate equipment.

Additionally, we reviewed 27 maintenance and repair expense transactions and found that the accounting office improperly recorded as a maintenance and repair expense a software cost of $20,000; this cost should have been capitalized as an intangible asset. The accounting office recorded this item as an expense because staff did not thoroughly read the contract. Although the contract specified that the vendor would provide free maintenance for one year, the accounting office assumed that the $20,000 cost for software was a maintenance expense. We brought the error to the attention of the accounting office, which made the necessary corrections before preparing the financial statements. We reported a similar weakness during our financial audit for fiscal years 1985-86 and 1986-87 when we stated that the OSP did not capitalize an improvement and an installation as equipment.

Criteria: The State Administrative Manual, Section 8616, requires that an asset's depreciable cost be spread over the period benefited. The Department of General

Services Administrative Order No. 86-5 established equipment classes and estimated useful lives for each class to be used in accounting for equipment. Further, the State Administrative Manual, Section 8615, defines intangibles as assets lacking physical substance but giving valuable rights to the owner. The section also provides software as an example of an intangible asset.

Recommendation: The department should ensure that the accounting office depreciates equipment according to the department's policies. Additionally, the accounting office should capitalize all costs of acquiring intangibles and should amortize the cost over the estimated useful life.

**Item 5.** **Incomplete Corrections in the Stock Inventory System**

Finding: During our financial audit for fiscal year 1986-87, we reported several weaknesses in the inventory system that the department uses to account for the OSP's paper stock and other goods. The department has not yet completely corrected errors related to two weaknesses that we reported. Specifically, although the OSP revised the inventory system on April 1, 1988, it did not correct information entered before that date.

First, we found that the inventory system's transaction detail, which is a listing of transactions that were entered into the system, still differed from the on-line data at June 30, 1988, by approximately $512,000 because of differences for the months before April 1, 1988. Additionally, we identified immaterial differences between the transaction detail and the on-line data for July and August 1988. The transaction detail may differ from the on-line data when the system allows a transaction to be recorded to either the on-line data or the transaction detail, but not to both. Neither the OSP nor the accounting office researched these differences before preparing its financial statements to determine whether the transaction detail or the on-line data was correct. Moreover, the accounting office assumed that the on-line data was correct and adjusted the inventory account balance by approximately $512,000 at the end of the fiscal year.

Second, the system still contains many inaccurate roll averages. A roll average is the average weight in pounds for the paper rolls with the same stock number. During the physical count at the end of the year, the OSP multiplies the roll average in the system by the number of paper rolls counted for each stock item. The OSP corrected the system to calculate revised roll averages as new paper roll stock was received on or after April 1, 1988; however, it did not revise the roll averages already in the stock inventory system before April 1, 1988. As a result, if new paper-roll stock was received after April 1, 1988, the system used the old roll average together with the new roll average to calculate a revised roll average. If no paper-roll stock was received after April 1, 1988, the roll average was not revised.

We reviewed the inventory results of 173 items of paper-roll stock and found that the roll averages in the stock inventory system differed from the actual roll averages observed during the physical inventory for 71 items. Of the 71 items, 32 roll averages in the system differed from the actual roll averages by more than 30 pounds. Nine of the 32 roll averages differed by more than 100 pounds. Because of the inaccuracy of the roll averages, the OSP's physical inventory may be imprecise. Additionally, because significant differences in roll averages caused significant variances in inventory totals, OSP staff counting the inventory were required to perform additional counts that would not have been needed if the roll averages had been accurate.

Criteria: The State Administrative Manual, Section 4820, requires that each state agency maintain an information management function that ensures the integrity of the information that is processed. In addition, the California Government Code, Section 13403, requires state agencies to ensure that a proper system of recordkeeping procedures is in place to provide effective accounting control over assets. Further, proper accounting procedures prescribe that the OSP maintain complete and accurate inventory records that are summarized and priced accurately.

Recommendation: The department should ensure that the OSP correct the stock inventory system to prevent differences between the transaction detail and the on-line data. Further, the OSP should research all differences between data in the stock inventory system and make the appropriate corrections as differences occur. In addition, the OSP should revise all roll averages that were not corrected when the system was revised and calculate new roll averages as new paper stock is received.

Item 6. **Insufficient Controls Over the Disposal of State Vehicles**

Finding: The department did not have sufficient controls over the disposal of state vehicles. Specifically, the department disposed of vehicles without preparing property survey reports and did not have adequate procedures for following up on vehicles that it had released for disposal. Without sufficient property accounting controls in place, the department cannot protect against and detect theft or the unauthorized use and sale of state vehicles.

Although the State Administrative Manual requires the department to prepare a property survey report authorizing the disposal of state property before the sale, the accounting office's policy was to release ownership documents (pink slips) to the Office of Fleet Administration upon request, but not to prepare the property survey reports until the Office of Fleet Administration notified the accounting office that it had disposed of a vehicle. For example, the department did not prepare property survey reports until one to three months after the date of disposal for 109 vehicles disposed of between February and May 1988.

Additionally, the department did not have adequate procedures for following up on vehicles for which the accounting office had released pink slips but for which the accounting office had not been notified of the sale. As a result, the accounting office was not aware that 26 vehicles had been disposed of several years before. Further, the department cannot now adequately explain what happened to 22 of the vehicles.

In fiscal year 1987-88, the department's property inspector discovered that the vehicles were missing. He prepared property survey reports at that time and indicated that the vehicles had been disposed of between 1983 and 1987. According to these property survey reports, the department sold 19 of the 22 vehicles. However, because the department did not maintain sufficient documentation, the department could not determine the name of the purchaser, the date of the sale, or the amount received, if any, from the sale.

The remaining 3 vehicles were destroyed by a fire, as documented during an inventory count performed in September 1987. However, the department did not provide documentation regarding the 3 vehicles or a statement that the state police or a local law enforcement agency had been notified, as required by the State Administrative Manual.

On October 5, 1988, after we brought this matter to its attention, the department implemented a new policy for preparing property survey reports and releasing pink slips. Under the new policy, the Office of Fleet Administration will provide the accounting office with an approved list of vehicles to be sold. Upon receiving the list, the department's accounting office will release applicable pink slips and will prepare property survey reports. The property inspector will approve the property survey reports and will forward them to the Office of Fleet Administration.

Criteria: The State Administrative Manual, Section 4172, requires agencies to prepare a property survey report whenever they propose to dispose of a state-owned vehicle. Also, the State Administrative Manual, Section 8640, requires that agencies receive approval from the property reutilization unit at the Department of General Services before disposing of property. Finally, the State Administrative Manual, Section 8643, requires departments to prepare a property survey report whenever property is lost, stolen, or destroyed. The report must contain a description of the events and a statement that the state police or a local law enforcement agency was notified.

Recommendation: The department should ensure that is has done all it can to determine whether it properly disposed of the 22 vehicles. Further, the department should prepare property survey reports and obtain necessary approval before disposing of vehicles. Also, the accounting office should not release pink slips to the Office of Fleet Administration until the accounting office has received an approved property survey report, and the department should follow up to ensure that it is promptly notified of disposals. If the department does not immediately dispose of the vehicles, the Office of Fleet Administration should return the pink slips to the accounting office. After disposing of the vehicle, the department should attach to the survey report a description of the transaction, the name of the purchaser, if applicable, and the amount of any proceeds received.

**Item 7.** **Weaknesses in the Department's Accounting for its Radio Maintenance Inventory**

Finding:

Procedures of the department's Telecommunications Division do not ensure that the department accurately records its radio maintenance inventory. As a result, the $1.2 million balance that the department reported did not accurately reflect the value of the radio maintenance inventory at the end of the fiscal year.

After its staff count and price the annual physical inventory, the Telecommunications Division notifies the accounting office of the new inventory balance. Using this information, the accounting office records the change from the previous year's balance. Because the department does not have a system that informs the accounting office of changes in the inventory account throughout the year, the accounting office relies entirely on the accuracy of the inventory balance computed by the Telecommunications Division for the amount that it reports in the financial statements. However, we have the following concerns regarding the process the Telecommunications Division uses to compute the inventory balance:

- The Telecommunications Division does not sufficiently review the pricing computations made by its staff. After staff determine the price for each unit of an inventory item, they multiply the price by the number of items counted during the physical inventory and record the total price on the inventory worksheet. The results are not always accurate. The inventory worksheets for fiscal year 1987-88 showed that staff computed the total price of one item as $165,075 rather than the correct price of $1,650.75. Thus, approximately $163,000 of the more than $241,000 increase in inventory that the accounting office recorded, based on the Telecommunications Division's reported inventory balance, was incorrect. After we brought this matter to its attention, the department submitted corrections to its financial statements to the State Controller's Office;

- The department's method of pricing does not result in a recorded value that reflects the actual cost of the inventory on hand. The Telecommunications Division prices all like items at the same value even though the items may have been purchased at different prices. Further, staff use whatever information is readily available to price the inventory. For example, in some cases, staff used the manufacturer's price book and, in other cases, the latest purchase document. The Telecommunications Division does not document how it obtains prices, and we were unable to conclude, for 17 of the 43 items that we reviewed, that the recorded prices were reasonable;

- The accounting office changes the account balance only after a physical inventory. Because the inventory was taken during the third week of April, the balance recorded as of June 30, 1988, actually reflected the status of the inventory over two months earlier; and

- The department does not use certain important control procedures when counting the inventory. We observed the physical inventory counts by the Telecommunications Division at its headquarters and the Sacramento radio shop; these locations accounted for 78 percent of the inventory recorded at approximately $1.2 million. Because staff counting the inventory already knew what the counts for each item should be, according to the Telecommunications Division's records, the department lacks assurance that the physical inventory count resulted in an independent verification of the Telecommunications Division's records. Additionally, staff counting the inventory did not count sequentially by location and did not tag items to indicate that they had counted them. Thus, the department does not have assurance that all items were counted.

Criteria: The California Government Code, Section 13401, requires agencies to maintain an effective system of internal control. In addition, the California Government Code, Section 13403, requires that the system of internal control include recordkeeping procedures sufficient to provide effective accounting control over assets and expenses. Further, generally accepted accounting principles prescribe that inventories be valued at the cost of acquiring the inventories.

Recommendation: The department should ensure that the Telecommunications Division sufficiently review all pricing computations. Additionally, the Telecommunications Division should use a consistent, documented method of pricing inventory that causes the recorded inventory to reflect the acquisition costs. Further, to ensure that the amount reported in the financial statements reflects the value of the inventory at June 30, the Telecommunications Division should hold its physical inventory as close to the end of the fiscal year as possible and should analyze transactions occurring during the period between the physical inventory and the end of the fiscal year. Finally, the Telecommunications Division should not allow staff counting the inventory to know what the recorded count is and should instruct staff to count items sequentially by location and tag the items once they have counted them.

**Item 8.** **Improper Accounting for Equipment-Installation and Site-Preparation Charges**

Finding: We reviewed 63 equipment operating expense transactions, totaling approximately $589,000, in the Service Revolving Fund and found that the department improperly recorded equipment- installation charges totaling approximately $286,000 as operating expenses instead of capitalizing the charges as part of the cost of the equipment. Because the errors related to equipment purchased by the Telecommunications Division only, we reviewed additional operating expense transactions associated with equipment purchases at that division. We found that the department had also improperly recorded site-preparation charges totaling approximately $17,300 and shipping charges totaling approximately $10,800 as expenses rather than as part of the cost of the equipment.

The errors initially occurred because the Telecommunications Division did not assign the proper accounting codes to the costs noted on the purchase documents. Subsequently, the accounting office, which approves purchase documents, did not properly review the documents to ensure that costs identified as changes for installation, site-preparation, and freight were assigned proper accounting codes.

As a result of the errors in assigning accounting codes, the department overstated its expenses and understated its equipment in the Service Revolving Fund by approximately $314,100. After we brought this matter to its attention, the department corrected $8,300 of the errors and submitted corrections to its financial statements to the State Controller's Office for the remaining errors.

Criteria: The State Administrative Manual, Section 8614, states that the cost of equipment includes the purchase price plus all costs to acquire, install, and prepare equipment for its intended use.

Recommendation: The Telecommunications Division and the accounting office should review all invoices and purchase documents related to equipment acquisition to ensure that charges are properly classified.

**Item 9. Inaccurate Computation of Architecture Revolving Fund Liabilities**

Finding: The department did not accurately compute the amount owed by the Architecture Revolving Fund for goods and services received before June 30, 1988. Instead of determining the amount of goods and services that had been received, the department's accounting office recorded as fiscal year 1987-88 liabilities all amounts included in claim schedules filed with the State Controller's Office during July and part of August 1988. The department also did not have a procedure for estimating the amount of liabilities as of June 30 that had not yet been included in claim schedules filed with the State Controller's Office by the date that the accounting office calculated the amount of liabilities.

As a result of these weaknesses, the department inappropriately reported approximately $1.6 million in transactions for fiscal year 1988-89 as liabilities for fiscal year 1987-88. Additionally, we identified approximately $1.3 million in liabilities for fiscal year 1987-88 that were not recorded as liabilities in that fiscal year. We believe that the department should have been able to identify or estimate a significant portion of the $1.3 million of unrecorded liabilities. Approximately $550,000 of the $1.3 million was for services billed on invoices dated June or earlier.

An additional $480,000 related to services for six ongoing construction projects that are billed monthly.

In addition to the misstatements caused by the department's method of computing its liabilities, staff made various clerical errors, undetected by supervisorial review, that resulted in a net understatement of approximately $800,000. The largest error, approximately $882,000, resulted because staff did not properly record the rejection of a claim schedule. We reported a similar weakness during our financial audit of fiscal year 1986-87 when we reported a significant clerical error in work that had not been reviewed by the supervisor.

As a result of the conditions described above, the Architecture Revolving Fund liabilities for fiscal year 1987-88 were understated by approximately $500,000. After we brought this matter to its attention, the department submitted corrections to the State Controller's Office.

Criteria: The State Administrative Manual, Section 10544, requires state agencies to review their records to ensure that they have accurately recorded all amounts owed to others.

Recommendation: The department should ensure that it has accurately recorded the amounts that it owes at the end of the fiscal year. To ensure that it has included all significant liabilities, the department should establish a process by which the accounting office can make a reasonable estimate of liabilities for items that have not yet been submitted for payment. In addition, the department should ensure that supervisors review work supporting the financial statements.

**Item 10. Delays in Returning Unused Balances in the Architecture Revolving Fund**

Finding: As in previous fiscal years, the department does not always return unused funds to depositing agencies within the time required by the California Government Code. Delays in returning unused balances to the depositing agency delay the funds from being available for appropriation by the Legislature.

The State appropriates funds for construction projects from the agencies that will benefit from the project. The agency receiving the appropriation then transfers the appropriated funds to the Architecture Revolving Fund. Within three months after the project is completed or within three years after the initial transfer of the funds, the department is required to return any unused balances to the agency that received the original appropriation.

We reviewed 18 completed projects to determine if the department returned unused funds promptly. For 10 of the 18 projects, the department took four to nine months to return unused balances of completed projects. In addition, because the accounting office's staff could not locate the project files, we were unable to determine if the department returned unused funds promptly for an additional 4 of the 18 projects.

Further, the department does not always return unused funds for projects that are not yet complete within three years from the time the funds are originally transferred to the Architecture Revolving Fund. Six of 15 projects we reviewed, from which funds were transferred to the Architecture Revolving Fund before September 30, 1985, had unused funds at September 30, 1988, that had not been returned within the three years required by the California Government Code. In addition, because the accounting office's staff could not locate the project files, we were unable to determine if the department returned unused funds promptly for an additional 2 of the 15 projects.

During our financial audits for fiscal years 1983-84, 1984-85, 1985-86, and 1986-87, we reported similar delays in returning unused funds within the three-month limit. Additionally, for fiscal year 1986-87, we reported similar delays in returning unused funds within the three-year limit. We have not previously reported instances of missing project files. Although the department implemented procedures in March 1987 to reduce delays in returning unused balances and we noted improvement in fiscal year 1986-1987 over previous years, delays continued to occur.

Criria: The California Government Code, Section 14959, requires the department to transfer unused balances of the Architecture Revolving Fund to the original appropriation within three months after the project is completed or within three years from the time that the funds were originally transferred to the Architecture Revolving Fund.

Recommendation: The department should ensure that it returns unused balances within the time limits required by the California Government Code, Section 14959.

**Item 11.** **Insufficient Architecture Revolving Fund Reconciliations**

Finding: The department did not prepare certain reconciliations and investigate reconciling items for two accounts within the Architecture Revolving Fund before issuing its financial statements. Failure to prepare reconciliations between records may prevent the prompt detection and correction of errors.

Specifically, the accounting office did not reconcile the encumbrance account in the general ledger with the cost accounting system that provides detailed information by project throughout the year. Encumbrances for Office of State Architect projects in the general ledger were $6.2 million lower than the cost accounting system at the end of the fiscal year. Encumbrances for Office of Project Development and Management projects were $1.4 million higher in the general ledger than in the cost accounting system. To ensure that the general ledger reflected the cost accounting system balance, the accounting office simply adjusted the general ledger for the $4.8 million difference. The accounting office identified items that caused the differences for the period July 1987 through May 1988 but did not analyze the differences to determine if the differences indicated errors in the cost accounting system. Further, the accounting office never prepared a reconciliation for June 1988.

Additionally, the accounting office did not reconcile until November 1988 the $616.7 million project deposits account in the general ledger with the cost accounting system for the period January through June 1988; this reconciliation occurred more than two months after the department issued its financial statements. The accounting office used the general ledger balance when preparing the department's financial statements.

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| Criteria: | The State Administrative Manual, Section 7900, discusses the importance of preparing regular reconciliations. Reconciliations represent an important part of internal control because they provide a high level of confidence that the transactions have been properly recorded and that the financial records are complete. |
| Recommendation: | The department should prepare reconciliations regularly so that errors can be detected before it issues its financial statements. |

## PUBLIC EMPLOYEES' RETIREMENT SYSTEM

We reviewed the Public Employees' Retirement System's (PERS) compliance with federal and state regulations for the Statewide Cost Allocation Plan (SWCAP) and state regulations for the Prorata Allocation Plan.

**Item** — **Error In Expenditure Data Reported to the Department of Finance**

Finding: Because of clerical errors, the PERS overstated the expenditures for health benefits for retired annuitants that it reported to the Department of Finance (department) by approximately $18,000 for fiscal year 1987-88. These errors could result in over-collections from the federal government of approximately $1,500 and over-collections from the State's special funds of approximately $6,000. These potential over-collections are less than .017 of one percent of the State's estimated reimbursements from federal programs and special funds for health benefits for retired annuitants.

The PERS summarizes expenditures incurred to provide health benefits for retired annuitants, and it reports these expenditures to the department. The department includes these expenditures in the SWCAP and prorata. The SWCAP is the plan that each state agency uses to pay for its federal programs' share, if any, of the State's costs for central services. The prorata is the plan that each state agency uses to pay for its special funds' share, if any, of the State's costs for central services. From data that the PERS reported for fiscal year 1987-88, the department estimated that the expenditures for health benefits for retired annuitants in the SWCAP and prorata would be approximately $108.3 million. The department estimated that the State would recover from the federal government approximately $9.0 million (8.3 percent) of the expenditures for health benefits for retired annuitants included in the SWCAP. The department estimated that the State's General Fund would recover from the State's special funds approximately $35.7 million (33 percent) of the expenditures for health benefits for retired annuitants included in the prorata.

Criteria: The federal Office of Management and Budget, Circular No. A-87 requires the State to charge the federal government only for allowable costs. In addition, the State Administrative Manual, Section 8752, requires state agencies to recover full costs for goods or services provided to other state agencies.

Recommendation: The PERS should develop procedures to be sure that the amounts that it reports to the Department of Finance for expenditures for health benefits for retired annuitants are accurate.

**YOUTH AND ADULT CORRECTIONAL**

## BOARD OF CORRECTIONS

We reviewed the financial operations and related internal controls at the Board of Corrections (board).

| **Item** | **Inaccurate Year-End Financial Reports** |
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| Finding: | The board's year-end financial reports for its three capital expenditure funds were inaccurate. Specifically, the Department of the Youth Authority, which performs the accounting for the board, did not record all of the transfers-in and transfers-out related to the first of two loans from the Pooled Money Investment Account (PMIA). Consequently, the board's transfers-in and transfers-out accounts in the three capital expenditure funds were understated. For the County Correctional Facility Capital Expenditures Fund of 1986, transfers-in were understated by $6,696,137 and transfers-out were understated by $6,627,137. For the County Jail Capital Expenditure Fund-Bond Act of 1984, transfers-in were understated by $101,062,634 and transfers-out were understated by $180,914,804. For the County Jail Capital Expenditure Fund-Bond Act of 1981, transfers-in were understated by $57,196,641 and transfers-out were understated by $82,145,838. Failure to submit accurate financial reports delays the compilation by the State Controller's Office of the State's financial statements. |
| Criteria: | The State Administrative Manual, Section 7950 through Section 7979, describes the requirements for preparing accurate financial reports. In addition, a management memorandum from the Department of Finance, dated June 2, 1988, reminded agency officials of their responsibility for preparing accurate year-end financial reports. This memorandum also explained which specific accounts departments should use to record transactions related to their loans from the PMIA. Finally, the Department of Finance issued a CALSTARS Procedure No. P-14 that describes how departments should account for PMIA loans. |
| Recommendation: | The Department of the Youth Authority should prepare complete and accurate year-end financial reports in accordance with the requirements of the State Administrative Manual and the Department of Finance. |

## DEPARTMENT OF CORRECTIONS

We reviewed the financial operations and related internal controls at the Department of Corrections (items 1-3). In addition, we reviewed the Department of Corrections' (department) internal audit unit (items 4-5).

**Item 1.** **Improper Identification of Encumbrances**

Finding: For its three construction funds, the department incorrectly identified and reported to the State Controller's Office accounts payable and amounts due to other funds as encumbrances. Specifically, for its New Prison Construction Fund, we calculated that the department incorrectly reported $1,730,273 of accounts payable and $558,909 of due to other funds as encumbrances. For its 1984 Prison Construction Fund, we calculated that the department incorrectly reported $5,151,743 of accounts payable and $1,148,208 of due to other funds as encumbrances. For its 1986 Prison Construction Fund, we calculated that the department incorrectly reported $17,451,584 of accounts payable and $522,569 of due to other funds as encumbrances. These errors occurred because the department did not thoroughly analyze its commitments to determine if goods or services were received before or after June 30. If the department does not properly identify encumbrances, accounts payable, and amounts due to other funds 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 reported a similar weakness in our financial audit for fiscal year 1986-87. The department responded that it would perform a detailed analysis of its accruals at the end of each fiscal year. However, the department continues to report its accounts payable and due to other funds improperly.

Criteria: The State Administrative Manual, Section 10544, requires state agencies to analyze their encumbrances to determine whether they are valid obligations as of June 30. Further, the State Controller's Office issued a memorandum, dated May 20, 1988, instructing agencies to report the amount of encumbrances so that the State

Controller's Office can prepare the State's financial statements in accordance with generally accepted accounting principles. Under generally accepted accounting principles, encumbrances are commitments for goods or services to be received in the next fiscal year.

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

**Item 2.** **Improper Accounting for Amounts Owed to the Department**

Finding: The department has not followed all of the procedures required by the State Administrative Manual for accounting for receivables. We noted the following specific deficiencies:

- The department could not provide the supporting documentation for 26 of the 45 receivable items that we reviewed. Moreover, these 26 items, totaling $288,200, have been outstanding from three to seven years;

- The department did not promptly send out invoices totaling $19,450 for 3 of the 45 receivable items that we reviewed. Specifically, the department did not send an invoice for $8,350 until 34 months after it had provided the services, and it did not send an invoice for $5,850 until 22 months after it had provided the services. In addition, as of September 1988, the department had not sent an invoice for $5,250, 15 months after it had provided the services. The department did not promptly send out invoices because it does not have procedures to do so;

- The department inappropriately accrued two items totaling $45,426 as accounts receivable although the department had not yet earned the amounts. The items relate to contracts that the department has with other states for housing their inmates; and

- The department inappropriately reported $33,865 of due from other governments and $5,850 of due from other funds as accounts receivable.

As a result of this improper accounting, the department is unable to provide details to support its receivables at June 30, 1988. Additionally, the department is not collecting all of the amounts owed to it. Further, it misstated its accounts receivable, due from other governments, and due from other funds accounts.

Criteria: The State Administrative Manual, Sections 7620 and 8776, defines the proper way to classify accounts receivable, due from other governments, and due from other funds. In addition, the State Administrative Manual, Section 7951, states that agencies should retain detail to support general ledger account balances as of June 30 for use by the auditors. Further, the State Administrative Manual, Section 8776.3, requires the preparation of an invoice or other type of claim document to be sent out as soon as possible after the recognition of a claim. Finally, the State Administrative Manual, Section 8710.1, requires each department to develop collection procedures that will assure prompt follow-up of receivables.

Recommendation: The department should provide the accounting staff with training so that the staff will properly record amounts due to the department. In addition, the department should reconstruct supporting documentation so that action can be taken to collect past-due amounts owed to it. The department should also bill receivables promptly and accelerate collection efforts.

**Item 3.** **Lost Vendor Discounts and Late Payments**

Finding: The department did not always take advantage of vendor discounts. Specifically, the department did not take vendor discounts of $708 on five of the seven invoices offering discounts that we reviewed in our disbursements sample. We reported a similar weakness in our audit for fiscal year 1986-87. The department responded that it had established new procedures to monitor all vendor invoices.

In addition, the department does not always make payments to vendors within the time limit prescribed by law. Of 77 invoices that we reviewed, we found 3 that were paid late. As a result, the department was required to pay $46 in late penalties to the vendors.

The lost vendor discounts and late payments occurred because the department's institutions do not always send the stock-received reports or other documents to the accounting unit in time to take advantage of the discounts or to make payments within the time limit. The department's accounting unit does not submit a claim for payment until it has received all of the necessary documents.

Criteria: The State Administrative Manual, Section 8422.1, requires state agencies to determine that cash discounts have been taken before submitting claims to the State Controller's Office for payment. In addition, the California Government Code, Section 926.17, requires agencies to submit these claims to the State Controller's Office for payment within 35 days of the postmark date of the invoice. Otherwise, the agency is responsible for interest penalty fees.

Recommendation: The department should require its institutions to promptly submit all necessary documents so that the department can take advantage of vendor discounts and pay its vendors within the required time limits.

**Item 4.** **The Internal Audit Unit Lacks an Audit Charter**

Finding: The department has no formal audit charter or similar document that outlines the unit's scope, purpose, authority, and responsibility. Although the department's administrative manual contains information on the operation of the unit, it does not describe the unit's position within the department and its line of reporting or the unit's authority to perform internal audits. The lack of an audit charter can result in misunderstandings between the auditees and the internal auditors.

Criteria: Sections 110.01.4 and 510.01 of the "Standards for the Professional Practice of Internal Auditing" (SPPIA) require the department to have a formal written audit charter for its unit. The audit charter should include the unit's position within the department, its scope of activities, and its authority for access to records, personnel, and physical properties necessary to perform internal audits.

Recommendation: The department should define, in a formal written document, the purpose, authority, and responsibility of the unit and its placement within the organization.

**Item 5.** **Internal Audit Workpapers Lack Sufficient Evidence To Support Audit Conclusions**

Finding: Audit workpapers do not sufficiently support audit findings and recommendations. Specifically, we found that, for the audit of the Deuel Vocational Institution, the internal auditors did not perform sufficient transaction tests to ensure that the system of internal control was working. Additionally, several pages of the audit program and other workpapers were missing. As a result, we were unsure whether the auditors had sufficient evidence to support audit conclusions. Failure to properly document evidence in the workpapers prevents management from being assured that the audit results are complete and accurate. These deficiencies occurred because of insufficient supervision.

According to the acting inspector general in charge of internal audits, who is also a program administrator in the department's Program Compliance Unit, he does not have the time to properly supervise and review the auditors' work. He also stated that the department plans to fill the inspector general's position as soon as possible.

Criteria: The SPPIA, Section 420.01.5, requires the internal auditors to document in the workpapers the information that they obtain and their analyses. This section also requires that workpapers support the findings and recommendations that the auditors report.

Recommendation: The department should develop a training program to improve the internal auditors' technical skills in preparing workpapers and gathering and documenting sufficient, competent, and relevant evidence. In addition, the department should provide proper supervision for the internal auditors to ensure that the workpapers are prepared correctly.

## DEPARTMENT OF CORRECTIONS
## CALIFORNIA INSTITUTION FOR MEN

We reviewed the financial operations and related internal controls at the Department of Corrections, California Institution for Men (institution).

**Item 1.** **Misstatement of Expenditures and Liabilities**

Finding: The institution overstated its June 30, 1987, liabilities and expenditures by $542,029 for the institution's portion of the State's General Fund. During our audit, we found the following specific errors:

- The institution overstated accounts payable and expenditures by $310,100, as of June 30, 1987, because it incorrectly recorded seven invoice payments; and

- The institution failed to disencumber six completed purchase contracts and agreements totaling $231,929.

Criteria: The State Administrative Manual, Section 10503, discusses the correct method for recording the payment of obligations. Also, the State Administrative Manual, Section 10544, requires agencies to adjust encumbrances to reflect only valid obligations.

Recommendation: The institution should ensure that payments of obligations are correctly recorded. Also, as of June 30, the institution should ensure that its outstanding encumbrances and accounts payable reflect only valid obligations.

**Item 2.** **Improper Billings**

Finding: The institution's invoices to its headquarters for $90,805 in reimbursable expenditures that the institution incurred during fiscal years 1985-86 and 1986-87 did not contain sufficient documentation, and consequently, the institution's headquarters would not accept them. As a result, as of April 18, 1988, the institution had not collected the amounts owed to it.

Criteria: The Department of Corrections' headquarters requires institutions to provide sufficient documentation when requesting reimbursement from the department headquarters.

Recommendation: The institution should provide sufficient documentation when requesting reimbursement from its headquarters.

**Item 3.** **Misstated Reimbursements and Assets**

Finding: The institution understated its portion of the State's General Fund reimbursements and accounts receivable at June 30, 1987, by approximately $22,000 because it did not accrue reimbursable expenditures owed to it by a private entity.

Criteria: The State Administrative Manual, Section 8776.2, requires agencies to accrue receivables at June 30 that were not previously billed or accrued but that are estimated as collectible within the following fiscal year.

Recommendation: The institution should accrue all amounts owed to it at June 30 as instructed in the State Administrative Manual, Section 8776.2.

**Item 4.** **Inadequate Controls Over Disbursements**

Finding: The institution does not always maintain control over disbursements. Specifically, the institution did not always take advantage of vendor discounts. Of the 60 invoices that we reviewed, we found 5 invoices for which the institution did not use the available discounts and, as a result, lost $697 in vendor discounts. The institution's senior accounting officer indicated that some discounts are lost because the institution is not alert to the availability of the discounts.

In addition, the institution sometimes pays invoices without first obtaining authorization. Of the 80 invoices that we reviewed, the institution paid 4 invoices totaling $5,812 that had not been signed by an official of the institution.

Criteria: The State Administrative Manual, Section 8422.1, requires agencies to determine that cash discounts have been taken before submitting invoices for payment. Further, the State Administrative Manual, Section 8422.1, requires agencies to determine that authority exists to obtain goods or services before submitting invoices for payment.

Recommendation: The institution should take advantage of available vendor discounts. Further, the institution should ensure that all invoices are appropriately authorized before they are processed for payment.

**Item 5.** **Failure To Return Undelivered Payroll Warrants to the State Treasurer's Office**

Finding: The institution did not return two undelivered payroll warrants totaling $1,352 to the State Treasurer's Office within 90 days after receipt of the warrants. Seven months had elapsed since the receipt of one of the warrants and five months since the receipt of the other warrant. Failure to return the undelivered warrants to the State Treasurer's Office increases the risk of their loss or misappropriation. According to the institution's senior accounting officer, the warrants were not returned because the employee responsible for custody of the undelivered warrants was not aware of the requirement, and the employee's supervisor did not periodically check to determine whether the warrants had been returned as required.

Criteria: The State Administrative Manual, Section 8580.5, requires agencies to return to the State Treasurer's Office those payroll warrants that are not delivered within 90 days of receipt.

Recommendation: The institution should comply with the State Administrative Manual, Section 8580.5, by returning to the State Treasurer's Office those payroll warrants that are not delivered within 90 days of receipt.

**Item 6.** **Long-Outstanding Expense Advances**

Finding: The institution does not promptly collect outstanding advances made to employees from the revolving fund. As of March 31, 1988, the institution had a total of 27 expense advances totaling $11,347 that had been outstanding for more than 21 months. According to the institution's accounting officer, the institution cannot locate documentation for 16 of the 27 advances and, therefore, has been unable to recover them.

Although the institution indicated that the remaining 11 advances have been submitted to the Franchise Tax Board for offset against the employee's income tax refund or to the State Board of Control for discharge of accountability, the institution could not provide evidence that these steps had been taken for 8 of the 11 advances. Failure to collect 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 collected.

Criteria: The State Administrative Manual, Sections 8710.1, 8116(1), and 8118, describes the methods that agencies must follow to promptly collect employee advances. In addition, Section 8710.1 describes the process by which agencies may submit claims to the State Board of Control for discharge of accountability. Finally, Section 8790.55 describes the process by which agencies may submit advances to various state agencies for tax refund offset procedures.

Recommendation: The institution should investigate the long-outstanding advances and attempt to recover them through collection from employees, submission to various state agencies for tax refund offset procedures, or submission to the State Board of Control for discharge of accountability. Further, the institution should determine the status of those advances that have been submitted to the Franchise Tax Board for income tax offset or to the State Board of Control for discharge of accountability.

<u>Item 7</u>. **<u>Incorrect Year-End Revolving Fund Adjustment</u>**

Finding: In its year-end revolving fund adjustment, the institution misclassified five payments. As a result, the financial statements of fiscal year 1986-87 for the institution's portion of the State's General Fund included the following errors: a \$50,424 understatement of cash on hand, a \$50,424 overstatement of due from other funds, a \$1,398 understatement of claims filed, and a \$1,398 overstatement of accounts payable. Further, as a result of the misclassifications, the financial statements of fiscal year 1986-87 for the institution's Inmate Welfare Fund included the following errors: a \$51,287 overstatement of claims filed, an $862 understatement of accounts payable, and a $50,424 overstatement of the clearing account.

The institution's senior accounting officer stated that the misclassifications occurred because of the high volume of transactions within the revolving fund that made it difficult to correctly classify all items in the year-end adjustment to revolving fund cash.

Criteria: The State Administrative Manual, Section 10537, describes the fiscal year-end revolving fund adjustment. The section defines the correct classification of the various types of revolving fund disbursements and reimbursements.

Recommendation: The institution should perform the year-end revolving fund adjustment as instructed in the State Administrative Manual, Section 10537.

## DEPARTMENT OF CORRECTIONS
## CALIFORNIA MEN'S COLONY

We reviewed the financial operations and related internal controls at the Department of Corrections, California Men's Colony (institution).

**Item 1.** **Insufficient Separation of Duties**

Finding: The institution does not provide adequate separation of duties in its accounting department. One employee who receives remittances and prepares receipt forms also prepares checks and records receipt information. In addition, two employees who sign and review checks for proper support and authorization also have access to or control over the blank check stock. Unless duties are properly segregated, an employee could conceal irregularities, and the responsibility for errors may not be determined.

Criteria: The State Administrative Manual, Sections 8080 and 8080.2, prescribes separation of duties for agencies whose accounting systems include manual and automated processes. The sections specify that an employee who receives remittances may not prepare checks or record receipt information. Furthermore, these sections specify that an employee who signs checks after comparing them with authorizations and supporting documents may not have access to or control over the blank check stock.

Recommendation: The institution should reassign duties among employees in the accounting department to provide the separation of duties required by the State Administrative Manual.

**Item 2.** **Failure To Collect Salary Advances Promptly**

Finding: The institution did not promptly collect outstanding salary advances made to employees from the institution's revolving fund. As of June 30, 1987, eight salary advances, totaling approximately $3,500, were outstanding for over nine months; five of these salary advances, totaling $3,049, were made in 1983 or earlier. Because the institution did not promptly collect these salary advances from the next payroll warrants that it issued, many of the advances are uncollectible.

Failure to collect advances due from employees may result in the loss of state funds if employees leave state service without repaying the advances. Further, until the institution takes appropriate action either to collect or to write off these outstanding advances, revolving fund monies are not available for other uses.

Criteria: The State Administrative Manual, Section 8118, requires the institution to collect salary advances from the next payroll warrants that are issued to the employee. In addition, the State Administrative Manual, Section 8710.1, states that if all reasonable collection procedures do not result in payment, the institution may request from the State Board of Control relief from accountability for uncollectible amounts by filing an Application for Discharge from Accountability and Claim for Reimbursement.

Recommendation: The institution should collect current outstanding salary advances from the next payroll warrants that it issues to employees. The institution should also pursue collection of old outstanding salary advances. If normal collection efforts fail, the institution should attempt to recover the advances made to employees who have left state service through the income tax offset procedures of the Franchise Tax Board. Finally, the institution should request from the State Board of Control release from accountability and reimbursement for those salary advances that are still uncollectible.

**Item 3.** **Misstated Accounts Receivable**

Finding: At June 30, 1987, the institution overstated its accounts receivable abatements by $8,637 and understated its expenditures by the same amount. We reviewed 23 of the institution's abatement accounts, totaling $16,795. The balances in 12 of the 23 accounts were incorrect. These misstatements resulted because, in some instances, the institution recorded the wrong amount from the source document to establish the account, and, in other instances, the institution recorded the wrong collection amount to reduce the account. According to the accounting supervisor, she did not have time to sufficiently train the staff responsible for recording receivables. Additionally, she was unable to review their work until after the institution had issued its June 30, 1987, financial statements.

Criteria: The California Government Code, Section 13402, requires agency heads to establish and maintain a system of internal accounting and administrative control within their agencies. Further, the California 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 institution should ensure that its accounting staff receive sufficient training to record accounts receivable transactions correctly. In addition, the institution's accounting supervisor should periodically review amounts recorded by accounting staff to ensure that account balances are correct and reconcile with supporting accounting records.

**Item 4.** **Misstated Liability Account Balances**

The institution misstated the balances of its liability accounts. Specifically, at June 30, 1987, the institution understated its accounts payable balance by $1,299,345. Also, it overstated the balances of its due to other funds by $987,658, its due to other governments by $45,270, and its claims filed by $266,417. These misstatements occurred because of the following reasons:

- The institution used the incorrect amount when it prepared the entry to remove encumbrances from accounts payable that belonged in the due to other funds and due to other governments accounts at year end. The institution used the obligation amount, which represents goods and services received, rather than the encumbrance amount, which represents goods and services ordered but not received. As a result of this error, the accounts payable balance was understated by $716,126, the due to other funds balance was overstated by $670,856, and the due to other governments balance was overstated by $45,270.

- The institution improperly classified some of its liabilities. For example, $316,802 of accounts payable owed to private entities were classified as due to other funds. In addition, $266,417 of accounts payable were classified as claims filed even though such claims had not been filed with the State Controller's Office as of June 30, 1987. As a result of these misclassifications, the accounts payable balance was understated by $583,219, the due to other funds balance was overstated by $316,802, and the claims filed balance was overstated by $266,417.

Criteria: The CALSTARS procedures manual shows the year-end adjusting entry to record encumbrances in the appropriate due to account(s).

Also, the State Administrative Manual, Section 7630, requires that amounts due to private entities for outstanding obligations be reported as accounts payable. In addition, this section requires that only claims filed with the State Controller's Office be reported in the claims filed account.

Recommendation: The institution should prepare its year-end adjusting entry to record encumbrances in accordance with the CALSTARS procedures manual. In addition, the institution should classify its liabilities in accordance with the State Administrative Manual.

**Item 5.** **Revolving Fund Entry Incorrectly Prepared**

Finding: The institution did not correctly develop the revolving fund adjustment at year end for the general fund. When determining the revolving fund adjustment for claims filed, the institution did not determine the amount of reimbursement warrants to the revolving fund dated before but received after June 30. In addition, the institution recorded revolving fund disbursements to be reimbursed by the Special Account for Capital Outlay and the 1984 Prison Construction Fund as claims filed instead of as due from other funds. Furthermore, the institution recorded an advance to its subrevolving fund as a deferred charge rather than as cash on hand. As a result of these errors, the institution understated due from other funds by approximately $195,000, understated cash on hand by approximately $177,000, understated claims filed by approximately $322,000, and overstated deferred charges by approximately $50,000.

Criteria: The State Administrative Manual, Section 7965, shows that reimbursement warrants to the revolving fund that are dated before but received after June 30 and subrevolving fund balances at June 30 should be reported as cash on hand. In addition, revolving fund disbursements scheduled for reimbursement by other funds should be recorded as due from other funds.

Recommendation: The institution should ensure that its accounting staff correctly prepare the revolving fund adjustment at year end.

## DEPARTMENT OF THE YOUTH AUTHORITY

We reviewed the financial operations, internal controls, and administration of two federal programs at the Department of the Youth Authority (items 1-7). These programs are the United States Department of Agriculture grants, Federal Catalog Numbers 10.553 and 10.555. In addition, we reviewed the Department of the Youth Authority's (department) internal audit unit (items 8-12).

**Item 1.** **Weaknesses in Controls Over the Revolving Fund**

Finding: The headquarters office has weaknesses in controls over its revolving fund. For each of the last eight months of fiscal year 1987-88, the headquarters office overdrew its revolving fund by an average of approximately $138,000 per month. These overdrafts were caused by the headquarters office not promptly scheduling expense advances for reimbursement and not recovering salary advances from the next payroll warrants issued. For example, as of June 30, 1988, approximately $277,000 or 35 percent of the total amount advanced from the revolving fund was outstanding for at least 60 days. This amount includes two salary advances dating back as far as 1970. If the department had promptly obtained reimbursement for the $277,000, the department could have prevented the overdraft of its revolving fund in June 1988.

When the headquarters office overdraws its revolving fund, it must finance its overdrafts with monies from other funds or cash receipts not yet accounted for in a fund. Financing the overdrafts with monies from other funds or cash receipts not yet accounted for weakens the controls over these monies.

In addition, when the headquarters office fails to promptly schedule expense advances for reimbursement and fails to recover salary advances from the next payroll warrants issued, those monies are not available for other uses. Further, the failure of the headquarters office to clear salary advances promptly may result in the loss of state funds if the employees leave state service before repaying the advances.

Criteria: The State Administrative Manual, Section 8047, requires agencies to make every effort to prevent overdrafts in their checking accounts. In particular, Section 8047 requires agencies to promptly schedule claims for reimbursement of the revolving fund. In addition, the State Administrative Manual, Section 8118, requires agencies to recover salary advances from the next payroll warrants issued.

Recommendation: The headquarters office should make every effort to prevent overdrafts in its revolving fund by promptly obtaining reimbursement for its expense advances and by recovering salary advances from the next payroll warrants issued. In addition, the headquarters office should request that the Franchise Tax Board recover the long outstanding salary advances from former employees by deducting the amounts owed from any income tax refunds due to the employees. For those salary advances that it cannot collect, the headquarters office should request reimbursement from the State Board of Control.

<u>Item 2</u>. <u>Lack of Records To Support Field Services Revolving Fund Balance at June 30, 1988</u>

Finding: The headquarters office was unable to provide details to support the amounts advanced from its field services revolving fund at June 30, 1988. The amounts advanced totaled approximately $57,000 at June 30, 1988. Although the headquarters office maintains a file of check foils that provides support for advances currently outstanding, it does not maintain historical records to show the activity in the fund for the fiscal year.

Criteria: The State Administrative Manual, Section 8190, requires each agency to maintain a cash book and receivables ledger to account for all transactions of a revolving fund.

Recommendation: The headquarters office should maintain a cash book and a receivables ledger for the field services revolving fund to account for all transactions of the revolving fund for the fiscal year.

<u>Item 3</u>. <u>Warrants Outstanding Over Two Years</u>

Finding: The headquarters office did not transfer to the Special Deposit Fund money for unclaimed warrants outstanding over two years, nor issue stop-payment notices to the State Treasurer's Office for warrants outstanding over four years. As of June 30, 1988, the department had 134 warrants totaling approximately $6,200 outstanding over two years. Twenty-six of the 134 warrants were outstanding more than four years. The 26 warrants totaled approximately $2,400. As a result of not transferring money for unclaimed warrants outstanding over two years to the Special Deposit Fund, the headquarters office must review these warrants each month to determine whether they are still outstanding when it prepares the bank reconciliation. Additionally, by retaining the outstanding amounts in its accounts, the headquarters office is delaying the process that returns the money to the State's General Fund so that the Legislature can reappropriate it.

Criteria: The State Administrative Manual, Section 8042, requires agencies to transfer money for warrants outstanding over two years to the Special Deposit Fund as unclaimed property. In addition, Section 8042 also requires agencies to send stop-payment notices to the State Treasurer's Office when warrants are outstanding more than four years. Finally, the California Government Code, Section 16374, requires that, if the unclaimed amounts are not paid out by the State Treasurer's Office within two years, the money revert to and become part of the State's General Fund or the fund against which the warrants were drawn.

Recommendation: The headquarters office should transfer to the Special Deposit Fund the money for unclaimed warrants outstanding over two years. In addition, the headquarters office should issue stop-payment notices for those warrants outstanding over four years.

**Item 4.** **Inaccurate Meal Count Reports**

Finding: The department did not ensure that its facilities reported accurate meal counts to the headquarters office before it charged the State Department of Education for meals served to eligible students under the School Breakfast Program and the National School Lunch Program. The department requested reimbursement for meals served at its facilities using unsupported and inaccurate reports. As a result, the department improperly charged the State Department of Education for meals.

At the Northern California Youth Center (NCYC), we reviewed the supporting documentation for 48 meal counts totaling 73,498 breakfasts and lunches. In these meal counts, the NCYC overstated the total number of meals served by 126 meals because of clerical errors. In addition, at the Fred C. Nelles School (Nelles School), we reviewed the supporting documentation of 36 meal counts totaling 27,484 breakfasts and lunches. The Nelles School reported some meal counts to the department that did not agree with the supporting documents. Based on the supporting documents, the Nelles School overreported 1,294 meals and failed to report 282 meals. Based on the supporting documents, the discrepancies noted at both facilities resulted in the department requesting reimbursement for more meals than it was entitled to claim from the School Breakfast Program and the National School Lunch Program.

Criteria: The Code of Federal Regulations, Title 7, Sections 210.9(b)(8) and 220.7(6), states that only meals served to eligible students may be claimed for reimbursement at the assigned rates. In addition, the Code of Federal Regulations, Title 7, Sections 210.15(b) and 220.9(a), specifies that to participate in the School Breakfast Program and the National School Lunch Program, a facility must maintain records to demonstrate compliance with program requirements.

Recommendation: The department should ensure that its facilities report accurate meal counts and maintain records to support their meal counts so that the department charges the State Department of Education for the correct number of meals served.

**Item 5.** **Failure to Document Meal Contents**

Finding: The department did not ensure that its facilities prepared daily menu worksheets indicating the contents of meals served and the quantities of meal contents. Specifically, the Northern California Youth Center did not have daily menu worksheets that listed the contents of meals served and the quantities of meal contents for 16 of 48 meals that we reviewed. Without these worksheets, the department lacks evidence to demonstrate that the meals served meet the federal requirements of the School Breakfast Program and the National School Lunch Program. We reported a similar weakness at Nelles School during our financial audits for fiscal years 1985-86 and 1986-87. In response to our report, the department indicated that it would ensure compliance with federal and departmental requirements.

Criteria: The Code of Federal Regulations, Title 7, Section 210.15(b)(2) and Section 220.9(a), requires the maintenance of meal production and participation records to support the claims for reimbursement. In addition, the department's Special Feeding Program Handbook requires facilities to prepare a daily menu worksheet for each meal.

Recommendation: The department should ensure that its facilities prepare daily menu worksheets indicating the contents of meals served and the quantities of meal contents.

**Item 6.** **Improper Reporting of Obligations and Encumbrances**

Finding: The department did not report the correct amount of obligations and encumbrances as of June 30, 1988, to the State Controller's Office. We found the following specific deficiencies:

- The headquarters office improperly reported as encumbrances approximately $398,000 for goods or services that it had already received and paid for before June 30. Encumbrances represent commitments for goods or services to be received in future fiscal years. Since these goods and services had already been received and paid for before June 30, the headquarters office should not have included them in its encumbrances total as of June 30. As a result, the headquarters office overstated encumbrances that it reported to the State Controller's Office by approximately $398,000;

- The headquarters office failed to include in its obligations approximately $263,000 for goods or services received and paid for from its revolving fund but not yet scheduled for reimbursement as of June 30. Then, following procedures required by the State Administrative Manual, the headquarters office reduced its obligations at June 30, 1988, by the $263,000. However, because this amount was not originally included in the obligations total, the headquarters office understated obligations that it reported to the State Controller's Office by approximately $263,000; and

- The headquarters office improperly reported, as encumbrances rather than obligations, goods or services received on or before June 30, 1988, totaling approximately $220,000. The headquarters office incorrectly reported these items as encumbrances because it had not sufficiently analyzed its accounts to determine whether the goods or services were received before or after June 30.

As a result of these errors, the department reported incorrect amounts of obligations and encumbrances to the State Controller's Office as of June 30, 1988. The department understated its obligations by approximately $483,000 and overstated its encumbrances by approximately $618,000. The department's failure to properly report its obligations and encumbrances to the State Controller's Office could prevent the State Controller's Office from accurately preparing the State's financial statements in accordance with generally accepted accounting principles.

Criteria: The State Administrative Manual, Section 10440 and Section 10544, requires agencies to accrue as encumbrances commitments for goods or services expected to be received in future years. In addition, Section 10440 also requires agencies to accrue, as obligations, goods or services received that have not been scheduled for payment at June 30. Finally, the State Administrative Manual, Section 10544, requires agencies to analyze their obligations and encumbrances at June 30 and determine whether goods or services were received before or after June 30.

Recommendation: The department should accrue as encumbrances commitments for goods or services that are expected to be received in future years. In addition, the department should accrue, as obligations, goods or services that have been received on or before June 30 but have not been scheduled for payment with the State Controller's Office. Finally, the department should analyze its obligations and encumbrances to determine whether the goods or services were received before or after June 30 and report them appropriately as obligations or encumbrances.

**Item 7.** **Failure To Review Contractor Evaluations and Evaluate Contractors**

Finding: The department does not review contractor evaluations on file with the Department of General Services before it awards consulting contracts. In addition, the department did not always evaluate contractors within 30 days of the completion of their contracts. We reviewed nine completed contracts in excess of $1,000 and found that the department had not evaluated seven of these contractors. As a result of not reviewing contractor evaluations on file with the Department of General Services, the department may have entered into consulting contracts with unreliable contractors. As a result of not always evaluating contractors within 30 days of the completion of their contracts, the department has not provided a record of contractor performance to prevent itself or other agencies from possibly contracting with unreliable contractors in the future.

Criteria: The California Public Contract Code, Section 10371(e)(1), requires the department to review contractor evaluations on file at the Department of General Services before awarding a consulting contract. In addition, the California Public Contract Code, Section 10371(h), requires the Department of General Services to restrict or terminate the authority of a state agency to enter into consultant contracts if the agency or office has consistently avoided the proper preparation and submission of evaluation forms. Finally, the State Administrative Manual, Section 1218, requires departments with contracts of $1,000 or more to complete a Contract/Contractor Evaluation form within 30 days of completion of the contract.

Recommendation: The department should review the contractor evaluations on file at the Department of General Services before awarding consulting contracts. In addition, the department should prepare contractor evaluations within 30 days of completion of its contracts and submit them to the Department of General Services.

**Item 8.** **The Internal Audit Unit Lacks an Audit Charter**

Finding: The department has no formal audit charter or similar document that outlines the unit's purpose, authority, and responsibility. Although the department's administrative manual contains information on the operation of the unit, it does not describe the unit's position within the department and its line of reporting or the unit's authority to perform internal audits. The lack of an audit charter can result in misunderstandings between the auditees and the internal auditors.

Criteria: Sections 110.01.4 and 510.01 of the "Standards for the Professional Practice of Internal Auditing" (SPPIA) require the department to have a formal written audit charter for its unit. The audit charter should include the unit's position within the department, its scope of activities, and its authority for access to records, personnel, and physical properties necessary to perform internal audits.

Recommendation: The department should define, in a formal written document, the purpose, authority, and responsibility of the unit and its placement within the organization.

**Item 9.** **The Organizational Placement of the Internal Audit Unit Impairs Its Independence**

Finding: The organizational placement of the department's unit impairs the unit's independence. Specifically, the unit is organizationally under the deputy director of the Administrative Services Branch who has authority over the activities of the accounting, personnel, and data processing units that the internal auditors are required to review. If the unit is not independent of the areas that it audits, less assurance exists that the audits are conducted in an impartial and unbiased manner. In addition, external auditors cannot rely on the work of the unit and, therefore, may duplicate the work of the internal auditors.

We reported a similar weakness in our reviews for fiscal years 1985-86 and 1986-87. In response to our management letter, the department stated that, from a day-to-day management perspective, having the unit report directly to the chief deputy director would be impractical. The response also stated that the chief deputy director reviews the audit reports and acts on audit recommendations. However, we still believe that the deputy director of the

Administrative Services Branch can influence the scope of the audit and audit reports before they are received by the department chief deputy director.

Criteria: The SPPIA, Section 110.01.1, requires that the chief of the unit be responsible to an individual in the organization with sufficient authority to promote independence and to ensure broad audit coverage, adequate consideration of reports, and appropriate action on audit recommendations.

Recommendation: The department should have the unit report to either the director or the chief deputy director.

**Item 10.** **Lack of a Quality-Assurance Program**

Finding: The department has not established a quality-assurance program to ensure proper management of the unit. In our review of the internal auditors' two internal audits, we found that audit workpapers did not sufficiently support audit findings and that the workpapers were not reviewed by the supervisor. We also found that the unit did not prepare audit plans or follow up on corrective action. As a result, evidence was insufficient to meet audit objectives and to support the audit findings. Failure to properly plan the audit can result in inefficient use of audit resources. Failure to follow up on corrective actions leaves the management with less assurance that appropriate actions were taken.

Criteria: Sections 230.01, 230.02, and Section 560 of the SPPIA require the department to establish and implement a quality-assurance program that would ensure proper staff supervision, sufficient review of auditors' workpapers, and sufficient evidence to support audit findings.

Recommendation: The department should establish and implement a quality-assurance program that would monitor the progress and quality of the internal audits.

**Item 11.** **Insufficient Scope of Audit**

Finding: We found that the scope of the internal audits was insufficient to meet all internal audit responsibilities. Specifically, we found that the internal auditors did not perform transaction tests to ensure that the system of internal controls at Preston School of Industry was working. Without sufficient transaction tests, the internal auditors may not detect departure from prescribed internal control procedures.

Criteria: The SPPIA, Section 300, requires that the scope of an internal audit include an examination and evaluation of the adequacy and effectiveness of the department's system of internal control.

Recommendation: The department should require its unit to perform sufficient transaction tests to evaluate the effectiveness of the department's internal control systems.

**Item 12. The Internal Audit Workpapers Lack Sufficient Evidence To Support Audit Conclusions**

Finding: Audit workpapers for the two internal audits that we reviewed did not contain sufficient evidence to support audit findings and recommendations. For example, the workpapers for the audit of the Preston School of Industry did not contain documentation of information sources, audit procedures used, analyses of collected data, or a conclusion related to the school's system of internal control. Additionally, workpapers for the audit of the Fenner Canyon Camp Ward Canteen did not contain sufficient evidence to support a finding on a deficit in the canteen's cash fund. Failure to properly document evidence in the workpapers prevents management from being assured that the audit results are complete and accurate.

Criteria: The SPPIA, Section 420.01.5, requires the internal auditors to document in the workpapers the information that they obtain and their analyses. This section also requires that workpapers support the findings and recommendations that the auditors report.

Recommendation: The department should provide training to improve the internal auditors' technical skills in preparing workpapers and in gathering and documenting sufficient, competent, and relevant evidence.

**DEPARTMENT OF THE YOUTH AUTHORITY**
**SOUTHERN RECEPTION CENTER-CLINIC**

We reviewed the financial operations, related internal controls, and administration of two federal programs at the Department of the Youth Authority, Southern Reception Center-Clinic (facility). These programs are the United States Department of Agriculture grants, Federal Catalog Numbers 10.553 and 10.555. The facility's accounting records are maintained by the accounting staff at Fred C. Nelles School.

**Item 1.** **Weaknesses in the Administration of the Revolving Fund**

Finding: We noted the following weaknesses in the Fred C. Nelles School's administration of the facility's revolving fund during fiscal years 1986-87 and 1987-88:

- Of the 35 revolving fund disbursements in our sample for fiscal years 1986-87 and 1987-88, we identified 8 payments to vendors for claims that neither offered discounts nor required immediate payment, and therefore should have been paid through the regular claims process;

- The Fred C. Nelles School does not promptly pay vendor invoices that offer discounts for prompt payment. The facility failed to take advantage of 6 of the 11 available discounts offered by vendors and, consequently, lost approximately $95 in vendor discounts. Although this is a relatively small amount, the potential exists to lose larger discounts;

- The Fred C. Nelles School failed to make five vendor payments promptly during fiscal years 1986-87 and 1987-88. The facility either paid the vendors more than 50 days after the facility received the invoices or scheduled the claim for payment more than 35 days after the facility received the invoices. The facility did not include the late payment penalties required for four of the five payments. The penalties totaled approximately $8. In one instance, the facility paid the vendor 100 days after the invoice was received;

- As of June 30, 1987, the Fred C. Nelles School had not submitted to the State Controller's Office claims requesting reimbursement of the facility's revolving fund for 18 travel-expense claims totaling $1,350. The claims had remained unreimbursed for more than six months. One of the 18 travel-expense claims had remained unreimbursed since December 1980; and

- As of April 1, 1988, the facility had not submitted to the State Controller's Office claims requesting reimbursement of the revolving fund for 26 of the 68 unreimbursed revolving fund vendor payments outstanding at June 30, 1987. The unreimbursed claims totaled $3,011. The facility is required to submit claims to reimburse the revolving fund within 30 days from the date goods are received or the date of the invoice. Failure to promptly reimburse the fund restricts the availability of funds for other disbursements.

Criteria: The State Administrative Manual, Section 8110, specifies the appropriate uses of revolving funds, including payments for compensation earned, travel expenses and advances, and immediate payments when required. Section 8422.1 requires facilities to determine that cash discounts have been taken before submitting claims to the State Controller's Office for payment. In addition, the California Government Code, Section 926.17, specifies that agencies are to include penalties with claim payments that are not made within prescribed time limits. When no payment date is specified by contract, the section allows agencies 50 days after the postmark of the invoice to make authorized revolving fund payments, or 35 days after the postmark of the invoice to submit payment requests to the State Controller's Office. Further, the State Administrative Manual, Sections 8170 and 8422, specifies that claims requesting reimbursement of the revolving fund should be submitted to the State Controller's Office at intervals that ensure that reimbursement is received within 30 days from either the date that goods and services are received or the date of the non-discounted invoice, whichever is received later.

Recommendation: The facility and the Fred C. Nelles School should only use the revolving fund for authorized purposes that include payments to take advantage of vendor discounts or immediate payment when required. In addition, the facility and the Fred C. Nelles School should take advantage of all vendor discounts that meet the specific requirements. Further, the facility and the Fred C. Nelles School should ensure that vendors are paid within the required time period to avoid late payment penalties. Also, the facility and the Fred C. Nelles School should submit claim schedules requesting reimbursement of the revolving fund at intervals to ensure reimbursement within the required period.

**Item 2.** **Weaknesses in Separation of Duties Over Cash and Revolving Funds**

Finding:

The facility and the Fred C. Nelles School do not properly separate duties related to cash. The business manager at the facility has access to the blank check stock and is authorized to sign checks. Also, the cashier at the facility receives accounts receivable collections and posts the receipts to the accounting records. Additionally, at the Fred C. Nelles School, an accounting officer who handles disbursements for the facility compiles invoices, signs the related revolving fund checks, and prepares and signs the claim schedules to reimburse the revolving fund.

Failure to maintain proper separation of duties may result in material errors or irregularities that may go undetected.

Criteria:

The State Administrative Manual, Section 8080, specifies that individuals responsible for authorizing disbursements and manually signing checks will not have access to or control the blank check stock. In addition, this section specifies that facilities should separate functions so that one person performs no more than one of the following duties: receiving and depositing of remittances, authorizing disbursements, signing checks manually, or posting to any subsidiary ledger affected by cash transactions.

Recommendation:

The facility and the Fred C. Nelles School should reassign duties among employees in the accounting offices to provide for proper separation of duties. When necessary, employees of units other than the accounting unit should be used to provide proper separation of duties.

**Item 3.** **Incomplete Documentation of Bank Reconciliation**

Finding: The Fred C. Nelles School did not retain a list of facility checks outstanding as of June 30, 1987. The facility needs this list to support the portion of the bank reconciliation pertaining to the facility.

Criteria: The State Administrative Manual, Section 7967, specifies that the amount of outstanding checks in the reconciliation be supported by a list showing the number, date, and amount of each outstanding check.

Recommendation: The Fred C. Nelles School should retain a list of outstanding checks to support bank reconciliations pertaining to the facility.

**Item 4.** **Unsupported Meal Count Records**

Finding: The facility did not retain the documents to support approximately 340,000 breakfast and lunch counts that it reported to the Department of the Youth Authority (department) for fiscal year 1985-86. Further, for fiscal year 1986-87, the facility reported meal counts that did not always agree with the supporting documents. Based on the supporting documents for fiscal year 1986-87, we determined that the facility overreported 118 meals and failed to report 90 meals. We compared 48 of the facility's daily meal count totals to the supporting documents. The facility reported serving 28,328 breakfast and lunch meals during the 24 days tested. Without complete supporting documents, the facility lacks evidence to demonstrate that the meal count totals are accurate. Further, the facility and the department's failure to demonstrate compliance with federal regulations may place the state in jeopardy of fiscal sanctions by the federal government.

Criteria: The Code of Federal Regulations, Title 7, Section 210.15(b) specifies that in order to participate in the program, a facility shall maintain records to demonstrate compliance with program requirements. Further, the State Administrative Manual, Section 20014, states that all state agencies receiving federal funds will retain all supporting schedules and worksheets for a minimum of three years.

Recommendation: The facility should retain the documentation that supports the meal counts reported to the department.

**Item 5.** **Lack of Documentation of Meal Contents**

Finding: The facility did not prepare worksheets that listed menus for 3,648 sack lunches served during fiscal years 1985-86 and 1986-87. According to the facility's superintendent, menu worksheets were not prepared because sack lunches were only prepared on an "as needed basis" when wards were transferred to other facilities. Nevertheless, without these worksheets, the facility lacks evidence to demonstrate that the meals served met the federal nutritional requirements for reimbursement under the National School Lunch Program. The facility and the department's failure to demonstrate compliance with federal regulations may place the State in jeopardy of fiscal sanctions by the federal government.

Criteria: The Code of Federal Regulations, Title 7, Section 210.15(b)(2) and Section 220.9(a), requires the maintenance of meal production and participation records to support the claims for reimbursement. In addition, the Department of the Youth Authority's Special Feeding Program Handbook requires facilities to prepare a daily menu worksheet for each meal and to retain these worksheets for a period of at least three years.

Recommendation: The facility's food services staff should prepare a daily menu worksheet for each meal served, including the sack lunches. Further, the department should monitor the facility's compliance with the federal requirements.

**Item 6.** **Unauthorized Purchase of Equipment**

Finding: The facility did not obtain the required approval of the Department of General Services before purchasing electronic equipment that cost $3,035. The Department of General Services' Office of Procurement authorized the facility to purchase certain groups of items without prior approval as long as the total price of the purchase did not exceed $2,500. However, the facility falsely indicated on the payment support that a portion of the original purchase had been returned to the vendor and that the total purchase price was less than $2,500. As a result, the facility was able to circumvent the controls established at the State Controller's Office to detect facilities that exceed their delegated purchase authority. The facility later prepared a second payment request for the excluded equipment.

Criteria: The State Administrative Manual, Section 3571, specifies that the splitting of purchases to avoid the monetary limitation of a facility's delegated purchase authority is not permitted.

Recommendation: The facility should obtain approval from the Department of General Services before purchasing items that cost more than the facility's delegated purchase authority.

## DEPARTMENT OF THE YOUTH AUTHORITY
## YOUTH TRAINING SCHOOL

We reviewed the financial operations, related internal controls, and administration of two federal programs at the Department of the Youth Authority, Youth Training School (facility). These programs are the United States Department of Agriculture grants, Federal Catalog Numbers 10.553 and 10.555.

**Item 1.** **Failure To Promptly Collect Reimbursement for Revolving Fund Payments to Employees**

Finding:

The facility does not promptly collect reimbursement for salary payments made to employees from its revolving fund cash account. As of June 30, 1987, the facility had recorded on its financial statements $178,600 in uncollected amounts for salary payments made to employees. The facility has filed claims with the State Board of Control to obtain reimbursement for approximately $67,000 for some salary payments made from 1978 through April 1985. The facility is seeking reimbursement from the State Board of Control because the facility did not correctly file claims with the State Controller's Office within the three-year deadline allowed by state law to obtain reimbursement. In addition, as of April 1988, the facility was still investigating or planned to collect from past or present employees approximately 28 percent of the remaining uncollected salary payments that we examined as of June 30, 1987.

According to the facility's business manager, the facility did not correctly file claims with the State Controller's Office in time to obtain reimbursement because of excessive backlogs, untrained staff, and a lack of organization within the facility's personnel office.

Revolving fund monies are not available for other uses when the facility does not promptly collect reimbursements for revolving fund payments. In addition, the facility may lose money if employees leave state service without repaying the facility, and the long-uncollected payments make it difficult for the facility's management to properly account for the facility's revolving fund cash account.

Criteria: The State Administrative Manual, Section 8118, requires the facility to collect salary payments made to employees from the facility's revolving fund cash account from the subsequently issued payroll warrant for the time period covered by the salary payment. Furthermore, the State Administrative Manual, Section 8776.55, requires the facility to attempt to collect its receivables that are the result of payroll transactions.

Recommendation: The facility should collect outstanding salary payments made from its revolving fund cash account in accordance with the requirements of the State Administrative Manual.

**Item 2. Weaknesses in Bank Reconciliation Procedures**

Finding: The facility has weaknesses in controls over its bank reconciliation procedures. We noted the following weaknesses:

- The facility has had unreconciled differences between its cash balances shown on its bank reconciliation and its general ledger cash account for its cash trust accounts since 1985. As of June 30, 1987, the facility's actual cash balance for its cash trust accounts as shown on the bank reconciliation exceeded the general ledger cash balance by $1,374. As of April 30, 1988, this difference increased to $5,585. The facility's accounting officer could not explain the differences. Failure to reconcile these differences indicates that the facility improperly records cash transactions; and

- The facility discarded its list of checks outstanding as of June 30, 1987. Without a list of checks outstanding, the facility is unable to support the reported balance of approximately $230,000 of outstanding checks shown on its bank reconciliation dated June 30, 1987.

Criteria: The State Administrative Manual, Section 8060, requires the facility to promptly reconcile its bank accounts to its records at the end of each month. The State Administrative Manual, Section 7967, requires the facility to prepare a list showing the number, date, and amount of each outstanding check to support the amount of outstanding checks that it presents in its bank reconciliations. The California Government Code, Section 14755(a) and (b), requires that no agency destroy or otherwise dispose of any record of the State, unless it is determined by the director that the record has no further administrative, legal, or fiscal value and an audit has been performed.

Recommendation: The facility should reconcile its bank account to its records at the end of each month. In addition, the facility should retain lists of outstanding checks to support the amount that it presents in its bank reconciliations.

**Item 3.** **Failure To Promptly Obtain Reimbursement for the Revolving Fund**

Finding: The facility failed to promptly obtain revolving fund reimbursements. At June 30, 1987, the facility's list of revolving fund expenditures incurred, but not scheduled for reimbursement within the required 30 days, amounted to approximately $16,500. Sixteen of these items totaling approximately $10,700 were incurred between 1982 and June 30, 1985, but have not been scheduled for reimbursement. Failure to promptly request revolving fund reimbursements results in the facility not having funds available for other purposes.

Criteria: The State Administrative Manual, Sections 8170 and 8422, specifies that claims requesting reimbursement of the revolving fund should be submitted to the State Controller's Office at intervals that ensure that reimbursement is received within 30 days from either the date that goods and services are received or the date of the invoice, whichever is later.

Recommendation: The facility should submit claims for reimbursement of the revolving fund within the 30-day time limit specified in the State Administrative Manual.

**Item 4.** **Weaknesses in Control Over Disbursements**

Finding: The facility has weaknesses in its controls over cash disbursements. We noted the following weaknesses:

- Two checks in excess of $15,000 each were written to vendors without obtaining the required two signatures. Failure to obtain the required signatures reduces control over cash transactions and could result in the misuse of state funds;

- The facility improperly used the revolving fund to pay some vendor invoices. To avoid late payment penalties, the facility sometimes paid invoices by revolving fund checks rather than through the normal claim processing procedure. Using the revolving fund in this manner could be avoided by processing invoices more promptly. Improper use of the revolving fund circumvents state controls over disbursements and could result in a misuse of state funds; and

- We were unable to document the authorization of six of nine expenditures made as a result of contracts because the facility did not retain copies of all contracts.

Criteria: The State Administrative Manual, Section 8041, requires two authorized signatures on any check payable to a vendor for more than $15,000. The State Administrative Manual, Section 8110, allows use of the revolving fund when immediate payment is necessary. In determining whether or not immediate payment is necessary, the determining factor is whether payment could be made through the normal claim processing procedure and a State Controller's warrant issued for payment. The California Government Code, Section 14755(a) and (b), requires that no agency destroy or otherwise dispose of any record of the State, unless it is determined by the director that the record has no further administrative, legal, or fiscal value and an audit has been performed.

Recommendation: The facility should ensure that all checks to vendors for more than $15,000 contain two signatures and that its revolving fund be used only for authorized purposes. In addition, the facility should retain copies of contracts until the director determines that the records have no further administrative, legal, fiscal, or audit value.

**Item 5.** **Inaccurate Year-End Financial Reports**

Finding: The facility prepared inaccurate year-end financial reports for its portion of the State's General Fund. We found the following deficiencies:

- The facility did not record encumbrances in its report of accruals for the year ended June 30, 1987. As a result, the facility overstated its accounts payable balance and understated its encumbrances on its report of accruals for June 30, 1987. Our testing identified $342,187 of accounts payable that should have been recorded as encumbrances; and

- The facility did not record amounts due from the Department of the Youth Authority headquarters and other facilities for disbursements made on behalf of these entities. As a result, the facility understated its assets by approximately $45,948.

As a result of these omissions, the facility misstated amounts on the year-end financial reports that it submitted to the State Controller's Office as of June 30, 1987.

Criteria: The State Administrative Manual, Section 7952, requires agencies to report the amount of encumbrances applicable to their accruals. The California Government Code, Section 13403, requires a satisfactory system of internal control including a system of authorization and recordkeeping procedures adequate to provide effective accounting control over assets.

Recommendation: The facility should prepare complete and accurate year-end financial reports.

REPORT ON COMPLIANCE

WITH FEDERAL GRANT REQUIREMENTS

Telephone:
(916) 445-0255

STATE OF CALIFORNIA

# Office of the Auditor General

660 J STREET, SUITE 300
SACRAMENTO, CA 95814

Kurt R. Sjoberg
Acting 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, 1988, and have issued our report thereon dated December 16, 1988, except for the information in Note 26 for which the date is January 11, 1989. 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 United States General Accounting Office; the Single Audit Act of 1984; and the provisions of the United States 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 (university). 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, certain cities and counties, and certain nonprofit agencies, have OMB Circular A-128 audits or OMB Circular A-110 audits performed by independent auditors or state agencies. The scope of our examination includes evaluating the State's reviews of those audit reports prepared by independent auditors and reviewing the audit reports prepared by state agencies.

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 93 through 361 of our report. Management's comments regarding the recommendations appear on page 421 of this report. Additionally, beginning on page 401, we present a schedule listing instances of noncompliance that we consider to be minor. 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 1986-87 that have not been corrected are included in the section beginning on page 93.

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, 1988, 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, except as noted on pages 93 through 361, and on page 401. 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 369. 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 only revenue 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 the estimated value of food stamps and commodities received by the State for the year ended June 30, 1988; it also indicates the grants that 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 the Single Audit Act of 1984 audit, we performed other reviews related to federal programs. A schedule of the pertinent reports issued from July 1, 1987, through December 31, 1988, begins on page 391 of this report.

OFFICE OF THE AUDITOR GENERAL

Curt Davis

CURT DAVIS, CPA
Deputy Auditor General

February 10, 1989

## SCHEDULE OF FEDERAL ASSISTANCE
## FISCAL YEAR ENDED JUNE 30, 1988

| Federal Agency/Program Title | Federal Catalog Number | Grant Amounts Received |
|---|---|---|
| Department of Agriculture: | | |
| Agricultural Conservation Program | 10.063 | $ 46,000 |
| Forestry Incentives Program | 10.064 | 24,000 |
| Farm Labor Housing Loans and Grants | 10.405 | 13,821 |
| Food Distribution | 10.550 | 116,235,640 A * |
| Food Stamps | 10.551 | 654,193,932 A ** |
| School Breakfast Program | 10.553 | 60,788,609 A |
| National School Lunch Program | 10.555 | 318,183,431 A |
| Special Milk Program for Children | 10.556 | 966,010 |
| Special Supplemental Food Program for Women, Infants, and Children | 10.557 | 161,467,706 A |
| Child Care Food Program | 10.558 | 62,113,331 A |
| State Administrative Expenses for Child Nutrition | 10.560 | 5,473,039 |
| State Administrative Matching Grants for Food Stamp Program | 10.561 | 123,703,698 A |
| Nutrition Education and Training Program | 10.564 | 499,641 |
| Temporary Emergency Food Assistance (Administrative Costs) | 10.568 | 59,965,424 A * |

Footnotes are presented on page 386.

| Federal Agency/Program Title | Federal Catalog Number | Grant Amounts Received |
|---|---|---|
| Cooperative Forestry Assistance | 10.664 | 1,004,604 |
| Schools and Roads--Grants to States | 10.665 | 52,560,193 A |
| Schools and Roads--Grants to Counties | 10.666 | 228,355 |
| Other--U.S. Department of Agriculture | 10.999 | 1,183,549 |
| Department of Commerce: | | |
| Economic Development--Support for Planning Organizations | 11.302 | 166,793 |
| Special Economic Development and Adjustment Assistance Program--Sudden and Severe Economic Dislocation and Long-Term Economic Deterioration | 11.307 | 396,455 |
| Anadromous and Great Lakes Fisheries Conservation | 11.405 | 624,538 |
| Interjurisdictional Fisheries Act of 1986 | 11.407 | 276,774 |
| Coastal Zone Management Program Administration Grants | 11.419 | 1,486,565 |
| Coastal Zone Management Estuarine Research Reserves | 11.420 | 285,430 |
| Fisheries Development and Utilization Research and Development Grants and Cooperative Agreements Program | 11.427 | 31,259 |
| Other--U.S. Department of Commerce | 11.999 | 388,652 |

Footnotes are presented on page 386.

| Federal Agency/Program Title | Federal Catalog Number | Grant Amounts Received |
|---|---|---|
| Department of Defense: | | |
| Flood Control Projects | 12.106 | 30,109 |
| Navigation Projects | 12.107 | 27,541 |
| Other--U.S. Department of Defense | 12.999 | 1,405,722 |
| Department of Health and Human Services: | | |
| Food and Drug Administration--Research | 13.103 | 282,180 |
| Maternal and Child Health Federal Consolidated Programs | 13.110 | 289,470 |
| Project Grants and Cooperative Agreements for Tuberculosis Control Programs | 13.116 | 295,100 |
| Acquired Immunodeficiency Syndrome (AIDS) Activity | 13.118 | 1,571,030 |
| Emergency Medical Services for Children | 13.127 | 314,702 |
| Refugee Assistance - Mental Health | 13.128 | 72,838 |
| Alcohol, Drug Abuse Treatment and Rehabilitation Block Grant | 13.141 | 9,952,568 |
| Drug and Alcohol Abuse--High-Risk Youth Demonstration Grants | 13.144 | 173,916 |
| AIDS Drug Reimbursements | 13.146 | 5,372,985 |
| Drug Abuse Community Service | 13.235 | (105,078) |
| Mental Health Clinical or Service Related Training Grants | 13.244 | 56,992 |

Footnotes are presented on page 386.

| Federal Agency/Program Title | Federal Catalog Number | Grant Amounts Received |
|---|---|---|
| Alcohol Formula Grants | 13.257 | (30,984) |
| Childhood Immunization Grants | 13.268 | 1,113,500 |
| Drug Abuse Prevention Formula Grants | 13.269 | (41,255) |
| Drug Abuse Prevention/Programs | 13.275 | (40,513) |
| Drug Abuse Clinical/Service Training Programs | 13.280 | (16,953) |
| Centers for Disease Control--Investigations and Technical Assistance | 13.283 | 205,917 |
| Professional Nurse Traineeships | 13.358 | 116,836 |
| Nursing Student Loans | 13.364 | 71,103 |
| Cancer Control | 13.399 | 151,773 |
| Administration on Developmental Disabilities--Basic Support and Advocacy Grants | 13.630 | 4,402,327 |
| Special Programs for the Aging--Title III, Part B--Grants for Supportive Services and Senior Centers | 13.633 | 63,530,757 A |
| Child Welfare Services--State Grants | 13.645 | 16,785,878 |
| Administration for Children, Youth and Families--Adoption Opportunities | 13.652 | 547 |
| Foster Care--Title IV-E | 13.658 | 178,889,277 A |
| Adoption Assistance | 13.659 | 11,002,753 |
| Social Services Block Grant | 13.667 | 300,331,482 A O |
| Special Programs for the Aging--Title IV--Training, Research, and Discretionary Projects and Programs | 13.668 | 42,099 |

Footnotes are presented on page 386.

| Federal Agency/Program Title | Federal Catalog Number | Grant Amounts Received |
|---|---|---|
| Administration for Children, Youth and Families--Child Abuse and Neglect State Grants | 13.669 | 264,080 |
| Administration for Children, Youth and Families--Child Abuse and Neglect Discretionary Activities | 13.670 | 8,048 |
| Family Violence Prevention and Services | 13.671 | 882,335 |
| Child Abuse Challenge Grants | 13.672 | 860,867 |
| Grants to States for Planning and Development of Dependent Care Programs | 13.673 | 615,145 |
| Independent Living | 13.674 | 835,066 |
| Medical Assistance Program | 13.714 | 2,844,048,128 A O |
| Medicare--Hospital Insurance | 13.773 | 2,517,344 |
| Medicare--Supplementary Medical Insurance | 13.774 | 7,276,955 |
| State Medicaid Fraud Control Units | 13.775 | 4,846,000 |
| State Survey and Certification of Health Care Providers and Suppliers | 13.777 | 7,676,203 |
| Family Support Payments to States-Assistance Payments | 13.780 | 2,150,421,766 A O |
| Assistance Payments--Research | 13.782 | 679,083 |
| Child Support Enforcement | 13.783 | 110,749,653 A |
| Refugee and Entrant Assistance--State Administered Programs | 13.787 | 142,835,827 A |
| Low-Income Home Energy Assistance | 13.789 | 74,393,601 A O |
| Work Incentive Program | 13.790 | 10,681,444 |

Footnotes are presented on page 386.

| Federal Agency/Program Title | Federal Catalog Number | Grant Amounts Received |
|---|---|---|
| Community Services Block Grant | 13.792 | 20,388,962 A |
| Social Security--Disability Insurance | 13.802 | 92,617,638 A O |
| Arthritis, Musculoskeletal, and Skin Diseases Research | 13.846 | 36,642 |
| Microbiology and Infectious Diseases Research | 13.856 | 64,974 |
| Preventive Health Services--Sexually Transmitted Diseases Control Grants | 13.977 | 1,302,000 |
| Preventive Health Services--Sexually Transmitted Diseases Research, Demonstrations, and Public Information and Education Grants | 13.978 | 303,500 |
| Mental Health Disaster Assistance and Emergency Mental Health | 13.982 | 63,924 |
| Health Programs for Refugees | 13.987 | 1,165,500 |
| Cooperative Agreements for State-Based Diabetes Control Programs | 13.988 | 214,500 |
| Preventive Health and Health Services Block Grant | 13.991 | 4,934,787 |
| Alcohol and Drug Abuse and Mental Health Services Block Grant | 13.992 | 53,445,145 A |
| Maternal and Child Health Services Block Grant | 13.994 | 25,182,620 A |
| Other--Department of Health and Human Services | 13.999 | 4,456,258 |
| Department of Housing and Urban Development: | | |
| Lower Income Housing Assistance Program | 14.156 | 14,257,964 |

Footnotes are presented on page 386.

| Federal Agency/Program Title | Federal Catalog Number | Grant Amounts Received |
|---|---|---|
| Community Development Block Grants/Secretary's Discretionary Fund/Technical Assistance Program | 14.227 | 22,877 |
| Community Development Block Grants/State's Program | 14.228 | 20,330,196 A |
| Emergency Shelter Grants Program | 14.231 | 166,306 |
| Equal Opportunity in Housing | 14.400 | 60,975 |
| Solar Energy and Energy Conservation Bank | 14.550 | 45,265 |
| Other--Department of Housing and Urban Development | 14.998 | (42,791) |
| Department of the Interior: | | |
| Small Reclamation Projects | 15.503 | 1,042,605 |
| Anadromous Fish Conservation | 15.600 | 293,045 |
| Sport Fish Restoration | 15.605 | 6,028,495 |
| Wildlife Restoration | 15.611 | 4,171,702 |
| Endangered Species Conservation | 15.612 | 373,530 |
| Geological Survey--Research and Data Acquisition | 15.808 | 92,687 |
| Historic Preservation Fund Grants-In-Aid | 15.904 | 547,997 |
| Outdoor Recreation--Acquisition, Development and Planning | 15.916 | 2,894,707 |
| Shared Revenue--Potash/Sodium Lease | 15.999 | 28,796,094 A |
| Outer Continental Shelf Lands Act Amendments of 1985 | 15.999 | 10,915,447 |

Footnotes are presented on page 386.

| Federal Agency/Program Title | Federal Catalog Number | Grant Amounts Received | |
|---|---|---|---|
| Other--U.S. Department of the Interior (Comprehensive Planning Assistance) | 15.999 | 421,977 | |
| Other--U.S. Department of the Interior | 15.999 | 2,525,191 | |
| Department of Justice: | | | |
| Juvenile Justice and Delinquency Prevention--Allocation to States | 16.540 | 4,390,524 | |
| Criminal Justice Statistics Development | 16.550 | 119,953 | |
| Justice Research and Development Project Grants | 16.560 | 4,202,414 | |
| Criminal Justice Discretionary Grants | 16.574 | 2,696,604 | |
| Crime Victim Assistance | 16.575 | 3,881,804 | 0 |
| Crime Victim Compensation | 16.576 | 6,353,000 | 0 |
| State and Local Narcotics Control Assistance | 16.579 | 3,337,863 | 0 |
| Corrections--Technical Assistance/Clearinghouse | 16.603 | 80,241 | |
| Other--U.S. Department of Justice | 16.999 | 517,639 | |
| Department of Labor: | | | |
| Labor Force Statistics | 17.002 | 3,925,009 | |
| Employment Service | 17.207 | 73,356,268 A | |
| Unemployment Insurance | 17.225 | 239,955,829 A | |
| Senior Community Service Employment Program | 17.235 | 5,197,974 | |

Footnotes are presented on page 386.

| Federal Agency/Program Title | Federal Catalog Number | Grant Amounts Received | |
|---|---|---|---|
| Employment and Training Assistance--Dislocated Workers | 17.246 | 13,714,237 | |
| Job Training Partnership Act | 17.250 | 253,303,098 A | |
| Occupational Safety and Health | 17.500 | 3,030,488 | |
| Mine Health and Safety Grants | 17.600 | 263,314 | |
| Disabled Veterans Outreach Program | 17.801 | 9,042,685 | |
| Local Veterans Employment Representative Program | 17.804 | 4,815,429 | |
| Other--U.S. Department of Labor | 17.999 | 624,530 | |
| Department of Transportation: | | | |
| Airport Improvement Program | 20.106 | 166,804 | |
| Highway Planning and Construction | 20.205 | 933,466,004 A | |
| Motor Carrier Safety | 20.217 | 1,839,532 | |
| Grants-in-Aid for Railroad Safety--State Participation | 20.303 | 60,129 | |
| Local Rail Service Assistance | 20.308 | 68,271 | |
| Urban Mass Transportation Capital Improvement Grants | 20.500 | 4,583,817 | O |
| Urban Mass Transportation Technical Studies Grants | 20.505 | 354,261 | O |
| Urban Mass Transportation Capital and Operating Assistance Formula Grants | 20.507 | 325,344 | O |
| Public Transportation for Nonurbanized Areas | 20.509 | 2,636,874 | |
| State and Community Highway Safety | 20.600 | 11,294,208 | |
| Pipeline Safety | 20.700 | 116,780 | |

Footnotes are presented on page 386.

| Federal Agency/Program Title | Federal Catalog Number | Grant Amounts Received | |
|---|---|---|---|
| State Marine Schools | 20.806 | 329,401 | 0 |
| Other--U.S. Department of Transportation | 20.994 | 689,059 | |
| Department of the Treasury: | | | |
| Other--U.S. Department of Treasury | 21.999 | 52,556 | |
| Equal Employment Opportunity Commission: | | | |
| Employment Discrimination--State and Local Anti-Discrimination Agency Contracts | 30.002 | 1,923,856 | |
| General Services Administration: | | | |
| Donation of Federal Surplus Personal Property | 39.003 | 7,496,457 | * |
| National Aeronautics and Space Administration: | | | |
| Aerospace Education Services Project | 43.001 | 48,190 | |
| National Foundation on the Arts and the Humanities: | | | |
| Promotion of the Arts--Dance | 45.002 | 45,000 | |
| Promotion of the Arts--Arts in Education | 45.003 | 192,400 | |
| Promotion of the Arts--State Programs | 45.007 | 646,000 | |
| Promotion of the Arts--Visual Arts | 45.009 | 6,000 | |
| Promotion of the Arts--Folk Arts | 45.015 | 51,104 | |

Footnotes are presented on page 386.

| Federal Agency/Program Title | Federal Catalog Number | Grant Amounts Received |
|---|---|---|
| Promotion of the Humanities-Elementary and Secondary Education in the Humanities | 45.127 | 64,992 |
| Promotion of the Humanities-Fellowships for College Teachers and Independent Scholars | 45.143 | 6,878 |
| National Science Foundation: | | |
| Undergraduate Science, Engineering, and Mathematics Education | 47.071 | 65,548 |
| Small Business Administration: | | |
| Business Development Assistance to Small Business | 59.005 | 11,600 |
| Veterans Administration: | | |
| Grants to States for Construction of State Home Facilities | 64.005 | 5,551,663 |
| Veterans State Domiciliary Care | 64.014 | 1,744,023 |
| Veterans State Nursing Home Care | 64.015 | 3,490,783 |
| Veterans State Hospital Care | 64.016 | 137,631 |
| Veterans Educational Assistance | 64.111 | 190,359 |
| Other--U.S. Veterans Administration | 64.999 | 1,023,617 |
| Environmental Protection Agency: | | |
| Air Pollution Control Program Support | 66.001 | 1,385,431 |
| Air Pollution Control--National Ambient Air and Source Emission Data | 66.007 | 97,214 |

Footnotes are presented on page 386.

| Federal Agency/Program Title | Federal Catalog Number | Grant Amounts Received | |
|---|---|---|---|
| Construction Grants for Wastewater Treatment Works | 66.418 | 927,966 | 0 |
| Water Pollution Control--State and Interstate Program Support | 66.419 | 2,378,833 | 0 |
| State Underground Water Source Protection | 66.433 | 481,359 | |
| Water Pollution Control--Lake Restoration Cooperative Agreements | 66.435 | 374,558 | |
| Construction Management Assistance | 66.438 | 6,923,094 | |
| Water Quality Management Planning | 66.454 | 1,806,887 | |
| Solid Waste Disposal Research | 66.504 | 1,273,429 | |
| Safe Drinking Water Research and Demonstration | 66.506 | 1,544,539 | |
| Toxic Substances Research | 66.507 | 293,844 | |
| Toxic Substances Compliance Monitoring Cooperative Agreements | 66.701 | 172,049 | |
| Hazardous Waste Management State Program Support | 66.801 | 5,256,629 | 0 |
| Hazardous Substance Response Trust Fund | 66.802 | 1,998,834 | 0 |
| State Underground Storage Tanks Program | 66.804 | 250,236 | |
| Underground Storage Tank Trust Fund Program | 66.805 | 77 | |
| Other--U.S. Environmental Protection Agency | 66.999 | 476,893 | |

Footnotes are presented on page 386.

| Federal Agency/Program Title | Federal Catalog Number | Grant Amounts Received |
|---|---|---|
| Action: | | |
| Foster Grandparent Program | 72.001 | 1,210,215 |
| Service-Learning Programs | 72.005 | 8,719 |
| Department of Energy: | | |
| State Energy Conservation | 81.041 | 456,988 |
| Weatherization Assistance for Low-Income Persons | 81.042 | 3,313,924 |
| Energy Extension Service | 81.050 | 330,554 |
| Energy Conservation for Institutional Buildings | 81.052 | 144,124 |
| Renewable Energy Research and Development | 81.087 | 5,098 |
| Remedial Action and Waste Technology | 81.092 | 498 |
| Federal Emergency Management Agency: | | |
| Flood Insurance | 83.100 | 317,212 |
| Emergency Management Institute--Field Training Program | 83.403 | 356,662 |
| Civil Defense--State and Local Emergency Management Assistance | 83.503 | 3,650,936 |
| State Disaster Preparedness Grants | 83.505 | 30,993 |
| Facility Survey, Engineering and Development | 83.509 | 177,553 |
| State and Local Emergency Operating Centers | 83.512 | 53,833 |
| Population Protection Planning | 83.514 | 532,920 |

Footnotes are presented on page 386.

| Federal Agency/Program Title | Federal Catalog Number | Grant Amounts Received | |
|---|---|---|---|
| Emergency Broadcast System Guidance and Assistance | 83.515 | 42,903 | |
| Disaster Assistance | 83.516 | 18,129,219 | O |
| Earthquake Hazards Reduction Grants | 83.521 | 797,690 | |
| Radiological Defense | 83.522 | 493,045 | |
| Other--U.S. Federal Emergency Management Agency | 83.999 | (24,023) | |
| Department of Education: | | | |
| Adult Education--State-Administered Program | 84.002 | 8,470,343 | |
| Bilingual Education | 84.003 | 941,232 | |
| Civil Rights Technical Assistance and Training | 84.004 | 503,419 | |
| Supplemental Educational Opportunity Grants | 84.007 | 7,294,829 | |
| Education of Handicapped Children in State Operated or Supported Schools | 84.009 | 1,279,255 | |
| Educationally Deprived Children--Local Educational Agencies | 84.010 | 330,670,666 | A |
| Migrant Education--Basic State Formula Grant Program | 84.011 | 82,497,685 | A |
| Educationally Deprived Children--State Administration | 84.012 | 2,802,042 | |
| Neglected and Delinquent Children | 84.013 | 3,631,326 | |
| Fulbright-Hays Training Grants--Faculty Research Abroad | 84.019 | 11,110 | |
| Handicapped Early Childhood Education | 84.024 | 96,205 | |

Footnotes are presented on page 386.

| Federal Agency/Program Title | Federal Catalog Number | Grant Amounts Received |
|---|---|---|
| Handicapped Education--Deaf-Blind Centers | 84.025 | 234,328 |
| Handicapped--State Grants | 84.027 | 118,186,123 A |
| Handicapped Education--Special Education Personnel Development | 84.029 | 271,931 |
| Higher Education Act Insured Loans | 84.032 | 53,617,610 A O |
| College Work-Study Program | 84.033 | 9,021,070 |
| Library Services | 84.034 | 7,694,267 |
| Interlibrary Cooperation and Resource Sharing | 84.035 | 1,357,661 |
| National Defense/National Direct/Perkins Loan Cancellations | 84.037 | 863,584 |
| Perkins Loans | 84.038 | 1,050,677 |
| Vocational Education--Basic Grants to States | 84.048 | 62,010,441 A |
| Vocational Education--Consumer and Homemaking Education | 84.049 | 2,716,348 |
| Vocational Education--Program Improvement and Supportive Service | 84.050 | 592,520 |
| Vocational Education--Special Programs for the Disadvantaged | 84.052 | 109,370 |
| Vocational Education--State Councils | 84.053 | 229,164 |
| Higher Education--Cooperative Education | 84.055 | 28,300 |
| Pell Grant Program | 84.063 | 58,590,874 B |
| Higher Education--Veterans Education Outreach Program | 84.064 | 16,516 |

Footnotes are presented on page 386.

| Federal Agency/Program Title | Federal Catalog Number | Grant Amounts Received |
|---|---|---|
| Grants to States for State Student Incentives | 84.069 | 11,689,030 |
| Postsecondary Education Programs for Handicapped Persons | 84.078 | 1 |
| Indian Education--Fellowships for Indian Students | 84.087 | 8,068 |
| Patricia Roberts Harris Fellowships | 84.094 | 30,680 |
| Rehabilitation Services--Basic Support | 84.126 | 94,938,092 A |
| Rehabilitation Services--Service Projects | 84.128 | 1,128,457 |
| Rehabilitation Training | 84.129 | 54,929 |
| Centers for Independent Living | 84.132 | 541,663 |
| Migrant Education--Interstate and Intrastate Coordination Program | 84.144 | 63,450 |
| Transition Program for Refugee Children | 84.146 | 4,886,208 |
| Improving School Programs--State Block Grants | 84.151 | 48,303,930 A |
| Public Library Construction | 84.154 | 1,907,412 |
| Handicapped--Special Studies | 84.159 | (2) |
| Emergency Immigrant Education | 84.162 | 13,281,995 |
| State Grants for Strengthening the Skills of Teachers and Instruction in Mathematics, Science, Foreign Languages, and Computer Learning | 84.164 | 7,479,348 |
| Handicapped--Preschool Grants | 84.173 | 9,712,073 |
| Vocational Education--Community Based Organizations | 84.174 | 382,561 |

Footnotes are presented on page 386.

| Federal Agency/Program Title | Federal Catalog Number | Grant Amounts Received |
|---|---|---|
| Paul Douglas Teacher Scholarships | 84.176 | 1,097,177 |
| Handicapped Infants and Toddlers | 84.181 | 200,000 |
| Drug-Free Schools and Communities--State Grants | 84.186 | 9,971,759 |
| Other--U.S. Department of Education | 84.999 | 33,722 |
| Miscellaneous Grants and Contracts: | | |
| Shared Revenue--Flood Control Land | 98.002 | 241,640 |
| U.S. Department of Defense--Operating Reserve, Guard and Training Facilities | 98.008 | 15,563,209 |
| U.S. Department of Labor--Reed Act--Capital Outlay--Equipment | 98.012 | 1,930,637 |
| U.S. Department of Housing and Urban Development--College Housing Debt Service Government Program | 98.013 | 1,666,227 |
| U.S. Department of the Interior--Fire Suppression/Suppression Agreement | 98.014 | 1,280,586 |
| U.S. Department of Agriculture--Fire Prevention/Suppression | 98.015 | 224,882 |

Footnotes are presented on page 386.

| Federal Agency/Program Title | Federal Catalog Number | Grant Amounts Received |
|---|---|---|
| U.S. Department of Health and Human Services--Federal Reimbursements--Work for Others | 98.016 | 12,287,783 |
| Miscellaneous Federal Receipts | 98.999 | $ (653,795) |
| Total Grants Received | | $ 10,535,473,929 |
| Total Grants Audited for OMB Circular A-128 | | $ 10,005,478,856 |

A - The Office of the Auditor General reviewed these grants for fiscal year 1987-88 in compliance with OMB Circular A-128.

O - The Office of the Auditor General reviewed these grants in conjunction with various reports issued from July 1, 1987, through December 31, 1988. See Appendix B for a description of these reports.

B - Other independent auditors audited this grant. The grant amount is not included in the total grants audited amount on this page.

* This amount includes commodities.

** This amount represents the value of the stamps themselves.

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: Insufficient Support for Expenditures | Item Number: Insufficient Monitoring/ Auditing | Item Number: Early Request/Late Disbursement of Federal Funds | Item Number: Other |
|---|---|---|---|---|---|---|---|---|
| Department of Agriculture | | | | | | | | |
| 10.550 | Food Distribution | State Department of Education | 156 | 13,19 | | 20 | | |
| 10.553 | School Breakfast Program | State Department of Education | 156 | 13 | | 21 | | |
| 10.553 | School Breakfast Program | Department of the Youth Authority | 341 | | 4 | | | 5 |
| | | Southern Reception Center-Clinic | 351 | | 4 | | | |
| 10.555 | National School Lunch Program | State Department of Education | 156 | 13 | | 21 | | |
| 10.555 | National School Lunch Program | Department of the Youth Authority | 341 | | 4 | | | 5 |
| | | Southern Reception Center-Clinic | 351 | | 4 | | | 5 |
| 10.557 | Special Supplemental Food Program for Women, Infants, and Children | Department of Health Services | 218 | | 15 | 14 | | 13 |
| 10.558 | Child Care Food Program | State Department of Education | 156 | 13 | | | | |
| 10.561 | State Administrative Matching Grants for Food Stamp Program | Department of Social Services | 242 | 11,15 | 6 | | | |
| 10.561 | State Administrative Matching Grants for Food Stamp Program | State Controller's Office | 273 | | | 2 | | |
| 10.568 | Temporary Emergency Food Assistance (Administrative Costs) | Department of Social Services | 242 | 11 | | | | |
| Department of Health and Human Services | | | | | | | | |
| 13.633 | Special Programs for the Aging--Title III, Part B--Grants for Supportive Services and Senior Centers | Department of Aging | 201 | | | 1 | | |

| Federal Catalog Number | Grantor Agency/Program Title | Administering State Agency | Page Number | Item Number: Inadequate/ Late Reports | Item Number: Insufficient Support for Expenditures | Item Number: Insufficient Monitoring/ Auditing | Item Number: Early Request/Late Disbursement of Federal Funds | Item Number: Other |
|---|---|---|---|---|---|---|---|---|
| 13.658 | Foster Care--Title IV-E | Department of Social Services | 242 | 11,13 | 6 | | | |
| 13.658 | Foster Care--Title IV-E | State Controller's Office | 273 | | | 2 | | |
| 13.667 | Social Services Block Grant | State Controller's Office | 273 | | | 2 | | |
| 13.714 | Medical Assistance Program | Department of Health Services | 218 | 11,12 | | 3 | | 6 |
| 13.780 | Family Support Payments to States--Assistance Payments | Department of Social Services | 242 | 11,13 | 6 | 8 | | |
| 13.780 | Family Support Payments to States--Assistance Payments | State Controller's Office | 273 | | | 2 | | |
| 13.783 | Child Support Enforcement | Department of Social Services | 242 | 11 | 6 | | | |
| 13.783 | Child Support Enforcement | State Controller's Office | 273 | | | 2 | | |
| 13.787 | Refugee and Entrant Assistance--State Administered Program | Department of Social Services | 242 | 11,17 | | 10,16,17 | 3 | |
| 13.787 | Refugee and Entrant Assistance--State Administered Program | State Controller's Office | 273 | | | 2 | | |
| 13.789 | Low-Income Home Energy Assistance | Department of Economic Opportunity | 183 | | | | 2 | 1 |
| 13.792 | Community Services Block Grant | Department of Economic Opportunity | 183 | | | | 2 | |
| 13.802 | Social Security--Disability Insurance | Department of Social Services | 242 | | | | 3 | |
| 13.802 | Social Security--Disability Insurance | State Controller's Office | 273 | | | 2 | | |
| 13.992 | Alcohol and Drug Abuse and Mental Health Services Block Grant | Department of Alcohol and Drug Programs | 203 | | | 1,2,3,4 | 5 | |
| 13.992 | Alcohol and Drug Abuse and Mental Health Services Block Grant | Department of Mental Health | 234 | | | | 5 | |

| Federal Catalog Number | Grantor Agency/Program Title | Administering State Agency | Page Number | Item Number: Inadequate/Late Reports | Insufficient Support for Expenditures | Insufficient Monitoring/Auditing | Early Request/Late Disbursement of Federal Funds | Other |
|---|---|---|---|---|---|---|---|---|
| Department of Housing and Urban Development | | | | | | | | |
| 14.228 | Community Development Block Grants/State Program | Department of Housing and Community Development | 107 | 1 | 2 | | | |
| Department of Labor | | | | | | | | |
| 17.225 | Unemployment Insurance | Employment Development Department | 211 | 4,5 | | | | |
| 17.250 | Job Training Partnership Act | Employment Development Department | 211 | | | 3 | | |
| 17.250 | Job Training Partnership Act | State Department of Education | 156 | 13,22 | 23 | | | |
| Department of Transportation | | | | | | | | |
| 20.205 | Highway Planning and Construction | Department of Transportation | 119 | 2 | | 1 | | |
| Department of Education | | | | | | | | |
| 84.002 | Adult Education--State-Administered Program* | State Department of Education | 156 | | 11 | | | |
| 84.010 | Educationally Deprived Children--Local Educational Agencies | State Department of Education | 156 | 13 | 11 | | | |
| 84.011 | Migrant Education--Basic State Formula Grant Program | State Department of Education | 156 | 13 | | 15,16,17 | | |
| 84.027 | Handicapped--State Grants | State Department of Education | 156 | 13 | | | | 14 |
| 84.032 | Higher Education Act Insured Loans | California Student Aid Commission | 146 | 4,8 | 7 | | | 5,6 |
| 84.048 | Vocational Education--Basic Grants to States | State Department of Education | 156 | 13,18 | 11 | | | |

* We noted these weaknesses in compliance with federal regulations during audit testing at the state agency. We did not review for compliance with all federal regulations because the grant was under $20 million.

| Federal Catalog Number | Grantor Agency/Program Title | Administering State Agency | Page Number | Item Number: Inadequate/ Late Reports | Insufficient Support for Expenditures | Insufficient Monitoring/ Auditing | Early Request/Late Disbursement of Federal Funds | Other |
|---|---|---|---|---|---|---|---|---|
| 84.048 | Vocational Education--Basic Grants to States | California Community Colleges, Chancellor's Office | 129 | 2 | | | 1 | |
| 84.049 | Vocational Education--Consumer and Homemaking Education* | State Department of Education | 156 | | 11 | | | |
| 84.126 | Rehabilitation Services--Basic Support | Department of Rehabilitation | 239 | 1,2 | | | | |
| 84.151 | Improving School Program--State Block Grants | State Department of Education | 156 | 13 | 11 | | | |
| Various Federal Departments | | | | | | | | |
| | Numerous Federal Programs | State Controller's Office | 273 | | | 3 | | |
| | Numerous Federal Programs | State Department of Education | 156 | | | 12 | | |
| | Numerous Federal Programs | Department of Finance | 186 | | | | | 1,2,3, 4,6 |
| | Numerous Federal Programs | Public Employees' Retirement System | 320 | | | | | 1 |

* We noted these weaknesses in compliance with federal regulations during audit testing at the state agency. We did not review for compliance with all federal regulations because the grant was under $20 million.

SCHEDULE OF AUDIT REPORTS
INVOLVING FEDERAL GRANTS
JULY 1, 1987 THROUGH DECEMBER 31, 1988

From July 1, 1987, through December 31, 1988, 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 and Federal Catalog Number | Report Title and Description |
|---|---|---|
| Alameda-Contra Costa Transit District | Urban Mass Transportation Capital Improvement Grants, Urban Mass Transportation Technical Studies Grant, and Urban Mass Transportation Capital and Operating Assistance Formula Grants<br>20.500<br>20.505<br>20.507 | The Alameda-Contra Costa Transit District's Financial and Administrative Controls Need Improvement (P-767, 3-8-88)<br><br>(1) For fiscal years 1984-85, 1985-86, and 1986-87, the Alameda-Contra Costa Transit District (district) has incurred operating budget deficits, and, as of February 3, 1988, the district anticipated an operating budget deficit of up to $7.1 million for fiscal year 1987-88.<br><br>(2) In paying for $41,668 of the $91,957 in travel and entertainment expenses that the district paid for in calendar years 1986 and 1987, the district failed to comply with board policy or sound internal accounting controls and may have violated state law.<br><br>(3) The district's legal staff used district resources, including staff, equipment, and facilities, to conduct private law practices. |
| Bay Area Rapid Transit District | Urban Mass Transportation Capital Improvement Grants<br>20.500 | The Integrated Control System of the Bay Area Rapid Transit District Costs More, Has a Less Comprehensive Design, and Has Taken Longer To Complete Than Originally Planned (P-742, 12-9-87)<br><br>(1) The Bay Area Rapid Transit District (BART) has increased its estimate of the cost of the integrated control system project by more than $25 million and has delayed the expected date of completion by more than five years. These problems resulted from BART's attempt to assume responsibility for technical management of the project during 1983 and 1984, BART's changes in the design of the system, and the current contractor's failure to deliver an acceptable plan until August 1986. |

| Agency Receiving Federal Funds | Federal Grant and Federal Catalog Number | Report Title and Description |
|---|---|---|
| California Maritime Academy | State Marine Schools 20.806 | A Review of the California Maritime Academy's Interactions With the California Maritime Academy Foundation (F-759, 11-25-87) |
| | | (1) The California Maritime Academy (academy) has not exercised sufficient management control to protect state and federal assets. |
| | | (2) The academy allowed the California Maritime Academy Foundation (foundation) to charge 255 passengers for a cruise to Expo '86 in Canada on the Golden Bear, which is a federal training ship. Academy officials may be subject to federal and state civil or criminal penalties for taking unauthorized passengers on the cruise. In addition, the foundation retained profits of $25,600 from the fees that it charged the passengers. |
| | State Marine Schools 20.806 | The California Maritime Academy Complied With Recommendations of the Office of the Auditor General (F-848, 11-28-88). |
| | | (1) The academy has generally complied with the recommendations made in our report dated 11-25-87 (F-759). |
| California Student Aid Commission | Higher Education Act Insured Loans (Guaranteed Student Loans) 84.032 | California Student Aid Commission, State Guaranteed Loan Reserve Fund, Financial Audit Report, Years Ended June 30, 1986 and 1987 (F-740, 3-24-88) |
| | | (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 1986-87, loan defaults totaled $137.1 million. The federal government purchased $133.1 million of that amount under a reinsurance agreement; as a result, the fund had to absorb $4.0 million of the defaults. |
| Control, State Board of | Crime Victim Compensation 16.576 | A Review of the State Board of Control's Victims of Crime Program (P-771, 3-15-88) |
| | | (1) The State of California reimburses victims of crime for medical care, wage loss, and other costs that result from the crimes. The State Board of Control (board) is responsible for processing victims' claims for reimbursements through the Victims of Crime Program. During our review of the board for the period from July 7, 1987, through December 15, 1987, we found that the board does not process the claims promptly. |

| Agency Receiving Federal Funds | Federal Grant and Federal Catalog Number | Report Title and Description |
|---|---|---|
| | | (2) The board improperly denied, paid, or verified 27 percent of the 100 regular claims that we reviewed and made questionable denials on 13 of the 58 emergency award applications that we reviewed. |
| | | (3) The board does not inform claimants of the requirements for qualifying for emergency awards or for appealing staff decisions. |
| | | (4) The board has poor internal control over the payments that are made from the board's automated tapes, and the board does not use its automated system effectively to prevent duplicate payments or to monitor its payments to local agencies. This resulted in over $10,000 in payments to the wrong people and over $14,000 in duplicate payments. |
| Criminal Justice Planning, Office of | Crime Victim Assistance and State and Local Narcotics Control Assistance<br>16.575<br>16.579 | The Office of Criminal Justice Planning Can Improve Its Process For Awarding Grants and Evaluating and Directing Grantee Performance (F-814, 10-5-88) |
| | | (1) The Office of Criminal Justice Planning (OCJP) allocated approximately $59.6 million in grants for fiscal year 1987-88 to public and private organizations for the more than 30 programs that the OCJP administers. During our review of 6 programs for which the OCJP allocated approximately $25.4 million, we noted that the OCJP generally has an appropriate process for awarding grants, but it can make improvements. |
| | | (2) Further, once it has awarded funding to grantees, the OCJP has not properly evaluated and directed the grantees' performance in many instances. |
| Economic Opportunity, Department of | Low-Income Home Energy Assistance<br>13.789 | Contractors For the Low-Income Home Energy Assistance Program in Santa Clara County Have Not Fully Complied With Their State Contracts (P-668, 8-13-87) |
| | | (1) Since 1983, the Welfare Recipients League, Inc., has administered approximately $1 million in Low-Income Home Energy Assistance Program funds and has spent approximately $30,000 of this amount for questionable items such as rent subsidies, loans and salary advances, and babysitting fees. These expenditures are questionable because the money was spent on items that do not appear to be related to the energy assistance program. |

| Agency Receiving Federal Funds | Federal Grant and Federal Catalog Number | Report Title and Description |
|---|---|---|
| | | (2) The Economic and Social Opportunities, Inc., has regularly failed to submit required contractual reports on time. However, we concluded that this is a minor administrative problem that does not involve missing funds. |
| Education, State Department of | Asbestos Hazards Abatement (Schools) Assistance 66.702 (The schools receive their federal funds directly from the federal government.) | The State Department of Education Did Not Comply With Its Federal Fiscal Year 1985-86 Agreement With the Environmental Protection Agency Concerning Asbestos in Schools (P-725, 7-18-87) |
| | | (1) The State Department of Education (department) failed to identify violations at all seven school districts reinspected jointly by our office and the U.S. Environmental Protection Agency. |
| | | (2) The department failed to obtain spending authority from the Department of Finance before conducting U.S. Environmental Protection Agency inspections that cost the State at least $40,000. |
| | Family Support Payments to States--Assistance Payments 13.780 | The State Department of Education's Collection of AFDC Enrollment Information From Subsidized Child Care Programs (P-770, 12-21-87) |
| | | (1) The Budget Act of 1987 directed the Office of the Auditor General to certify the data collected by the State Department of Education (department) on the number of children of parents receiving Aid to Families with Dependent Children (AFDC) who are enrolled in child care programs subsidized by the department. However, because 11 of 13 child care contractors reported inaccurate data to the department, the department's information is also inaccurate. Consequently, we could not certify the data reported by the department. |
| General Services, Department of--Office of Local Assistance | Asbestos Hazards Abatement (Schools) Assistance 66.702 (The schools receive their federal funds directly from the federal government.) | California Can Improve Its Program To Fund Asbestos Abatement Projects In School Districts (P-773, 8-24-88) |
| | | (1) The Office of Local Assistance (OLA) of the Department of General Services administers the Asbestos Abatement Fund from which the OLA has disbursed to school districts approximately $8.6 million of the $24.75 million that has been appropriated to it since the fund's creation in 1984. |

| Agency Receiving Federal Funds | Federal Grant and Federal Catalog Number | Report Title and Description |
| --- | --- | --- |
| | | During our review, we noted that the OLA does not promptly process applications from school districts for monies from the Asbestos Abatement Fund. In addition, school districts have been slow in submitting the documentation required to support their applications for asbestos abatement funds. As a result, some school districts have not received available state funds to abate asbestos in their schools. |
| | | (2) The OLA failed to meet a deadline for submitting to the federal government an application for federal funds to inspect for asbestos-containing material and to develop plans for abating this asbestos. As a result, California and its school districts lost the opportunity to compete for up to $500,000 in federal funds. |
| Health Services, Department of | Medical Assistance Program<br>13.714 | A Review of the State Department of Health Services' Monitoring of Nursing Homes (P-667, 7-8-87) |
| | | (1) The Department of Health Services does not always investigate complaints about nursing homes by specified deadlines and does not always conduct follow-up visits after licensing inspections. As a result, nursing home patients are sometimes exposed for a prolonged time to conditions that are unsafe and unhealthy. |
| | Hazardous Waste Management State Program Support and Hazardous Substance Response Trust Fund<br>66.801<br>66.802 | Revenues and Expenditures of the State's Hazardous Waste Regulatory and Site Cleanup Programs (P-662, 7-30-87) |
| | | (1) This is an information report on revenue and expenditures of hazardous waste programs. |
| | | (2) From July 1, 1984, through March 31, 1987, hazardous waste facilities, generators, and disposers paid fees totaling $39.7 million for deposit into the Hazardous Waste Control Account. During this period, the Department of Health Services (department) spent and encumbered $44.3 million from the Hazardous Waste Control Account to regulate the management of hazardous waste. |

| Agency Receiving Federal Funds | Federal Grant and Federal Catalog Number | Report Title and Description |
|---|---|---|
| | | (3) In addition, from January 1, 1984, through December 31, 1986, hazardous waste generators paid taxes totaling $37.6 million for deposit into the Hazardous Substance Account. From July 1, 1984, through December 31, 1986, the department spent $28.6 million from the Hazardous Substance Account for cleaning up hazardous waste sites and hazardous materials. |
| | Medical Assistance Program<br>13.714 | An Evaluation of the Medi-Cal Program's System for Establishing Reimbursement Rates for Nursing Homes (P-646, 10-28-87) |
| | | (1) The State could better achieve its major objectives of ensuring sufficient access to high quality nursing home care for Medi-Cal patients within a cost controlled system by implementing a prospective facility specific reimbursement system that differentiates between expenditures related to patient care and other costs of operation. |
| Los Angeles, City of | Construction Grants for Waste Water Treatment Works<br>66.418 | The City of Los Angeles' Compliance With a Federal Court Order To Upgrade Its Hyperion Sewage Treatment Plant (P-746, 5-25-88) |
| | | (1) The City of Los Angeles (city) is in the midst of a $1.1 billion construction program to improve the city's Hyperion Sewage Treatment Plant (Hyperion Plant). The city has already spent $356 million of this on the construction of its new sludge processing plant, the Hyperion Energy Recovery System (HERS). The remaining approximately $800 million will be spent on other improvements at the Hyperion Plant that will enable the city to provide secondary treatment to all of the city's sewage by 1988, as required by a federal court order. |
| | | (2) The HERS has cost $77 million more than the original construction bids and will take 38.5 months longer to complete than the city's consultant originally estimated. |
| | | (3) The city, the State Water Resources Control Board, and the United States Environmental Protection Agency participated in a five-year study of various sludge management alternatives before deciding to use the HERS to process the city's sludge. |

| Agency Receiving Federal Funds | Federal Grant and Federal Catalog Number | Report Title and Description |
|---|---|---|
| | | (4) The city has generally complied with a 1987 amended consent decree by stopping its discharge of sewage sludge into the ocean by December 31, 1987, and by meeting other decree requirements. However, it has violated the amended consent decree by not reporting accidental discharges of insufficiently treated sewage into the Pacific Ocean. |
| | | (5) The city has established a master schedule for providing required secondary treatment of all municipal sewage by December 31, 1998, and it is proceeding with projects to meet that requirement. |
| Social Services, Department of | Social Security-Disability Insurance and Supplemental Security Income<br>13.802<br>13.807 | An Investigation of the Disability Evaluation Division of the Department of Social Services (I-717, 2-19-87; and I-738, 7-16-87) |
| | | (1) Eight officials with the Department of Social Services were demoted and received salary reductions ranging from $402 to $1,143 per month after we determined that they had interfered with the sampling procedures used to randomly select cases for quality assurance reviews by the Social Security Administration. |
| | Mental Health Services for Cuban Entrants<br>13.120 (These facilities receive their funds directly from the federal government.) | A Review of the Department of Social Services' Licensing and Regulation of Country Manor and Pomona Manor (P-578.3, 6-13-88) |
| | | (1) As part of our review of residential care facilities, we assessed the Department of Social Services' (department) compliance with licensing and regulation of Country Manor in Chino and Pomona Manor in Pomona, two adult residential facilities for Cuban refugees. Although both facilities are properly licensed, we found some instances of noncompliance. |
| | | (2) The department did not conduct all required annual evaluations at Country Manor. |
| | | (3) The department did not ensure that the administrators prepare a required plan of correction at the time that the department cited deficiencies at Pomona Manor. |

| Agency Receiving Federal Funds | Federal Grant and Federal Catalog Number | Report Title and Description |
|---|---|---|
| | | (4) The department did not always conduct follow-up visits at Pomona Manor after citing deficiencies. |
| | | (5) The department did not collect all civil penalties that it assigned to Country Manor. |
| | Disaster Assistance 83.516 | A Review of the Department of Social Services' Efforts To Assist Victims of the Earthquakes of October 1987 (P-661.1, 6-20-88) |
| | | (1) The Department of Social Services (department) did a better job in providing assistance to the victims of the Southern California earthquakes of October 1987 than it did in providing assistance to the victims of the Northern California floods of 1986. However, the department still took almost two months to secure all the staff that it used to process applications for grants and four months to secure all the staff that it used to process appeals of grant award determinations. As a result, the department did not promptly process victims' grant applications and appeals of grant award determinations. |
| | Social Services Block Grant 13.667 | A Review of California's Contracts For In-Home Supportive Services (P-712, 9-21-88) |
| | | (1) The State's In-Home Supportive Services (IHSS) program is funded by the federal, state, and county governments. In fiscal year 1987-88, contracts to provide IHSS were worth approximately $39.7 million, or 9 percent of the total IHSS program expenditures. Counties administer IHSS contracts locally; the Department of Social Services (department) is responsible for the approval and oversight of IHSS contracts statewide. |
| | | (2) Although most of the contract costs that we analyzed for seven original IHSS contracts and five renewed IHSS contracts were reasonable, neither the department nor the six counties that we reviewed have fully complied with the provisions governing these contracts, nor have they ensured that contract costs are reasonable. As a result, the department and the counties have missed opportunities to reduce the costs of IHSS contracts, and the interests of the State and the counties have not been fully protected. |

| Agency Receiving Federal Funds | Federal Grant and Federal Catalog Number | Report Title and Description |
|---|---|---|
| State Water Resources Control Board | Water Pollution Control--State and Interstate Program Support 66.419 | A Review of the San Diego Regional Water Quality Control Board (P-665, 7-29-87)<br><br>(1) Although the San Diego Regional Water Quality Control Board has recently made some improvements in its regulatory program, it needs to further improve its monitoring and enforcement activities. |

SCHEDULE OF MINOR FEDERAL ISSUES
FISCAL YEAR ENDED JUNE 30, 1988

| Agency Receiving Federal Funds | Federal Grant and Federal Catalog Number | Description of Issue |
|---|---|---|
| Alcohol and Drug Programs, Department of | Alcohol and Drug Abuse and Mental Health Services Block Grant 13.992 | (1) Before receipt of our last report, the department received federal receipts seven days or more before payment of expenses for 5 of 9 items we examined. The department followed our recommendation and developed a system to minimize the period federal funds are held. As a result, the department received federal receipts seven days or more before the payment of expenses for only one of 21 items we examined that related to the last half of the fiscal year. |
| California Community Colleges, Chancellor's Office | Vocational Education--Basic Grants to States 84.048 | (1) We reviewed 43 payments that the Chancellor's Office made to the college districts in fiscal year 1987-88 for final vocational education claims from fiscal years 1985-86 and 1986-87. The Chancellor's Office incorrectly calculated 3 of the final payments. As a result, the Chancellor's Office owes approximately $23,000 to the three college districts. The Chancellor's Office has taken steps to pay the three college districts the amounts owed them. |
| Developmental Services, Department of | School Breakfast Program and National School Lunch Program 10.553 10.555 | (1) The department made two keypunch errors that resulted in the department incorrectly charging the federal government for 42 meals of 4,679 meals we tested. The federal government was overcharged by $2 for each meal. |
| Education, State Department of | Food Distribution Program 10.550 | (1) The department submitted the processor's Monthly Inventory Status Report for the quarter ending March 1987 to the United States Department of Agriculture two days late. |
| | School Breakfast Program and National School Lunch Program 10.553 10.555 | (1) The department did not identify that 2 of the 28 audit reports of subrecipients that we tested did not include a sufficient report on internal controls. |
| | | (2) For one of 30 sponsors that we reviewed, the department did not ensure that the sponsor maintain a current year operating license before receiving federal funds. As a result, the department allowed a residential child care institution to receive federal funds after its license had expired. The sponsor is no longer associated with this federal program. |
| | | (3) For 3 of the 30 subrecipients that we tested, the department did not perform an Assessment, Improvement, and Monitoring System (AIMS) review once every four years. The department completed the three reviews between four and five years after the prior reviews. |

| Agency Receiving Federal Funds | Federal Grant and Federal Catalog Number | Description of Issue |
| --- | --- | --- |
| Education, State Department of | School Breakfast Program, National School Lunch Program, Child Care Food Program, Educationally Deprived Children--Local Educational Agencies, Handicapped--State Grants, and Vocational Education--Basic Grants to States<br>10.553<br>10.555<br>10.558<br>84.010<br>84.027<br>84.048 | (1) For 11 of the 266 claims that we tested, the department held the related federal grant money from 6 to 26 working days. However, the average number of days between receipt and disbursement of funds for the claims tested was only 2.74 days. In addition, for two claims, the State disbursed money from 3 to 5 working days before receiving the federal grant money. |
| | Child Care Food Program<br>10.558 | (1) The department did not perform a 90-day administrative review on time. The department allowed nine months to elapse before performing a review of one sponsor of 30 that we tested. The department was required to perform an administrative review for this newly participating sponsor, with five or more child care facilities, within the first 90 days of its program operations. |
| | Handicapped--State Grants<br>84.027 | (1) The department overstated the pupil count submitted to the federal government by 30 pupils. The department reported 389,034 pupils when the correct pupil count was 389,004. |
| | | (2) The department did not maintain adequate documentation to support the pupil count used for the entitlements of two Special Education Local Plan Areas (SELPAs). As a result, the department may have paid one SELPA approximately $844 more than it was entitled and another SELPA approximately $844 less than it was entitled. |
| | Vocational Education--Basic Grants to States<br>84.048 | (1) For the items examined, the department incorrectly calculated the number of pupils whose family receive Aid to Families with Dependent Children (AFDC). These minor errors constituted less than .4 percent of the total AFDC count. The total AFDC count, in turn, is one portion of the formulas for allocating money for three of the eight programs funded by the grant. The errors affect only the allocation of grant money to the participating local educational agencies. Total federal funds were not affected by the errors. |

| Agency Receiving Federal Funds | Federal Grant and Federal Catalog Number | Description of Issue |
|---|---|---|
| Employment Development Department | Work Incentive Program<br>13.790 | (1) One field office within the department did not adequately separate duties related to petty cash for the Work Incentive Program. The same person controlled the blank-check stock and was authorized to sign checks. |
| Housing and Community Development, Department of | Community Development Block Grants/ State's Program<br>14.228 | (1) For one of ten grantees we reviewed, the department allowed the grantee to retain a cash advance of approximately $13,000 over the allowable amount for three months during fiscal year 1987-88. |
| Rehabilitation, Department of | Rehabilitation Services--Basic Support<br>84.126 | (1) For one of 50 clients' cases that we reviewed, the department did not review the written rehabilitation plan for approximately 27 months. The department is required to review the written rehabilitation plans at least annually. |
| Social Services, Department of | State Administrative Matching Grants for Food Stamp Program<br>10.561 | (1) The department made two errors when preparing its financial status report for the period October 1, 1986, to September 30, 1987. As a result of the two errors, the federal government's share of state administrative costs for fair hearings was overstated by approximately $4 and other activities were understated by $21. |
| | Foster Care--Title IV-E<br>13.658 | (1) The department did not accurately prepare the quarterly statement of expenditures for the quarter ended March 31, 1988. As a result, the department understated the federal government's share of program costs by $1,090. The department corrected its error on the June 30, 1988, quarterly report. |

REPORT ON COMPLIANCE WITH

STATE LAWS AND REGULATIONS

Telephone:
(916) 445-0255

STATE OF CALIFORNIA
**Office of the Auditor General**
660 J STREET, SUITE 300
SACRAMENTO, CA 95814

Kurt R. Sjoberg
Acting 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, 1988, and have issued our report thereon dated December 16, 1988, except for the information in Note 26 for which the date is January 11, 1989. 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 United States 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 to determine whether the State maintains sufficient 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's Office;

- Money and credit held by the State Treasurer's Office reconciles to the records maintained by the State Controller's Office;

- Securities purchased and held by the State are limited to those authorized by the California Government Code, Section 16430;

- The State Treasurer's Office held securities as collateral for deposits with financial institutions as required by the California Government Code, Sections 16500 and 16600;

- Procurement of materials, supplies, equipment, and services is made in accordance with the California 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 sections of the California Education Code;

- Sales and use 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 California Welfare and Institutions Code;

- Trailer coach fees are apportioned to counties in accordance with the California Revenue and Taxation Code, Section 11003.3;

- Motor vehicle license fees are apportioned to cities and counties in accordance with the California Revenue and Taxation Code, Section 11005;

- Resource revenues are apportioned to state funds in accordance with the California Public Resources Code, Section 6217, and implementing legislation;

- New or additional investments in businesses having financial operations in South Africa are prohibited in accordance with the California Government Code, Sections 16640 to 16650;

- Lottery funds are distributed to educational entities in accordance with the California Government Code, Section 8880.5; and

- Cigarette tax collections are apportioned to cities and counties in accordance with the California Revenue and Taxation Code, Section 30462.

The results of our tests indicate that for the items tested, the State complied with those provisions of laws and regulations with which noncompliance 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 was not in compliance with laws and regulations with which noncompliance 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 that we identified as having a potentially material effect on the general purpose financial statements. We present a summary of the instances of noncompliance on page 411 and discuss them in more detail on pages 93 through 361 of our report. We also present recommendations to remedy the instances of noncompliance. Management's comments regarding the recommendations appear on page 421 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 10, 1989

WEAKNESSES IN COMPLIANCE WITH STATE LAWS AND REGULATIONS
DISTRIBUTION BY STATE AGENCY

| Agency | Requirement | Noncompliance |
|---|---|---|
| California State University | Agency financial records should reconcile with those of the State Controller's Office. | California State University, Fullerton, did not accurately reconcile expenditure balances in its final budget report with the accounts of the State Controller's Office. |
| Education, State Department of | School apportionments should be made in accordance with sections of the California Education Code. | (1) The department did not monitor and cannot sufficiently support the receipt of budget summaries and progress reports for the Elementary Awareness Program.<br>(2) The department did not sufficiently document the calculation for the apportionment of Project Work-Ability I funds.<br>(3) The department did not calculate the entitlements for the School Improvement Program in accordance with state statutes. |
| Equalization, Board of | Sales and use tax collections should be distributed to local governments in accordance with laws and contracts with local governments. | The board has an insufficient and ineffective system for assigning and reviewing tax area codes. The board does not have sufficient controls to ensure that all of the sales and use taxes that it collects are properly allocated between various jurisdictions. |
| Various (See table on page 82) | Procurement of materials, supplies, equipment, and services should be made in accordance with the California Public Contract Code. | Departments did not approve contracts before the beginning of contract work, did not promptly prepare post-contract evaluations, did not have sufficient documentation, and did not perform other required procedures. |

SCHEDULE OF ACTUAL AND POTENTIAL LOSSES IDENTIFIED
DURING OUR REVIEW OF THE STATE'S FINANCIAL ACTIVITIES

| | Page Number | Lost Interest and Discounts | Amounts Owed to the State for Extended Periods | Unnecessary Expenditures | Lost Revenue |
|---|---|---|---|---|---|
| Boating and Waterways, Department of (Item #2) | 285 | $ 21,000 | | | |
| California State University (Item #3) | 142 | | $ 153,900 | | |
| California Community Colleges, Chancellor's Office (Item #6) | 129 | | 63,000 | | |
| Corrections, Department of (Items #2 and 3) | 326 | 708 | 288,200 | | $ 5,250 |
| California Institution for Men (Items #4 and 6) | 331 | 697 | 11,347 | | |
| California Men's Colony (Item #2) | 336 | | 3,500 | | |
| Equalization, Board of (Item #2) | 265 | | | $139,000 | |
| Fire Marshal, Office of the State (Item #2) | 297 | | 1,721 | | |
| Franchise Tax Board (Items #2 and 3) | 300 | | 8,300,000 | | 309,000 |
| Health Services, Department of (Items #8 and 9) | 218 | | 48,000 | 137 | |
| Mental Health, Department of (Item #2) | 234 | | 6,524 | | |
| Real Estate, Department of (Item #1) | 116 | 22,200 | | | |
| Social Services, Department of (Items #3, 5, and 8) | 242 | 186,000 | 175,600 | | |
| Transportation, Department of (Items #1, 3, and 6) | 119 | 1,226,650 | | 43,426 | |
| Water Resources, Department of (Item #4) | 289 | 362 | | | |
| Youth Authority, Department of the | 341 | | | | |
| Southern Reception Center-Clinic (Item #1) | 351 | 95 | | | |
| Youth Training School (Item #1) | 357 | | 67,000 | | |
| Total | | $1,457,712 | $9,118,792 | $182,563 | $314,250 |

**APPENDIX B**

## REPORTS ISSUED BY THE OFFICE OF THE AUDITOR GENERAL JULY 1, 1987 THROUGH DECEMBER 31, 1988

| DATE OF ISSUE | REPORT TITLE | REPORT NO. |
|---|---|---|
| 1987 | | |
| Jul 08 | A Review of the State Department of Health Services' Monitoring of Nursing Homes | P-667 |
| Jul 16 | Public Reports of Auditor General Investigations Completed Between January 1, 1987 and June 30, 1987 | I-738 |
| Jul 28 | The State Department of Education Did Not Comply With Its Federal Fiscal Year 1985-86 Agreement With the Environmental Protection Agency Concerning Asbestos in Schools | P-725 |
| Jul 29 | A Review of the San Diego Regional Water Quality Control Board | P-665 |
| Jul 30 | The State of California Needs To Improve Its Administration of State-Owned Housing | P-654 |
| Jul 30 | Revenues and Expenditures of the State's Hazardous Waste Regulatory and Site Cleanup Programs | P-662 |
| Aug 12 | A Study of Consolidating the Cashiering Operations of the State's Three Largest Tax Collection Agencies | P-656 |
| Aug 13 | Contractors for the Low-Income Home Energy Assistance Program in Santa Clara County Have Not Fully Complied With Their State Contracts | P-668 |
| Aug 24 | A Review of the Sacramento Area Chapter of the Friends of the California State Railroad Museum | P-706 |
| Aug 31 | A Review of the Department of Fish and Game's Reduced Fee Sport-Fishing License Program | P-720 |

| DATE OF ISSUE | REPORT TITLE | REPORT NO. |
|---|---|---|
| Sep 02 | A Review of Examiner, Auditor, and Appraiser Attrition in the State Banking Department, the Department of Savings and Loan, the Department of Corporations, and the Department of Real Estate | P-756 |
| Oct 01 | A Review of the Golden Gate Bridge, Highway and Transportation District and the 50th Anniversary Celebration of the Golden Gate Bridge | P-745 |
| Oct 05 | A Review of the State's Support of the Peninsula Commute Service | P-711 |
| Oct 05 | A Review of Funding and Attendance in California's Pregnant Minor Programs | P-726 |
| Oct 07 | A Review of First-Year Admissions of Asians and Caucasians at the University of California at Berkeley | P-722 |
| Oct 15 | California's Data on High School Dropouts Are Inaccurate | P-641 |
| Oct 26 | Tulare County Department of Education | F-749 |
| Oct 26 | A Review of the Department of Fish and Game's Program for Issuing Deer Hunting Tags in Zone X5b | P-747 |
| Oct 28 | An Evaluation of the Medi-Cal Program's System for Establishing Reimbursement Rates for Nursing Homes | P-646 |
| Nov 02 | 1986-87 Annual Report | A-799 |
| Nov 02 | A Review of the State's Pilot Projects for Child Abuse Prevention | P-491 |
| Nov 25 | A Review of the California Maritime Academy's Interactions With the California Maritime Academy Foundation | F-759 |
| Nov 25 | Spending of Educational Resources at the State and Local Levels, July 1, 1981 Through June 30, 1986 | F-719 |

| DATE OF ISSUE | REPORT TITLE | REPORT NO. |
|---|---|---|
| Dec 02 | The Lack of Community Facilities Limits the Placement of Persons With Developmental Disabilities | P-709 |
| Dec 09 | The Integrated Control System of the Bay Area Rapid Transit District Costs More, Has a Less Comprehensive Design, and Has Taken Longer to Complete Than Originally Planned | P-742 |
| Dec 21 | The State Department of Education's Collection of AFDC Enrollment Information From Subsidized Child Care Programs | P-770 |
| Dec 22 | A Review of the Los Angeles Unified School District's Procurement Practices and Controls Over Property | P-721 |
| 1988 | | |
| Jan 12 | A Comparative Analysis of Boards of Directors' Fees and Expenses of the Golden Gate Bridge, Highway and Transportation District and Four Transit Organizations | P-745.1 |
| Jan 21 | A Review of the Budget Performance Measures of the California Public Utilities Commission and of Its Compliance With Statutes | P-758 |
| Feb 03 | The State Department of Mental Health Does Not Ensure That Counties Collect Revenue From Insurers and Does Not Maintain Accurate Data on Sources of Payment for Clients | P-715 |
| Feb 04 | A Review of the Department of Social Services' Regulation of Four Group Homes in Santa Barbara County | P-750 |
| Feb 10 | A Review of the California Horse Racing Board's Selecting and Licensing of Stewards | P-730 |
| Feb 24 | Public Reports of Auditor General Investigations Completed Between July 1, 1987 and December 31, 1987 | I-810 |
| Mar 08 | The Alameda-Contra Costa Transit District's Financial and Administrative Controls Need Improvement | P-767 |

| DATE OF ISSUE | REPORT TITLE | REPORT NO. |
|---|---|---|
| Mar 15 | A Review of the State Board of Control's Victims of Crime Program | P-771 |
| Mar 17 | State of California Comprehensive Financial and Compliance Audit Report Year Ended June 30, 1987 | F-700 |
| Mar 21 | State of California Financial Report Year Ended June 30, 1987 | F-705 |
| Mar 23 | The California Exposition and State Fair Has Continued To Improve Its Financial Condition and Management Controls But More Improvement Is Needed | F-743 |
| Mar 24 | California Student Aid Commission State Guaranteed Loan Reserve Fund Financial Audit Report Years Ended June 30, 1986 and 1987 | F-740 |
| Apr 04 | Residential Facilities for the Elderly | P-578.1 |
| Apr 06 | A Review of the State's Contracts With Positive Incident Control, a Contractor for Hazardous Waste Cleanup | P-741 |
| Apr 07 | The Native American Heritage Commission Needs To Improve the Management of Its Statutory Responsibilities and Related Activities | P-751 |
| Apr 11 | Review of the Expenses of the Members of the Board of Directors of the Alameda-Contra Costa Transit District | P-745.2 |
| May 04 | A Review of the Department of Fish and Game's Private Lands Wildlife Management Area Program | P-761 |
| May 25 | An Analysis of the Conditions and Procedures Leading to the Proposed Closure of a High School in the Palos Verdes Peninsula Unified School District | F-778 |
| May 25 | The City of Los Angeles' Compliance With a Federal Court Order To Upgrade Its Hyperion Sewage Treatment Plant | P-746 |
| Jun 15 | The Department of Social Services' Compliance With State Law and Regulations in Licensing Two Adult Residential Facilities for Cuban Refugees | P-578.3 |

| DATE OF ISSUE | REPORT TITLE | REPORT NO. |
|---|---|---|
| Jun 22 | A Review of the State Bar of California's Processing of Complaints Against Attorneys Accused of Misusing Client Trust Funds | P-716 |
| Jun 23 | The Department of Social Services' Response in Providing Financial Assistance to Victims of the Southern California Earthquakes of 1987 | P-661.1 |
| Jun 24 | A Review of the Department of Fish and Game's License and Revenue Branch | F-809 |
| Jun 29 | A Review of Economic Activity in the State's Enterprise Zones and Employment and Economic Incentive Areas | P-754 |
| Jun 29 | A Review of Costs, Including Bond Funding, To Build Four State Prisons | F-806 |
| Jun 30 | The Department of Social Services' Investigation of Allegations of Sexual Abuse at Two Group Homes for Teenage Girls | P-578.2 |
| Jun 30 | An Analysis of the Methods Used To Identify, Value, and Transfer the Assets and Resources of the Former San Bernardino County Lake Arrowhead Sanitation District With the Consolidated Lake Arrowhead Community Services District | F-774 |
| Jul 01 | State of California Statement of Security Accountability of the State Treasurer's Office June 30, 1987 | F-703 |
| Jul 07 | The Growth and Costs of California's Independent Study Program | P-755 |
| Jul 20 | A Review of the San Juan Suburban Water District's Accounting Controls, Contracting Practices, and Expenditure of Bond Proceeds | F-762 |
| Jul 27 | Public Reports of Investigations Completed by the Office of the Auditor General Between January 1, 1988 and June 30, 1988 | I-841 |
| Aug 18 | California's Regional Centers for the Developmentally Disabled Need Better Financial Controls | P-744 |

| DATE OF ISSUE | REPORT TITLE | REPORT NO. |
|---|---|---|
| Aug 24 | California Can Improve Its Programs To Fund Asbestos Abatement Projects in School Districts | P-773 |
| Aug 25 | California's Records on the Incidence of Child Abuse Are Incomplete and Inaccurate | P-739 |
| Aug 31 | The State Inappropriately Required the Boys' and Girls' Club of Escondido To Prohibit Its Administrators From Managing Its Child Care | P-763 |
| Sep 21 | A Review of California's Contracts for In-Home Supportive Services | P-712 |
| Oct 05 | The Office of Criminal Justice Planning Can Improve Its Process for Awarding Grants and Evaluating and Directing Grantee Performance | F-814 |
| Oct 19 | The Department of Health Services Did Not Comply With All Requirements for Awarding and Managing Consultant Contracts | P-753 |
| Nov 09 | The Office of State Registrar Promptly and Accurately Responds to Most Requests Regarding the State's Vital Records and Stores the Records Properly | P-748 |
| Nov 28 | Information on the Implementation of the Mentally Disordered Offender Program | P-734 |
| Nov 28 | The California Maritime Academy's Compliance With Recommendations of the Office of the Auditor General | F-848 |

STATE OF CALIFORNIA GEORGE DEUKMEJIAN, *Governor*

DEPARTMENT OF FINANCE
OFFICE OF THE DIRECTOR
SACRAMENTO, CA 95814-4998

February 22, 1989

Kurt R. Sjoberg
Acting Auditor General
660 J Street, Suite 300
Sacramento, CA 95814

Dear Mr. Sjoberg:

REPORT F-800--A REVIEW OF THE STATE'S PROGRESS IN IMPROVING CONTROLS OVER ITS FINANCIAL OPERATIONS

I appreciate the opportunity to respond to the draft copy of the subject report which was prepared in conjunction with your examination of the State's general purpose financial statements for the fiscal year ended June 30, 1988. This draft contains your findings resulting from your study and evaluation of internal controls and your report on the State's compliance with Federal grant requirements. These findings will be incorporated into the Single Audit report filed by the State of California covering fiscal year 1987-88.

We agree that the control of the State's financial operations is important and we are continuing to strive for improvements. As noted in your summary, the State has corrected many of the previously reported internal control weaknesses but some still remain. We appreciate the concerns expressed in the identification of actual and potential losses and are weighing the costs associated in recovering losses and designing control systems to reduce the potential for loss.

The State of California is a very large and diverse entity with numerous programs and activities being carried out for its citizens. It will continue to be the responsibility of all of us to work toward assuring that the assets under its control are properly guarded and the operations of its various units are carried out in the most cost efficient manner. While we know much remains to be done to effect improvements, the fact that the cumulative findings do not adversely affect the State's general purpose statements is evidence that the operation is generally working.

STATEWIDE CONCERNS

The statewide concerns address five separate areas: Financial reporting as it relates to Generally Accepted Accounting Principles (GAAP), the certificate of achievement, reconciliations and statement of accruals for non-governmental cost funds, the state's method of reporting Federal moneys as expenditures, and the necessity of including the District Agriculture Fairs into the State's reporting entity.

FPA:1877/2

## GAAP CONCERNS

- INCONSISTENT FINANCIAL REPORTING

  We are addressing the issue of GAAP in several areas, including budget preparation and state agency reporting. The Governors Budget for 1989-90 was changed to reflect GAAP treatment of encumbrances and continuing appropriations. Because of the complexity of the State's budgeting and reporting system we are progressing cautiously in order to assure that the necessary changes to be made are in the best interests of the State.

- PROBLEMS WITH THE STATE'S FINANCIAL REPORTING SYSTEM

  The State is endeavoring to reduce the time required to prepare and submit the year-end statements to the State Controller for incorporation into the annual report. Virtually all State agencies now submit statements no later than the first of September. A review of the financial statements needed for submission is now underway in several agencies.

- INSUFFICIENT ACCOUNTABILITY FOR FIXED ASSETS

  The Fixed Asset Task Force was created in an attempt to resolve the fixed asset reporting issue. The Department of General Services, as part of the Fixed Asset Task Force now estimates completion of the state-wide inventory of fixed assets in January 1990. This should then resolve the continuing problem of fixed asset reporting.

- INSUFFICIENT REPORTING OF LEASING INFORMATION

  The development of a central record of all lease commitments by the State is an enormously difficult task. The Department of General Services is now the central depository for the bulk of the leasing information but, at this time, does not have access to all lease data. In addition, the records which are centralized do not provide all the information required by GAAP. We will be examining what must be done to accomplish this task and developing a plan which would eventually overcome this deficiency.

- PROBLEMS WITH THE STATE'S CONVERSION TO GAAP

  The State of California is in the process of converting to GAAP where it is practical. Some changes will require legislation before conformance to GAAP can be attained. In accordance with Chapter 1286, Statutes of 1984 (AB 3372) the Department of Finance is charged with implementing these changes to the extent that the changes are in the best interests of the State.

  There are some areas of GAAP where the proper accounting treatment is not defined or is extremely impractical and costly. For example, the proper accounting treatment of continuing appropriations is subject to interpretation with no clear direction from GAAP. Other areas, such as accounting for vacation accruals require the establishment of very expensive record systems which do not aid in the effective administration of the State. Consequently we are proceeding cautiously in a number of GAAP areas.

FPA:1877/3

The next step planned involves the conversion of the current fund classifications used in the Governor's Budget to GAAP fund classifications. We have identified all the areas which would be affected by this change and the EDP effort associated with this change. This is a major project which affects not only the Governor's Budget presentation but also major changes to the records of the State Controller. As reported last year, it remains our intention to effect this change for the Governor's Budget for fiscal year 1990-91.

. ELIGIBILITY FOR CERTIFICATE OF ACHIEVEMENT

As we have previously stated, we recognize the desirability of qualifying California for the Certificate of Achievement for Excellence in Financial Reporting. To this end, we have established a number of committees to work toward overcoming the three major areas of concern which presently preclude us from qualifying for this award.

The Office of the State Controller has taken the lead role in the process of determining the steps necessary to prepare a comprehensive annual report in accordance with GAAP. The State Controller is currently issuing both an annual report in accord with the State's legal basis of accounting and an annual report containing general purpose financial statements in accordance with Chapter 1286, Statutes of 1984 (AB 3372). This represents a forward step in the overall conversion to GAAP.

The second area of concern involves the necessity to publish the annual financial report within six months of the end of the fiscal year. A statewide committee has been formed to address changes necessary to meet this requirement. The third area precluding the attainment of the certificate of achievement is the insufficiency of the State's fixed asset records. The fixed asset task force expects completion of a state-wide inventory by January of 1990.

All of the above items represent a difficult set of problems which require the cooperation of all state entities involved in the fiscal operations of the State. We are continuing to address these problems and bring the effort to a successful conclusion in the most practical manner and in the best interests of the State.

. FAILURE TO REQUIRE AGENCIES TO SUBMIT RECONCILIATIONS TO THE STATE CONTROLLER'S OFFICE AND FAILURE TO REQUIRE AGENCIES TO PREPARE A REPORT OF ACCRUALS

Since the solution to these two findings requires preparation and submission of statements not now required, it must be coordinated with the problem of timely submission of year-end statements, noted above. We will include the effect of new statements in the review of the necessity of preparation of all existing statements.

. FAILURE TO REQUIRE ACCOUNTING FOR EXPENDITURES OF FEDERAL MONEYS BY EACH FEDERAL PROGRAM

We agree that the accounting system presently used to record Federal moneys needs to be changed to one that will meet all Federal and State requirements, and will be addressing it as other priorities allow.

FPA:1877/4

- IMPROPER OMISSIONS FROM THE STATE REPORTING PROCESS

  We will ask for a determination from the State's legal counsel and move toward implementation of that opinion as to the appropriateness of including the District Agriculture Fairs into the State reporting entity.

In conclusion, we appreciate your efforts in reviewing and reporting upon the financial operations of the State of California. We are aware that in many areas efforts are already underway to correct and strengthen weaknesses disclosed by both your audit effort and those of our own internal control reviews. We wish to continue to show progress in our efforts to improve the controls over the State's financial operations. It will take the combined efforts of all of us to achieve this goal.

Very truly yours,

JESSE R. HUFF
Director of Finance

cc: Curt I. Davis, CPA
Deputy Auditor General

FPA:1877/4

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