

# California State Auditor

B U R E A U O F S T A T E A U D I T S

## **State of California:**

*Internal Control and State and  
Federal Compliance Audit Report  
for the Fiscal Year Ended June 30, 2003*



March 2004  
2003-002

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# CALIFORNIA STATE AUDITOR

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ELAINE M. HOWLE  
STATE AUDITOR

STEVEN M. HENDRICKSON  
CHIEF DEPUTY STATE AUDITOR

March 23, 2004

2003-002

The Governor of California  
President pro Tempore of the Senate  
Speaker of the Assembly  
State Capitol  
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As required by the California Government Code, Section 8542 et seq., the Bureau of State Audits presents its audit report concerning our review of the State of California's internal controls and compliance with state and federal laws and regulations for the year ended June 30, 2003.

This report concludes that the State continues to experience certain problems in accounting and administrative practices that affect its internal controls over financial reporting and over compliance with federal requirements. As a result, the State has not always complied with some state and federal regulations. Although none of the problems we identified is significant to the State's financial statements or the federal programs it administers, weaknesses in the State's internal control system could adversely affect its ability to provide accurate financial information and to administer federal programs in compliance with applicable requirements.

Respectfully submitted,

ELAINE M. HOWLE  
State Auditor

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# **AUDITOR'S SECTION**

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## **Independent Auditor's Reports on Compliance and Internal Control**

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# CALIFORNIA STATE AUDITOR

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ELAINE M. HOWLE  
STATE AUDITOR

STEVEN M. HENDRICKSON  
CHIEF DEPUTY STATE AUDITOR

## **Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With Government Auditing Standards**

The Governor and the Legislature of  
the State of California

We have audited the basic financial statements of the State of California as of and for the year ended June 30, 2003, and have issued our report thereon dated December 19, 2003. We did not audit the following significant amounts in the financial statements of:

### Government-wide Financial Statements

- Certain enterprise funds that, in the aggregate, represent 84 percent, 42 percent, and 58 percent, respectively, of the assets, net assets and revenues of the business-type activities.
- The University of California, State Compensation Insurance Fund, California Housing Finance Agency, and certain other funds that, in the aggregate, represent 74 percent, 88 percent, and 74 percent, respectively, of the assets, net assets and revenues of the discretely presented component units.

### Fund Financial Statements

- Certain funds that represent 99 percent, 95 percent, and 98 percent, respectively, of the assets, net assets and revenues of the Housing Loan fund, a major enterprise fund.
- The following major enterprise funds: Electric Power fund, Water Resources fund, Public Building Construction fund, and State Lottery fund.
- Certain nonmajor enterprise funds that represent 68 percent, 46 percent, and 85 percent, respectively, of the assets, net assets and revenues of the nonmajor enterprise funds.
- The funds of the Public Employees' Retirement System and the State Teachers' Retirement System and the University of California Retirement System that, in the aggregate, represent 90 percent, 91 percent, and 94 percent, respectively, of the assets, net assets and additions of the fiduciary funds.
- The discretely presented component units noted above.

Those financial statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for those funds and entities, is based on the reports of the other auditors. Except as discussed in the following paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America.

The financial statements of the State Compensation Insurance Fund (SCIF) have not been audited and we were not engaged to audit the SCIF financial statements as part of our audit of the State of California's basic financial statements. SCIF's financial activities are included in the State of California's basic financial statements as a discretely presented component unit and represent 25 percent, 9 percent, and 25 percent, respectively, of the assets, net assets and revenues of the State of California's aggregate discretely presented component units.

## **COMPLIANCE**

As part of obtaining reasonable assurance about whether the State of California's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

## **INTERNAL CONTROL OVER FINANCIAL REPORTING**

In planning and performing our audit, we considered the State of California's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the State of California's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 2003-19-1 through 2003-19-5.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the

internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described above is a material weakness.

This report is intended solely for the information and use of the governor and Legislature of the State of California, the management of the executive branch, and the federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

BUREAU OF STATE AUDITS

A handwritten signature in black ink that reads "Philip Jelicich". The signature is written in a cursive style with a large, prominent initial "P".

PHILIP J. JELICICH, CPA  
Deputy State Auditor

December 19, 2003

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# CALIFORNIA STATE AUDITOR

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ELAINE M. HOWLE  
STATE AUDITOR

STEVEN M. HENDRICKSON  
CHIEF DEPUTY STATE AUDITOR

## **Independent Auditor's Report on Compliance With Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133**

The Governor and the Legislature of  
the State of California

### **COMPLIANCE**

We have audited the compliance of the State of California with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2003. The State of California's major federal programs are identified in the summary of the auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the State of California's management. Our responsibility is to express an opinion on the State of California's compliance based on our audit. We did not audit the State of California's compliance with the requirements of the U.S. Environmental Protection Agency's Capitalization Grants for State Revolving Funds (CFDA Number 66.458). This program, which accounts for less than one percent of the total of federal assistance received by the State of California, is included in the accompanying schedule of findings and questioned costs and schedule of federal assistance. Other auditors have audited the State of California's compliance with this program's requirements and their report thereon has been furnished to us. Our opinion, insofar as it relates to this program, is based solely on the report of the other auditors.

The State of California's basic financial statements include the operations of the University of California and the California State University systems, as well as the California Housing Finance Agency, a component unit authority of the State. However, these entities are not included in the accompanying schedule of findings and questioned costs or schedule of federal assistance for the year ended June 30, 2003. The University of California and the California State University systems, and the California Housing Finance Agency, which reported expenditures of federal awards totaling \$2.7 billion and \$1.2 billion, and \$72.6 million, respectively, engaged other auditors to perform an audit in accordance with OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (OMB Circular A-133).

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133. Those standards and OMB Circular A-133

require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the State of California's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit and the reports of the other auditors provide a reasonable basis for our opinion. Our audit does not provide a legal determination of the State of California's compliance with those requirements.

In our opinion, the State of California complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2003. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs. See the attachment for a list of these issues.

### **INTERNAL CONTROL OVER COMPLIANCE**

The management of the State of California is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the State of California's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the State of California's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs. The attachment also contains a list of these issues.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions listed in the attachment is a material weakness.

## **SCHEDULE OF FEDERAL ASSISTANCE**

We have audited the basic financial statements of the State of California as of and for the year ended June 30, 2003, and have issued our report thereon dated December 19, 2003. We did not audit the following significant amounts in the financial statements of:

### Government-wide Financial Statements

- Certain enterprise funds that, in the aggregate, represent 84 percent, 42 percent, and 58 percent, respectively, of the assets, net assets and revenues of the business-type activities.
- The University of California, State Compensation Insurance Fund, California Housing Finance Agency, and certain other funds that, in the aggregate, represent 74 percent, 88 percent, and 74 percent, respectively, of the assets, net assets and revenues of the discretely presented component units.

### Fund Financial Statements

- Certain funds that represent 99 percent, 95 percent, and 98 percent, respectively, of the assets, net assets and revenues of the Housing Loan fund, a major enterprise fund.
- The following major enterprise funds: Electric Power fund, Water Resources fund, Public Building Construction fund, and State Lottery fund.
- Certain nonmajor enterprise funds that represent 68 percent, 46 percent, and 85 percent, respectively, of the assets, net assets and revenues of the nonmajor enterprise funds.
- The funds of the Public Employees' Retirement System and the State Teachers' Retirement System and the University of California Retirement System that, in the aggregate, represent 90 percent, 91 percent, and 94 percent, respectively, of the assets, net assets and additions of the fiduciary funds.
- The discretely presented component units noted above.

Those financial statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for those funds and entities, is based on the reports of the other auditors.

In addition, the financial statements of the State Compensation Insurance Fund (SCIF) have not been audited and we were not engaged to audit the SCIF financial statements as part of our audit of the State of California's basic financial statements. SCIF's financial activities are included in the State of California's basic financial statements as a discretely presented component unit and represent 25 percent, 9 percent, and 25 percent, respectively, of the assets, net assets and revenues of the State of California's aggregate discretely presented component units.

Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying schedule of federal assistance is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. OMB Circular A-133 requires the schedule of federal assistance to present total expenditures for each federal assistance

program. However, although the State's automated accounting system separately identifies receipts for each federal assistance program, it does not separately identify expenditures for each program. As a result, the State presents the schedule of federal assistance on a cash receipts basis. In addition, the schedule of federal assistance does not include expenditures of federal awards received by the University of California and the California State University systems, or the California Housing Finance Agency. These expenditures are audited by other independent auditors in accordance with OMB Circular A-133. The information in the accompanying schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of the governor and Legislature of the State of California, the management of the executive branch, and the federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

BUREAU OF STATE AUDITS



PHILIP J. JELICICH, CPA  
Deputy State Auditor

December 19, 2003

Attachment



## ATTACHMENT

The compliance issues are:

2003-1-1	2003-9-5
2003-1-2	2003-12-1
2003-1-3	2003-12-2
2003-1-5	2003-12-3
2003-2-1	2003-12-4
2003-2-2	2003-13-1
2003-3-2	2003-13-2
2003-3-3	2003-13-4
2003-3-4	2003-13-5
2003-3-6	2003-13-6
2003-3-8	2003-13-7
2003-3-10	2003-13-9
2003-3-12	2003-14-1
2003-4-1	2003-14-2
2003-5-1	2003-14-3
2003-7-2	2003-14-4
2003-7-3	2003-14-5
2003-8-1	2003-14-6
2003-9-1	2003-14-8
2003-9-2	2003-14-9
2003-9-3	

The internal control over compliance issues are:

2003-1-4	2003-9-4
2003-3-1	2003-12-2
2003-3-5	2003-13-3
2003-3-7	2003-13-6
2003-3-8	2003-13-8
2003-3-9	2003-14-2
2003-3-10	2003-14-4
2003-3-11	2003-14-5
2003-7-1	2003-14-7
2003-7-3	2003-14-9

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## **Schedule of Findings and Questioned Costs**

**STATE OF CALIFORNIA  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

**Summary of Auditor's Results**

**Financial Statements**

Type of report issued by auditors	Qualified
Internal control over financial reporting:	
Material weaknesses identified?	No
Reportable conditions identified that are not considered to be material weaknesses?	Yes
Noncompliance material to financial statements noted?	No

**Federal Awards**

Internal control over major programs:	
Material weaknesses identified?	No
Reportable conditions identified that are not considered to be material weaknesses?	Yes
Type of report the auditor issued on compliance for major programs	Unqualified
Any audit findings disclosed that are required to be reported in accordance with Section .510(a) of Circular A-133?	Yes
Dollar threshold used to distinguish between Type A and Type B programs	\$71.4 million
Auditee qualified as low-risk auditee?	No

*Identification of major programs:*

<b>CFDA Number</b>	<b>Name of Federal Program or Cluster of Programs</b>
	Aging Cluster
	Disability Insurance/SSI Cluster
	Employment Services Cluster
	Food Stamp Cluster
	Highway Planning and Construction Cluster
	Medicaid Cluster
	Special Education Cluster
	Student Financial Aid Cluster
	Workforce Investment Act Cluster
10.557	Special Supplemental Nutrition Program for Women, Infants, and Children
10.558	Child and Adult Care Food Program
10.665	Schools and Roads—Grants to States
14.228	Community Development Block Grant/State's Program
14.239	HOME Investment Partnerships Program
17.225	Unemployment Insurance
17.255	Workforce Investment Act
20.505	Federal Transit—Metropolitan Planning Grants
66.458	Capitalization Grants for State Revolving Funds
83.544	Public Assistance Grants
83.548	Hazard Mitigation Grant
84.002	Adult Education—State Grant Program
84.010	Title I Grants to Local Educational Agencies
84.011	Migrant Education—Basic State Grant Program
84.048	Vocational Education—Basic Grants to States
84.126	Rehabilitation Services—Vocational Rehabilitation Grants to States
84.318	Technology Literacy Challenge Fund Grants
84.340	Class Size Reduction
84.365	English Language Acquisition Grants
84.367	Improving Teacher Quality State Grants
93.558	Temporary Assistance for Needy Families
93.568	Low-Income Home Energy Assistance
93.569	Community Services Block Grant
93.658	Foster Care—Title IV-E
93.667	Social Services Block Grant
93.917	HIV Care Formula Grants
93.958	Block Grants for Community Mental Health Services
93.959	Block Grant for Prevention and Treatment of Substance Abuse
99.999	Temporary State Fiscal Relief

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**Compliance and Internal Control Issues  
Applicable to the Financial Statements  
and State Requirements**

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**DEPARTMENT OF HEALTH SERVICES  
DEPARTMENT OF DEVELOPMENTAL SERVICES**

Reference Number: 2003-19-1

**CONDITION**

During fiscal year 2002-03, two state departments involved in the processing of payments associated with the federal Medical Assistance Program (Medicaid) did not always minimize the number of days between the disbursement of state funds and the receipt of federal funds for reimbursement of costs incurred. As a result, the State missed opportunities to earn interest on funds that should have been in its accounts. Specifically, we estimate that the State lost more than \$261,000 in interest because prompt federal reimbursements were not obtained for four Medicaid claim schedules for developmental services and related administrative costs totaling \$148.8 million. For these four developmental service claims, the Department of Developmental Services (Developmental Services) and the Department of Health Services (Health Services) took up to 55 days to process claims and to obtain federal reimbursing funds after payment from the State General Fund. During fiscal year 2002-03, Developmental Services and Health Services paid \$349 million in developmental service claims.

**CRITERIA**

Sound cash management techniques require the State to take full advantage of its opportunities to earn interest on funds in its accounts by minimizing the number of days that elapse between the disbursement of state funds for federal program purposes and the receipt of federal reimbursing funds.

**RECOMMENDATION**

Health Services and Developmental Services should jointly evaluate their cash management systems with the goal of reducing the number of days that elapse between the payment of developmental service claims using State General Fund money and the receipt of federal reimbursing funds.

**DEPARTMENTS' VIEWS AND CORRECTIVE ACTION PLANS**

Health Services agrees with reservations to the recommendation. The four Medicaid claim schedules that were audited had an average of 24.25 days (8 days to 48 days) from the date received in Program to the date paid by the State Controller's Office (State Controller). The average days from the date received in Accounting to the date paid by the State Controller was 15.75 days (8 days to 28 days). As the Program is

the liaison with the Developmental Services, the Program should work with Developmental Services to reduce the amount of time between payment by Developmental Services and invoicing by Developmental Services to Health Services. Accounting will continue to try to reduce the amount of time to process Developmental Services' invoices.

Developmental Services concurs with the Bureau of State Audits finding, but notes that Developmental Services makes every effort to minimize the number of days between the General Fund expenditure and submitting the reimbursement invoice to Health Services.

The billing process requires that data from two systems be carefully coordinated. Data from the Regional Centers is transmitted to Developmental Services Headquarters through the Uniform Fiscal System, which consists of two separate files for the billing and expenditure information. The billing data is forwarded to Developmental Services' Federal Program Operations Section (FPOS) for subsequent billing to Health Services. Prior to submitting the billing, FPOS reviews the information to resolve any potential over-billings and to check for any other anomalies. The expenditure data supports the Regional Center's monthly claims that are forwarded to Developmental Services' Accounting Section for payment. The claims are received by Developmental Services' Accounting Section between the 20<sup>th</sup> day of the current month and the first week of the following month. Due to the two billing systems, there are occasions when payments to the Regional Centers and the invoice to Health Services for reimbursement, do not occur on the same day. Although Developmental Services strives to minimize any delays in claiming federal funds, caution must be taken to assure that an invoice is not sent to Health Services for reimbursement from the federal government prior to the payments being remitted to the Regional Centers.

In addition, the cash flow needs of the Regional Centers to promptly pay service providers, preclude Developmental Services from delaying payments until the data for Health Services invoice is compiled, and the Medi-Cal eligibility list is established by FPOS. Payment delays could result in increased health and safety issues for consumers residing in the community.

Developmental Services is aware of the importance of minimizing the number of days federal funding is not being utilized, and will continue to review internal processes to assure that reimbursement invoices are submitted to Health Services as quickly as possible. Developmental Services will also work with Health Services to ensure that all actions are taken to minimize the time delay in billing for federal funds.

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## **VARIOUS STATE DEPARTMENTS**

Reference Number:

2003-19-2

### **CONDITION**

State departments do not always report their employees' taxable fringe benefits and business expense reimbursements. Federal and state tax laws require that employers report income and related tax for payments other than regular wages, including fringe benefits and business expense reimbursements. Fringe benefits—cash, property, or services received in addition to regular pay—are reportable as taxable income unless specifically excluded in Internal Revenue Service (IRS) regulations. Examples of such taxable reimbursements include mileage compensation for commuting or personal travel between home and office when employees must work overtime (overtime or callback mileage), payment for employees' meals when they must work overtime or travel for less than 24 hours without lodging, and compensation for personal use of state vehicles.

The State Controller's Office (Controller's Office) informs state departments through its Payroll Procedures Manual and its Payroll Letters of the IRS and state requirements for reporting taxable benefits and taxable business expenses. These employee fringe benefits and business expense reimbursements must then be included in a report to the Controller's Office by the 10<sup>th</sup> of the month following the month in which the payments were made. The Controller's Office then calculates and deducts the required taxes.

Despite these requirements, some departments do not consistently ensure that all employees' taxable benefits or taxable business expense reimbursements are being reported to the Controller's Office. In addition to following up on issues reported for fiscal year 2001-02, we reviewed the reporting of employee taxable benefits and reimbursements at five additional state departments for fiscal year 2002-03. We reviewed from 118 to 289 travel expense claims at each of the five entities to verify that the departments properly reported employee taxable reimbursements. However, not all of the travel expense claims we reviewed included claims for taxable fringe benefits.

The five additional departments that we reviewed, the California Department of Education's California School for the Deaf—Fremont, the Department of Fish and Game, the Department of Industrial Relations, the Military Department, and the California Department of the Youth Authority's Southern Youth Correctional Reception Center and Clinic (Southern Youth Reception Center) did not always ensure that they met the reporting requirements the Controller's Office described. The table shows the total number of travel expense claims with reportable items that we reviewed and the number of items the departments did not report to the Controller's Office.

We also determined if those departments that issued vehicle home storage permits reported the personal use of state vehicles to the Controller's Office. Of the departments that we reviewed, the California School for the Deaf—Fremont, the Department of Fish and Game, and the Department of Industrial Relations did not always ensure that they reported the personal use of state vehicles to the Controller's Office. The table also shows the total number of employees with personal use of state vehicles that we reviewed that were not reported to the Controller's Office.

Further, the California School for the Deaf—Fremont, the Department of Fish and Game, the Department of Industrial Relations, and the Southern Youth Reception Center have not developed written procedures to help ensure that they consistently and correctly report taxable fringe benefits. In addition, although the Military Department did not have written procedures during the period that we tested, it subsequently developed written procedures to help ensure that it consistently and correctly reports taxable fringe benefits.

We reported similar concerns for fiscal year 2001-02 at seven other departments. We reviewed the reporting of employee taxable benefits and reimbursements at these state departments from January 2003 to June 2003, the period since our last review. Two of these departments have established and implemented internal procedures for reporting taxable benefits to the Controller's Office. However, as we reported the last four fiscal years, the State Water Resources Control Board (board) has not implemented any internal procedures for reporting personal use of state vehicles to the Controller's Office. Further, the board has not accurately reported taxable benefits to the Controller's Office. In addition, as we reported last year, the Department of Corrections' (Corrections) California Substance Abuse Treatment Facility—Corcoran has not developed written procedures to help ensure that it correctly reports taxable fringe benefits. Finally, although Corrections, the Department of Health Services, and the Department of Transportation have, since our last review, developed internal procedures for reporting taxable benefits, they have not accurately reported taxable benefits to the Controller's Office. The total number of travel expense claims with reportable items that we reviewed and the number of items not reported to the Controller's Office for these five departments are shown in the table.

Furthermore, Corrections did not always ensure that it reported the personal use of state vehicles to the Controller's Office. As we reported for fiscal year 2001-02, Corrections informed us that its agents are exempt from reporting personal use of state vehicles based on its view of IRS regulations that exempt unmarked law enforcement vehicles if the employee uses the vehicle for law-enforcement functions. However, to qualify as exempt, specific conditions must be satisfied and documented by actual facts and circumstances. For unmarked law enforcement vehicles to qualify, any personal use must be both authorized and incident to law enforcement functions such as reporting directly from home to a stakeout or surveillance site, or to an emergency situation. Travel directly from home to headquarters or from headquarters to home would not be exempt from reporting. Further, Corrections has not fully documented the actual facts and circumstances of the daily travel of the agents that we tested. The table also shows the total number of employees with personal use of state vehicles that we reviewed that were not reported to the Controller's Office.

**Table****Reportable Items Reviewed That Were Not Reported  
to the Controller's Office in Fiscal Year 2002-03**

State Agency	Total Number of Travel Expense Claims With Reportable Items Reviewed	Items Not Reported		
		Overtime/ Callback Mileage	Meals for Less Than 24-Hour Travel/Overtime Meals	Employees with Personal Use of State Vehicle *
California School for the Deaf—Fremont	8	N/A	10	1
Department of Fish and Game	33	N/A	50	1
Department of Industrial Relations	39	N/A	83	16
Military Department	17	N/A	11	N/A
Southern Youth Correctional Reception Center and Clinic	17	0	22	N/A
California Substance Abuse Treatment Facility—Corcoran	13	N/A	2	0
Department of Corrections	69	3	9	3
Department of Health Services	15	N/A	4	N/A
Department of Transportation	36	9	0	0
State Water Resources Control Board	21	N/A	10	N/A
<b>TOTALS</b>	268	12	201	21

Note: Some travel expense claims contained more than one type of reportable item.

N/A: None included in travel expense claims reviewed or no vehicle home storage permits issued.

\*Personal use of state vehicles is reported on documents separate from travel expense claims.

When state departments do not properly report their employees' taxable benefits and business expense reimbursements, the Controller's Office cannot calculate and withhold the related tax, as required by federal and state laws and regulations.

## **CRITERIA**

The Controller's Office Payroll Procedures Manual, sections 120 through 170, provides procedures for reporting to the Controller's Office taxable fringe benefits and business expense reimbursements provided to state employees. These procedures are based on federal and state tax laws. The following benefits and payments included in this manual relate to our testing of agency compliance:

- Section 129.1 states that the use of state-owned or leased vehicles for personal commutes between home and office is reportable taxable income.
- Section 129.1.3 describes an IRS exemption for unmarked law-enforcement vehicles if the use of the vehicle is authorized and incident to law-enforcement functions and the actual facts and circumstances are documented.
- Section 130.1.2 states that reimbursements to employees for commuting expenses, such as for expenses from commuting or personal travel between home and office, is considered taxable income. This would include callback and overtime mileage.
- Section 143.3 states that overtime meal compensation is reportable and taxable income.
- Section 145.1.2 states that meal reimbursement for less than 24-hour travel without lodging is taxable income. Simply stated, if an employee receives reimbursement for meals during travel in which there was no overnight stay, this reimbursement is taxable income.

## **RECOMMENDATION**

To ensure proper reporting, all state departments should ensure that they have procedures established and implemented to properly report taxable fringe benefits and taxable employee business expense reimbursements.

## **DEPARTMENTS' VIEWS AND CORRECTIVE ACTION PLANS**

The California Department of Education agrees with the finding. It indicates that the California School for the Deaf—Fremont will correct the errors found during the testing and report them to the Controller's Office. Further, the California School for the Deaf—Fremont is utilizing the Controller's Payroll Procedural Manual to determine the proper reporting of taxable fringe benefits and developing written desk procedures identifying roles and responsibilities to properly report these benefits.

The Department of Fish and Game agrees with the finding. It indicates that it has corrected the errors found during the testing and reported them to the Controller's Office. Also, it states that lack of training specific to the reporting requirement was the cause of non-reporting. It indicates that staff responsible for these reports currently

follow the procedures contained in the Controller's Payroll Procedural Manual. In addition, it states that it will develop and adopt written procedures and provide necessary training, when warranted and to the extent possible.

The Department of Industrial Relations agrees with the finding. It indicates that its accounting office has implemented procedures and trained staff to ensure that taxable items claimed on an employee's travel expense claim are identified and reported to the Controller's Office. Further, the Department of Industrial Relations states that it is reviewing all assigned state vehicles in order to ensure that employees are in compliance with reporting requirements. Finally, it states that it will require managers and supervisors to collect home storage permits from employees and forward the permits to its business management unit.

The Military Department agrees with the finding. It indicates that it has reviewed 100 percent of all travel expense claims for the current and past fiscal years, determined taxable fringe benefits and business expense reimbursements, and reported the information to the Controller's Office as required. In addition, it states that on August 21, 2003, that it implemented procedures to ensure that it identifies all travel expense claims with taxable fringe benefits and business expense reimbursements and reports them to the Controller's Office. Further, the Military Department states that it completed the reviews for the first half of this fiscal year.

The California Department of the Southern Youth Reception Center agrees with the finding. It indicates that the regional accounting office will develop and implement written procedures to properly report taxable fringe benefits and taxable employee business expenses reimbursements. It adds that it will continue to report monthly vehicle usage and mileage to the regional accounting office.

Corrections agrees with the finding for the California Substance Abuse Treatment Facility—Corcoran. It states that the California Substance Abuse Treatment Facility—Corcoran has notified the Controller's Office of the reportable items that we found. Further, it states that the regional accounting office is working on finalizing the Regional Accounting Manual, which includes a section on tax reporting. The Corrections estimates that this section will be finalized in the Spring of 2004.

Corrections agrees with each of the exceptions that we reported on overtime/call back mileage and meals for less than 24-hours travel/overtime meals. Also, it states that its Headquarters Accounting Services Section's travel unit has received training from the Department of Personnel Administration. Furthermore, it states that it is expanding the use of the State Controller's Office Automated Travel Expense Reimbursement System (CALATERS). CALATERS automatically reports taxable reimbursement items to the Controller's Office, eliminating the necessity for manual tracking and reporting. However, Corrections disagrees with the finding on the personal use of state vehicles. It states that its interpretation of the IRS guidelines is based on prior discussions with the Controller's Office. Although it disagrees with the finding, the deputy director of the Financial Services Branch has directed the Accounting Management Branch to re-evaluate the instructions given in its Financial Information Memo 2000-10 and to determine if adjustments to those instructions are warranted.

The Department of Health Services agrees with the finding. It indicates that it will ask its accounting office to be more diligent in identifying and reporting taxable fringe benefits.

The Department of Transportation agrees with the finding. It indicates that it has reported the taxable items to the Controller's Office. Further, it notes that seven of the nine items identified occurred prior to implementing a secondary review in February 2003. Finally, it states that it has reiterated to department staff the procedures in the Payroll Procedures Manual to ensure that they report taxable fringe benefits to the Controller's Office.

The State Water Resources Control Board agrees with the finding. It indicates that after 100 percent staff turnover that it has trained new staff on the procedures for reporting travel less than 24 hours. In addition, it states as of November 11, 2003, it has established procedures for reporting of personal use of state vehicles and began reporting personal use of state vehicles to the Controller's Office with the November 2003 pay period.

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## **DEPARTMENT OF PARKS AND RECREATION**

Reference Number: 2003-19-3

### **CONDITION**

For the fiscal year ending June 30, 2002, we reported that the Department of Parks and Recreation (Parks and Recreation) did not have adequate procedures to account for and report its real property. Specifically, its acquisition unit had not reported 40 land additions valued at \$186 million acquired between July 2001 and June 2002 to the Department of General Services' (General Services) Real Estate Services Division. In addition, its acquisition unit did not report \$3.4 million in ancillary costs for the assets acquired. Furthermore, its accounting unit did not report the gift value of land additions totaling approximately \$64 million to the State Controller's Office (Controller's Office) for inclusion in the state's financial statements. In its corrective action plan, Parks and Recreation stated that it would train staff on reporting requirements for General Services' Statewide Property Inventory, as well as monitor the reporting of additions for the Statewide Property Inventory. It also indicated that it had taken steps necessary to ensure gift values were reported to the accounting unit and that it included ancillary costs of purchasing land in its reporting to General Services.

At the time of our follow-up review in February 2004, we determined that as of January 30, 2004, the acquisition unit had reported all 40 land additions to General Services, but it had not reported the \$3.4 million in ancillary costs. On its fiscal year



2002-03 financial statements, the accounting unit only reported to the Controller's Office approximately \$1.8 million of the \$64 million gift value because it had not received the information from the acquisition unit when it prepared the year-end report.

In addition to our follow-up, we reviewed Parks and Recreation's reporting for fiscal year 2002-03. We found that the acquisition unit reported only 11 of 42 land additions acquired between July 2002 and June 2003 to General Services. Furthermore, the acquisition unit still does not report ancillary costs to General Services even though it tracks these costs and periodically reconciles with the accounting unit. In addition, although the accounting unit receives gift values from the acquisition unit, it does not receive the information in time to include gift values in its year-end report to the Controller's Office.

Unless Parks and Recreation reports complete and accurate information to the Controller's Office and General Services' Real Estate Services Division, the State's financial statements will be misstated and/or the State Property Inventory will be incomplete and inaccurate.

## **CRITERIA**

The California Government Code, Section 11011.15, requires each agency to furnish General Services with a record of each parcel of real property that it possesses and to update its real property holdings by July 1 of each fiscal year. It also requires General Services to maintain a complete and accurate inventory of all real property held by the State. General Services includes Parks and Recreation's information in the Statewide Property Inventory.

Additionally, the State Administrative Manual, sections 7463, 7977, and 8660, requires agencies to report to the Controller's Office in a Statement of Changes in General Fixed Assets all additions and deductions to real property funded by governmental funds. The Controller's Office includes this information in the State's financial statements.

Further, the Department of Finance (Finance) issued directives in July 2000 and September 2003 requiring agencies to evaluate the risk of an incomplete inventory and to reconcile the amounts reported in the Statewide Property Inventory with the Statement of Changes in General Fixed Assets. Finance also required agencies to periodically reconcile their real property inventories to ensure the inventories are complete and accurate.

## **RECOMMENDATIONS**

We recommend that Parks and Recreation take the following actions:

- Ensure that the acquisition unit submits to General Services, by July 1, a record of each parcel purchased in the previous fiscal year.
- Report ancillary costs to General Services for inclusion in the Statewide Property Inventory.
- Ensure that the acquisition unit provides timely gift values to the accounting unit for inclusion in the State's financial statements.
- Reconcile the amounts reported in the Statewide Property Inventory with its Statement of Changes in General Fixed Assets.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

Parks and Recreation concurs with our findings and indicates that it has developed a system that will ensure the inclusion of gift values of current year acquisitions in the Statement of Changes in General Fixed Assets. In addition, it will develop a procedure for its acquisition unit to provide information to General Services at different points as purchases are made, finalized, and completed. Further, Parks and Recreation states that it is working with General Services to develop a process to include ancillary costs in the Statewide Property Inventory if possible. Finally, it will develop procedures to reconcile amounts reported in the Statewide Property Inventory and the Statement of Changes in General Fixed Assets throughout the year.

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## **DEPARTMENT OF FISH AND GAME**

Reference Number: 2003-19-4

### **CONDITION**

The Department of Fish and Game (Fish and Game) has inadequate procedures for accounting and reporting its real property. Fish and Game has two branches that report information on land and buildings and improvements to the Department of General Services' (General Services) Real Estate Services Division for inclusion in the Statewide Property Inventory. Its Land and Facilities Branch is responsible for reporting to General Services and reconciling with the Statewide Property Inventory. Its Fiscal and Administrative Services Branch, Property Unit has the same responsibilities for buildings and improvements. Its accounting unit reports real property information to the State Controller's Office (Controller's Office) for inclusion in the State's financial statements. However, for fiscal year 2001-02, the two branches did not reconcile their property listings with the Statewide Property Inventory. Further, the two branches and the accounting unit did not reconcile the property listings and

Statement of Changes in General Fixed Assets. Also, the accounting unit reported incorrect information to the Controller's Office.

Fish and Game also accounts for and reports real property information for the Wildlife Conservation Board (board). To compare Fish and Game's records to the Statewide Property Inventory, we had to include real property amounts for the board because General Services uses the same agency number for both agencies in the Statewide Property Inventory. Specifically, we determined the following:

- For the year ending June 30, 2002, Fish and Game's property listings for itself and the board had land of approximately \$490.1 million and buildings and improvements of approximately \$89 million, while the Statewide Property Inventory had approximately \$587.7 million and \$86.9 million, respectively, differences of \$97.6 million and \$2.1 million, respectively. In some instances, Fish and Game had items on its property listing that we could not match to the Statewide Property Listing. For example, we found 149 land items totaling \$56.4 million on the property listing, but not on the Statewide Property Inventory. Also, we found 191 land items totaling \$150.2 million on the Statewide Property Inventory that we could not locate on Fish and Game's property listing.
- Fish and Game and the board's Statements of Changes in General Fixed Assets reported as of June 30, 2002, land of approximately \$578.3 million and buildings and improvements of approximately \$106.1 million, differences of \$88.2 million and \$17.1 million, respectively, greater than the property listings. The primary reason for these differences is that the accounting unit records transactions at year end that may not have been finalized by June 30. For the year ended June 30, 2002, the accounting unit included land of approximately \$146.4 million and buildings and improvements of approximately \$17.9 million that may not have represented completed asset purchases.
- The accounting unit overstated land additions in the board's Statement of General Fixed Assets by at least \$2.5 million by including cash grants given to a non-state entity. In addition, for fiscal year 2002-03, we determined that Fish and Game reported an additional \$65.9 million in cash grants as land additions. Further, in fiscal year 2002-03, Fish and Game understated the gift value of land purchased by the board by \$46.1 million.

Unless Fish and Game reconciles its property listings to the Statewide Property Inventory, reconciles its property listings to its Statement of General Fixed Assets, and reports complete and accurate information to the Controller's Office and General Services' Real Estate Services Division, the State's financial statements will be misstated and the Statewide Property Inventory will be incomplete and inaccurate.

## **CRITERIA**

The California Government Code, Section 11011.15, requires each agency to furnish General Services with a record of each parcel of real property that it acquires and to update its real property holdings by July 1 of each fiscal year. It also requires General Services to maintain a complete and accurate inventory of all real property held by the State. General Services includes Fish and Game's information in the Statewide Property Inventory.

Additionally, the State Administrative Manual, sections 7463, 7977, and 8660, requires agencies to report to the Controller's Office in a Statement of Changes in General Fixed Assets all additions and deductions to real property funded by governmental funds. The Controller's Office includes this information in the State's financial statements.

Further, the Department of Finance (Finance) issued directives in July 2000 and September 2003 requiring agencies to evaluate the risk of an incomplete inventory and to reconcile the amounts reported in the Statewide Property Inventory with the Statement of Changes in General Fixed Assets. Finance also required agencies to periodically reconcile their real property inventories to ensure the inventories are complete and accurate.

## **RECOMMENDATIONS**

To ensure that it reports complete and accurate information for the State's financial statements and the Statewide Property Inventory, Fish and Game should:

- Annually reconcile the property listings with the amounts it reports in the Statewide Property Inventory and with the Statements of Changes in General Fixed Assets.
- Report in the Statement of Changes in General Fixed Assets real property that has been acquired on or before the end of the fiscal year.
- Report in the Statement of Changes in General Fixed Assets only real property acquired for the State.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

Fish and Game concurs with the identified weaknesses in reporting and reconciling general fixed assets. It states that it will reconcile the Statement of Changes in General Fixed Assets and the Statewide Property Inventory by June 30, 2004. In addition, Fish and Game states that it is evaluating weaknesses in the current system and will take corrective action that should make future reconciliations more efficient and accurate. Finally, it will develop procedures to ensure that grants to non-state entities are not recorded as general fixed assets.

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## **SECRETARY OF STATE**

Reference Number: 2003-19-5

### **CONDITION**

For the fiscal year ending June 30, 2002, we reported that the Secretary of State's Office did not exercise adequate control over its cash account during fiscal year 2001-02. Specifically, it did not promptly take action to cancel or send stop payment requests to the State Treasurer's Office (Treasurer's Office) for stale-dated checks that its records indicated were outstanding. In addition, the Secretary of State's Office did not adequately segregate duties in its accounting unit according to state administrative manual directions. In its corrective action plan, the Secretary of State's Office stated that it had established a policy to cancel stale-dated checks on a monthly basis. Further, it stated that due to the hiring freeze and recent elimination of vacant positions, it has been unable to secure additional employees to allow for appropriate segregation of accounting duties. However, it indicated that it is working to ensure the most important duties are appropriately segregated as outlined in the State Administrative Manual.

At the time of our follow-up review in January 2004, we determined that the accounting unit improved its operations by routinely canceling or sending stop payment requests to the Treasurer's Office in a timely fashion. However, the Secretary of State's Office continues to lack adequate separation of duties in its accounting unit. Specifically, one employee periodically enters data into the automated cash disbursements register and prints signed checks. This lack of adequate segregation of duties may allow errors and irregularities to go undetected.

### **CRITERIA**

The California Government Code, Section 13401, requires state agencies to effectively maintain internal accounting and administrative controls. Section 13403 indicates that such controls include segregation of duties appropriate for proper safeguarding of state agency assets. Specifically, the State Administrative Manual, Section 8080.1, provides that the same person should not maintain books of original entry for cash disbursements and produce signed checks.

### **RECOMMENDATION**

We recommend that the Secretary of State's Office ensure that a single individual is not in a position to enter data into the automated cash disbursements register and print signed checks.

## **OFFICE'S VIEW AND CORRECTIVE ACTION PLAN**

The Secretary of State's Office concurs with our finding and indicates that it has taken appropriate action to ensure that assets are properly safeguarded.

## **Compliance Issue Related to All Federal Grants**

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## **IDENTIFYING PROGRAM EXPENDITURES**

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Reference Number: 2003-12-1  
Federal Program: All Programs  
Category of Finding: Reporting

### **CRITERIA**

In our review of federal reports, we determined the following were among state and federal compliance requirements:

The U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (OMB Circular A-133), requires that the State prepare a schedule showing total expenditures for the year for each federal program. Further, OMB Circular A-133 requires that the State identify and audit all high-risk Type A federal programs. Type A programs are those exceeding .15 percent of total federal program moneys the State expends during the fiscal year. The California Government Code, Section 13300, assigns the Department of Finance (Finance) the responsibility for maintaining a complete accounting system to ensure that all revenues, expenditures, receipts, disbursements, resources, obligations, and property of the State are properly tracked and reported.

### **CONDITION**

Because of limitations in its automated accounting systems, the State has not complied with the provision of OMB Circular A-133 requiring a schedule showing total expenditures for each federal program. As a result, the schedule (beginning on page 155) shows total receipts, rather than expenditures, by program. Expenditure information is necessary to identify Type A programs. To ensure that we identified and audited all high-risk Type A programs, we reviewed accrual basis expenditures, which are identified manually, for all programs that we did not already plan to audit and that had cash receipts within 10 percent of the Type A program threshold. We identified one such program. Our review of the expenditures of this program showed that it did not exceed the Type A threshold.

### **RECOMMENDATION**

As priorities and resources permit, Finance should modify the State's accounting system to separately identify expenditures for all major programs.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

Finance states that the State's accounting system will require substantial modification to compile expenditure information to meet all federal and State requirements. Because the State has limited resources, Finance has no plans at this time to enhance the State's accounting system or to implement a new system.

**Compliance and Internal Control Issues  
Related to Specific Grants Administered  
by Federal Departments**

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## **U.S. DEPARTMENT OF AGRICULTURE**

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Reference Number:	2003-3-3
Federal Catalog Number:	10.557
Federal Program Title:	Special Supplemental Nutrition Program for Women, Infants, and Children
Federal Award Numbers and Calendar Years Awarded:	7CA700CA7; 2001 7CA700CA7; 2002
Category of Finding:	Cash Management
State Administering Department:	Department of Health Services

### **CRITERIA**

Our review of the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) program identified the following compliance requirements related to cash management:

The Code of Federal Regulations, Title 45, Section 92.20(b)(7), states that procedures for minimizing the time elapsing between the transfer of funds from the federal government and subsequent disbursement by subrecipients must be followed whenever the State makes advance payments to subrecipients. The Department of Health Services' (Health Services) WIC program manual limits prospective payments to one-twelfth of the contract amount. Such payments may be made before the execution of the contract but after its effective date. The program manual further states that Health Services will make prospective payments to subrecipients with cash-flow problems.

### **CONDITION**

Health Services does not always limit "prospective" payments of WIC program funds to the subrecipients' immediate needs. As a result, some subrecipients likely received WIC program funds in excess of their immediate cash needs. Specifically, Health Services paid WIC program funds to two of 10 subrecipients we reviewed that exceeded one-twelfth (one month) of their contract amount. In one instance, Health Services paid approximately 2.5 times the maximum one-month share of the contract amount. In the second instance, Health Services paid twice the maximum allowable amount. In both instances, Health Services paid the funds at the beginning of the contract term, before the subrecipients should have incurred any expenditures related to the contract. Because Health Services made prospective payments

to subrecipients that exceeded allowed amounts, it has less assurance that subrecipients minimize the time elapsing between the receipt and use of federal funds.

## **RECOMMENDATION**

Health Services should limit prospective payments of WIC program funds to one-twelfth of the subrecipients' contract amount.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

Health Services concurs that it should limit awarding federal funds for advance payments to meet the immediate needs of subrecipients and minimize the time federal funds are received and disbursed. Health Services awards advance payments to prospective local agencies prior to executing the contract, but no earlier than the contract effective date, to deter cash flow problems.

Health Services will implement the following procedures to limit advances of WIC program funds to one-twelfth of the subrecipients' contract amount:

- Include instructions in subrecipient contract award letters on how to request advance payments.
- Develop a spreadsheet to track the advance payment request process.
- Calculate one-twelfth of the contract amount based on the proposed contract budget at the time of the advance request.
- Award one advance payment for each of the three subsequent calendar months following the effective date of the contract.

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Reference Number:	2003-3-4
Federal Catalog Number:	10.557
Federal Program Title:	Special Supplemental Nutrition Program for Women, Infants, and Children
Federal Award Numbers and Calendar Years Awarded:	7CA700CA7; 2001 7CA700CA7; 2002
Category of Finding:	Cash Management
State Administering Department:	Department of Health Services

## **CRITERIA**

Our review of the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) identified the following compliance requirements related to cash management:

The Code of Federal Regulations, Title 31, Section 205, authorizes states to enter into a Treasury-State Agreement (agreement) with the federal Department of the Treasury to establish rules and procedures for the transfer of funds between the federal government and the State. For those programs receiving more than \$150 million in federal grant awards, California's agreement for fiscal year 2002-03 specifies which of the available methods state departments must use to transfer funds from the federal government.

The agreement identifies the "modified zero balance accounting" method as the one to be used by the WIC program to transfer federal funds to pay for state-issued food vouchers redeemed to the State by grocery and other stores. Under this transfer method, the Department of Health Services (Health Services) must estimate the amount of federal funds it needs daily to redeem food vouchers. Two days in arrears, Health Services must also account for the difference between the estimated and actual amounts by adjusting that day's transfer. The agreement states that neither the federal government nor the State will incur an interest liability for minor adjustment amounts.

## **CONDITION**

During the first three quarters of state fiscal year 2002-03, Health Services used an incorrect method when transferring funds from the federal government. Although it corrected the error, using the modified zero balance accounting method during the fourth quarter, Health Services did not always apply this method correctly. Specifically, Health Services did not accurately adjust two federal draws during May 2003. Consequently, Health Services maintained excess federal cash balances ranging from \$646,900 to \$3.4 million between May 16, 2003, and June 23, 2003. The overdrafts occurred because Health Services incorrectly believed that sufficient funds did not exist to cover the daily redemption of food vouchers.

## **RECOMMENDATION**

Health Services should continue to use the method specified in the agreement to draw federal funds to pay for state-issued food vouchers and limit draws of federal funds to the amount needed to cover the estimated daily redemption of food vouchers.

## DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Health Services concurs with the finding. In a Department of Finance review of the Treasury-State Agreement for the Cash Management Improvement Act (agreement), it was discovered that Health Services was not using the methodology identified in the agreement for WIC food vouchers. The Department of Finance asked that Health Services correct its tracking methodology. Health Services had been using the post issuance methodology. The method identified in the agreement is the modified zero balance funding technique. This adjustment was made in April 2003. To change its tracking method, Health Services prepared new spreadsheets to capture this information. Due to an erroneous formula in the spreadsheet, a rebate received was not offset against the correct day's food vouchers. This resulted in more federal funds being drawn than were actually needed. During the reconciliation process at the end of the quarter, staff discovered the error and corrected the formula in the spreadsheet and on June 25, 2003, a correction for the cash overage was made. Health Services does not expect this issue to reoccur.

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Reference Number:	2003-3-6
Federal Catalog Number:	10.568
Federal Program Title:	Emergency Food Assistance Program (Administrative Costs)
Federal Award Numbers and Calendar Years Awarded:	7CA810CA8; 2002 7CA810CA8; 2003
Category of Finding:	Cash Management
State Administering Department:	Department of Social Services

### CRITERIA

Our review of the Emergency Food Assistance Program identified the following compliance requirements related to cash management:

The Code of Federal Regulations, Title 31, Part 205, Subpart B, provides the cash management requirements for federal programs not covered in the Cash Management Improvement Act agreement between the U.S. Department of the Treasury and the State. Section 205.33 requires the State to limit cash advances from the U.S. Department of the Treasury to the minimum amounts needed.



## **CONDITION**

The Department of Social Services (Social Services) did not always limit cash advances of federal funds to the minimum amounts needed for the Emergency Food Assistance Program. In June 2003, Social Services transferred in an advance of \$600,000 in federal funds for the program. It based the size of this advance on the maximum amount it believed would be necessary to cover monthly expenditures incurred from July through September 2003. However, Social Services did not charge all or a portion of the expenditures it incurred against the advance; instead, it transferred in additional federal funds each month to reimburse itself for the prior month's expenditures. Consequently, Social Services had excess monthly balances of federal funds on hand in the State's accounts for July through October 2003 that ranged from \$499,700 to \$600,000 more than necessary to cover monthly expenditures. Social Services liquidated a portion of the \$600,000 advance between October 2003 and December 2003, four to six months after receiving it, leaving a balance of \$198,000 as of mid-December 2003.

## **RECOMMENDATIONS**

Social Services should limit advances of federal funds to the minimum amounts needed for the Emergency Food Assistance Program. To accomplish this objective, Social Services should reassess the level of federal funds it needs in light of actual expenditure activity and should ensure that it promptly liquidates excess cash balances.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

Social Services does not concur with the above finding. Based on the prior year's Bureau of State Audit's finding, Social Services reevaluated its advance estimation process and believes the \$600,000 advance was reasonable and consistent with Title 31, Part 205, Subpart B of the Code of Federal Regulations.

For nine to eleven months annually Social Services uses a General Fund Clearing Account to initially fund these costs. It is not until the end of the state fiscal year that operating capital is reduced, thus prompting the need for an advance based on an estimation of a program's monthly operating costs. The dates and actual costs displayed in the following table demonstrate that even though the advance is estimated for a given month, in reality it is funding both the prior month and current month costs.

**Table**

**ADVANCE/DRAW BREAKDOWN**

Date	Month	Advance/ Draw Amount	Recoup	Balance of Actuals	New Advance	Period Covered by Monthly Advance
June 2, 2003	ADVANCE	\$600,000			\$600,000	6/1—7/15 (45 days)
July 15, 2003	June 2003	\$1,364,185	\$(600,000)	\$764,185	\$600,000	7/1—9/19 (81 days)
Sept. 19, 2003	July 2003	\$547,902	\$(600,000)	\$(52,098)	\$600,000	8/1—9/26 (56 days)
Sept. 26, 2003	Aug. 2003	\$870,822	\$(600,000)	\$270,822	\$600,000	9/1—10/27 (57 days)
Oct. 27, 2003	Sept. 2003	\$100,325	\$(100,325)	0	0	10/1—11/21 (52 days)
Nov. 21, 2003	Oct. 2003	\$293,637	\$(293,637)	0	0	

Social Services believes that the aforementioned table demonstrates that Social Services did limit its cash advance to cover minimum operational needs.

**AUDITOR'S COMMENTS ON THE DEPARTMENT'S VIEW**

As we describe in the Condition, through September 2003 Social Services fully reimbursed itself for expenditures it incurred for the Emergency Food Assistance Program. It was not until October 2003 that Social Services began reducing the \$600,000 advance. To provide an accurate depiction, the last two lines of the "Balance of Actuals" column on Social Services' table should reflect the unliquidated portion of the advance of \$499,675 and \$206,038, respectively. We stand by our finding and recommendation.

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Reference Number: 2003-9-4  
Category of Finding: Suspension and Debarment  
State Agency: Health and Human Services  
State Administering Department: Department of Social Services

(See listing of the specific federal program details following the discussion of the issues below.)

## **CRITERIA**

Our review of the Emergency Food Assistance Program identified the following requirements related to suspension and debarment:

The Code of Federal Regulations, Title 7, Section 3017.225, prohibits the State from contracting with any party that is suspended or debarred or otherwise ineligible to participate in federal assistance programs. In addition, Section 3017.510 requires the State to obtain certifications from participating organizations indicating that they are not suspended, debarred, ineligible, or voluntarily excluded from transactions by any federal agency.

## **CONDITION**

For fiscal year 2002-03, the Department of Social Services (Social Services) did not require 46 of its Emergency Food Assistance Program subrecipients requiring suspension and debarment certifications to submit them. In response to our audit finding for fiscal year 2001-02, Social Services stated it would obtain the required suspension and debarment certifications from its subrecipients by making the certifications part of its future Memoranda of Understanding (MOU). Existing MOUs with these subrecipients expire on September 30, 2004. Social Services stated it will have suspension and debarment certifications included in the agreements that take effect on October 1, 2004. When Social Services does not obtain the required certifications for its current subrecipients, it risks unknowingly allowing suspended or debarred parties to participate in the federal program.

## **RECOMMENDATION**

Social Services should ensure that it obtains the necessary suspension and debarment certifications from all current subrecipients, in addition to obtaining certifications when approving their future participation in the Emergency Food Assistance Program.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

The Bureau of State Audits (BSA) audit correctly states that, in response to the fiscal year 2001-02 audit, the Emergency Food Assistance Program planned to include suspension and debarment certificates as part of its future MOU with its food bank subrecipients beginning federal fiscal year 2004 when the current agreements expire. In addition to these measures, the Emergency Food Assistance Program included additional measures in its previous response that this BSA audit omits.

The EFAP staff logged into the General Services Administration's federal "Excluded Parties Listing System" (EPLS) at [www.epls.gov](http://www.epls.gov). EPLS is the electronic version of the Lists of Parties Excluded from Federal Procurement and Non-procurement Programs,

which identifies those parties excluded throughout the U.S. Government from receiving federal contracts or certain subcontracts and from certain types of federal financial and non-financial assistance and benefits. The Emergency Food Assistance Program personally confirmed that none of the food bank recipients were suspended or debarred during the interim period. The Emergency Food Assistance Program believed that this “no-cost” method of certifying the eligibility of the food banks was a reasonable and more reliable alternative to developing and processing interim self-certification forms to the food banks. However, in recent discussions with the United States Department of Agriculture, they have expressed their unwillingness to accept the Emergency Food Assistance Program’s review of the EPLS as suspension and debarment certification. Therefore, the Emergency Food Assistance Program is currently preparing interim suspension and debarment certificates that will be sent to the food banks for signature to be returned by March 15, 2004.

### **U.S. DEPARTMENT OF AGRICULTURE**

Federal Catalog Number:	10.568
Federal Program Title:	Emergency Food Assistance Program (Administrative Costs)
Federal Award Numbers and Calendar Years Awarded:	7CA810CA8; 2002 7CA810CA8; 2003

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Federal Catalog Number:	10.569
Federal Program Title:	Emergency Food Assistance Program (Food Commodities)
Federal Award Numbers and Calendar Years Awarded:	TEFAP-2002-02, FD-05-06-3; 2002 TEFAP-2003-03, FD-5-6-3; 2003

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Reference Number:	2003-13-1
Federal Catalog Number:	10.558
Federal Program Title:	Child and Adult Care Food Program
Federal Award Number and Calendar Year Awarded:	7CA300CA3; 2002
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Education

## **CRITERIA**

Our review of the Child and Adult Care Food Program (food program) determined that the following federal requirement relates to subrecipient monitoring:

The U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (OMB Circular A-133), Section 400(d), requires that the State identify federal award information to subrecipients at the time of the award. This includes such information as the Catalog of Federal Domestic Assistance title and number, award name and number, and name of the federal agency.

## **CONDITION**

The Department of Education (Education) did not adequately fulfill its subrecipient monitoring responsibilities for the food program. Specifically, four of the five applications Education uses for its adult day care centers, child care centers, and day care homes did not contain the required federal award information. According to Education, it is ensuring during fiscal year 2003-04 that all applications it sends to subrecipients contain the required federal award information. Nevertheless, when Education does not identify the federal award information, it cannot ensure that subrecipients of the food program will identify for their independent auditors all their federal awards for audits conducted under OMB Circular A-133.

## **RECOMMENDATION**

Education should ensure that the federal award information is identified and provided to all subrecipients of the food program at the time of the award.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

Effective February 2004, Education plans to add a one-page document containing the required federal award information to new and renewal applications for child care centers and day care homes.

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Reference Number:	2003-13-5
Federal Catalog Number:	10.557
Federal Program Title:	Special Supplemental Nutrition Program for Women, Infants, and Children

Federal Award Numbers and Calendar Years Awarded:	7CA700CA7; 2001 7CA700CA7; 2002
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Health Services

## **CRITERIA**

Our review of the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) identified the following compliance requirements related to subrecipient monitoring:

The Code of Federal Regulations, Title 7, Section 246.19(b)(3), requires the State to conduct monitoring reviews of local agencies receiving WIC program funds at least once every two years. Additionally, Section 246.19(b)(1) states that the monitoring must include, among other things, a review of the local agency's operations and financial reports. Section 246.19(b)(4) requires the State to promptly notify a local agency of any finding resulting from a monitoring review. Health Services has established guidelines that require it to issue letters of findings to the local agencies within 60 days of the exit conferences. This section also requires the local agency to submit a corrective action plan within 60 days of receipt of the findings from the State. Finally, this section requires the State to monitor the local agencies' implementation of the corrective action plan.

## **CONDITION**

The Department of Health Services (Health Services) did not perform required biennial reviews of subrecipients of WIC program funds. Health Services performs the majority of the monitoring procedures during the on-site reviews, but it contracts with the State Controller's Office to perform the financial management portion of the review. However, four of the 40 reviews completed by the State Controller's Office in fiscal year 2002-03 were not completed within two fiscal years of the previous reviews. The delays ranged from 93 days to 411 days. Additionally, Health Services did not complete one of 41 on-site reviews within two fiscal years of completing the previous on-site review. Failure to conduct these biennial reviews may prevent the early detection and correction of deficiencies in services provided by the local agencies.

Additionally, Health Services does not always promptly notify the local agencies of findings identified during on-site reviews. Specifically, Health Services took more than 60 days following the exit conference to send a letter of finding to 20 of 40 local agencies we reviewed that had findings. The delays ranged from three to 126 days, averaging 40 days. According to Health Services, while the WIC guidelines state that it will send a letter of findings to local agencies within 60 days of the exit conference, in practice it attempts to issue the letter within 60 to 90 days. We also noted that up to five of the 40 local agencies for which Health Services reported findings did not submit their corrective action plans within 60 days, as required. Health Services could not

provide the corrective action plans for two of these five. Finally, Health Services could not provide evidence that it had evaluated the adequacy of five local agencies' implementation of corrective action plans from prior on-site reviews. As a result, Health Services cannot ensure that its subrecipients correct deficiencies promptly.

## **RECOMMENDATIONS**

To ensure that it complies with applicable federal laws and regulations, Health Services should conduct biennial on-site reviews of local agencies, as required. Additionally, Health Services should stress compliance with internal policies regarding issuing letters of findings to local agencies and ensuring that local agencies submit corrective action plans promptly. Health Services should consider revising its internal policies if it believes they are too restrictive.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

Health Services concurs that four of the 40 reviews conducted by the State Controller's Office in fiscal year 2002-03 were not done within two fiscal years of the previous review. The new State Controller's Office contract (effective July 1, 2004) will include language that clearly specifies timelines for completing each subrecipient review.

Health Services concurs that one of the 41 on-site visits performed by Health Services was not conducted within two fiscal years of the previous visit. This visit was originally scheduled on time but was postponed twice due to staff unavailability. Due to staff shortage of nutritionists available to conduct program evaluations, there was no one to replace these individuals at the time. Since then, Health Services has trained nutritionists from other sections of the WIC branch who can substitute for staff that become unavailable on short notice.

Health Services concurs that it does not always promptly notify the local agencies of findings identified during on-site reviews. The WIC Training Manual is an internal staff procedural training manual that states its goal for submitting the written report to the local agency is within 60 days of the exit conference. Health Services will revise the manual by March 1, 2004 to include a new goal that reflects a more realistic timeline (greater than 60 days) for submitting the written report, in consideration of reduced staff resources.

Health Services concurs that five of the 40 local agencies for which it reported findings, did not submit their corrective action plans within 60 days, as required. Health Services will be reviewing its procedures regarding local agency corrective action plans and will make appropriate changes to ensure follow-up.

Health Services concurs that it could not provide evidence that it had evaluated the adequacy of five local agencies' implementation of corrective action plans from prior on-site reviews conducted by WIC. Health Services has addressed this issue and has

revised its procedures to include technical assistance visits to verify correction of findings and a letter of closure when all findings have been addressed.

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Reference Number: 2003-13-6  
Category of Finding: Subrecipient Monitoring  
State Agency: Health and Human Services  
State Administering Department: Department of Social Services

(See listing of the specific federal program details following the discussion of the issues below.)

## **CRITERIA**

Our review of the Emergency Food Assistance Program identified the following compliance requirements related to subrecipient monitoring:

The U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (OMB Circular A-133), describes the requirements the State must follow when it passes federal funds through to subrecipients. Section 400(d) requires the State to ensure that subrecipients expending \$300,000 or more in federal assistance meet applicable audit requirements, including the submission of an audit report to the State within nine months following the end of the audit period. Also, the State is required to issue management decisions on audit findings within six months of receiving audit reports. Further, Section 400(d) requires the State to provide its subrecipients with information such as the federal grant title and number, award year, and the name of the federal agency.

## **CONDITION**

During fiscal year 2002-03, the Department of Social Services (Social Services) did not have an adequate system to ensure it met the OMB Circular A-133 requirements it must follow when it passes federal funds through to subrecipients. Specifically, Social Services did not have procedures to determine whether all of its 46 nonprofit subrecipients were required to submit audit reports. Such steps may include requiring each subrecipient to either inform Social Services that it did not expend \$300,000 or more in total assistance from all federal programs or to submit an appropriate audit report, and to identify nonprofit subrecipients to which it provided \$300,000 or more in federal assistance. Based on information available at Social Services, we determined that it provided at least \$300,000 in federal assistance during fiscal year 2002-03 solely from the Emergency Food Assistance Program to 17 of its 46 nonprofit



subrecipients. Social Services received audit reports from 16 of these 17 subrecipients, although it received six of them from one to seven months after the nine-month deadline. Social Services has not received the audit report that was due in June 2003 from the remaining subrecipient. Moreover, Social Services did not have procedures to ensure that it issued timely management decisions when audit reports disclosed findings. One of the 16 audit reports that Social Services received contained findings related to the Emergency Food Assistance Program. Although the required management decision was due by August 2003, Social Services did not issue it until October 2003. Finally, Social Services did not provide any of its nonprofit subrecipients with the required grant-related information, such as the federal grant title and number, the award year, and the name of the federal agency.

Although Social Services had prepared draft procedures as of August 2003 to ensure that it complies with OMB Circular A-133 requirements, these procedures were not in place during fiscal year 2002-03. Without an effective system to identify all nonprofit subrecipients required to have audits and to track the prompt receipt of these required audit reports, Social Services has reduced assurance that its nonprofit subrecipients are spending federal assistance according to applicable laws and regulations. Furthermore, when it does not issue timely management decisions on audit findings, Social Services cannot ensure that its subrecipients are taking prompt and appropriate action to address audit findings. Lastly, when Social Services does not provide subrecipients with information related to the federal grant, Social Services cannot assure that subrecipients will identify for their independent auditors all of their federal awards for audits conducted under OMB Circular A-133.

## **RECOMMENDATIONS**

Social Services should implement its draft procedures to identify those nonprofit subrecipients required to submit audit reports and should obtain audit reports from them in a timely manner. Additionally, it should promptly issue the required management decisions on audit findings affecting the Emergency Food Assistance Program. Finally, Social Services should ensure that it informs its subrecipients of the required federal grant information.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

The Bureau of State Audits (BSA) reported that during fiscal year 2002-03 Social Services did not have an adequate system to ensure it met OMB Circular A-133 requirements that require the food bank subrecipients to submit an audit report if they receive more than \$300,000 in total federal assistance during the year.

This finding was first brought to Social Services' attention during the BSA fiscal year 2001-02 audit of the Emergency Food Assistance Program. Because of an extraordinary amount of bonus United States Department of Agriculture commodities accepted by the Emergency Food Assistance Program in that fiscal year, many food banks that normally do not meet the A-133 criteria exceeded the \$300,000 threshold.

After the 2001-02 BSA audit brought this procedural deficiency to Social Services' attention, corrective measures were implemented. However, because the BSA audit was conducted late in fiscal year 2002-03, these corrective measures were not implemented until the beginning of fiscal year 2003-04. BSA had acknowledged with Social Services staff that it realized these findings would reoccur for fiscal year 2002-03 because of the timing of this audit. BSA staff also stated that this audit would make note of this circumstance.

The fiscal year 2002-03 audit finding also states that Social Services did not receive one audit report that was due in June 2003. The referenced audit has now been received and reviewed. There were no audit findings affecting the Emergency Food Assistance Program.

Also, in July 2003, as part of the new procedures developed by Social Services, a letter was sent to all food banks with a certification form for them to complete certifying whether or not they received \$300,000 or more in federal assistance. The letter also provided the food banks with the required grant-related information. As part of the new procedures, Social Services will be providing this information annually to the food banks. Unfortunately, the BSA audit did not review the corrective measures that the Emergency Food Assistance Program implemented during fiscal year 2003-04. Instead, Social Services has been advised that these measures will be reviewed during BSA's fiscal year 2003-04 audit of the Emergency Food Assistance Program next year. At that time, we hope to learn that our corrective measures are complete and effective.

**U.S. DEPARTMENT OF AGRICULTURE**

Federal Catalog Number:	10.568
Federal Program Title:	Emergency Food Assistance Program (Administrative Costs)
Federal Award Numbers Calendar Years Awarded:	7CA810CA8, 2002 7CA810CA8, 2003

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Federal Catalog Number:	10.569
Federal Program Title:	Emergency Food Assistance Program (Commodities)
Federal Award Numbers and Calendar Years Awarded:	TEFAP-2002-02, FD-05-06-3, 2002 TEFAP-2003-03, FD-5-6-3, 2003

## **U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**

Reference Number:	2003-7-1
Federal Catalog Number:	14.239
Federal Program Title:	HOME Investment Partnerships Program
Federal Award Number and Calendar Year Awarded:	M02-SG060100; 2002
Category of Finding:	Matching
State Administering Department:	Department of Housing and Community Development

### **CRITERIA**

Our review of the HOME Investment Partnerships Program (HOME) identified the following compliance requirements related to matching:

The Code of Federal Regulations, Title 24, Section 92.218 (a), states that each participating jurisdiction must make contributions to housing that qualifies as affordable housing under the HOME program throughout the fiscal year. Further, the same regulation states that those contributions must total at least 25 percent of the funds drawn from the jurisdiction's HOME Investment Trust Fund Treasury account in that fiscal year except for certain specific exclusions and reductions. Reductions include waivers provided by the federal government for distressed communities.

### **CONDITION**

The Department of Housing and Community Development's (Housing) system for determining whether it has made the necessary matching contributions for its HOME program is deficient. Housing's calculation of how much it needs to match and how much it has matched is based on self-reporting by local jurisdictions. Housing does not have a process for determining the completeness of these reports, such as reconciling the data to state accounting or other Housing records. Thus, for fiscal year 2002-03, we estimate that Housing did not include approximately \$6.8 million in HOME funds when calculating its matching needs.

In addition, the form Housing uses to obtain data from local jurisdictions requests that they identify the amount of funds subject to a waiver. However, the form does not differentiate between federally-waived funds, which are not subject to matching, and state-waived funds, which are subject to matching. According to Housing, when it instituted state waivers, it did not update the form to make a distinction between

federal and state waivers. As a result, in fiscal year 2002-03, local jurisdictions reported \$5.2 million in waived funds, which Housing did not include in its match calculation even though it says that no relevant federal waivers were in effect during that period. Because its system for determining its matching needs is deficient, we estimate that Housing understated its match requirement for fiscal year 2002-03 by approximately \$3 million.

Despite the problems identified above, Housing met its matching requirement during fiscal year 2002-03. This was the case because local jurisdictions provided funds that far exceeded the matching requirement, even after making corrections for the errors described earlier.

When Housing does not use accurate information to calculate both the matching requirement and the amount of its match, it risks failing to meet the matching requirement and having to repay the federal awarding agency for unmatched funds.

## **RECOMMENDATION**

Housing should change its system for calculating its required match to assure that the supporting data is accurate and complete.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

According to the Department of Housing and Urban Development (HUD) Community Planning and Development notice CPD 97-3, the HOME participating jurisdiction:

- incurs a 25 percent match obligation each federal fiscal year based on the amount of HOME funds drawn from the federal treasury, and
- must make eligible matching contributions in an amount equaling the match obligation incurred that fiscal year.

The CPD Notice further states that “matching contributions made in excess of the match obligation may be carried forward as match credit toward meeting obligations incurred in future years.” This means that matching requirements are based on funds actually drawn down, adjusted for excess match from previous fiscal years. Because of the carryover authorization, the true test of sufficient match is total funds drawn down compared to total eligible match invested in funded projects since the program began.

Housing uses the City Software application to perform the analysis of what match is required and whether or not matching requirements are being met. Housing also uses this system to determine potential excess match collected that would provide flexibility for a State match waiver if determined necessary to facilitate affordable housing development. Actual expenditures and match contributions are tracked in City Software beginning at the time the project is entered into this system (set up) and this

data, rather than the jurisdictions' annual performance reports or the Consolidated Annual Performance and Evaluation report (CAPER), are used by Housing for analysis of match obligations. Therefore, Housing does not agree that there is a risk of failing to meet the matching requirement or having to repay the federal awarding agency for unmatched funds.

Housing agrees, however, that the self-reporting data provided by local jurisdictions in their annual performance reports and used to prepare the CAPER can conflict with the State accounting records. This occurs because of variations in the timing of the local cash requests sent to the HOME Program.

In order to improve our reporting capacity, Housing will amend the annual performance report forms for 2003-04 to clearly distinguish federal and state match waivers. In addition, Housing consulted with HUD and has begun development of an alternative State tracking and reporting system to record our match obligation and outcomes. This project has now been included in a new Federal Integrated Financial Information System currently under development. Housing will continue to monitor matching contributions closely through City Software until the new project is completed. When fully deployed, Housing will use the new system, rather than data from jurisdictions' annual performance reports, to report matching contributions to HUD.

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Reference Number:	2003-9-2
Federal Catalog Number:	14.228
Federal Program Title:	Community Development Block Grant/State's Program
Federal Award Numbers and Calendar Years Awarded:	B-00-DC-06-0001; 2001 B-01-DC-06-0001; 2002
Category of Finding:	Suspension and Debarment
State Administering Department:	Department of Housing and Community Development

## **CRITERIA**

Our review of the Community Development Block Grant/State's Program (CDBG) identified the following compliance requirements related to suspension and debarment:

The Code of Federal Regulations, Title 24, Section 24.225, prohibits the State from knowingly doing business with any party that is suspended, debarred, or otherwise ineligible to participate in federal assistance programs. Further, Section 24.510 requires the State to obtain signed certifications from participating organizations regarding debarment, suspension, ineligibility, and involuntary exclusion.

## **CONDITION**

The Department of Housing and Community Development (Housing) did not obtain the suspension and debarment certifications from 26 of 40 subrecipients of CDBG funds we reviewed. Although Housing revised the standard agreement it makes with subrecipients to include suspension and debarment certifications in response to a similar finding for fiscal year 2001-02, it still failed to obtain certifications from 13 of the 26 subrecipients even though it entered into these agreements after revising its standard agreement. Although the new certification was part of the Housing application package, five of these 13 subrecipients did not include the certification with their signed agreement and Housing did not follow up by requesting that they submit the document. In addition, Housing failed to include the certification in the application package for the remaining eight. When Housing does not obtain the required certifications, it risks unknowingly allowing suspended or debarred parties to participate in the federal program. For these 26 transactions, we used an alternative test to determine that the subrecipients were not suspended or debarred.

## **RECOMMENDATION**

Housing should ensure that it consistently includes the suspension and debarment certification in its application package and that its subrecipients submit the certification.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

The Code of Federal Regulations prohibits the State from knowingly doing business with any party that is suspended, debarred or otherwise ineligible to participate in federally assisted programs. No cities or counties that participate in the California State CDBG program are or have been on the Federal Suspended/Debarred list. However, in its response to a 2002-03 Bureau of State Audits (BSA) finding for the CDBG program, Housing agreed to include self certification language in future applications for funding. Prior to the 2002-03 audit finding, the CDBG program had already begun phasing in this new procedure as a result of a 2001-02 BSA finding for the HOME program, adding the certification to its 2002 Planning/Technical Assistance Application. In March of 2003, during the review of the General/Native American/Colonias allocation applications, Housing requested and received an "addendum" to the Statement of Assurances from each applicant city or county that certified they were not on the Federal debarred/suspended list. As stated in Housing's October 2003 correspondence to the Department of Finance on the status of prior

year findings, the revised Statement of Assurances containing the certification language was included in all CDBG NOFA/Applications as of July 2003.

Notwithstanding these measures, Housing concurs that five applicant jurisdictions submitted a prior version of the Statement of Assurances after July 2003 that lacked the debarment/suspension language. This omission was not found by the CDBG representatives during the review of applications. To prevent future omissions, Housing has included a revision date on the top of the Statement of Assurances and instructed staff to ensure that only the most recent revision is submitted.

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Reference Number:	2003-14-3
Federal Catalog Number:	14.239
Federal Program Title:	HOME Investment Partnerships Program
Federal Award Number and Calendar Year Awarded:	M02-SG060100; 2002
Category of Finding:	Special Tests and Provisions
State Administering Department:	Department of Housing and Community Development

## **CRITERIA**

Our review of the HOME Investment Partnerships Program (HOME) found the following requirements related to special tests and provisions:

The Code of Federal Regulations, Title 24, Section 92.250(b), states that before committing funds to a project, the State must evaluate the project in accordance with guidelines that it has adopted for this purpose and will not invest more HOME funds, in combination with other governmental assistance, than necessary to provide affordable housing. Additionally, Directive Number 98-01 issued by the U.S. Department of Housing and Urban Development recommends the same evaluation be performed when determining the level of HOME funds to be used in a project even when there is no other governmental assistance.

The California Department of Housing and Community Development's (Housing) HOME Program Application Training Manual (manual) states that a subsidy-layering analysis must be completed for *all* rental projects to ensure that no more HOME funds than necessary are being invested. Additionally, Housing's HOME contracts require

recipients to demonstrate that the amount of HOME funds, in combination with other governmental assistance, is not more than is necessary to provide housing to low-income households.

## **CONDITION**

Our review of six HOME contracts that had expenditures for rental housing developments in fiscal year 2002-03 revealed that Housing did not obtain the required layering analysis for one of them. The contract missing the layering analysis identified more than \$752,000 of HOME funds in addition to other governmental assistance to rehabilitate 95 rental units. Without the layering analysis, Housing cannot ensure that it is not investing more HOME funds than necessary to provide affordable housing.

## **RECOMMENDATION**

Housing should ensure that state recipients who apply for assistance with rental projects submit the required layering-analysis certification before distributing any HOME program funds.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

According to Housing's HOME Program management, one staff member did not obtain a layering-analysis certificate or other evidence to show that a layering analysis was completed. HOME Program management agrees that a layering analysis should be done for all rental property projects and further states that existing procedures, included in Housing's HOME contract management manual (used by both Housing staff and state recipients), require the analysis and certificate to be completed. HOME management has trained the erring employee on appropriate procedures and reminded other staff of these requirements.



## U.S. DEPARTMENT OF LABOR

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Reference Number: 2003-2-1

Category of Finding: Allowable Costs

State Administering Department: Employment Development Department

(See listing of the specific federal program details following the discussion of the issues below.)

### CRITERIA

Our review of federal programs at the Employment Development Department (EDD) determined that the following are among the compliance requirements for allowable costs and cost principles:

The U.S. Office of Management and Budget Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments* (OMB Circular A-87), Attachment A, Section C, states that for costs to be allowable under federal awards, they must be allocable to federal awards under the provisions of this circular. This is the case if the goods or services involved are chargeable or assigned to a grant in accordance with the relative benefits achieved. In addition, this section states that where an accumulation of indirect costs will ultimately result in charges to a federal award, a cost-allocation plan will be required as described in OMB Circular A-87, Attachments C, D, and E. OMB Circular A-87, Attachment E, Section A, states that indirect costs are incurred for common or joint purposes. These costs benefit more than one cost objective and cannot be readily identified with a particular final cost objective without effort disproportionate to the results achieved.

In addition, OMB Circular A-87, Attachment B, Section 11, states that charges to federal awards for salaries and wages will be based on payrolls documented according to the generally accepted practice of the governmental unit and approved by a responsible official of the governmental unit. EDD's employee time reports include a signature block for the person approving an employee's time.

### CONDITION

EDD allocated eight of 40 expenditures we reviewed even though it had not obtained federal approval to do so as part of its indirect cost rate proposal. These included two payroll and six operating expense and equipment (OE&E) transactions. EDD used the allocation codes to distribute payroll costs for printing and mailing services, office supply costs, and information technology payroll and OE&E costs that it could not specifically identify with a particular program. Consequently, EDD should have included and distributed these allocated costs under its indirect cost rate proposal.

Costs related to the eight test items totaled \$25,016. Although we could not determine the amount of allocated costs charged to the federal programs we audited, according to EDD, during fiscal year 2002-03 it used 65 allocation codes to distribute personnel costs and 85 allocation codes to distribute OE&E costs totaling more than \$62 million and \$36 million, respectively. These allocated costs were not included under EDD's indirect cost rate proposal. In total, these allocated costs represented 9 percent of EDD's state operations expenditures of \$1.1 billion for fiscal year 2002-03. When EDD does not distribute indirect costs under an indirect cost rate proposal, it is less likely to adequately demonstrate that these costs are distributed in accordance with the relative benefits received by its various programs.

We reported a similar finding related to inadequately documented allocation codes during our audits for fiscal years 1998-99 through 2001-02.

In addition, for five of the 25 payroll expenditures we reviewed, the signature block for approval of the related employee time sheet was blank. When a time sheet is not reviewed and approved there is less assurance that reported time accurately reflects the work of employees. The payroll expenditures from these five time sheets totaled more than \$22,000. We reported a similar condition during our audit for fiscal year 2001-02.

## **RECOMMENDATIONS**

EDD should include in its indirect cost rate proposal documentation to substantiate its use of indirect costs for such expenditures as information technology services, office supplies, and mailing costs. EDD should also reiterate to its staff that supervisors must review and approve employee time sheets.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

EDD will continue to implement changes toward achieving full compliance with Office of Management and Budget (OMB) Circular A-87. As part of ongoing efforts, EDD will include documentation for its allocated costs in the indirect cost rate proposal. EDD reminds all staff periodically, and soon will again issue an administrative email to all staff, that employee time sheets must be supervisor reviewed and approved. A similar notification will be sent to all attendance clerks emphasizing the need to monitor employee timesheets for the approvals.

## **U.S. DEPARTMENT OF LABOR**

Federal Catalog Number:	17.207
Federal Program Title:	Employment Service
Federal Award Number and Calendar Year Awarded:	ES-12119-02-55; 2002

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Federal Catalog Number: 17.801  
Federal Program Title: Disabled Veterans' Outreach Program  
Federal Award Number and  
Calendar Year Awarded: E-9-5-3-5085; 2003

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Federal Catalog Number: 17.804  
Federal Program Title: Local Veterans' Employment  
Representative Program  
Federal Award Number and  
Calendar Year Awarded: E-9-5-3-5085; 2003

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Federal Catalog Number: 17.225  
Federal Program Title: Unemployment Insurance  
Federal Award Number and  
Calendar Year Awarded: UI118080255; 2001

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Federal Catalog Number: 17.258  
Federal Program Title: WIA Adult Programs  
Federal Award Number and  
Calendar Year Awarded: AA-12000-02-50; 2002

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Federal Catalog Number: 17.259  
Federal Program Title: WIA Youth Activities  
Federal Award Number and  
Calendar Year Awarded: AA-12000-02-50; 2002

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Federal Catalog Number: 17.260  
Federal Program Title: WIA Dislocated Workers  
Federal Award Number and  
Calendar Year Awarded: AA-12000-02-50; 2002

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Reference Number: 2003-2-2  
Category of Finding: Allowable Costs  
State Administering Department: Employment Development Department

(See listing of the specific federal program details following the discussion of the issues below.)

## **CRITERIA**

Our review of the Employment Service program identified the following compliance requirements related to allowable costs:

The U.S. Office of Management and Budget Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments* (OMB Circular A-87), Attachment A, Section C, states for costs to be allowable under federal awards, they must not be included as a cost of any other federal award in either the current or a prior period, except as specifically provided by federal law or regulation.

## **CONDITION**

The Employment Development Department (EDD) drew down federal funds under one program to pay the costs of another program. Specifically, we found that EDD drew down \$2.8 million in excess of its expenditures for the Employment Service program between April and June 2003. This amount related to costs that EDD had recorded in its accounting system for the Labor Certification for Alien Workers (Labor Certification) program rather than the Employment Service program. EDD states that although it received budget authority for the Labor Certification program from the U.S. Department of Labor, the federal government delayed releasing funds for the program. Therefore, EDD requested cash for Labor Certification program expenditures under the Employment Service program account until the federal government released Labor Certification funds on June 13, 2003. EDD believes that using Employment Service funds to pay for Labor Certification costs was justified since both awards were included in the same federal grant. However, although both programs are part of the same grant, the federal government authorized the State to draw funds for each program separately. Subsequent to June 13, 2003, EDD reduced its cash requests for the Employment Service program, and by June 25, 2003, it had brought cash draws into line with actual program expenditures.

When EDD draws funds for programs where the federal government has not authorized it to do so, it risks having to return funds if the federal government does not eventually provide authorization.

## RECOMMENDATION

EDD should ensure that funds authorized for one federal program are used only for that program.

## DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

There is often a delay between grant approval by the U.S. Department of Labor (DOL) and posting the authority to draw cash. The DOL expects EDD to start operating the program immediately after the grant approval. In the example cited in the finding, EDD incurred expenditures that had to be paid before the cash was posted, therefore cash was drawn from a similar federal program where the expenditures would be allowable under either program. As noted by the auditors, cash draws were adjusted between the two programs. We are not aware of any instance when we did not receive authority to draw cash within a few weeks of receiving grant approval; when adjustments are necessary, they are routinely made promptly to ensure accurate program cash draws.

### U.S. DEPARTMENT OF LABOR

Federal Catalog Number:	17.207
Federal Program Title:	Employment Service
Federal Award Number and Calendar Year Awarded:	ES-12119-02-55; 2002

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Federal Catalog Number:	17.203
Federal Program Title:	Labor Certification for Alien Workers
Federal Award Number and Calendar Year Awarded:	ES-12119-02-55; 2002

## **U.S. DEPARTMENT OF TRANSPORTATION**

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Reference Number:	2003-4-1
Federal Catalog Number:	20.205
Federal Program Title:	Highway Planning and Construction
Federal Award Number and Calendar Year Awarded:	N4520.169; 2003
Category of Finding:	Davis-Bacon; Suspension and Debarment; Special Tests and Provisions
State Administering Department:	Department of Transportation

### **CRITERIA**

Our review of the Highway Planning and Construction program identified the following compliance requirement:

The Code of Federal Regulations, Title 49, Section 18.42, in part, requires the State to retain all financial and program records, supporting documents, statistical records, and other records considered pertinent to program regulations or the grant agreement for a three-year period. This period starts on the day the grantee, which is the State, submits its final expenditure report to the U.S. Department of Transportation, Federal Highway Administration (FHWA).

### **CONDITION**

The California Department of Transportation (Caltrans) could not always locate its contract files or other documents to show that it complied with certain federal requirements for its highway construction projects. Specifically, of the 40 construction contracts we tested that were active during fiscal year 2002-03, Caltrans could not locate the signed proposal and contract for four. We identified similar records-retention errors during our audit for fiscal years 2000-01 and 2001-02. In addition, we could not ensure that two of Caltrans' district offices performed quality-assurance testing on all materials and workmanship they used for four of 11 construction projects we tested, because the offices could not locate the supporting documents or had used an incorrect retention start date and prematurely purged the project files. We identified similar records-retention errors at a Caltrans district during our audit for fiscal year 2001-02. Further, we were unable to ensure prevailing wages had been paid to the laborers on one of the 40 construction contracts we tested, because Caltrans staff at the district labor compliance office could not locate the certified payroll records for that contract. Finally, of the five contracts we tested for contract change order approvals,

Caltrans did not have required FHWA project extension approvals for seven change orders for one of these contracts. Caltrans said that the lack of approvals on this project was the result of inaction on the part of FHWA. However, Caltrans had not documented its efforts to obtain FHWA approval in most of these cases. Thus, we could not ensure that Caltrans was not at least partially responsible for the lack of FHWA approval on its change orders. As a result, we cannot conclude that Caltrans fulfilled its responsibilities related to these compliance requirements. Furthermore, when Caltrans does not properly maintain documents that demonstrate its compliance with federal requirements for highway construction projects, it risks incurring costs that FHWA may not reimburse.

## **RECOMMENDATIONS**

Caltrans should remind its staff to ensure the accuracy of its system of tracking contract files and other documents for its highway construction projects as well as ensure that the contract files are retained for the length of time required by federal regulations. To ensure that the records-retention period is started from the correct date, Caltrans should provide records-retention staff with the date on which it submitted final expenditure reports for individual projects. Finally, Caltrans should begin documenting its efforts to obtain FHWA approval for all contract change orders on non-exempt projects.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

Two compliance issues reported are repeat findings from the prior year's audit. However, when compared to the total number of active construction projects as of June 30, 2003 (626), the four compliance issues are considered minor. Nonetheless, we will re-emphasize to staff the importance of ensuring the accuracy of tracking documents contained in contract files. Staff will again be reminded that the file retention period begins on the date the final federal voucher is submitted. All construction records coordinators have been verbally instructed about this requirement. Further, Caltrans will ensure that the appropriate Caltrans staff is routinely provided with a list of recent federal voucher submittals to establish the file retention periods. Staff will also be provided with a copy of the Records Retention Schedule, which designates the retention period for various documents. Lastly, staff that processes change orders will be instructed to keep a record of the request for FHWA approval.

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Reference Number:	2003-9-3
Federal Catalog Number:	20.505
Federal Program Title:	Federal Transit—Metropolitan Planning Grants

Federal Award Number and  
Calendar Year Awarded: CA-81-X003-00; 2002

Category of Finding: Suspension and Debarment

State Administering Department: Department of Transportation

## **CRITERIA**

Our review of the Federal Transit—Metropolitan Planning Grants (planning grant) program identified the following compliance requirement:

The Code of Federal Regulations, Title 49, Section 18.35, requires that the State neither make an award nor permit a subgrantee to make an award to any party which is debarred or suspended. Further, Title 49, Section 29.510, states that each participant must submit a certification regarding suspension and debarment at the time the participant submits its proposal.

## **CONDITION**

Although the California Department of Transportation (Caltrans) states in its guidance to subrecipients of the planning grant that subrecipients must submit suspension and debarment certifications, Caltrans did not always have suspension and debarment certifications from its subrecipients. More specifically, of the 22 subrecipients tested, Caltrans did not have the appropriate certifications for six. When Caltrans does not obtain the required certifications, it risks unknowingly allowing suspended and debarred parties to participate in the federal program. For the six subrecipients that did not have certifications, we used an alternative test to determine that the subrecipients had not been suspended or debarred.

## **RECOMMENDATION**

Caltrans should ensure that subrecipients submit the required suspension and debarment certification before it approves their participation in the planning grant program.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

Caltrans, through a series of procedures, will ensure that subrecipients submit the required suspension and debarment certifications before it approves their participation in the planning grant program. The procedures will include placing greater emphasis on completion and retention of all certifications and assurances by written Overall Work Program (OWP) guidance (completed in January 2004), double-checking final OWP packages by Regional Coordinators, and not approving encumbrance of funds until all required certifications and assurances, including suspension and debarment certifications, are completed and on file.



## **U.S. ENVIRONMENTAL PROTECTION AGENCY**

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Reference Number:	2003-12-4
Federal Catalog Number:	66.458
Federal Program Title:	Capitalization Grants for State Revolving Funds
Year Awarded:	State fiscal year 2002-03
Category of Finding:	Reporting
State Administering Department:	State Water Resources Control Board

### **CRITERIA**

The Water Pollution Control Revolving Fund (Fund) is required to submit Financial Status Reports (Form 269) to the U.S. Environmental Protection Agency (EPA).

### **CONDITION**

As a result of the accounting for EPA grant funding on a first in first out basis, the manner in which the Fund has been applying the indirect cost allocation on a monthly basis to the grant awards has resulted in incorrect reporting of the indirect cost rate on the Form 269s filed for each grant award. Although there were incorrect amounts reported, the Fund did not draw funds in excess of the amounts allowed and therefore there are no questioned costs.

### **RECOMMENDATIONS**

We recommend the Fund appropriately report the indirect costs applied to each grant year. This will require a monthly analysis of the indirect costs charged to the grants to appropriately identify when one grant award has been completely expended and when the next grant award is beginning to be utilized.

### **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

The Fund agrees with the finding and has reviewed procedures along with providing additional training to staff to ensure that information submitted to the EPA is accurate. The Fund has revised the procedures for adjusting indirect cost percentages. Indirect cost percentages for the current fiscal year ended June 30, 2003, were adjusted correctly; however, when averaged with the higher percentages from adjustments

posted in previous years the percentages submitted to the EPA on current Financial Status Reports (Form 269) will remain above the approved rates. The revised procedures for adjusting indirect cost percentages will be fully implemented by the end of the fiscal year ending June 30, 2004, after which the average indirect cost rate will be correctly reflected.

# FEDERAL EMERGENCY MANAGEMENT AGENCY

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Reference Number: 2003-12-2  
Category of Finding: Reporting  
State Administering Department: Office of Emergency Services

(See listing of the specific federal program details following the discussion of the issues below.)

## CRITERIA

Our review of the Public Assistance Grants and Hazard Mitigation Grant programs determined that the following compliance requirements relate to reporting:

The Code of Federal Regulations, Title 44, Section 13.20, requires the Office of Emergency Services (Emergency Services) to maintain accounting records to properly track and accurately report financial activities related to federal grants. Additionally, Title 44, Section 13.41(b), requires Emergency Services to use the financial status report form to report on the status of federal funds for nonconstruction grants. To meet this requirement, the Federal Emergency Management Agency (FEMA) requires Emergency Services to submit quarterly financial status reports for each disaster. FEMA mandates that these status reports are to include total recipient and subrecipient non-federal expenditures and administrative expenses.

## CONDITION

Emergency Services' financial status reports do not always contain complete and accurate expenditure information. Specifically, because it does not have an internal control process to review its reports for accuracy, Emergency Services overstated the federal share of outlays by \$2.7 million on one of its financial status reports for its Public Assistance Grants program. After we brought this error to the attention of Emergency Services, it submitted a corrected report to FEMA.

In addition, for each of the 16 financial status reports for fiscal year 2002-03 that we tested, Emergency Services did not report subrecipient share of outlays for the Hazard Mitigation Grant program because it does not have a process to capture the expenditure information it receives from subrecipients. Also, Emergency Services did not provide separate disclosure of its and the subrecipients' administrative costs in the financial status reports for the Public Assistance and Hazard Mitigation grant programs. FEMA requires separate reporting of administrative expenditures so that it can accurately compute and analyze the shared costs of the disaster.

## RECOMMENDATIONS

Emergency Services should establish a process to review its reports for accuracy. It should also compile the subrecipient share of outlays it receives and accurately report these expenditures. Finally, Emergency Services should separately account for and report its and the subrecipients' administrative costs per FEMA instructions.

## DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Emergency Services has made several attempts over the years to discuss with the Department of Homeland Security/FEMA how best to report California Disaster Activity (which currently involves several thousand individual projects) into a single, generic federal report format. Given the repeat nature of this finding; however, Emergency Services will initiate a formal request to FEMA management this year to reach a consensus on how to report on-going disaster assistance activity without creating a burdensome workload for the State.

Emergency Services acknowledges the error in its reporting and will ensure a more thorough review be completed to ensure accuracy.

### FEDERAL EMERGENCY MANAGEMENT AGENCY

Federal Catalog Number:	83.544
Federal Program Title:	Public Assistance Grants
Year Awarded:	State fiscal year 2002-03

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Federal Catalog Number:	83.548
Federal Program Title:	Hazard Mitigation Grant
Year Awarded:	State fiscal year 2002-03

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Reference Number:	2003-13-3
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Office of Emergency Services

(See listing of the specific federal program details following the discussion of the issues below.)

## **CRITERIA**

Our review of the Public Assistance Grants and Hazard Mitigation Grant programs determined that the following compliance requirements relate to subrecipient monitoring:

The U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (OMB Circular A-133), requires subrecipients spending \$300,000 or more in federal assistance to submit audit reports to the State within nine months of the end of their fiscal year. If an audit finds that a subrecipient has failed to comply with federal program requirements, OMB Circular A-133 also requires the State to issue a management decision regarding the resolution of the audit finding within six months of receiving the audit report and to ensure that the subrecipient proceeds with corrective action as rapidly as possible.

## **CONDITION**

The Office of Emergency Services (Emergency Services) did not adequately fulfill its subrecipient monitoring responsibilities for its Public Assistance Grants and Hazard Mitigation Grant programs. Specifically, during fiscal year 2002-03, Emergency Services did not ensure that it received and reviewed audit reports for each of the 23 private nonprofit subrecipients that expended \$300,000 or more in federal assistance. Although Emergency Services asserted that it received and reviewed five audit reports from these subrecipients, it failed to obtain the audit reports from another six, and it did not review the audit reports it did receive from another eight. However, our testing showed that Emergency Services did receive and review an additional four audit reports.

Additionally, the State Controller's Office reviewed the annual audit reports of local government agencies receiving \$300,000 or more and forwarded one unresolved finding to Emergency Services for its follow up to ensure the local agency took corrective action. However, as of September 2003, the State Controller's Office had no record of whether Emergency Services insured that corrective action had been taken. Further, Emergency Services could not determine whether it had resolved this finding, citing its current practice not to track and review audit reports.

According to Emergency Services, in May 2003 it decided to no longer track and review audit reports of its subrecipients due to staffing limitations. When Emergency Services does not adequately fulfill its subrecipient monitoring responsibilities, it reduces assurance that its subrecipients comply with federal program regulations and administrative requirements.

## RECOMMENDATIONS

Emergency Services should promptly reinstitute its former practice of reviewing and tracking nonpublic subrecipient audit reports, as well as following up on all reported audit findings concerning subrecipients.

## DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Emergency Services agrees that it did not fulfill all pass-through agency requirements included in OMB Circular A-133; however, Emergency Services has other programmatic procedures in place to ensure that subrecipients comply with federal program regulations and administrative requirements. Due to the existence of these other procedures, staff have been redirected from OMB Circular A-133 subrecipient monitoring to other duties.

During the past 12 months, Emergency Services has experienced a staffing decrease of approximately 40 percent, while at the same time experiencing an increased workload related to Homeland Security grants. OMB Circular A-133 subrecipient monitoring will be reinstated when staffing levels are increased to meet all programmatic requirements.

### FEDERAL EMERGENCY MANAGEMENT AGENCY

Federal Catalog Number:	83.544
Federal Program Title:	Public Assistance Grants
Year Awarded:	State fiscal year 2002-03

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Federal Catalog Number:	83.548
Federal Program Title:	Hazard Mitigation Grant
Year Awarded:	State fiscal year 2002-03

## U.S. DEPARTMENT OF EDUCATION

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Reference Number:	2003-1-5
Federal Catalog Number:	84.048
Federal Program Title:	Vocational Education—Basic Grants to States
Federal Award Number and Calendar Year Awarded:	V048A020005; 2002
Category of Finding:	Activities Allowed
State Administering Department:	California Community Colleges, Chancellor's Office

### CRITERIA

Our review of the Vocational Education—Basic Grants to States program (Vocational Education) identified the following requirements related to activities allowed:

The United States Code, Title 20, Section 2342(c)(1)(B), requires the State to develop criteria to approve subrecipients' applications for Vocational Education funds. Based on this requirement, the California Community Colleges, Chancellor's Office (Chancellor's Office) has developed procedures to approve subrecipient applications for Vocational Education funds.

### CONDITION

The Chancellor's Office did not ensure that it approved applications for subrecipients of the Vocational Education program. Subrecipients annually submit to the Chancellor's Office applications that identify how they plan to use Vocational Education funds. Because the Chancellor's Office disburses Vocational Education program funds to its subrecipients through monthly apportionments, it does not always approve applications before it disburses funds to the subrecipients. We considered an approval appropriate when the Chancellor's Office approved the application during the fiscal year. However, we found that for fiscal year 2002-03 the Chancellor's Office did not approve applications by the end of the fiscal year for three of the 40 subrecipient files we reviewed. The Chancellor's Office disbursed approximately \$1.3 million to the three subrecipients during fiscal year 2002-03. Although we found no evidence that the Chancellor's Office paid the subrecipients for unallowable activities, the Chancellor's Office risks doing so if it disburses funds to subrecipients without an approved application in its files.

## RECOMMENDATION

The Chancellor's Office should ensure that each subrecipient of its Vocational Education program has an approved application in the Chancellor's Office files for verification of allowable activities and costs.

## DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Upon review of this issue, the Chancellor's Office deems this citing to be one of record documentation and retention, stemming from unprecedented staffing changes, shortages, and restrictions on filling vacant positions prior to their abolishment.

The Chancellor's Office performs two application reviews for Perkins Title I-C: Technical and Program. Prior to certifying a recipient eligible for funding through the California Community College apportionment process, the application receives a Technical Review and approval. The Technical Review verifies that the applicant has met the threshold for funding. The Program Review focuses on technical assistance from the Chancellor's Office to optimize the local programs' effectiveness.

For future application approval processes, the Chancellor's Office will strive for the positive documentation of Technical Review approval.

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Reference Number:	2003-3-1
Category of Finding:	Cash Management
State Administering Department:	Department of Education

(See listing of the specific federal program details following the discussion of the issues below.)

## CRITERIA

Our review of the Special Education—Grants to States program (Special Education) and Special Education—Preschool Grants program identified the following requirements relating to cash management:

The Code of Federal Regulations, Title 34, Section 80.21, allows subrecipients to receive advance payments provided they demonstrate the ability to minimize the time elapsing between the receipt and disbursement of federal funds. Otherwise, reimbursement is the preferred method of payment. Further, this section requires subrecipients to promptly pay to the federal agency any interest earned greater than \$100 per year that they earned on the advances. Additionally, if subrecipients receive advance payments, Section 80.20(b)(7) requires them to follow procedures for minimizing the time between the receipt and disbursement of federal funds.



## **CONDITION**

The Department of Education (Education) does not have adequate procedures to ensure that program subrecipients demonstrate the ability to minimize the elapsed time between their receipt and use of federal program funds. Under its payment procedures, Education disburses predetermined percentages of program funds to subrecipients rather than assess each subrecipient's immediate cash needs and disburse funds accordingly. For example, during the grant period from July 2002 through September 2003, Education disbursed to Special Education subrecipients 25 percent of their initial grant awards in November 2002, April 2003, and June 2003, respectively. In addition, Education disbursed to Special Education—Preschool Grants subrecipients 50 percent of their initial grant awards in April 2003 and 25 percent in May 2003. After it receives the subrecipients' final expenditure reports, which are due 60 days after the end of the grant period, Education disburses any remaining amounts owed. Although the timing of the disbursements appears reasonable, Education does not require subrecipients to report their expenditures before disbursing the second and third payments. Thus, it has no assurance that subrecipients minimize the time between their receipt and disbursement of federal program funds.

Of the 40 transactions we reviewed for the Special Education and Special Education—Preschool Grants programs, 29 were advance payments to subrecipients where Education disbursed at least two payments during the fiscal year. Because Education disbursed approximately 75 percent of the program funds before it received expenditure reports, it disbursed \$99,949,136 with no assurance that these subrecipients had minimized the time between the receipt and use of federal funds.

For the fiscal year 2002-03 grant award, Education required subrecipients by November 30, 2003, to report and remit interest in excess of \$100 earned on federal program advances. However, Education did not require subrecipients of fiscal year 2001-02 grant awards to report and remit interest in excess of \$100 earned on federal program advances on the final expenditure reports it received during fiscal year 2002-03. As a result, the subrecipients may have used the interest on federal program advances for activities that may not be allowable.

## **RECOMMENDATIONS**

To minimize the elapsed time between the receipt and use of federal program funds, Education should implement procedures to assess each subrecipient's cash needs and adjust its advance payments accordingly. Additionally, Education should ensure its subrecipients report their program expenditures in time to allow Education to assess their cash needs before making additional advance payments. If Education determines it cannot implement procedures to ensure the subrecipients report program expenditures in time for it to assess cash needs and make additional payments, it should consider procedures to pay its subrecipients on a reimbursement basis rather than in advance. Education should also continue to ensure that subrecipients report and remit interest earned in excess of \$100.

## DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

In fiscal year 2003-04, Education implemented a midyear report for special education grants to assess each subrecipient's cash needs and adjust its advance payment accordingly. Education continues to ensure that subrecipients report and remit interest earned in excess of \$100.

### U.S. DEPARTMENT OF EDUCATION

Federal Catalog Number:	84.027
Federal Program Title:	Special Education—Grants to States
Federal Award Numbers and Calendar Years Awarded:	H027A010116; 2001 H027A020116; 2002

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Federal Catalog Number:	84.173
Federal Program Title:	Special Education—Preschool Grants
Federal Award Number and Calendar Year Awarded:	H173A020120; 2002

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Reference Number:	2003-3-5
Category of Finding:	Cash Management
State Administering Department:	California Community Colleges, Chancellor's Office

(See listing of the specific federal program details following the discussion of the issues below.)

### CRITERIA

Our review of federal programs identified the following requirements relating to cash management:

The Code of Federal Regulations, Title 34, Section 80.21, allows a state's subrecipients to receive advance payments provided they demonstrate the ability to minimize the time elapsing between the receipt and disbursement of federal funds. Otherwise, reimbursement is the preferred method of payment. Further, if a state's subrecipients receive advance payments, Section 80.20(b)(7) requires them to follow procedures for minimizing the time between the receipt and disbursement of federal funds.

## CONDITION

The California Community Colleges, Chancellor's Office (Chancellor's Office) does not have adequate procedures to ensure that subrecipients of the Vocational Education—Basic Grants to States program (Vocational Education) and Tech-Prep Education program (Tech-Prep) minimize the time elapsing between their receipt and use of federal program funds. Under its payment procedures, the Chancellor's Office approves program advances for each subrecipient and disburses these advances each month based on predetermined percentages. However, because the Chancellor's Office approves advances that exceed some subrecipients' immediate cash needs, some subrecipients carry excessive cash balances during the fiscal year.

The Chancellor's Office approves subrecipient applications, calculates advances, and pays these advances in monthly installments. To determine if a subrecipient's spending approximates the advances, the Chancellor's Office uses the subrecipients' quarterly year-to-date expenditure reports to compare the reported expenditures to the amounts it advanced to each subrecipient. If it determines that a subrecipient's spending approximates the advances, the Chancellor's Office authorizes further advance payments in full; otherwise, it reduces the subrecipient's monthly advance payments. Further, when the Chancellor's Office determines that a reduction in the monthly advance payment amount is warranted, it generally begins making these adjustments in the third quarter of the fiscal year. For fiscal year 2002-03, the Chancellor's Office revised its initial advance calculation for the Vocational Education program. The Chancellor's Office based the calculation on the amounts subrecipients spent in the first quarter of the prior year and it certified subrecipients to receive specific percentages of their tentative grant award.

Our review found that a significant number of subrecipients of the Vocational Education and Tech-Prep programs maintained high cash balances during the first and second quarters of fiscal year 2002-03. For example, although the adjustments the Chancellor's Office made to its initial advance calculation for the Vocational Education program reduced the number of subrecipients with high cash balances in the first two quarters, we still found that 11 of the 33 subrecipients we reviewed for the Vocational Education program maintained high cash balances ranging from \$2,370 to \$58,540 during the first quarter. By the third quarter, three of the 33 subrecipients maintained high cash balances ranging from \$66,060 to \$199,409. We considered balances high when they exceeded 10 percent of the amounts advanced by the Chancellor's Office. Similarly, for the Tech-Prep program, during the second quarter 12 of the 19 subrecipients we reviewed maintained high cash balances ranging from \$7,639 to \$62,275. During the third quarter, three of the 19 subrecipients we reviewed maintained high cash balances ranging from \$9,542 to \$14,931. Because the Tech-Prep program subgrants are small, we considered balances high when they exceeded \$7,000 and 10 percent of the amounts advanced for this program.

The Chancellor's Office is responsible for ensuring that subrecipients minimize the time between their receipt and use of federal funds. Because the Chancellor's Office bases its initial advance for the Vocational Education program on the prior year first quarter

expenditures, its process may not be sufficient to minimize the subrecipients' cash balances when the first quarter expenditures vary significantly from year to year. Moreover, when the Chancellor's Office does not adequately assess its subrecipients' immediate cash needs before approving monthly advances, it cannot assure that subrecipients minimize the time elapsing between the receipt and use of federal funds.

Finally, we found that the Chancellor's Office did not always ensure that it obtained and reviewed all quarterly expenditure reports from its Vocational Education subrecipients. Specifically, the Chancellor's Office could not provide a third quarter expenditure report from one subrecipient and fourth quarter expenditure reports from six subrecipients. By not ensuring that it obtains and reviews all expenditure reports from its subrecipients, the Chancellor's Office cannot identify subrecipients who may not be expending all funds advanced to them.

## **RECOMMENDATIONS**

To minimize the time elapsing between the receipt and use of federal program funds, the Chancellor's Office should reassess the amount disbursed through the advance process and approve initial advances that more closely reflect each subrecipient's immediate cash needs. In addition, the Chancellor's Office should consider basing its calculation of the initial advance for the Vocational Education program on the average of first quarter expenditures for multiple fiscal years. Further, the Chancellor's Office should ensure that it obtains all quarterly expenditure reports from its Vocational Education subrecipients.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

The Chancellor's Office has been exploring methods to align better the cash needs of the state's subrecipients with the fund disbursement process used, the California Community College apportionment process. Intrinsic to the monthly payment method of the apportionment process is the metering of funds out to the subrecipients over the entire program year, with a holdback until after the program year. Yet, there are times when subrecipients' expenditures are less than funds received. The fundamental difficulty is a non-alignment of the dates expenditure reports are received versus those dates when the flow of funds can be adjusted.

To address this issue, the Chancellor's Office devised a formula for the 2003-04 apportionment process that responds to subrecipients' expenditure pattern over the 2002-03 program year. The formula was developed to be more restrictive in the flow rate of the funds at all apportionment periods and the formula for Advanced apportionment was expanded to cover both first and second quarters of the prior year which more closely resembles the period of Advanced apportionment. On a formulaic basis, the Advanced apportionment for some subrecipients was reduced based on the expanded historic expenditure pattern. That reduction is to avoid excess cash situations. Based on subrecipients' expenditure patterns during the 2003-04 program year, the apportionment can be adjusted at the 1<sup>st</sup> and 2<sup>nd</sup> Principal Apportionment.

Those adjustments may either restore or further reduce fund availability, based on expenditure patterns.

Upon review of the issue regarding missing quarterly reports, the Chancellor's Office deems this citing to be one of record documentation and retention, stemming from unprecedented staffing changes, shortages, and restrictions on filling vacant positions prior to their abolishment. Even in the face of significantly reduced staffing, the Chancellor's Office has made substantial changes for the 2003-04 year that provide more timely review and easier tracking of quarterly reports for all grant recipients.

### **U.S. DEPARTMENT OF EDUCATION**

Federal Catalog Number:	84.048
Federal Program Title:	Vocational Education—Basic Grants to States
Federal Award Number and Calendar Year Awarded:	V048A020005; 2002

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Federal Catalog Number:	84.243
Federal Program Title:	Tech-Prep Education
Federal Award Number and Calendar Year Awarded:	V243A020005; 2002

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Reference Number:	2003-3-7
Category of Finding:	Cash Management
State Administering Department:	Department of Education

(See listing of the specific federal program details following the discussion of the issues below.)

### **CRITERIA**

Our review of federal programs identified the following requirements relating to cash management:

The Code of Federal Regulations, Title 34, Section 80.21, allows a state's subrecipients to receive advance payments provided they demonstrate the ability to minimize the time elapsing between the receipt and disbursement of federal funds.

Otherwise, reimbursement is the preferred method of payment. Further, this section requires a state's subrecipients to promptly pay to the federal agency any interest greater than \$100 that they earned on the advances. Additionally, if a state's subrecipients receive advance payments, Section 80.20(b)(7) requires them to follow procedures for minimizing the time between the receipt and disbursement of federal funds. Moreover, sections 299.1 and 299.2, state that the regulations in Section 80 apply to titles I through XIII of the Elementary and Secondary Education Act of 1965, as amended.

## **CONDITION**

The Department of Education (Education) does not have adequate procedures to ensure that program subrecipients demonstrate the ability to minimize the time elapsing between their receipt and use of federal program funds. Under its payment procedures, Education disburses predetermined percentages of program funds to subrecipients rather than assessing and disbursing funds based on each subrecipient's immediate cash needs. Further, Education does not require its subrecipients to report on their use of program advances before it makes additional payments to them. Combining Education's lack of procedures to assess each subrecipient's cash needs with its predetermined advance-payment process does not ensure that subrecipients minimize the time elapsing between their receipt and disbursement of federal program funds.

Of the 40 expenditure transactions we reviewed for the Title I Grants to Local Educational Agencies subgrant awards, Education disbursed 100 percent of the funds during fiscal year 2002-03 before receiving information on the subrecipients' use of funds. As a result, Education disbursed at least \$46 million with no assurance that subrecipients minimize the time elapsing between the receipt and use of federal funds.

Additionally, for the 39 subrecipients we reviewed for the Title V—Innovative Education Program Strategies program where Education made advance payments, it disbursed 80 percent of the funds during fiscal year 2002-03 without receiving information on the subrecipients' use of funds. As a result, Education disbursed approximately \$624,000 with no assurance that subrecipients minimized the time elapsing between the receipt and use of federal funds. Moreover, our review found that Education awarded and disbursed to the same subrecipients \$771,000 for fiscal year 2001-02. However, 14 of the 39 subrecipients carried over \$276,000 (36 percent) from fiscal year 2001-02 to fiscal year 2002-03. The amounts that these 14 subrecipients carried over ranged from \$1,231 to \$119,901. The percentages of amounts that the 14 subrecipients carried over ranged from 15 percent to 197 percent of the amounts Education disbursed in previous fiscal years.

Finally, Education did not require subrecipients to report and remit interest in excess of \$100 earned on these federal program advances. As a result, these subrecipients may use the interest earned on federal program advances for activities that may not be allowable.

## **RECOMMENDATIONS**

To minimize the time elapsing between the receipt and use of federal program funds, Education should implement procedures to assess each subrecipient's cash needs and, if necessary, adjust its advance payments to more closely reflect each of its subrecipients' immediate cash needs. Additionally, Education should ensure its subrecipients report their program expenditures in time to allow Education to assess their cash needs before making additional advance payments. Education should also establish controls for reporting earnings greater than \$100 on these advances so it can ensure these interest earnings are repaid to the federal awarding agency. Finally, if Education cannot demonstrate its ability to ensure that subrecipients minimize the time elapsing between the receipt and disbursement of federal program advances, it should implement procedures to pay its subrecipients on a reimbursement basis rather than paying them in advance.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

With limited resources available to monitor whether subrecipients' advance payments are expended before subsequent payments are issued, Education is exploring various options for an optimal approach on monitoring, which includes seeking guidance from the United States Department of Education on its expectations.

In the interim, Education continues to allocate funds proportionate to the unpaid months that have elapsed prior to and including the month of the current apportionment, based on the principle that local education agencies (LEAs) incur federal expenditures fairly constantly through the year.

Furthermore, Education is currently checking carryover federal fund balances using annual financial data to identify any LEAs with significant balances in Title I and Title V programs. Beginning with fiscal year 2003-04, Education added language to the apportionment letters for federal programs notifying LEAs of the timely use of apportioned funds and the delay of future apportionments for LEAs with significant balances. In addition, Education included in the apportionment letters a statement that LEAs are required to remit to the federal agency any interest greater than \$100 per year that they earned on advances.

## U.S. DEPARTMENT OF EDUCATION

Federal Catalog Number: 84.010  
Federal Program Title: Title I Grants to Local Educational Agencies  
Federal Award Number and  
Calendar Year Awarded: S010A020005; 2002

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Federal Catalog Number: 84.298  
Federal Program Title: Title V (formerly Title VI)—Innovative Education  
Program Strategies  
Federal Award Number and  
Calendar Year Awarded: H173A020120; 2002

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Reference Number: 2003-3-8  
Federal Catalog Number: 84.318  
Federal Program Title: Education Technology State Grants  
Federal Award Numbers and  
Calendar Years Awarded: S318X010005; 2001  
S318X020005; 2002  
Category of Finding: Cash Management  
State Administering Department: Department of Education

### CRITERIA

Our review of the Education Technology State Grants program identified the following requirements relating to cash management:

The Code of Federal Regulations, Title 34, Section 80.21, allows a state's subrecipients to receive advance payments provided they demonstrate the ability to minimize the time elapsing between the receipt and disbursement of federal funds. Otherwise, reimbursement is the preferred method of payment. Further, this section requires a state's subrecipients to promptly pay to the federal agency any interest greater than \$100 per year that they earned on the advances. Additionally, if a state's



subrecipients receive advance payments, Section 80.20(b)(7) requires them to follow procedures for minimizing the time between the receipt and disbursement of federal funds.

## **CONDITION**

The Department of Education (Education) does not have adequate procedures to ensure that Education Technology State Grants program subrecipients demonstrate the ability to minimize the time elapsing between their receipt and use of federal program funds. Under its payment procedures, Education disburses predetermined percentages of program funds to subrecipients rather than assessing and disbursing funds based on each subrecipient's immediate cash needs. Further, Education does not always require its subrecipients to report on their use of program advances before it makes additional payments to them. Combining Education's inadequate procedures to assess each subrecipient's cash needs with its predetermined advance-payment process does not ensure that subrecipients minimize the time elapsing between their receipt and disbursement of federal program funds.

Of the 15 subrecipients we reviewed for the 2001 Education Technology State Grants program, Education made advance payments to 10 subrecipients during fiscal year 2002-03. However, Education did not require eight of the 10 subrecipients to report their expenditures before it disbursed second and third advance payments to them. In addition, although Education requires each subrecipient to submit a final expenditure report before it disburses the final payment, it disbursed funds to two of the 15 subrecipients before receiving final expenditure information on the subrecipients' use of funds. As a result, Education disbursed \$645,000 during fiscal year 2002-03 with no assurance that subrecipients minimized the time elapsing between the receipt and use of federal funds.

In addition, for the 16 subrecipients we reviewed for the 2002 Education Technology State Grants program, Education disbursed 90 percent of the funds awarded during fiscal year 2002-03. Education disbursed the subgrant awards in two equal payments of 45 percent and generally made the disbursements in April 2003 and June 2003, respectively. After it receives each subrecipient's final expenditure report, which is due shortly after the end of the funding period, Education plans to disburse any remaining amounts owed. Although the timing of the disbursements appears reasonable, Education does not require subrecipients to report their expenditures before disbursing the second payment. As a result, Education disbursed \$596,000 with no assurance that subrecipients minimized the time elapsing between the receipt and use of federal funds.

Further, Education did not require subrecipients of its fiscal year 2001-02 grant award to report and remit interest in excess of \$100 earned on federal program advances. As a result, the subrecipients may have used the interest on federal program advances for activities that may not be allowable. Education has since modified its fiscal year 2002-03 grant award final expenditure reports to require subrecipients to report and remit interest in excess of \$100 on federal program advances.

## RECOMMENDATIONS

To minimize the time elapsing between the receipt and use of federal program funds, Education should implement procedures to assess each subrecipient's cash needs and, if necessary, adjust its advance payments to more closely reflect each of its subrecipients' immediate cash needs. Additionally, Education should ensure its subrecipients report their program expenditures in time to allow Education to assess their cash needs before making additional advance payments. Education should also continue to ensure that subrecipients report and remit interest earnings greater than \$100 on these advances so these earnings are repaid to the federal awarding agency. Finally, if Education cannot develop procedures to ensure subrecipients minimize the time elapsing between the receipt and disbursement of federal program advances, it should pay its subrecipients on a reimbursement basis rather than in advance.

## DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

The Enhancing Education Through Technology (EETT) formula grant program provides local education agencies (LEAs) advance payments to implement their approved technology plan, which may require significant purchases of hardware and software. To facilitate the LEA's ability to make the required EETT program purchases and take advantage of discounts, Education provides the LEAs advance payments.

With almost 1,000 potential EETT grantees, and over 500 grant awards under \$10,000, Education is exploring various methods for an optimal monitoring approach, including seeking guidance from the United States Department of Education to meet federal monitoring expectations with Education's limited resources.

In the interim, Education continues to monitor end of period expenditure reports, which provides signed assurances that funds were expended in accordance with the grant award documents. In addition, the end of period expenditure reports include a reporting section that requires LEAs to indicate interest earned on advance payments, and to remit prompt payment of interest greater than \$100.

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Reference Number:	2003-3-9
Federal Catalog Number:	84.002
Federal Program Title:	Adult Education—State Grant Program
Federal Award Number and Calendar Year Awarded:	V002A020005; 2002
Category of Finding:	Cash Management
State Administering Department:	Department of Education

## **CRITERIA**

Our review of the Adult Education—State Grant Program (Adult Education program) identified the following requirements related to cash management:

The Code of Federal Regulations, Title 34, Section 80.21, allows a state's subrecipients to receive advance payments provided they demonstrate the ability to minimize the time elapsing between the receipt and disbursement of federal funds. Otherwise, reimbursement is the preferred method of payment. Further, this section requires a state's subrecipients to promptly pay to the federal agency any interest greater than \$100 per year that they earned on the advances. Additionally, if a state's subrecipients receive advance payments, Section 80.20 (b)(7) requires them to follow procedures for minimizing the time between the receipt and disbursement of federal funds.

## **CONDITION**

The Department of Education (Education) does not have adequate procedures to ensure that program subrecipients demonstrate the ability to minimize the time elapsing between their receipt and use of federal program funds. Under its payment procedures, Education disburses predetermined percentages of program funds to subrecipients rather than assess and disburse funds based on each subrecipient's immediate cash needs. During the fiscal year, Education typically disburses funds to subrecipients through two payments of 33 percent of the subgrant award for the English Literacy and Civics Education component of the Adult Education program. In addition, Education disburses funds to subrecipients for sections 225 and 231 of the Adult Education program through two payments of 50 percent and 25 percent, respectively, of the subgrant award. After it receives the subrecipients' final expenditure report, Education disburses the final payment. Although the timing of the disbursements appears reasonable, Education does not require subrecipients to report their expenditures before disbursing the second payment. Thus, it has no assurance that subrecipients minimize the time elapsing between their receipt and disbursement of federal program funds.

Of the 40 payments to subrecipients we reviewed for the Adult Education program, 29 involved disbursements made before Education received information on the subrecipients' use of funds. For the 29 transactions, Education disbursed almost \$1.6 million to the subrecipients with no assurance that the subrecipients had minimized the time elapsing between the receipt and use of federal funds.

Finally, Education did not require subrecipients to report and remit interest in excess of \$100 per year earned on these federal program advances. As a result, these subrecipients may use the interest earned on these federal program advances for activities that may not be allowable.

## RECOMMENDATIONS

To minimize the time elapsing between the receipt and use of federal program funds, Education should implement procedures to assess each subrecipient's cash needs and adjust its advance payments accordingly. Additionally, Education should ensure its subrecipients report their program expenditures in time to allow Education to assess their cash needs before making additional advance payments. Education should also establish controls for reporting earnings greater than \$100 on these advances so it can repay these interest earnings to the federal awarding agency. Finally, if Education determines it cannot implement procedures to ensure the subrecipients report program expenditures in time for it to assess cash needs and make additional payments, it should consider procedures to pay its subrecipients on a reimbursement basis rather than in advance.

## DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

For the 2004-05 grant year the Adult Education Office (AEO) will amend its payment method to subrecipients in order to minimize the time elapsing between the receipt and use of federal program funds. Subrecipients will initially receive 50 percent of their grant award amount, and then will be required to submit a mid-year report showing expenditures and encumbrances toward their grant award amount. If the AEO determines the subrecipient expended or encumbered at least 80 percent of the initial payment, the AEO will process a second payment of 25 percent of the grant award amount. If the AEO determines the subrecipient expended or encumbered less than 80 percent of the initial payment, the AEO will process a second payment of only 12.5 percent of the grant award amount. The AEO will continue to require a final report showing total grant expenditures and encumbrances.

In addition, the subrecipients will be required to indicate on the mid-year and final reports the amount of interest earned on advance payments, and to promptly remit interest greater than \$100 to the federal agency.

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Reference Number:	2003-3-10
Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education—Basic State Grant Program
Federal Award Number and Calendar Year Awarded:	S011A020005; 2002
Category of Finding:	Cash Management
State Administering Department:	Department of Education

## **CRITERIA**

Our review of the Migrant Education—Basic State Grant Program (Migrant Education) identified the following requirements relating to cash management:

The Code of Federal Regulations, Title 34, Section 80.21, allows a state's subrecipients to receive advance payments provided they demonstrate the ability to minimize the time elapsing between the receipt and disbursement of federal funds. Otherwise, reimbursement is the preferred method of payment. Further, this section requires a state's subrecipients to promptly pay to the federal agency any interest greater than \$100 per year that they earned on the advances. Additionally, if a state's subrecipients receive advance payments, Section 80.20(b)(7) requires them to follow procedures for minimizing the time between the receipt and disbursement of federal funds.

## **CONDITION**

The Department of Education (Education) does not have adequate procedures to ensure that Migrant Education subrecipients demonstrate the ability to minimize the time elapsing between their receipt and use of federal program funds. Under its payment procedures, Education disburses program funds to subrecipients based on predetermined limits rather than assess and disburse funds based on each subrecipient's immediate cash needs. During fiscal year 2002-03, Education revised its payment and reporting procedures to reduce the amount it paid in the first advance payment and to require subrecipients to submit quarterly expenditure reports. However, Education was unable to fully implement the revisions to its procedures. As a result, many of the subrecipients followed Education's prior payment and reporting procedures, which were not sufficient for Education to assess each subrecipient's immediate cash needs. Further, Education does not always require its subrecipients to report on their use of current-year program advances before making the second payment to them.

Of the 40 expenditure transactions we reviewed for the Migrant Education program, 34 were payments to 19 of Migrant Education's 22 regional offices. For the fiscal year 2002-03 grant award, we compared Education's first advance payment to these regional offices against their midyear expenditure reports, and found that seven had high ending balances ranging from \$14,822 to \$862,893. We considered any positive balance high because Education disbursed the first advance payment, which ranged from approximately 25 percent to 40 percent of the subaward, before the end of the six-month period for which the regional offices reported expenditures. In addition, we found that Education disbursed second advance payments to four of the seven subrecipients before it received the midyear expenditure reports.

During fiscal year 2003-04, Education plans to revise its payment procedures to require subrecipients to spend or encumber at least 90 percent of their current-year advance payments before Education makes subsequent payments to them. Nevertheless, when Education does not assess its subrecipients' immediate cash

needs before making federal program advances, it cannot assure that subrecipients minimize the time elapsing between the receipt and use of federal funds.

Finally, Education did not require subrecipients to report and remit interest in excess of \$100 earned on these federal program advances. Although Education has begun to revise its expenditure reports to require the subrecipients to report interest earned, the midyear expenditure reports we reviewed did not include information about the interest earned by the subrecipients. As a result, these subrecipients may use the interest earned on federal program advances for activities that may not be allowable.

## **RECOMMENDATIONS**

To minimize the time elapsing between the receipt and use of federal program funds, Education should ensure it implements procedures to assess each subrecipient's immediate cash needs and adjust its advance accordingly. Additionally, Education should continue to ensure its subrecipients report their program expenditures in time to allow Education to assess their cash needs before making additional advance payments. Education should also ensure the implementation of controls for reporting earnings greater than \$100 on these advances so it can repay these interest earnings to the federal awarding agency.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

Effective January 2004, Education implemented a policy that before subsequent cash advances are processed, migrant regional offices must expend or encumber at least 90 percent of the cash advances already received. When requesting the second and third cash advances, the migrant regional offices must submit a fiscal report that shows the outstanding balances from cash advances already received.

In addition, fiscal reports require migrant regional offices to indicate the amount of interest earned on cash advances, and to promptly remit interest greater than \$100 to the federal agency.

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Reference Number:	2003-3-11
Category of Finding:	Cash Management
State Administering Department:	Department of Education

(See listing of the specific federal program details following the discussion of the issues below.)

## **CRITERIA**

Our review of federal programs identified the following requirements related to cash management:

The Code of Federal Regulations, Title 34, Section 80.21, allows a state's subrecipients to receive advance payments provided they demonstrate the ability to minimize the time elapsing between the receipt and disbursement of federal funds. Otherwise, reimbursement is the preferred method of payment. Further, this section requires a state's subrecipients to promptly pay to the federal agency any interest greater than \$100 that they earned on the advances. Additionally, if a state's subrecipients receive advance payments, Section 80.20(b)(7) requires them to follow procedures for minimizing the time between the receipt and disbursement of federal funds.

## **CONDITION**

The Department of Education (Education) does not have adequate procedures to ensure that program subrecipients demonstrate the ability to minimize the time elapsing between their receipt and use of federal program funds. Under its payment procedures, Education disburses predetermined percentages of program funds to subrecipients rather than assessing and disbursing funds based on each subrecipient's immediate cash needs. Further, Education does not require its subrecipients to report on their use of program advances before making additional payments to them. Combining Education's lack of procedures to assess each subrecipient's cash needs with its predetermined advance-payment process does not ensure that subrecipients minimize the time elapsing between their receipt and disbursement of federal program funds.

Of the 40 expenditure transactions we reviewed for the Title III—English Language Acquisition Grants program, Education disbursed 100 percent of the funds in two payments during fiscal year 2002-03 before receiving information on the subrecipients' use of funds. Education did not require its subrecipients to report on their use of program advances until October 2003, after it had disbursed the full amount of the grant. As a result, Education disbursed at least \$5.8 million with no assurance that its subrecipients minimize the time elapsing between the receipt and use of federal funds. Moreover, our review found that 26 subrecipients reported as of November 2003 that they had carried over \$2.6 million (45 percent) from fiscal year 2002-03 to fiscal year 2003-04. The amounts that these 26 subrecipients carried over ranged from \$525 to \$410,922. The percentages of amounts the 26 subrecipients carried over ranged from 2 percent to 94 percent of the amounts Education disbursed to them in fiscal year 2002-03.

In addition, of the 40 subrecipients we reviewed for the Improving Teacher Quality State Grants program, Education disbursed 100 percent of the funds without receiving information on the subrecipients' use of funds. As a result, Education disbursed \$12.6 million with no assurance that subrecipients minimize the time elapsing between the receipt and use of federal funds.

Finally, Education did not require subrecipients to report and remit interest in excess of \$100 per year earned on these federal program advances. As a result, these subrecipients may use the interest earned on federal program advances for activities that may not be allowable.

## **RECOMMENDATIONS**

To minimize the time elapsing between the receipt and use of federal program funds, Education should implement procedures to assess each subrecipient's cash needs and, if necessary, adjust its advance payments to more closely reflect each of its subrecipient's immediate cash needs. Additionally, Education should ensure its subrecipients report their program expenditures in time to allow Education to assess their cash needs before making additional advance payments. Education should also establish controls for reporting earnings greater than \$100 on these advances so it can repay these interest earnings to the federal awarding agency. Finally, if Education determines it cannot implement procedures to ensure the subrecipients report program expenditures before it assesses cash needs and makes additional payments, it should implement procedures to pay its subrecipients on a reimbursement basis rather than in advance.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

With limited resources available to monitor whether subrecipients' advance payments are expended before subsequent payments are issued, Education is exploring various options for an optimal approach on monitoring, which includes seeking guidance from the United States Department of Education on its expectations.

In the interim, Improving Teacher Quality State Grants program (Title II) funds continue to be apportioned in three payments during the last six months; February (40 percent), April (40 percent) and June (20 percent); and Title III funds will be disbursed in three payments throughout the year. Both disbursement approaches seem to be proportionate to the expenditure needs of the local education agencies (LEAs).

Education monitors carryover balances of Title II and Title III funds using annual financial data reported by LEAs. LEAs receive reports from Education that reiterate they should only request needed funds. In addition, beginning with fiscal year 2003-04, Education added language to the apportionment letter for federal programs notifying LEAs of the timely use of apportioned funds and the delay of future apportionments for LEAs with significant balances. Furthermore, Education included in the apportionment letter a statement that LEAs are required to remit to the federal agency interest greater than \$100 per year that they earned on advances.

The explanation of the large carryover balances of Title III funds from fiscal year 2002-03 was because the LEAs received their funding late in the year due to fiscal year 2002-03 being the start-up year and delays in Education processing.



## U.S. DEPARTMENT OF EDUCATION

Federal Catalog Number: 84.365  
Federal Program Title: Title III—English Language Acquisition Grants  
Federal Award Number and  
Calendar Year Awarded: T365A020005; 2002

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Federal Catalog Number: 84.367  
Federal Program Title: Improving Teacher Quality State Grants  
Federal Award Number and  
Calendar Year Awarded: S367A020005; 2002

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Reference Number: 2003-5-1  
Federal Catalog Number: 84.126  
Federal Program Title: Rehabilitation Services—Vocational  
Rehabilitation Grants to States  
Federal Award Numbers and  
Calendar Years Awarded: H126A020005; 2001  
H126A030005; 2002  
Category of Finding: Eligibility  
State Administering Department: Department of Rehabilitation

### CRITERIA

Our review of the Rehabilitation Services—Vocational Rehabilitation Grants to States program (Vocational Rehabilitation) determined that the following are among the compliance requirements for eligibility:

The Code of Federal Regulations, Title 34, Section 361.42, requires the State to assess an applicant's eligibility and priority for program services. This section further requires the State to base the applicant's eligibility on a determination that:

- The individual has a physical or mental impairment.
- The impairment substantially impedes employment.
- A presumption that the individual can benefit from program services.
- The individual requires program services to prepare for, secure, retain, or regain employment.

Additionally, Section 361.41 requires the State to determine an individual's eligibility for program services within 60 days of receiving his or her application, with certain exceptions.

## **CONDITION**

The Department of Rehabilitation (Rehabilitation) does not always determine applicant eligibility for the Vocational Rehabilitation program within the required time period. However, ongoing efforts to improve its ability to determine eligibility promptly have had a positive impact. Specifically, of the 34,409 applications received by the department between July 1, 2002, and April 30, 2003, Rehabilitation did not determine eligibility, obtain an extension, or close cases within the 60-day period for 5,103 cases (14.6 percent). In fiscal year 2001-02, Rehabilitation exceeded the 60-day period 21 percent of the time. In 3,499 cases of the 34,409 applications (10.2 percent), Rehabilitation determined an applicant's eligibility after 60 days or obtained an agreed-upon extension after the deadline.

Of the cases for which Rehabilitation did not determine eligibility within 60 days, Rehabilitation was fewer than 10 days late in 51 percent of the cases, between 11 and 30 days late in another 28 percent of the cases, and between 31 and 60 days late in an additional 14 percent of the cases. Rehabilitation took more than 60 additional days after the required 60 days to determine eligibility in 6.8 percent of the cases. Rehabilitation had not determined eligibility status in 85 cases as of July 31, 2003, and 1,429 cases had other resolutions after the 60-day deadline. When Rehabilitation does not determine an applicant's eligibility within the required time period, it reduces the assurance that clients receive the required vocational rehabilitation services promptly.

## **RECOMMENDATION**

To ensure that applicants receive program services promptly, Rehabilitation should continue with its efforts to determine eligibility within the required time period.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

Rehabilitation agrees with this finding and appreciates the Bureau of State Audits' (BSA) acknowledgement of our efforts in reducing the percentage of overdue eligibility

determinations. As correctly noted by BSA, Rehabilitation's ongoing efforts have resulted in a significant decline in the number of overdue eligibility determinations. In the spring of 2003, in response to the 2001 federal compliance report finding, Rehabilitation implemented the following actions to further reduce the number of overdue eligibility determinations:

### **Action #1—Share information with district administrators**

Through regional district administrators' meetings, best practices for timely eligibility determinations are being identified and shared. The district administrators are now receiving reports that track the number of overdue eligibility determinations for each counselor on a monthly basis. These reports are distributed to rehabilitation supervisors and counselors for prompt and immediate follow-up.

### **Action #2—Inform and educate rehabilitation staff**

The importance of timely eligibility determination continues to be stressed in all Rehabilitation sponsored training courses and during staff meetings at all levels. The Case Recording Handbook, Chapter 2, also provides a full description of the presumptive eligibility provisions in the Code of Federal Regulations (CFR). Counselors and rehabilitation supervisors continue to receive automated reminder notices on the Field Computer System (FCS) before the expiration of the 60 days allowed for eligibility determination.

The Employment Preparation Services (EPS) deputy directors are working directly with the district administrators to ensure the maximum use of the presumptive eligibility and use of existing information provisions in the CFR. Counselors and rehabilitation supervisors are being urged to fully implement these provisions and to determine applicant eligibility based on existing information and SSI/SSDI verification at the time of application.

### **Action #3—Local level monitoring of eligibility determinations**

The rehabilitation supervisors continue to conduct reviews of eligibility determinations and extensions to ensure appropriateness and compliance with federal regulations. Rehabilitation supervisors work with the counselors to utilize existing information to the maximum extent possible and the presumptive eligibility criteria to ensure more timely eligibility determinations. Counselors and rehabilitation supervisors continue to receive automated reminder notices on the FCS before the expiration of the 60 days allowed for eligibility determination. In addition to the automated reminder notices, reports are generated monthly to track the number of overdue eligibility determinations in each district. These reports are shared with the district administrators and rehabilitation supervisors for review and follow up. In response to previous BSA findings, these reports have been modified to include information as to whether the consumer receives SSI or SSDI to ensure that presumptive eligibility criteria is being applied in a manner consistent with the Rehabilitation Act to expedite the eligibility determination process for consumers.

#### **Action #4—Executive level monitoring of eligibility determinations**

On a monthly basis, EPS regional administrators prepare regional and district summary reports for each deputy director. The deputy directors review these overdue eligibility reports and the Consumer Satisfaction Surveys to identify trends of overdue eligibility determinations and then work with the district administrators to resolve the issues preventing the timely determination of eligibility. The district administrators are asked to review these reports and report back to the deputy directors with corrective plans to address any overdue eligibility determination issues.

These actions that were implemented in the spring of 2003 resulted in a noticeable reduction in the percentage of overdue eligibility determinations for the 2002-reporting year (14.6%). Rehabilitation is very pleased to report that there continues to be a significant reduction in the percentage of overdue eligibility determinations for the 2003-reporting year beginning July 2003. Using BSA's methodology, the overdue eligibility percentage for the July 1, 2003 to November 27, 2003 time frame is .086 or 9% (1477 overdues/17143 apps).

Rehabilitation recognizes the importance of meeting eligibility determination timelines and remains committed to improve in this area through a collaborative effort with district administrators and rehabilitation supervisors. Utilizing the aforementioned action plan, Rehabilitation will continue to monitor, identify and promote best practices that will contribute to obtaining compliance with this federal requirement.

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Reference Number:	2003-7-2
Federal Catalog Number:	84.298
Federal Program Title:	Title V (formerly Title VI)—Innovative Education Program Strategies
Federal Award Number and Calendar Year Awarded:	S298A000005; 2000
Category of Finding:	Earmarking
State Administering Department:	Department of Education

#### **CRITERIA**

Our review of the Title V—Innovative Education Program Strategies (Title V) program, formerly known as Title VI, identified the following requirements related to earmarking:

The United States Code, Title 20, Section 7331(b), requires that no more than 25 percent of funds available for state programs be used for administration. Additionally, Section 8821 allows the State to consolidate administrative funds of several programs, including the Title V program.

## **CONDITION**

The Department of Education (Education) does not have adequate procedures to ensure that it meets the Title V program earmarking requirements. Thus, it cannot assure that it spent federal funds in compliance with federal regulations. For the fiscal year 2000-01 grant award, Education consolidated its state administration funds for Title V and several other federal programs. Using the funds from each program, it determined the proportionate share for each program and applied those proportions to the costs it incurs. For the Title V program, Education consolidated the entire \$5.6 million available for state use and spent these funds for administration and other state-level activities, such as technical assistance and statewide education reform. However, based on our calculations including adjustments, it should have consolidated only \$1.1 million of the funds set aside for state use and should have restricted administrative expenditures to this consolidated pool. It should have tracked separately the remaining \$4.5 million for other state-level activities. As a result, the Title V program may have borne a disproportionate share of state administration costs incurred.

We reported a similar finding in our audit of fiscal year 2001-02. At that time, Education asserted that the U.S. Department of Education (USDE) should have been aware it consolidated as administrative funds most of the allocation for state operations in the Title V program since 1996. However, the USDE determined in February 2003 and informed Education that it should have consolidated as administrative funds no more than 25 percent of the amount allocated for state use.

## **RECOMMENDATION**

Education should ensure that it consolidates for state administration no more than 25 percent of the funds set aside for its use to meet the Title V earmarking requirement.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

Education addressed the consolidation of administration costs with a waiver request and in the Consolidated State Plan to the United States Department of Education. With the approval of these documents, Education believed it had the authority to consolidate the state administrative funds and administered the funds accordingly. However, this issue will not occur in the future since Education is no longer consolidating administrative funds with the implementation of No Child Left Behind in fiscal year 2002-03.

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Reference Number:	2003-7-3
Federal Catalog Number:	84.048
Federal Program Title:	Vocational Education—Basic Grants to States
Federal Award Number and Calendar Year Awarded:	V048A020005; 2002
Category of Finding:	Level of Effort
State Administering Department:	Department of Education

## **CRITERIA**

Our review of the Vocational Education—Basic Grants to States program (Vocational Education) identified the following requirement related to level of effort:

The United States Code, Title 20, Section 2413(a), requires the State to provide from nonfederal sources for state administration of Vocational Education programs an amount that is not less than the amount provided by the State from nonfederal sources for state administrative costs for the preceding fiscal year.

## **CONDITION**

The Department of Education (Education) did not ensure that it met its level of effort requirement for administration of the Vocational Education program for fiscal year 2002-03. Specifically, Education did not ensure that it identified all administrative expenditures from nonfederal sources for the Vocational Education program. Beginning with fiscal year 2002-03, Education adopted a new process that identified all nonfederal administrative expenditures incurred by Education, the California Community Colleges, Chancellor's Office (Chancellor's Office), and the Department of Corrections (Corrections). Education included \$3,878,264 of nonfederal administrative expenditures incurred by Corrections during fiscal year 2002-03 because Corrections administers the Vocational Education program at its correctional facilities and receives federal Vocational Education program funds from the Chancellor's Office. However, Education did not ensure that the expenditures reported by Corrections agreed with the supporting data Corrections provided. Moreover, Education did not obtain sufficient information about the nonfederal administrative expenditures Corrections incurred during fiscal year 2001-02. Further, Education did not identify expenditures incurred during fiscal years 2001-02 and 2002-03 by the Department of the Youth Authority (Youth Authority), which receives federal Vocational Education program funds from Education.

Consequently, Education did not have sufficient information to determine the nonfederal administrative expenditures incurred by Corrections and the Youth Authority during fiscal years 2001-02 and 2002-03. As a result, we were unable to include expenditures from Corrections and the Youth Authority when we recalculated the administrative level of effort for Education. Based on our calculation using the available data, Education did not meet the administrative level of effort requirement for fiscal year 2002-03. Specifically, it incurred approximately \$640,000 less in nonfederal administrative expenditures during fiscal year 2002-03 than the preceding fiscal year. When Education does not meet its administrative level of effort, it may receive a reduced grant award in future years.

## **RECOMMENDATIONS**

Education should continue to implement a process to ensure that it properly calculates its administrative level of effort. In doing so, Education should include amounts provided by the State from all nonfederal sources for administrative expenditures, including those provided by Education, the Chancellor's Office, Corrections, and the Youth Authority. Further, Education should ensure that it obtains accounting records to support its calculation of level of effort.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

Education reorganized its internal systems to ensure compliance with the level of effort (state administration funds match) requirement for fiscal year 2002-03 and future years. The Youth Authority's state administrative expenditures will be included in the 2002-03 final Financial Status Report to the United States Department of Education. In addition, Corrections submitted its 2002-03 state administrative expenditures, and will provide Education with detailed accounting records to verify state administration expenditures incurred in the program year 2002-03.

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Reference Number:	2003-9-1
Federal Catalog Number:	84.126
Federal Program Title:	Rehabilitation Services—Vocational Rehabilitation Grants to States
Federal Award Numbers and Calendar Years Awarded:	H126A020005; 2001 H126A030005; 2002
Category of Finding:	Suspension and Debarment
State Administering Department:	Department of Rehabilitation

## **CRITERIA**

Our review of the Rehabilitation Services—Vocational Rehabilitation Grants to States program (Vocational Rehabilitation) determined that the following are among the compliance requirements for suspension and debarment:

The Code of Federal Regulations, Title 34, Section 80.35, prohibits the State from knowingly doing business with any party that is suspended, debarred, or otherwise ineligible to participate in federal assistance programs. In addition, Title 34, Section 85.510, mandates the State to require certifications from participating organizations affirming they are not suspended, debarred, ineligible, or voluntarily excluded from transactions by any federal agency. Further, Section 85.110 makes procurement contracts for goods or services expected to equal or exceed \$100,000 subject to the suspension and debarment certification requirements.

## **CONDITION**

The Department of Rehabilitation (Rehabilitation) did not obtain the required suspension and debarment certification from any of the five contractors we reviewed. Rehabilitation awarded these participants of the Vocational Rehabilitation program procurement contracts of \$100,000 or more. The five contracts we reviewed totaled more than \$1.3 million. Without obtaining the required certifications, Rehabilitation risks unknowingly allowing suspended or debarred parties to participate in the Vocational Rehabilitation program. For the transactions we reviewed, we used an alternative test to determine that these participants were not suspended or debarred.

## **RECOMMENDATION**

Rehabilitation should ensure that Vocational Rehabilitation participants receiving procurement contracts of \$100,000 or more submit the required suspension and debarment certifications before Rehabilitation approves their participation in the Vocational Rehabilitation program.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

Rehabilitation agrees with the finding and has already developed suspension and debarment language to include in applicable contracts. This language is being used in all fiscal year 2003-04 contract amendments and will be used in all fiscal year 2004-05 contracts that are \$100,000 or more.



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Reference Number:	2003-12-3
Federal Catalog Number:	84.048
Federal Program Title:	Vocational Education —Basic Grants to States
Federal Award Number and Calendar Year Awarded:	V048A020005; 2002
Category of Finding:	Reporting
State Administering Department:	Department of Education

## **CRITERIA**

Our review of the Vocational Education—Basic Grants to States program (Vocational Education) identified the following requirement related to performance reports:

The United States Code, Title 20, Section 2323(c), requires the State to prepare and submit an annual report containing data on whether it met its adjusted performance levels for each of four core indicators of performance and other indicators.

## **CONDITION**

The Department of Education (Education) did not report accurate, complete, and supported data in its Vocational Education performance accountability report. Specifically, Education did not ensure that it included the performance data from all eligible subrecipients. For example, of the 10 subrecipients we reviewed, Education did not include performance data for three subrecipients in its Vocational Education performance report. Education explained that although these three subrecipients submitted their performance data by the required date, it inadvertently omitted the data from the performance report.

Further, some subrecipients did not accurately report data to Education. The subrecipients report the data to Education grouped separately by gender and ethnicity of the students. The total population data by ethnicity should equal the total population data by gender. However, we found that the aggregated statewide population data by ethnicity did not agree with the aggregated statewide population data by gender. As a result, Education adjusted the statewide ethnicity data to agree with the statewide gender data. Education stated that it believed that the gender data was accurate and, therefore, it adjusted the ethnicity data. Nevertheless, when Education does not compile and report accurate and complete data, the U.S. Department of Education cannot accurately assess the State's performance in the Vocational Education program.

## RECOMMENDATIONS

Education should ensure that it obtains accurate performance data from all subrecipients in a timely manner and that its Vocational Education performance report is supported and complete.

## DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

The omission of data from three reports for the 2001-02 Consolidated Annual Performance, Accountability, and Financial Status Report (CAR) was due to key data error. In addition, the discrepancy between the gender and ethnicity totals resulted from local education agencies reporting students with multiple ethnicities and the use of an Excel spreadsheet that did not provide for automated data validation.

The State's new course-based, online Career Technical Education program data collection and reporting system eliminates potential reoccurrence of both of these accountability performance reporting errors. The new system was successfully used for the 2002-03 CAR and subrecipient enrollment and program completion reports.

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Reference Number:	2003-13-7
Federal Catalog Number:	84.048
Federal Program Title:	Vocational Education—Basic Grants to States
Federal Award Number and Calendar Year Awarded:	V048A010005; 2001
Category of Finding:	Subrecipient Monitoring
State Administering Department:	California Community Colleges, Chancellor's Office

## CRITERIA

Our review of the Vocational Education—Basic Grants to States program (Vocational Education) identified the following requirements related to subrecipient monitoring:

The U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (OMB Circular A-133), describes the audit requirements for recipients of federal funds. Sections 200 and 320 require subrecipients spending \$300,000 or more annually in federal awards to submit audit reports to the State when the reports address findings related to the federal awards

that the State administers. Further, Section 400(d) requires the State to issue management decisions on audit findings within six months of receiving audit reports and to make sure subrecipients take appropriate and timely corrective action.

## **CONDITION**

The California Community Colleges, Chancellor's Office (Chancellor's Office) did not ensure that it issued management decisions within six months of receiving audit reports from its subrecipients and did not ensure that subrecipients took appropriate and timely corrective action on the audit findings. Specifically, the Chancellor's Office did not issue management decisions until nearly eight months after it received all three of the audit reports we reviewed that contained findings related to the Vocational Education program. Moreover, the Chancellor's Office did not ensure for one of these three audit reports that the subrecipient took appropriate and timely corrective action. The audit report identified a finding with \$12,000 in questioned costs. Although the Chancellor's Office issued its management decision on the finding in August 2003, it did not ensure that the subrecipient began to take corrective action on the finding until December 2003, after we brought it to the attention of the Chancellor's Office.

When the Chancellor's Office does not issue timely management decisions on audit findings that affect its programs, the Chancellor's Office cannot ensure that its subrecipients are taking prompt and appropriate action to address audit findings. Further, when the Chancellor's Office does not ensure that subrecipients take appropriate and timely corrective action, it cannot be certain that federal funds have been charged appropriately.

## **RECOMMENDATIONS**

The Chancellor's Office should ensure that it issues the required management decisions within six months of receiving audit reports from its subrecipients. In addition, the Chancellor's Office should ensure that its subrecipients take appropriate and timely corrective action on findings identified in the audit reports.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

The Chancellor's Office acknowledges the issue of timely responses required for corrective action of findings identified in program audit reports. While not an excuse, the loss of approximately 50 full-time positions (over 25 percent of total agency staffing) in the last year has contributed to an environment where this sort of problem can occur. The Chancellor's Office will, however, modify its existing process to ensure that audit findings and corrective actions are resolved in a timely manner.

The OMB Circular A-133, Section 400(d)(5) specifies that the pass-through entity (the Chancellor's Office) will "issue a management decision on audit findings within six months after receipt of the subrecipient's audit report and ensure that the subrecipient takes appropriate and timely corrective action."

Management decisions issued by the Chancellor's Office will clearly state whether or not the audit finding is sustained, the reasons for the decision and the expected auditee action to repay disallowed costs, make financial adjustments, or take other actions. If the auditee has not completed corrective action, a timetable for follow-up will be specified.

We will, therefore, revise the 2002-03 Contract District Audit Process and Procedures as follows:

1. ALL findings will be provided to the Vice Chancellor of each program area for response with a one-week response time. The initial response should specify the resolution status of the district's audit finding and include an estimated date of resolution by the district if not already resolved.
2. Fiscal Accountability staff will maintain a schedule of audit findings and track the status of their resolution. Initially, we will follow up after two weeks with the appropriate Vice Chancellor for any findings for which we have not received an initial response.
3. The program units will provide a copy to fiscal services of all management decisions issued to subrecipients in response to district audit citations. Fiscal services will note district actions yet to be accomplished and establish a follow-up date of four months from the audit receipt date for an updated progress report of the district's resolution activities and implementation of any management decisions issued for that citing. Program units will notify fiscal services upon confirmation of the district's final resolution of the citing and implementation of any management decisions issued for the initial citing.
4. The Vocational Education Unit will ask the Accounting Department of the Chancellor's Office to invoice the Los Angeles Community College District for \$12,000 to resolve its Vocational Education and Technical Education Act audit citing.

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Reference Number:	2003-13-8
Federal Catalog Number:	84.318
Federal Program Title:	Education Technology State Grants
Federal Award Number and Calendar Year Awarded:	S318X020005; 2002
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Education

## **CRITERIA**

Our review of the Education Technology State Grants program identified the following requirement relating to subrecipient monitoring:

The Code of Federal Regulations, Title 34, Section 80.40(a), requires the State to monitor subrecipient activities supported by federal program funds to ensure that they comply with applicable federal requirements and meet performance goals.

## **CONDITION**

The Department of Education (Education) does not sufficiently monitor the activities of its subrecipients awarded Education Technology State Grants program funds. Education awards 50 percent of the program funds allocated to subrecipients through a formula and awards 50 percent competitively. For program funds awarded competitively, Education requires subrecipients to submit semiannual performance reports and plans to perform site visits for 10 percent of the subrecipients. However, for program funds awarded to subrecipients through a formula, Education neither requires interim reporting nor plans to perform site visits of the subrecipients. Education disbursed \$17 million during fiscal year 2002-03 to the subrecipients awarded program funds through a formula. Education cannot ensure that the subrecipients' use of program funds complies with federal requirements and meets performance goals when it does not monitor the activities of the subrecipients.

## **RECOMMENDATION**

Education should ensure that it monitors the activities of subrecipients awarded funds through a formula for the Education Technology State Grants program.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

Since fiscal year 2002-03 was the first year of the Enhancing Education Through Technology (EETT) program, and local education agencies (LEAs) and charter schools have until August 2004 to obligate these funds, Education continues to develop and implement its monitoring process over EETT formula grant awards. As part of the monitoring process, Education envisions using the signed End of Period Expenditure Reports, which incorporate the initial Grant Award Assurances and are not due to Education until August 2004.

Once the cycle closes in August 2004, Education will monitor the LEAs' progress in implementing technology using California Technology Assessment Profile (CTAP<sup>2</sup>) and technology hardware surveys. Education will also attempt to model the accountability features of the EETT competitive grant program to the EETT formula grant. However, the EETT formula grant has approximately ten times more grantees in the formula program than in the competitive program. With limited resources, the sheer quantity of grantees requires Education to explore various options to monitor the activities of subrecipients awarded formula grant funds. These options include:

1. Reviewing the impact and accountability of EETT formula grant funds at the same time as the EETT competitive grant's annual site reviews are conducted.
2. Selecting a sample of EETT formula recipients in several CTAP regions and conducting on-site visits to review the reasonableness of EETT formula expenditures and how they were spent in accordance with approved district technology plans.
3. Requiring LEAs submit to Education a description of the process and accountability measures used to evaluate the extent to which activities funded under the program are effective in (1) integrating technology into curricula and instruction; (2) increasing the ability of teachers to teach; and (3) enabling students to meet challenging State standards; and an annual report describing the results.
4. Requesting Education's Coordinated Compliance Review include a step to review LEAs awarded EETT formula grants.
5. Utilizing the CTAP<sup>2</sup> and technology hardware surveys to monitor the LEAs' progress in implementing technology.
6. Reviewing End of Period Expenditure Reports and signed Grant Award Assurances received from the LEAs.

Reference Number:	2003-14-4
Federal Catalog Number:	84.032
Federal Program Title:	Federal Family Education Loans
Year Awarded:	State fiscal year 2002-03
Category of Finding:	Special Tests and Provisions
State Administering Department:	California Student Aid Commission

**CRITERIA**

Our review of the Federal Family Education Loans program (loan program) identified the following compliance requirements related to special tests and provisions:

The Code of Federal Regulations (CFR), Title 34, Section 682.402(e)(9)(i), requires guaranty agencies, such as the California Student Aid Commission (Student Aid), to evaluate a borrower's request to have his or her obligation to repay a loan discharged on the basis that his or her eligibility to obtain such loan under the loan program was falsely certified by a school.

Further, the CFR, Title 34, Section 682.402(e)(9)(ii)(C), requires guaranty agencies to, not later than 30 days after determining the borrower was falsely certified, refund to the borrower all amounts paid by the borrower with respect to the discharged loan amount, including any late fees or collection charges imposed by the lender or agency related to the discharged loan amount.

## **CONDITION**

During our review of four false certification claims that Student Aid paid to lenders and reimbursed with loan program funds, we noted that two of the four loans resulted in borrower refunds that occurred three years after Student Aid approved the borrowers' requests for a loan discharge. Specifically, Student Aid approved the borrowers' requests for a loan discharge, on the grounds of false certification, in January and May 2000; however, Student Aid did not refund the borrowers' payments until April and May 2003, respectively.

According to Student Aid, in both instances the borrowers had multiple loans that were consolidated and guaranteed. Subsequently, these borrowers defaulted on their consolidated loans, one in 1991 and the other in 1996. Following each default, Student Aid paid the lender a default claim. In 1999, both borrowers requested a discharge of certain loans that had been included in their defaulted consolidated loans. Student Aid requested that the loan servicer provide the borrower with payment histories, which were at that time almost ten years old, in order to identify each borrower's refund amount. However, Student Aid cannot determine from its records when it received the borrower payment histories from the loan servicer.

Student Aid's inability to process the borrower refunds in a timely manner appears to stem from weak internal controls. Specifically, Student Aid's procedures for processing falsely certified loans that are contained within a defaulted consolidated loan did not specify the timeframe within which borrower refund payments needed to be issued in accordance with federal regulations. Student Aid's false certification processing procedures do not address the 30-day borrower refund requirement. Rather, under Student Aid's procedures, all borrower payments on the falsely certified loans are reversed with accrued interest and applied to the portion of the defaulted consolidated loan that was not falsely certified. If this process results in an overpayment, then this amount is refunded to the borrower. However, these procedures do not specify the timeframe for this refund, nor do they require follow-up with loan servicers that maintain the borrower payment histories so that any borrower refund can be promptly calculated.

Although Student Aid acknowledges that this process may be considered too lengthy, it assumed incorrectly that a different federal regulation applied in this case that did not prescribe any timeframes within which a guaranty agency must act. The U.S. Department of Education (USDE) has clarified for Student Aid the appropriate regulations that govern borrower refund requirements under these circumstances.

## **RECOMMENDATION**

Student Aid should implement procedures and controls in order to ensure that all borrowers, whose consolidated loans have defaulted and then been deemed falsely certified, receive their refunds within the 30-day timeframe established under federal regulations.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

We believe that 34 CFR 682.402(e)(9) is not the applicable section to be used as criteria for this finding. The reasons are twofold:

1. The section specifically applies to a "loan held by an agency for which a discharge request is submitted..."The Commission did not hold the loan in question because the loan no longer existed. The loan had been extinguished years earlier through consolidation. Therefore, the discharging of a defaulted loan as referenced in 34 CFR 682.402(e)(9) was not required because the original loan no longer existed as a result of consolidation.
2. The specific reference cited is that of failing within 30 days to refund to the borrower "all amounts paid by the borrower to the lender or the agency with respect to the discharged loan amount." [682.402(e)(9)(ii)(C)]. There were no amounts paid by the borrower on the discharged loan amount in either case. It did take a lengthy period of time to obtain the payment histories on the underlying loans that were the subject of discharge. Due to the lapse in time, the payment histories were no longer readily available to the servicer, and they had to be rebuilt. This is a very time-intensive process. Once the payment histories were received, it was clear that no amounts had been paid by the borrowers, thus no amounts falling under the 30-day return provision of 682.402(e)(9)(ii)(C) were due.

Upon a detailed examination, we found that no regulation currently exists to address this isolated issue. There were no existing loans to discharge, no borrower payments to refund, and no claims being processed. In fact, the internal process used was to build a mock claim for the underlying loan, i.e. replicating a lender claim in order to correct the amount of reinsurance. As a result, a claim payment to a lender was not required because the loan did not exist. The purpose of the transaction was to reduce the balance of the borrower's defaulted consolidation loans by the amounts discharged and to properly reflect the financial transaction on Forms 2000. The internal process we followed accomplished both.



While no applicable regulation was identified, the transactions most clearly resemble the requirements specified in 34 CFR 682.402(h)(v)(1). This regulation provides instruction regarding the discharge of a loan that has been included in a consolidation loan. Though the regulation applies specifically to a non-defaulted consolidation loan claim payment by a guaranty agency to a lender, it provides the methodology for determining the remaining balance of the consolidation loan following the discharge of any underlying loans.

Following this methodology, CSAC acted as if it were the holder of the defaulted consolidated loans. CSAC calculated the amount that it would have paid as a claim (through mock claims process), and the result in each case was an overage on the loan balance (due to intervening payments and/or offsets). It was the overage that was refunded to the borrower, not the amounts previously paid by the borrower. The overage, while delayed, was not in violation of any timely payment requirement under any regulation.

The USDE may not have been fully aware of the uniqueness of this specific issue when it provided guidance to BSA. We have recently provided USDE with further detail on the issue. The guidance provided by USDE in its electronic correspondence dated November 4, 2003, states that USDE has permitted guaranty agencies to reduce a defaulted borrower's outstanding balance owed to the agency by the amount of payments previously made by the borrower on a loan for which the borrower later qualified for discharge, if the guaranty agency chose to do so. USDE indicated the 30-day time period would apply in this case.

This guidance infers that the refund is permissive, in which case there cannot be a failure later asserted. Yet it is our understanding that the borrower is entitled to the benefit of the discharge. Additionally, guaranty agencies have not received any formal regulatory guidance regarding this issue.

While we do not believe the cited reference is applicable to this issue, we have examined our current process and strengthened our controls. Staff will be trained, and EdFund's internal audit department will review this specific process as part of its internal controls audit cycle.

## **AUDITOR'S COMMENTS ON THE DEPARTMENT'S VIEW**

Student Aid asserts that the federal regulation we cite, CFR, Title 34, Section 682.402(e)(9)(i), does not apply to the loans with which we take issue because the loans in question were paid off through consolidation and the borrowers never made any payments. However, in December 2003, USDE told us which regulation to apply in such circumstances. Student Aid also expresses concern that the USDE may not have been fully aware of the uniqueness of the issue when it provided this guidance. However, in response to Student Aid's own request for clarification of this issue, USDE told Student Aid its interpretation of regulations was incorrect.

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Reference Number:	2003-14-6
Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education—Basic State Grant Program
Federal Award Number and Calendar Year Awarded:	S011A020005; 2002
Category of Finding:	Special Tests and Provisions
State Administering Department:	Department of Education

## **CRITERIA**

Our review of the Migrant Education—Basic State Grant Program (Migrant Education) determined that the following compliance requirements relate to the subgrant process:

The United States Code, Title 20, Section 6394(b)(5), requires the State to determine the amount of subgrants it awards to local educational agencies (LEAs) by taking into account the numbers and needs of migratory children, the priority for services for certain migratory children, and the availability of funds from other federal, state, and local programs.

## **CONDITION**

The Department of Education (Education) did not take into account all of the required information when it awarded subgrants to LEAs for the Migrant Education program. During fiscal year 2002-03, Education allocated funds to LEAs using current data on the numbers, needs, and priority for services of migratory children in the State. However, although Education obtains through its applications and coordinated compliance review process limited information about the availability of funds from other federal, state, and local programs, it did not take the information into account when it determined the amount of subgrants to LEAs. As a result, Education cannot be sure it appropriately funded the LEAs with the greatest needs when it determined the subgrants for the Migrant Education program.

## **RECOMMENDATION**

Education should ensure that it obtains sufficient information about the availability of funds from other federal, state, and local programs and takes the information into account when it determines the size of subgrants to LEAs for the Migrant Education program.

## DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Education's fiscal year 2004-05 program application for Migrant Education includes a section where the LEA enters the funds received from other federal, state and local programs. The program application must include the amount of other available funds that a local operating agency may leverage to provide services to migrant children prior to migrant funds. The availability of funds from other federal, state, and local programs are considered prior to Migrant Education's approval of the application.

In addition, Education will contact the United States Department of Education to obtain clarification on how it should take into account the availability of funds from other federal, state, and local programs when determining the amount of subgrant it awards to LEAs.

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Reference Number:	2003-14-7
Federal Catalog Number:	84.032
Federal Program Title:	Federal Family Education Loans
Year Awarded:	State fiscal year 2002-03
Category of Finding:	Special Tests and Provisions
State Administering Department:	California Student Aid Commission

### CRITERIA

Our review of the Federal Family Education Loans program (loan program) identified the following compliance requirements related to special tests and provisions:

The Code of Federal Regulations, Title 34, Section 682.414, requires guaranty agencies, such as the California Student Aid Commission (Student Aid), to maintain current, complete, and accurate records for each loan they hold. Good internal controls over information systems would include strong general controls, which are the structure, policies, and procedures that apply to an entity's overall computer operations. Some of the major categories of general controls are entitywide security program planning and management, and access controls.

Further, the California Education Code, Section 69522, authorized Student Aid to establish a nonprofit auxiliary to administer activities associated with the loan program. This section also requires the operations of the auxiliary organization to be conducted in conformity with an operating agreement approved annually by Student Aid and requires Student Aid to oversee the operations of the auxiliary organization.

## CONDITION

Student Aid's auxiliary organization administers the loan program. However, the auxiliary organization has not developed adequate internal controls over its information systems to provide reasonable assurance that it keeps current, complete, and accurate records of each loan. Specifically, we found weaknesses in the auxiliary organization's controls over entitywide security planning and management, and restriction of access to sensitive locations and to computer software and data files. We also found weaknesses in the operating agreement between Student Aid and its auxiliary organization. These weaknesses hamper Student Aid's ability to ensure that the auxiliary maintains strong controls over its information systems.

The auxiliary organization's management has not provided sufficient entitywide security planning and management. We found that the auxiliary organization has neither performed a comprehensive security risk assessment nor developed an entitywide security program plan. This plan should clearly describe the auxiliary's security program and the policies and procedures that support it. In addition, the plan should cover all major facilities and systems and outline the duties of the security management function. The lack of planning and management has led to insufficient protection of sensitive or critical computer records. According to Student Aid, it expects to have an entitywide security program plan finalized within the next year.

In August 2003, the auxiliary hired a director of information security, who is now responsible for developing and assisting in the formulation and implementation of information security procedures and standards, as well as for facilitating processes to manage and mitigate security risk. However, good business practices dictate that an information security officer be responsible to the auxiliary's president, and be of a sufficiently high classification that he or she can execute the responsibilities of the office in an effective and independent manner. At the auxiliary, the director of information security reports to the vice president of technology solutions and services. This reporting relationship is not ideal because the director of information security could report security issues that are not also communicated to the auxiliary's president.

The auxiliary organization does not have adequate physical security controls, which are the controls that limit access to sensitive areas and protect them from loss or impairment. We found that the auxiliary organization did not limit access to the computer operations facility to those employees who have a legitimate need for access to perform their job duties. For fiscal year 2001-02, we reported that 56 individuals were allowed to access the computer operations facility although their job duties were not related to the maintenance or operation of the information system. This year we identified five individuals, authorized to access the computer operations facility in June 2003, whose job functions did not require such access. Although this demonstrates that Student Aid has taken steps to limit access to its computer operations facility, the access rights for these five individuals remain in question. Moreover, the layout of the computer operations facility can be strengthened. We noted that certain equipment and the tape library are centrally located within the computer operations facility instead of in separate secure areas with limited access. Compounding these weaknesses is the fact that the auxiliary organization's computer

operations staff run the computer operations facility from a remote location separate from the computer operations facility, which may allow individuals with access to the facility to have unmonitored access.

The auxiliary organization also needs to strengthen its logical security controls. Logical security controls are the policies and electronic access controls designed to restrict access to computer software and data files. The auxiliary organization has the following weaknesses in controls over its software and data files:

- It does not promptly remove employees' electronic access when they transfer or leave the employ of the auxiliary. We tested a sample of 25 employees who had left the employ of the auxiliary and found that in 13 cases the auxiliary organization did not promptly remove the employees' electronic access. Electronic access rights for 10 of these 13 employees were not removed from the system for more than 200 days after they had left the employ of the auxiliary. For four of these 13 employees, administrators had received notice to delete the account but did not do so.
- It has given four employees from two divisions the ability to add, change, or delete information from student loan data and the information system's master files. This level of access can allow for inappropriate modification of sensitive loan data and system files.
- It has not developed preventative controls that would prohibit the 54 employees with a total of 152 guaranteed student loans from modifying or deleting their own borrower information. In addition, the auxiliary organization has not performed reviews that could promptly identify whether student loan data has been modified inappropriately. However, in April 2003, the auxiliary instituted a monthly process that identifies if an employee's guaranteed student loan is delinquent so that the auxiliary can work with the employee to bring the loan current.
- It allows a limited number of employees to make changes to sensitive data in an environment that is not subject to the normal edits of its information system. In addition, the auxiliary does not maintain a complete history or audit trail of data changes for a sufficient period of time to allow for the audit of these changes. The logical access controls do not limit access on a "need-to-know" basis, which allows these employees to access data that is not related to their business function.

Finally, Student Aid's operating agreement with the auxiliary organization does not include provisions to ensure that the auxiliary organization maintains strong controls over its information systems. Currently, the operating agreement does not detail Student Aid's expectations for the operation of the information technology system that maintains the records for the loan program. Such expectations could include requirements for information security, the performance of a security risk assessment, and development of an information security program plan. Furthermore, Student Aid could require its auxiliary organization to obtain an audit of its information technology controls that are relevant to Student Aid's financial statements. This audit should report on whether such controls were suitably designed to achieve specified control

objectives, whether they have been enacted as of a specific date, and whether the controls were sufficient to provide reasonable, but not absolute, assurance that the related control objectives were achieved during the period specified.

## **RECOMMENDATIONS**

Student Aid's auxiliary organization should implement an entitywide program for security planning and management that addresses the required independence of the security management function and provides for strong physical and logical security controls over its information systems. This will ensure that it maintains current, complete, and accurate records for each loan that it holds. In addition, Student Aid should amend its operating agreement with its auxiliary organization to specify its expectations related to the control structure over the information system.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

### *Security Planning and Management*

In the second quarter of 2003, Student Aid's auxiliary hired Jacque Silver as its Chief Information Officer/Vice President of Technology Solutions and Services reporting directly to the President of the auxiliary. Ms. Silver was also appointed as the auxiliary's Information Security Officer (ISO). In August 2003, Ms. Silver hired a Director of Information Security, Gregory High, to assist her in her responsibilities as ISO. The auxiliary is currently developing a company-wide Information Security Management System (ISMS) initiative in accordance with recognized best practices and is planning to implement the ISMS during the auxiliary's current federal fiscal year.

### *Physical Controls*

The draft findings noted that five individuals authorized to access the computer operations facility in June 2003 did not have job functions that required such access. The audit finding further notes that "although this demonstrates that the Commission has taken steps to limit access to its computer operations facilities, the access rights for these five individuals remain in question."

- The auxiliary has reviewed the job duties of these five individuals and determined that four of the five employees have a business need to access the secured computer operations area for purposes of facilities and business continuity management. The fifth employee, who is the President of the auxiliary, directed that her access be deleted. This access has been removed.

The audit findings further noted that the layout of the computer operations facilities could be strengthened, specifically that the tape library was not separately housed. The auxiliary has corrected this issue.

- The auxiliary moved the computer room tape library to an adjacent, secured room separate from other computer equipment.
- The auxiliary installed video cameras, which are used as an ongoing additional control, to monitor and record when staff members enter and exit the secure computer room facility.

### Logical Controls

The audit findings state that the auxiliary does not promptly remove employees' access when they transfer or leave the employ of the auxiliary.

- The auxiliary has taken steps to correct this issue. Test samples were provided to the auditors covering the period July 1 through September 30, 2003, to demonstrate the effectiveness of the changed procedures of the auxiliary. The sample tests demonstrated compliance with the auxiliary's policy and procedures. However, these results were excluded from the audit findings because they exceeded the specified audit scope end date of June 30, 2003.

The audit findings stated that the auxiliary has not developed preventative controls to prohibit employees from modifying or deleting their own borrower information, nor have they performed periodic reviews to ensure that no inappropriate modifications have occurred.

- The auxiliary has a number of controls in place to protect the integrity of borrower information:
  - Existing policies prohibit the alteration of loan files for personal benefit or gain and provide for periodic internal audits to insure adherence to this policy.
  - Existing procedures provide for an automated monthly comparison of employees to active student loans. Any employee who enters preclaim status is identified to Human Resources for corrective action in accordance with the auxiliary's policies.
  - Daily financial reconciliations report all financial status changes.
  - Routine lender reconciliations uncover discrepancies between the auxiliary and lender's borrower records.
  - Internal Audit will periodically review and test compliance with the auxiliary's policies.

It was noted that four employees from two divisions have the ability to add, change or delete information from student loan data and the information system's master files. It was recommended that this level of access could allow for inappropriate modification of sensitive loan data and system files.

- The auxiliary has determined that this level of privilege is essential for business operations. The access privilege is highly restricted and limited to approximately four out of its 700 employees. Procedures have been in place to log before and after records of their activity.

The report stated that a limited number of auxiliary employees are allowed to make changes to sensitive data in an environment that is not subject to the normal edits of its information systems. Further, it noted that the auxiliary does not maintain a history of data changes for a sufficient length of time to permit for an audit of these changes. Finally it stated that the logical access controls do not limit access on a need to know basis.

- The auxiliary has reviewed and verified data maintenance and table maintenance requirements and strengthened table maintenance procedures. This action includes the ability to track and document table changes with before and after snapshots of the table maintenance screens. The protection log files, which are used for system recovery and record all transaction activity including changes made through data and table and maintenance screens, are also retained for one year. Access of this type is limited to the fewest number of employees necessary to fulfill this function.

Operating Agreement

The audit finding notes that Student Aid’s Operating Agreement with its auxiliary does not include provision to ensure that the auxiliary maintain strong controls over its information systems.

- Discussions are underway between Student Aid and its auxiliary to determine what types of reviews are appropriate, and the auxiliary will take specific action pursuant to these reviews.

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Reference Number:	2003-14-8
Federal Catalog Number:	84.032
Federal Program Title:	Federal Family Education Loans
Year Awarded:	State fiscal year 2002-03
Category of Finding:	Special Tests and Provisions
State Administering Department:	California Student Aid Commission

**CRITERIA**

Our review of the Federal Family Education Loans program (loan program) identified the following compliance requirements related to special tests and provisions:

The Code of Federal Regulations, Title 34, Section 682.410(b)(2), requires guaranty agencies, such as the California Student Aid Commission (Student Aid), to charge a borrower an amount equal to the reasonable costs incurred by the guaranty agency in collecting a loan on which the guaranty agency has paid a default or bankruptcy claim.



The amount charged by the guaranty agency for loans that are neither consolidated nor rehabilitated must equal the lesser of the amount the same borrower would be charged for collection costs under the formula at the Code of Federal Regulations, Title 34, Section 30.60; or the amount the same borrower would be charged if the loan was held by the U.S. Department of Education (USDE).

The USDE charges a borrower for collection costs up to 25 percent of the outstanding principal and interest on a defaulted loan. In applying the formula at Title 34, Section 30.60, of the Code of Federal Regulations, the USDE expects guaranty agencies to annually estimate for the upcoming year the amount of collection costs they will incur for trying to collect on defaulted loans. Considering these costs, USDE further expects guaranty agencies to determine and apply a collection cost rate to borrowers' payments on defaulted loans for the upcoming year to recover these estimated costs.

## **CONDITION**

Student Aid's auxiliary organization annually reviews collection cost and recovery data to calculate the collection cost rate it will apply to borrowers' payments for the upcoming year. However, our review of the auxiliary's collection cost calculation revealed that the auxiliary factored in and recovered costs that were unallowable. Specifically, the auxiliary included approximately \$8.1 million in costs it incurred while performing default aversion activities prior to these loans going into default. As a result of the auxiliary's inclusion of these costs, it calculated and applied a collection cost rate to defaulted borrower payments that was in excess of what was permissible under federal regulations.

The auxiliary had included these default aversion costs because it presumed that it could recoup these costs since, in its opinion, the federal regulations did not distinguish between collection costs incurred prior to default and collection costs incurred after default on the very same loans. However, according to the USDE, federal regulations and statutes do provide this distinction, stating that default aversion fees are defined as costs incurred before the default occurs, while collection costs are incurred after default. USDE's position is that the regulations describing collection activities on defaulted loans describe exclusively activities that begin after the guarantor pays a default claim and takes assignment of the loan. Further, USDE maintains that the reason a cost incurred before a loan defaults is called a "default aversion cost," and not a cost of collection on a defaulted loan, is that the cost was not incurred to collect a defaulted loan, but rather a delinquent loan that was not yet in default when the cost was incurred.

## **RECOMMENDATIONS**

In the future, the auxiliary should only include and recover allowable collection costs through its collection cost rate calculation. Further, if the auxiliary disagrees with USDE's interpretation of the federal regulations, it should seek USDE's acceptance of a mutually acceptable collection cost rate methodology.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

This finding is the result of informal discussions between the Bureau of State Audits and an individual at the USDE. The information provided by USDE is beyond the scope of the applicable regulations and has not been provided as official guidance or interpretation of the regulations to the industry.

The auxiliary included costs in its collection rate calculation that it reasonably believed were incurred in performing collection activities and properly includable in the calculation. The calculation included all costs incurred in performing collection activities, whether such activities were delinquency or default collections. Federal regulations allow guaranty agencies to charge a borrower "an amount equal to reasonable costs incurred by an agency in collecting a loan on which the agency has paid a default or bankruptcy claim." The default aversion collection activities included in the calculation were costs incurred in collecting on the loans that subsequently resulted in a claim. This regulation does not draw a distinction between collection costs incurred prior to default and collection costs incurred after default on the very same loans. Our methodology established delinquency processing as the beginning of our collection effort and, as such, included those collection costs in the calculation.

Another regulation pertinent to this issue, Title 34, Section 30.60, of the Code of Federal Regulations, specifically uses the term "delinquent debtors" in defining its scope. It does not establish default as the trigger for cost eligibility. It also references broader costs that are includable by using the phrase "Federal loan servicing and debt collection activities." Common industry terminology views both the term "delinquent" and "Federal Loan servicing" as occurring prior to default.

Student Aid concurs with the recommendation that it ensure going forward that its collection cost rate calculation includes only allowable collection costs. Further, Student Aid will review its methodology and resolve any open issues with USDE.

## **AUDITOR'S COMMENTS ON THE DEPARTMENT'S VIEW**

Student Aid's justification for including default aversion costs in its collection cost rate is based on the premise that federal regulations do not draw a distinction between costs incurred before and after a loan defaults. However, both federal statute and regulations clearly make this distinction based on how the activities associated with these costs are defined. Specifically, the Code of Federal Regulations, Title 34, Section 682.410(b)(6), defines the required collection activities on defaulted loans by exclusively listing collection activities that occur after default. Further, the U.S. Code, Title 20, Section 1072b, defines default collection activities of a guaranty agency as those that are directly related to the collection of a loan on which a default claim has been paid to the participating lender. This same statute defines default aversion activities differently, defining these activities as those directly related to providing collection assistance to the lender on a delinquent loan, prior to the loan legally being in default status. Further, federal regulations provide a separate mechanism for guaranty agencies to recover default aversion costs, called a default aversion fee.

We asked the USDE's office of the general counsel to confirm our understanding of the loan program's statutes and regulations. The deputy assistant general counsel confirmed our understanding, citing the regulations and statutes above as evidence of a clear distinction between costs incurred before and after a loan defaults.

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Reference Number: 2003-14-9

Category of Finding: Special Tests and Provisions,  
Subrecipient Monitoring

State Administering Department: Department of Education

(See listing of the specific federal program details following the discussion of the issues below.)

## **CRITERIA**

Our review of the Migrant Education—Basic State Grant Program (Migrant Education) and the Title I Grants to Local Educational Agencies program (Title I, Part A) determined that the following compliance requirements relate to the comparability of school services and subrecipient monitoring:

The United States Code, Title 20, sections 6321(c) and 6394(c), requires local educational agencies (LEAs) that receive Migrant Education and Title I, Part A funds to use state and local funds to provide school services that are at least comparable to services provided by schools not receiving these federal funds, unless otherwise excluded. In addition, these sections state that an LEA will have met the requirement of comparability if the LEA has filed with the state education agency a written assurance that the LEA has established and implemented an LEA-wide salary schedule; a policy to ensure equivalence among schools in teachers, administrators, and other staff; and a policy to ensure equivalence among schools in the provision of curriculum materials and instructional supplies. Furthermore, these sections state that each LEA must develop procedures and maintain records to comply with the requirements.

In addition, the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, Section 400(d), requires the State to monitor the activities of subrecipients to ensure compliance with laws and regulations.

## **CONDITION**

The Department of Education (Education) did not require LEAs receiving Migrant Education funds to file with Education a specific written assurance that they have developed procedures and maintain records to comply with the comparability requirements. In addition, Education has not monitored whether LEAs receiving Migrant Education and Title I, Part A funds have complied with the requirement to provide school services that are at least comparable to services provided by schools not receiving these federal funds.

Education requires LEAs receiving Migrant Education funds to file with Education written legal assurances stating the options LEAs may use to determine the comparability of school services. However, the Migrant Education legal assurances did not require LEAs to state they have developed procedures and maintained records to comply with the requirements. In addition, although Education attempted to monitor compliance with comparability of school services during its fiscal reviews of LEAs in fiscal year 2002-03, none of the four fiscal reviews Education conducted fully addressed the review of policies and procedures to ensure compliance with the requirement. Education provided guidance regarding compliance with the comparability requirement to its Migrant Education program subrecipients in June 2003. Education stated that it plans in fiscal year 2003-04 to incorporate into its fiscal reviews of subrecipients an examination of compliance with the requirement.

In addition, during fiscal year 2002-03, Education began to require LEAs that receive Title I, Part A funds to file with Education a specific written assurance that the LEAs have established and implemented an LEA-wide salary schedule; a policy to ensure equivalence among schools in teachers, administrators, and other staff; and a policy to ensure equivalence among schools in the provision of curriculum materials and instructional supplies. However, Education has not established and implemented procedures to monitor the LEAs' compliance with these requirements although it plans to implement a comparability check for one of these requirements during fiscal year 2004-05.

Because Education did not require LEAs receiving Migrant Education funds to assure in writing that they have developed procedures and maintain records to comply with the comparability requirements, it cannot be sure that LEAs are using the funds to provide educationally disadvantaged students the additional assistance they need to achieve academic success. Moreover, when Education does not monitor the LEAs' compliance, it cannot be sure that LEAs receiving Migrant Education and Title I, Part A funds have established and implemented the policies and procedures federal law requires to ensure comparable school services.

## **RECOMMENDATIONS**

Education should revise its legal assurances for the Migrant Education program to ensure that subrecipients submit a written assurance stating they have developed procedures and maintain records to comply with the comparability requirement.

Additionally, Education should complete the revisions to its Migrant Education monitoring processes and should continue its efforts to establish and implement a Title I, Part A monitoring process to ensure that LEAs receiving these federal program funds provide school services that are at least comparable to the services provided by schools not receiving Migrant Education and Title I, Part A funds.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

Education revised its fiscal year 2003-04 legal assurances for the Migrant Education program to state:

*The LEA has developed procedures for complying with comparability requirements and must maintain records that are updated biennially documenting compliance with those requirements. 20 U.S.C. Section 6321 (c).*

In addition, Education continues to develop its Migrant Education monitoring process to review for compliance with the comparability requirements when conducting its bi-monthly monitoring visits at the migrant education regions.

For Title I, Part A, Education plans to incorporate a comparability page into the Consolidated Application for fiscal year 2004-05. The proposed comparability page was shared with the United States Department of Education, and their input was incorporated into Education's process. The Consolidated Application process will involve calculating the teacher-pupil ratio for the LEAs, then comparing the Title I and Non-Title I teacher-pupil ratios for like schools. If an LEA does not meet the comparability requirement, the Consolidated Application system will not accept the LEA's application until the staffing allocations are adjusted and it meets the comparability requirement. This built-in error check will help ensure LEAs meet comparability requirements.

### **U.S. DEPARTMENT OF EDUCATION**

Federal Catalog Number:	84.010
Federal Program Title:	Title I Grants to Local Educational Agencies
Federal Award Number and Calendar Year Awarded:	S010A020005; 2002

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Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education—Basic State Grant Program
Federal Award Number and Calendar Year Awarded:	S011A020005; 2002

## **U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES**

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Reference Number: 2003-1-1

Federal Catalog Number 93.959

Federal Program Title: Block Grants for Prevention and Treatment of Substance Abuse

Federal Award Number and Calendar Year Awarded: 01B1CASAPT; 2000

Category of Finding: Activities Allowed

State Administering Department: Department of Alcohol and Drug Programs

### **CRITERIA**

Our review of the Block Grants for Prevention and Treatment of Substance Abuse program identified the following compliance requirement related to activities allowed:

The United States Code, Title 42, Section 300x-21, requires that grant funds be expended only for the purpose of planning, carrying out, and evaluating activities to prevent and treat substance abuse, and for related activities regarding tuberculosis and human immunodeficiency requirements.

### **CONDITION**

The Department of Alcohol and Drug Programs (DADP) expended funds from its Block Grants for Prevention and Treatment of Substance Abuse program for unallowable activities. Specifically, DADP contracted with an outside vendor to provide violence prevention services, which are not allowable activities as defined by the United States Code. DADP spent approximately \$77,600 in federal funds during fiscal year 2002-03 to provide violence prevention services administered under the contract. DADP justified the use of federal funds for this contract by stating that there was a close and direct correlation between substance abuse and violence. However, the Substance Abuse and Mental Health Services Administration (SAMHSA), the federal agency administering the Block Grants for Prevention and Treatment of Substance Abuse, stated that DADP should have used federal funds only for the portion of those services related to substance abuse prevention or treatment. SAMHSA also said that, if DADP is unable to determine the portion related to these allowable activities, DADP should not use any Block Grants for Prevention and Treatment of Substance Abuse funds to pay for this contract.

## RECOMMENDATION

DADP should ensure that it expends Block Grants for Prevention and Treatment of Substance Abuse funds only for allowable activities as required by the United States Code.

## DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

DADP appreciates the efforts of the State Auditor to secure clarification as to the appropriateness of the expenditure through its contact with staff at SAMHSA.

DADP will resolve the issue with SAMHSA's Center for Substance Abuse Prevention (CSAP) as it believes the expenditure of federal Block Grants for Prevention and Treatment of Substance Abuse (SAPT) prevention funds was consistent with the controlling regulations. Representatives from DADP's Prevention Services Division will contact CSAP to secure clarification of their interpretation of the regulations as conveyed to the State Auditor. This action will provide DADP with a better understanding of CSAP's position relating to the appropriate use of SAPT funds.

Further, should DADP contemplate entering into any future contracts of a similar nature to the one in question, prior confirmation of compliance will be sought from SAMHSA's Center for Substance Abuse Prevention.

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Reference Number:	2003-1-2
Federal Catalog Number:	93.778
Federal Program Title:	Medical Assistance Program
Federal Award Numbers and Calendar Years Awarded:	05-0205CA5028; 2001 05-0305CA5028; 2002
Category of Finding:	Activities Allowed
State Administering Department:	Department of Health Services

## CRITERIA

Our review of the Medical Assistance Program (Medicaid) identified the following compliance requirements related to activities allowed:

Public Law number 107-300, the Improper Payments Information Act of 2002, defines an improper payment as any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under

statutory, contractual, administrative, or other legally applicable requirements by a federal agency, a federal contractor, or a governmental or other organization administering a federal program or activity. In addition, the State's Medicaid Provider Manual requires that reimbursement for drugs be the lowest of the maximum allowable ingredient cost plus current professional fees, the federal allowable cost plus current professional fees, the estimated acquisition cost plus current professional fees, or the charge to the general public.

## **CONDITION**

During fiscal year 2002-03, the Department of Health Services (Health Services) did not always correctly reimburse vendors of Medicaid-covered drugs, resulting in Health Services underpaying some vendors. For one of the five drug claims in our sample of Medicaid expenditures, we found that although the reimbursement table in the State's automated Medicaid payment system showed the estimated acquisition cost to be the lowest of the available reimbursement methods, with a reimbursement rate of \$.0052 per milliliter for a particular drug, the price paid to vendors for this drug was only \$.0051 per milliliter. Health Services determined that the underpayments were due to a data entry error in the reimbursement table. Additionally, Health Services determined that the underpayments for this drug began in March 1998 and continued through November 2002. Although Health Services corrected the error in December 2002, during the previous 57 months it underpaid providers more than \$67,000 prior to the correction. Moreover, other data entry errors during this period resulted in almost \$9,300 more in underpayments for this drug.

## **RECOMMENDATION**

Health Services should ensure that the correct rate is used when reimbursing providers for Medicaid services.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

Health Services agrees with this finding.

A pricing error was made for a specific nutritional product (Ensure) for a manufacturer (Ross) for whom pricing updates were manually performed. One of two drug pricing fields for the audited drug was inadvertently not updated, which resulted in the underpayments. The manual process, even with peer review, allowed for inaccuracies. The manual update process for this manufacturer was discontinued and replaced with an electronic update with a 100 percent review of all changes prior to installation. Other manufacturers' products are electronically updated.

In April 1999, the Medi-Cal Fiscal Intermediary implemented changes which strengthened quality controls by requiring two peer reviews and a pharmacist's final review and approval of all pricing updates prior to them being installed into the system.



In addition, in November 2002, procedures were changed for these and related products so that neither the “estimated acquisition cost” or “lowest cost” fields have to be manually keyed as the prices are now accepted electronically from First Data Bank (FDB). Health Services feels the current controls significantly reduce the potential price discrepancies.

The pricing error was corrected on December 1, 2002, via an electronic monthly update from FDB. The manual process for updating Ross products has been replaced with an electronic update process with a 100 percent review process prior to installation.

Impacted claims with dates of service March 1998 through November 2002 will be reprocessed and providers will be reimbursed the deficient payment.

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Reference Number:	2003-1-3
Federal Catalog Number:	93.778
Federal Program Title:	Medical Assistance Program
Federal Award Numbers and Calendar Years Awarded:	05-0205CA5028; 2001 05-0305CA5028; 2002
Category of Finding:	Activities Allowed
State Administering Department:	Department of Health Services

## **CRITERIA**

Our review of the Medical Assistance Program (Medicaid) identified the following compliance requirements related to activities allowed:

The United States Code, Title 42, Section 1396, enables states to provide medical assistance to Medicaid beneficiaries. Additionally, the Code of Federal Regulations, Title 42, Part 456, requires states to provide methods and procedures to safeguard against the unnecessary utilization of care and services, which include conducting post-payment reviews for the necessity, quality, and timeliness of these services.

## **CONDITION**

The Department of Health Services (Health Services) did not always ensure that all services approved for Medicaid beneficiaries were supported by sufficient documentation. Since Health Services is required to conduct post-payment reviews,

we requested that it conduct field reviews of client records and other pertinent documents to substantiate the medical necessity of the services billed to the Medicaid program for the 30 claims that we reviewed.

Health Services' review revealed that three of the 30 claims did not have adequate support to substantiate a need for the provided services that were paid for by the Medicaid program.

- Health Services found that the service for one claim was not documented as billed, and there was no documentation to validate the medical diagnosis. Specifically, there was no documentation to indicate a Hepatitis C antibody test had been performed as billed. In this case, Health Services determined that the error was a system problem, as eight out of 10 similar test requisitions showed the same problem.
- For another claim, the physician's records conflicted as to the strength of the medication to be provided, amounting to a lack of adequate support. Health Services found an original handwritten order prescribing 10-milligram strength; however, the physician's treatment plan indicated a dosage strength of 20 milligrams. Health Services determined that this was an isolated case since the service was documented to be medically necessary and that it is very probable the physician changed the order to a different dosage.
- According to Health Services, the claim form for a third item had the incorrect identification of the prescribing physician. Health Services found that the provider's billing system could not automatically accommodate more than one referring physician per beneficiary, leading to the error, even though the appropriate physician had prescribed the service. As a system/biller error, Health Services determined it to be systemic. However, the responsible software company is modifying the software that the provider used for billing. Health Services has received a written explanation acknowledging the error and a plan of action to prevent the error from recurring.

In addition, Health Services determined that two more of the 30 claims were not medically justified:

- In one instance, Health Services found that though a review of laboratory records revealed the billed service for a claim was documented, there was no documentation to validate that the test was medically necessary. Specifically, there was no documentation to demonstrate the medical diagnosis, although a test requisition indicated a test was ordered and a surgical pathology report indicated the test was performed. In this case, the lack of documentation constituted a system problem, and it was confirmed as such by the laboratory director and the provider's own policy and procedures.
- For another claim, Health Services found an isolated problem. A review of the patient's related medical record showed no documentation to indicate that the recipient had symptoms related to seasonal and perennial allergies. Therefore, the prescription for allergy medication was not clinically warranted.

According to Health Services, although some of the errors it identified represented systemic problems with the provider, it has not taken any action to ensure the weaknesses are corrected.

## **RECOMMENDATIONS**

Health Services should ensure that it analyzes all its systemic findings to determine whether investigation or technical assistance is required to prevent further unnecessary utilization of care and services. Additionally, Health Services should implement procedures to ensure that systemic weaknesses identified during reviews of Medicaid provider records are promptly corrected. Finally, Health Services should seek restitution from providers if services are not properly documented or medically justified.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

The scope of the review of the 30 paid claims for the Bureau of State Audits (BSA) was designed to meet the expectations of the BSA's request as specified in the June 18, 2003, letter. A full review of the providers was not requested by the BSA, however, the review was expanded to determine if exceptions were "systemic" to the provider system or to the paid claiming system rather than isolated exceptions. In either instance the Department of Health Services (Health Services) conducted further review to determine the cause of the exception.

The BSA recommends that Health Services should analyze all systemic findings to determine if further investigation or technical assistance is required. Health Services agrees that the two providers who were identified to have systemic findings should be subject to a comprehensive review of paid claims to prevent any further unnecessary utilization. Currently, Health Services is developing cases on the two providers who were determined to have systemic findings to prevent any further unnecessary and excessive utilization.

In addition, Health Services has taken steps to detect and curtail any abusive laboratory billings. Effective January 1, 2004, all laboratory claims are subject to the frequency limitations where after exceeding the limitation the provider must contact the fiscal intermediary and provide the medical diagnosis with the medical necessity for the additional test before it is approved.

In addition, the BSA stated that Health Services should implement procedures to ensure that systemic problems that are identified during review of Medicaid providers are promptly corrected. Currently, when Health Services identifies a systemic problem with a Medicaid provider, action is taken promptly to develop a case for possible administrative action and/or criminal referral to the Department of Justice.

To further enhance its ability to identify abusive providers, Health Services is implementing a random claims review process where every claim is subject to review. The random claims review will improve Health Services' ability to promptly identify any

potential billing problems and apply any necessary utilization control or sanction as necessary.

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Reference Number:	2003-1-4
Federal Catalog Number:	93.778
Federal Program Title:	Medical Assistance Program
Federal Award Numbers and Calendar Years Awarded:	05-0205CA5028; 2001 05-0305CA5028; 2002
Category of Finding:	Activities Allowed
State Administering Department:	Department of Health Services

## **CRITERIA**

Our review of the Medical Assistance Program (Medicaid) identified the following compliance requirements related to activities allowed:

The Code of Federal Regulations, Title 42, Part 438, Subpart A, allows states to contract with managed care health plans (health plans) to provide health care to Medicaid beneficiaries. Under the terms of these contracts, the Department of Health Services (Health Services) pays the health plans a monthly capitation payment for each Medicaid beneficiary. The contracts allow Health Services to recover overpayments of any capitation payment it makes to the health plans.

## **CONDITION**

During fiscal year 2002-03, Health Services did not recover overpayments of Medicaid funds paid to health plans as capitation payments for beneficiaries who had died and thus were no longer eligible for Medicaid. As a result, Health Services allowed health plans to retain Medicaid funds to which they were not entitled. We found that Health Services paid health plans more than \$21,000 in monthly capitation payments for the 20 deceased beneficiaries we reviewed. In these 20 instances, Health Services paid capitation payments to the health plans for one to 11 months after a beneficiary had died. However, as of January 2004, Health Services had not recovered any of these payments. Furthermore, based on information provided by Health Services, we found that between August 2002 and August 2003 Health Services made monthly capitation payments to health plans for deceased beneficiaries 16,454 times. According to Health Services, the average monthly capitation payment paid to health plans is approximately \$100. Consequently, Health Services paid at least \$1,645,400 for

deceased beneficiaries during this period. Health Services has yet to recover any of these payments. Health Services' staff said that the backlog of overpayments for deceased members might extend as far back as 1999. Health Services' Managed Care Division, which is responsible for recovering overpayments, informed us that it has assigned staff to identify the extent of the overpayments and develop a method for recovering the overpayments, pending management approval. Additionally, Health Services stated that it is implementing a process that will enable it to identify overpayments monthly, thus allowing it to more quickly recover the overpayments.

## **RECOMMENDATIONS**

Health Services should continue in its efforts to determine the full extent of monthly capitation payments made to health plans for deceased beneficiaries and immediately implement procedures to recover the overpayments.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

The Medi-Cal Managed Care Division (MMCD) has reviewed the draft findings prepared by the Bureau of State Audits (BSA) concerning the above-mentioned period and has the following comments. The condition portion of the report states that "Health Services allowed health plans to retain funds to which they were not entitled". This statement is misleading and not accurate. As currently written, the draft document can be interpreted to mean that Health Services' intention was not to recover the overpayments. It has been, and continues to be, Health Services' intention to collect any identified overpayments but it was first necessary to determine the extent of the overpayments as identified and validated by the Information Technology Services Division. Health Services would therefore not characterize its actions as allowing plans "to retain Medicaid funds to which they were not entitled" but that once the overpayments were identified Health Services was obligated to practice due diligence in pursuing collection.

Health Services concurs with the BSA recommendation that it "continue" to determine the full extent of Plan overpayments and implement procedures to recover these overpayments immediately.

## **AUDITOR'S COMMENTS ON THE DEPARTMENT'S VIEW**

We believe the text of our finding accurately portrays the existing condition. This was a finding last year. The fact that Health Services has not recovered overpayments that may go back as far as 1999, a period of almost five years, supports our statement that Health Services has allowed health plans to retain funds to which they were not entitled.

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Reference Number: 2003-3-2  
Category of Finding: Cash Management  
State Administering Department: Department of Aging

(See listing of the specific federal program details following the discussion of the issues below.)

## **CRITERIA**

Our review of the Special Programs for the Aging—Title III, Part B, Grants for Supportive Services and Senior Centers, and Special Programs for the Aging—Title III, Part C, Nutrition Services (aging programs) identified the following compliance requirements related to cash management:

The Code of Federal Regulations, Title 45, Section 92.20, states that procedures for minimizing the time elapsing between the transfer of funds from the federal government and subsequent disbursement by subrecipients must be followed whenever the State makes advance payments to subrecipients. Further, the Code of Federal Regulations, Title 31, Part 205, Subpart B, provides the cash management requirements for programs not covered in the Cash Management Improvement Act Agreement between the U.S. Department of the Treasury and the State. Section 205.33 requires the State to exercise sound cash management when transferring funds to subrecipients. Finally, the Office of Management and Budget Circular A-102 requires the State to limit transfers to subrecipients' immediate needs.

## **CONDITION**

The Department of Aging (Aging) did not follow its procedures to ensure that subrecipients of the aging programs minimize the time elapsing between their receipt and use of federal program funds. Under its payment procedures, Aging advances funds to subrecipients based on their estimated monthly expenditures. Aging receives monthly expenditure data from the area agencies and reduces subsequent advances by the amount of any cash on hand. However, for two of 11 area agencies we reviewed, Aging did not reduce advances even though the subrecipients' expenditure data indicated they had cash on hand. Instead, Aging advanced funds to these two subrecipients for the full amount of their request. Consequently, the advances to these subrecipients exceeded their immediate cash needs by \$19,145 and \$3,623, respectively. When Aging does not adequately assess its subrecipients' immediate cash needs before approving monthly advances, it cannot assure that subrecipients minimize the time elapsing between the receipt and use of federal funds.

## RECOMMENDATION

To minimize the time elapsing between the receipt and use of federal program funds, Aging should adhere to its internal policies regarding the amount of funds to advance to subrecipients.

## DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

During the audit period, one staff person failed to follow established procedures for approving requests for funds from area agencies. A new process has been implemented that requires each fiscal specialist to complete the CDA 151 Reconciliation form and justify any request for funds that exceeds the "maximum approval request" amount. In addition, the fiscal team coach signs and approves all request for funds.

### U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Federal Catalog Number:	93.044
Federal Program Title:	Special Programs for the Aging—Title III, Part B Grants for Supportive Services and Senior Centers
Federal Award Numbers and Calendar Years Awarded:	02-02-AA-CA-1320; 2001 02-03-AA-CA-1320; 2002

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Federal Catalog Number:	93.045
Federal Program Title:	Special Programs for the Aging—Title III, Part C Nutrition Services
Federal Award Numbers and Calendar Years Awarded:	02-02-AA-CA-1712; 2001 02-02-AA-CA-1713; 2001 02-03-AA-CA-1712; 2002 02-03-AA-CA-1713; 2002

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Reference Number:	2003-3-12
Category of Finding:	Cash Management
State Administering Department:	Department of Community Services and Development

(See listing of the specific federal program details following the discussion of the issues below.)

## **CRITERIA**

Our review of federal programs identified the following requirements related to cash management:

The Code of Federal Regulations, Title 31, Part 205, Subpart B, provides the cash management requirements for federal programs not covered in the Cash Management Improvement Act agreement between the U.S. Department of the Treasury and the State. Section 205.20 requires the State to limit the cash advances from the U.S. Department of the Treasury to the minimum amounts needed.

## **CONDITION**

The Department of Community Services and Development (Community Services) does not have adequate procedures to ensure that it limits cash advances of federal program funds to the minimum amounts needed. Specifically, in August 2001, Community Services drew down \$851,760 and \$2,148,240, respectively, from the Low-Income Home Energy Assistance and Community Services Block Grant programs to establish a local assistance revolving fund (revolving fund) to pay subrecipient claims. According to Community Services, during fiscal year 2001-02, it did not make any payments to subrecipients from the revolving fund. However, Community Services did not use these funds to pay claims until July 2002, September 2002, and January 2003, between 11 and 18 months after drawing down the funds. Consequently, Community Services did not demonstrate actual, immediate cash needs, and it did not limit cash advances of federal funds to the minimum amounts needed.

## **RECOMMENDATION**

Community Services should limit advances of federal funds to the minimum amounts needed for the Low-Income Home Energy Assistance and Community Services Block Grant programs.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

The local assistance revolving fund was established in state fiscal year 2000-01 to assist agencies in financial need during the California energy crisis. When a determination had to be made to fund the fiscal year 2003-04 account, accounting staff realized that we had not made any payments to subrecipients in fiscal year 2001-02 and only two payments in fiscal year 2002-03. It was decided at that time to eliminate the account. The funds that were used to establish and continue the revolving fund account were used for expenses after they were freed up at the end of each fiscal year.



## U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Federal Catalog Number: 93.568  
Federal Program Title: Low-Income Home Energy Assistance  
Federal Award Numbers and  
Calendar Years Awarded: G-02BICALIEA; 2002  
G-0201CALIE2; 2002

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Federal Catalog Number: 93.569  
Federal Program Title: Community Services Block Grant  
Federal Award Number and  
Calendar Year Awarded: G-02BICACOSR; 2001

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Reference Number: 2003-8-1  
Federal Catalog Number 93.959  
Federal Program Title: Block Grants for Prevention and  
Treatment of Substance Abuse  
Federal Award Number and  
Calendar Year Awarded: 01B1CASAPT; 2000  
Category of Finding: Period of Availability  
State Administering Department: Department of Alcohol and Drug Programs

### CRITERIA

Our review of the Block Grants for Prevention and Treatment of Substance Abuse program identified the following compliance requirement relating to period of availability:

The United States Code, Title 42, Section 300x-62, requires the State to obligate and spend any Block Grants for Prevention and Treatment of Substance Abuse amounts by the end of the fiscal year following the fiscal year in which the amounts are awarded.

## **CONDITION**

The Department of Alcohol and Drug Programs (DADP) lacks adequate procedures to ensure that federal grant awards are obligated and spent within their applicable periods of availability for the Block Grants for Prevention and Treatment of Substance Abuse. In addition, it has not completed its corrective action on a period-of-availability finding we reported last year.

For the Block Grants for Prevention and Treatment of Substance Abuse program, DADP made payments to its subrecipients during fiscal year 2002-03 that it applied to the grant awarded to it in 2000. We found that DADP charged \$38,197 to a grant award for services that were provided after the award's period of availability had expired. When DADP does not ensure that it charges expenditures within the appropriate period of availability, DADP risks having to refund the funds to the federal awarding agency.

Additionally, DADP has not completed its corrective action related to a finding we reported last year. Specifically, for fiscal year 2001-02, we reported that DADP charged expenditures totaling \$145,491 to the 1999 and 2000 grant awards outside their periods of availability. As of the end of fieldwork in December 2003, DADP had yet to return these funds but was working with the federal awarding agency to resolve the issue.

## **RECOMMENDATIONS**

DADP should strengthen its procedures to ensure it obligates and expends funds only during each grant award's period of availability. In addition, DADP should make the appropriate adjustments to its accounting records. Further, DADP should resolve its issue with the federal awarding agency regarding the Block Grants for Prevention and Treatment of Substance Abuse program funds that it inappropriately spent outside their applicable periods of availability.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

The six transactions that totaled the \$38,197 identified in the finding have been corrected and charged to an award that was available during the period of the services provided. Documentation of those transactions has been forwarded to the Bureau of State Audits.

DADP has implemented edits in its Accounting system that will reject any transaction recorded after the period of availability. Desk procedure manuals that will include instructions on period of availability for federal grants are being prepared for the staff positions that process encumbrances and payables in the Accounting Office. The desk procedures are scheduled to be completed in June 2004. Finally, mandatory training, scheduled for March 2004, is required of all DADP staff responsible for monitoring contracts. This training will include clear direction on the period of availability for federal grant expenditures and obligations.

DADP has resolved the issue with the Federal agency. For the fiscal years involved, DADP exceeded its maintenance of effort requirement (MOE) under the Block Grants for Prevention and Treatment of Substance Abuse. The issue was resolved by substituting the excess MOE against the \$145,491. Per the January 23, 2004, letter from the Substance Abuse and Mental Health Services Administration (SAMHSA), DADP will be submitting revised MOE tables to SAMHSA by February 20, 2004.

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Reference Number: 2003-9-5

Category of Finding: Suspension and Debarment

State Agency: Health and Human Services

State Administering Department: Department of Social Services

(See listing of the specific federal program details following the discussion of the issues below.)

## **CRITERIA**

Our review of the Temporary Assistance for Needy Families (TANF) and Foster Care programs identified the following compliance requirements related to suspension and debarment:

The Code of Federal Regulations, Title 45, Section 76.225(a), prohibits the State from knowingly doing business with any party that is suspended, debarred, or otherwise ineligible to participate in federal assistance programs. Further, Section 76.510(b) requires the State to obtain signed certifications from participating organizations regarding suspension, debarment, ineligibility, and voluntary exclusion.

## **CONDITION**

The Department of Social Services (Social Services) did not obtain the required suspension and debarment certifications from two of the eight contractors we reviewed. Social Services awarded these participants of the TANF and Foster Care programs procurement contracts of \$100,000 or more. The two contracts we reviewed totaled more than \$734,000. Without obtaining the required certifications, Social Services risks unknowingly allowing suspended or debarred contractors to participate in its federal programs. For these two contracts, we used an alternative test to determine that these contractors had not been suspended or debarred.

## RECOMMENDATION

Social Services should ensure that it obtains the necessary suspension and debarment certificates from its contractors before it approves their participation in federal programs.

## DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Based on the information provided to the Contracts Bureau by the Bureau of State Audits (BSA), the following actions were taken to ensure that the suspension and debarment certificates are maintained in the contract files:

The requirement to obtain certificates for all federally funded contracts, including California Multiple Awards Schedules agreements, was emphasized in one of our weekly staff meetings. Staff were also instructed to include the signed certification in the contract package that is being forwarded for Social Services' signature and execution. Additionally, the "Contract Checklist" currently used by all contract analysts when developing contracts has been revised to include the Debarment Certification. The checklist now contains the Internet address of the Excluded Parties Listing System (<http://epls.arnet.gov>) used by BSA as an alternate method to verify contractor status. Last but not least, the Annual Business Plan for the Contracts Bureau contains an objective to create desk procedures on the contracting processes and obtaining the Debarment Certification will be included.

## U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Federal Catalog Number:	93.558
Federal Program Title:	Temporary Assistance for Needy Families
Federal Award Numbers and Calendar Years Awarded:	2002G996115; 2002 2003G996115; 2003

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Federal Catalog Number:	93.658
Federal Program Title:	Foster Care
Federal Award Numbers and Calendar Years Awarded:	2002G994107; 2002 2003G994107; 2003

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Reference Number: 2003-13-2  
Category of Finding: Subrecipient Monitoring  
State Administering Department: Department of Aging

(See listing of the specific federal program details following the discussion of the issues below.)

## **CRITERIA**

Our review of the Special Programs for the Aging—Title III, Part B, Grants for Supportive Services and Senior Centers, and Special Programs for the Aging—Title III, Part C, Nutrition Services (aging programs) identified the following compliance requirements related to subrecipient monitoring:

The United States Code, Title 42, Section 307(a)(4), requires the State to conduct periodic evaluations of activities and projects carried out under Title III of the Older Americans Act. Although the Code of Federal Regulations, Title 45, Section 1321.3, defines periodic as, at a minimum, once each fiscal year, the U.S. Administration on Aging has agreed that biennial onsite evaluations are adequate for monitoring the supportive and nutrition services funded by the aging programs. Finally, Section 1321.11 requires the State to establish policies that address the manner in which it will monitor the performance of all programs and activities funded by the aging grants for quality and effectiveness. Furthermore, the State is responsible for enforcement of these policies.

## **CONDITION**

The Department of Aging (Aging) is not fulfilling all of its monitoring responsibilities for the Area Agencies on Aging (area agencies). Specifically, two of the 19 biennial reviews that were conducted in fiscal year 2002-03 were done 340 and 361 days late, respectively. We also noted that Aging did not always promptly notify the area agencies of findings identified during onsite reviews. Aging's policy is to send a letter notifying the area agency of any findings within 120 days of completing the reviews. However, Aging notified two of the seven area agencies where it noted deficiencies nearly five and six months beyond the 120-day policy. Finally, Aging requires area agencies to submit corrective action plans within 60 days of being notified of any findings. However, one area agency submitted its corrective action plan almost two months late. Aging required a second area agency to submit its corrective action plan by September 13, 2003; however, it had yet to submit its plan as of December 31, 2003, or more than three months late.

Failure to conduct timely onsite evaluations may prevent early detection and correction of deficiencies in the services provided by the area agencies. Also, when Aging does not promptly notify area agencies of findings, it hampers their ability to initiate corrective action. Finally, when area agencies delay in submitting corrective action plans, Aging cannot ensure that area agencies are taking prompt and appropriate action to correct deficiencies.

## **RECOMMENDATIONS**

To ensure that they are complying with applicable federal laws and regulations, Aging should conduct biennial onsite reviews of area agencies, as required. Additionally, Aging should ensure that it complies with internal policies related to notifying area agencies of findings and receiving corrective action plans from the area agencies.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

The Department conducts biennial onsite reviews of Area Agencies on Aging (area agencies) using the State Fiscal Year versus the calendar year. Although the written report of the findings of the onsite visit do not always occur within the 120-day window, a full disclosure of all findings occurs at an exit conference that includes the participation of the entire staff of the area agency, representatives from the area agency's governing board and advisory council, as well as other interested parties. In addition, "high-risk" findings are discussed in detail at the exit conference and are documented in a corrective action letter to the area agency immediately upon return to the Department. Corrective action for "high-risk" findings is handled independently from the monitoring report and all documentation associated with the findings and corrective action is attached to the official monitoring report sent to the area agencies.

A procedure has been developed to ensure follow-up and submission of corrective action plans occurs by the due dates assigned. In addition, due to the need to "downsize" the area agency-based organizational structure (due to Personnel Services reductions), a new process will be developed which focuses on a streamlined monitoring and follow-up process.

## **U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES**

Federal Catalog Number:	93.044
Federal Program Title:	Special Programs for the Aging—Title III, Part B Grants for Supportive Services and Senior Centers
Federal Award Numbers and Calendar Years Awarded:	02-02-AA-CA-1320; 2001 02-03-AA-CA-1320; 2002

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Federal Catalog Number:	93.045
Federal Program Title:	Special Programs for the Aging—Title III, Part C Nutrition Services
Federal Award Numbers and Calendar Years Awarded:	02-02-AA-CA-1712; 2001 02-02-AA-CA-1713; 2001 02-03-AA-CA-1712; 2002 02-03-AA-CA-1713; 2002

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Reference Number:	2003-13-4
Federal Catalog Number:	93.917
Federal Program Title:	HIV Care Formula Grants
Federal Award Number and Calendar Year Awarded:	6 X07 HA 00041 12; 2002
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Health Services

## **CRITERIA**

Our review of the HIV Care Formula Grants program identified the following compliance requirements related to subrecipient monitoring:

The U.S. Office of Management and Budget Circular A-133, *Compliance Supplement* (Circular A-133 Compliance Supplement), requires the State to monitor the subrecipient's use of federal funds through site visits or other means to provide reasonable assurance that the subrecipient administers federal funds in compliance with applicable laws, regulations, and provisions of contracts or grant agreements. The Department of Health Services (Health Services) has established guidelines for administering the HIV Care Formula Grants program. Among other things, these guidelines require Health Services to conduct site visits of case management, consortia, and AIDS drug-assistance program subrecipients every 18 months, three years, and five years, respectively. Further, the policies require site visits of at least 50 AIDS drug-assistance program subrecipients each year.

Additionally, the Circular A-133 Compliance Supplement requires the State to ensure that subrecipients expending more than \$300,000 in federal assistance meet the audit requirements, to issue management decisions on audit findings within six months of receiving audit reports, and to ensure that subrecipients take appropriate and timely corrective action.

## **CONDITION**

Health Services does not adequately monitor subrecipients of the HIV Care Formula Grants program. For instance, it is not performing site visits as frequently as its established policies require nor is it performing as many site visits as required. Our review identified the following instances of noncompliance:

- Health Services did not conduct site visits within the last 18 months for seven of 17 case management program subrecipients that received funding in fiscal years 2001-02 and 2002-03. In fact, it had not conducted site visits for three of the seven since at least June 1999.
- Health Services did not review seven of the 37 consortia program subrecipients within three years of the last review.
- Health Services did not review 15 of the 123 AIDS drug-assistance program subrecipients that received annual funding during each of the last five years. Additionally, Health Services conducted only 18 of the required 50 site reviews during fiscal year 2002-03.

Health Services also did not adequately follow up to ensure that subrecipients corrected deficiencies identified in two audit reports conducted under U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

Because it does not conduct site visits in accordance with established policies and ensure that identified weaknesses are promptly addressed, Health Services has less assurance that subrecipients are complying with applicable laws and regulations.

## **RECOMMENDATIONS**

Health Services should ensure that it conducts site visits in accordance with its established policies and that subrecipients promptly correct weaknesses identified by department staff and independent auditors. Health Services may also want to reassess its policies related to subrecipient monitoring to determine if the current frequency of site visits is reasonable.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

The Office of AIDS (OA) concurs in part with the findings. Specific program responses are as follows:

### **1. Case Management Program**

The OA Community Based Care (CBC) section, which administers the AIDS Case Management Program and the AIDS Medi-Cal Waiver Program, concurs with the finding and is taking measures to correct the situation. Specifically, in August 2003,



a new database was created to track past site visits, dates future site visits are required and dates when the post-site visit reports are due. In addition, the CBC section uses information from the database to report which site visits are due for the upcoming quarter. The CBC section meets to discuss deficiencies from the previous quarter and to schedule site visits for the coming months. For specific staff, site visits are the main focus. Projects not visited in the last two years are the top priority. The section anticipates the required site visits will be completed and up-to-date by the end of the 2004 calendar year.

## **2. Consortia Program**

Concur in part. This process is not federally mandated, but has been established as a program policy that guides, and is guided by, the workload and resources available within the program. The OA CARE Section, which administers the Consortia Program, has administratively established a policy for fully monitoring each program contractor no less than once per three-year period. In addition to monitoring by program and fiscal staff, the Consortia Program annually budgets federal Ryan White CARE Act funding for a full time auditor assigned by Health Services' Audits and Investigations (A&I) Division. The program relies upon daily contact with contractors, detailed review of invoices, backup documentation and progress reports, as well as program monitoring and the audits completed by A&I, to adequately provide fiscal and programmatic oversight of the Consortia Program contracts.

The OA concurs with the finding for the noncompliant contracts. All have been recently monitored or audited in the period of time since the Bureau of State Audits (BSA) audit, or are scheduled for monitoring by the end of the current fiscal year. Program resources are considered in determining monitoring schedules. For instance, Inyo and Mono Counties, with relatively low client load and funding level, will be placed in a lower priority position than another county with higher funding levels and client load. Additionally, monitoring and audit priorities are periodically shifted if major program or fiscal issues are identified, or if a fiscal agent discontinues the contract.

## **3. AIDS Drug Assistance Program (ADAP)**

OA concurs that 15 of the 124 ADAP enrollment sites were not visited within the last five years and that the number of site visits performed did not meet our targeted goal as identified in our agreement with the Health Resources and Services Administration (HRSA). The reduced number of site visits was due in part to state budget cuts resulting in increased demands on staff's in-office time. Continuing staff time constraints led the program to reduce its monitoring schedule from 50 ADAP site visits per year to 30 site visits for the upcoming Year 14 (April 2004-March 2005) HRSA grant. During the site visits, ten percent of all active ADAP clients' charts (or at least ten charts in smaller enrollment sites) are reviewed to verify compliance with eligibility requirements. Staff will also provide technical assistance to local enrollment staff during these visits.

#### 4. Inadequate Follow-up

The two audit reports in question are as follows:

- a. St. Mary's Medical Finding: Health Services' A&I did not inform OA that there was a finding, so OA did not send a correction letter to St. Mary's Medical. However, when BSA reviewed the audit report, there was a finding pertaining to the HIV program.

OA concurs. OA received a memo from A&I dated May 1, 2003. The memo stated that nothing was found that required correction. Until OA was informed by the BSA via this audit finding on February 9, 2004, OA was unaware that any further action was necessary. OA will contact A&I to discuss the finding and will send a correction letter to the contractor. OA will input this information into the Audit Tracking System and will follow-up according to the protocols and timelines OA has in place.

- b. California Pacific Medical Center Finding: OA sent a correction letter on August 31, 2003. No response was received. OA planned to follow-up with this contractor during a site visit in September 2003. However, the site visit was cancelled and no follow-up was made after that.

OA concurs. OA sent a correction letter to the contractor on August 31, 2003. OA scheduled a site visit in September 2003 at which time the issue would have been addressed again, but because of travel constraints put into effect due to budgetary shortfalls, the visit never took place. The site visit is now scheduled for April 2004. The contractor was contacted via a telephone call on February 10, 2004, requesting that a correction be made to close their audit finding. Staff will follow-up in writing regarding this request.

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Reference Number:	2003-13-9
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Community Services and Development

(See listing of the specific federal program details following the discussion of the issues below.)

#### CRITERIA

Our review of the Low-Income Home Energy Assistance and Community Services Block Grant programs identified the following compliance requirements for subrecipient monitoring:

The U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (OMB Circular A-133), describes the requirements the State must follow when it passes federal funds through to subrecipients. Section 400(d) requires the State to ensure that subrecipients expending \$300,000 or more in federal assistance meet applicable audit requirements, including the submission of an audit report to the State within nine months following the end of the audit period. Also, the State is required to issue management decisions on audit findings within six months of receiving audit reports.

## **CONDITION**

The Department of Community Services and Development (Community Services) did not always review subrecipients' OMB Circular A-133 audit reports in time to issue any necessary management decisions within the required six-month period. As of December 31, 2003, Community Services was between eight and 196 days overdue in reviewing 10 of the 20 OMB Circular A-133 audit reports we sampled for the Low-Income Home Energy Assistance and Community Services Block Grant programs that met the reporting requirement. Although our review of the audit reports revealed no findings of noncompliance, without timely review, Community Services cannot ensure appropriate follow-up and corrective action on audit findings when they occur.

## **RECOMMENDATIONS**

Community Services should promptly review audit reports from its nonprofit subrecipients to ensure, when necessary, that it issues management decisions on audit findings within six months of receiving the audit reports.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

The condition identified is correct. Community Services has only three auditors and made a conscious decision to delay routine audit report reviews because we believed completion of two major agency investigations into whether federal fund expenditures were properly supported was a higher priority. One investigation involved the full time effort of one auditor for one year and required extended work at the agency site. The other investigation involved several fiscal years and required a legal opinion that resulted in a precedential decision involving conflict of interest. The reports for the two agencies have recently been issued allowing audit staff to begin work on reviewing audit reports. Community Services has a list of audit reports pending review, and has established priorities based on the date the audits were received. Community Services will have all audit reports reviewed by the end of April 2004. Community Services has no major investigations planned at this time and will return to its practice of reviewing audits within six months of receipt.

## U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Federal Catalog Number: 93.568  
Federal Program Title: Low-Income Home Energy Assistance  
Federal Award Numbers and Calendar Years Awarded: G-01B1CALIEA; 2001  
G-01B2CALIEA; 2001  
G-02B1CALIEA; 2000  
G-0201CALIE2; 2002

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Federal Catalog Number: 93.569  
Federal Program Title: Community Services Block Grant  
Federal Award Numbers and Calendar Years Awarded: G-01B1CACOSR; 2000  
G-02B1CACOSR; 2001

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Reference Number: 2003-14-1  
Federal Catalog Number: 93.959  
Federal Program Title: Block Grants for Prevention and Treatment of Substance Abuse  
Federal Award Number and Calendar Year Awarded: 03B1CASAPT; 2002  
Category of Finding: Special Tests and Provisions  
State Administering Department: Department of Alcohol and Drug Programs

### CRITERIA

Our review of the Block Grants for Prevention and Treatment for Substance Abuse identified the following requirement related to special tests and provisions:

The Code of Federal Regulations, Title 45, Section 96.136, requires the State to provide for independent peer reviews to assess the quality, appropriateness, and efficacy of treatment services provided to individuals of at least 5 percent of the treatment providers receiving funds.

## **CONDITION**

The Department of Alcohol and Drug Programs (DADP) did not ensure that independent peer reviews were conducted for at least 5 percent of the treatment providers receiving Block Grants for Prevention and Treatment for Substance Abuse funds. During fiscal year 2000-01, DADP entered into a contract that required the contractor to conduct 30 independent peer reviews. DADP later extended the contract and required the contractor to conduct 30 reviews each year through fiscal year 2002-03. However, we found that DADP had 641 treatment providers receiving Block Grants for Prevention and Treatment for Substance Abuse funds as of fiscal year 2001-02, the most recent year for which data was available. Using this data, DADP should have required its contractor to conduct at least 32 (5 percent) independent peer reviews during fiscal year 2002-03 rather than the 30 reviews required by its contract. DADP plans to enter into a new contract during fiscal year 2003-04 that requires the contractor to annually conduct 32 independent peer reviews. Nevertheless, DADP does not have procedures currently to monitor the number of these treatment providers and annually adjust the number of peer reviews required by its contract. As a result, DADP still runs the risk that independent peer reviews will be conducted for fewer than 5 percent of the treatment providers receiving Block Grants for Prevention and Treatment for Substance Abuse funds.

## **RECOMMENDATIONS**

DADP should implement procedures to monitor the number of treatment providers receiving Block Grants for Prevention and Treatment for Substance Abuse funds and ensure that at least 5 percent of these treatment providers annually receive an independent peer review.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

In compliance with the "independent from the funding source" requirement, DADP contracts out for the independent peer reviews via three-year term Invitations for Bids (IFB). When developing each IFB, DADP uses the most current list of Budgeted Block Grants for Prevention and Treatment of Substance Abuse (SAPT) funded treatment providers, to calculate the number of peer reviews needed to comply with the federal requirement. Bidders are to base their all-inclusive bid on an annual total of 30 independent peer reviews, and are advised that the lowest dollar bid earns extra points.

The Bureau of State Audits based their figure of 641 SAPT-funded treatment providers on the fiscal year 2001-02 cost reports. Since the cost reports contained more SAPT-funded treatment providers than the budget, DADP fell two providers short of complying with the independent peer review requirement. The fiscal year at issue (2002-03) is the last of a three-year contract during which the number of SAPT-funded providers fluctuated slightly from year to year, but did not require more than 30 annual

independent peer reviews. When developing the IFB, DADP had no way of predicting the significant increase in SAPT-funded treatment providers late into the fiscal year 2002-03 contract year; otherwise, provisions would have been addressed in the IFB.

DADP has modified its data systems to detect further growth in SAPT-funded treatment providers to ensure that at least 5 percent of SAPT-funded providers annually receive an independent review.

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Reference Number:	2003-14-2
Federal Catalog Number:	93.778
Federal Program Title:	Medical Assistance Program
Federal Award Numbers and Calendar Years Awarded:	05-0205CA5028; 2001 05-0305CA5028; 2002
Category of Finding:	Special Tests and Provisions
State Administering Department:	Department of Health Services

## **CRITERIA**

Our review of the Medical Assistance Program (Medicaid) identified the following compliance requirements related to special tests and provisions:

The Code of Federal Regulations, Title 42, sections 431.51(b) and (c), allows recipients to obtain Medicaid program services from any provider qualified to furnish the services. However, these regulations do not prohibit the state Medicaid agency from setting reasonable standards for provider qualifications. For example, the California Welfare and Institutions Code, Section 14043.6, requires the automatic suspension from the State Medicaid program of any provider whose license has been revoked, suspended, surrendered, or otherwise lost.

Additionally, the Code of Federal Regulations, Title 42, Part 455, Subpart B, sections 455.104 through 455.106, requires providers and organizations to make certain disclosures to the State regarding ownership, business transactions, and criminal convictions. The Code of Federal Regulations, Title 42, Section 431.107, requires the State to provide for an agreement between each provider or organization and the state agency administering the Medicaid program. Among other things, the provider or organization must agree to disclose the information required in Subpart B.

## CONDITION

As we discussed in our December 2003 report titled *Department of Health Services: It Needs to Better Plan and Coordinate Its Medi-Cal Antifraud Activities* (Report 2003-112), the Department of Health Services (Health Services) does not always ensure the continuing eligibility of enrolled providers. Our review of 30 providers disclosed two with canceled licenses, yet their provider numbers were being used to continue billing and receiving payment. In one case, the Provider Master File indicated that Health Services paid more than \$3 million in claims under the provider number after the cancellation of that provider's license. Further analysis revealed that Health Services received a change of ownership application for this provider, but it was not completely reviewed. Therefore, the enrollment branch permitted a new owner to receive payment from the Medicaid program even though the new owner had not been approved as an eligible Medicaid provider.

In the other case, the Provider Master File indicated payment of more than \$140,000 in claims after the license cancellation. The enrollment branch had not received any notification about the provider, including the provider's canceled license, because it does not check with professional licensing boards on a periodic basis.

Our review of selected providers also found that the enrollment branch did not always have the required agreements and disclosures on file. Of the 30 provider files reviewed, two did not contain disclosure statements. Additionally, Health Services could not locate agreements for 24 of these providers. Finally, during testing performed as part of our annual single audit, we noted that one of four managed care plans we tested did not submit its annual disclosure statement, as required. When Health Services cannot demonstrate that it obtained the required provider agreements and disclosures, it cannot ensure that it made Medicaid claim payments only to eligible providers.

## RECOMMENDATIONS

As recommended in our December 2003 report, Health Services should do the following:

- Develop a plan for re-enrolling all providers on a continuing basis. Such a plan should enable Health Services to ensure that all provider files meet federal and state laws and regulations requiring agreements and disclosure statements on file.
- Enforce laws permitting the deactivation of providers with canceled licenses or incomplete disclosures. Similarly, it should enforce its legal responsibility to deactivate provider numbers, such as when there is a known change of ownership.
- Establish agreements with state professional licensing boards so that any changes in license status can be communicated to Health Services for prompt updating of the Provider Master File.

In addition, Health Services should consider suspending payments to or terminating agreements with managed care plans that fail to submit the required disclosure statements.

## **DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN**

Health Services is fully committed to reenrolling all providers on a continuing basis in accordance with all Federal and State Statutes and Regulations. The Provider Enrollment Branch (PEB) of the Payment Systems Division (PSD) and the Medical Review Branch of the Audits and Investigations Division (A&I) have coordinated efforts to implement this strategy on a provider-type basis. Reenrollment of Durable Medical Equipment providers has been completed and Health Services is currently concentrating on non-chain pharmacies and physicians/groups identified by A&I as high-risk providers. To achieve maximum effectiveness, PEB and A&I will continue to coordinate efforts to identify providers posing the greatest risk to the Medi-Cal Program. One significant process involves utilizing analytical software that can be run against administrative claims data to identify potentially abusive or fraudulent providers. The outcome from the programs developed using such software, helps Health Services to utilize resources in the most effective manner. Once Health Services completes reenrollment of these high-risk providers, the process will be continued for all other providers on an ongoing basis. It should be noted that with over 100,000 providers enrolled in Medi-Cal and the time it takes to do an effective reenrollment process, with current staffing levels it will take several years to reenroll all providers in Medi-Cal.

Health Services will enforce all laws permitting the suspension or deactivation of providers with canceled licenses or incomplete disclosures. Health Services is actively pursuing procedures to meet statutory and regulatory requirements through the coordination of multiple divisions within Health Services. However, as currently written, statute and regulation require Health Services to follow due process when deactivating and suspending a provider number.

PSD is currently working with several professional boards to obtain permit/licensing information on a timely basis and in a format that is readily usable to ensure that applicants without proper licensing are not enrolled in the Medi-Cal program. These professional boards include the California Medical Board and the California Osteopathic Board. Licensing information is shared both electronically and manually on an on-going basis.

PSD will continue to work on establishing formal agreements with other professional licensing boards that will allow PSD to obtain permit/licensing information in an automated format. The preferred design would be an electronic/automated format that allows the matching of permit/licensing and enrollment data on the Provider Master File (similar to what is currently in place for verifying Internal Revenue Service and Social Security Administration data). It is anticipated that Medi-Cal will eventually establish agreements with the following boards:



- Acupuncture
- Audiology
- Optometry
- Hearing Aid Dispensers
- Licensed Clinical Social Workers
- Registered Nursing
- Pharmacy
- Occupational Therapy
- Physical Therapy
- Podiatry
- Psychology
- Speech Therapy
- Chiropractics

Additionally, Health Services hopes to establish relationships with the Departments of Insurance, Consumer Affairs, Corporations, and the Office of the Secretary of State. Until then, it will continue to use permit/licensing information available via the various Board websites and telephone information lines.

The Medi-Cal Managed Care Division will work with the Office of Legal Services, PSD and A&I to address the issue of plan providers who either fail to file proper disclosure statements with the Department, or who file disclosure statements requiring correction.

Reference Number: 2003-14-5

Category of Finding: Special Tests and Provisions

State Administering Department: Department of Health Services

(See listing of the specific federal program details following the discussion of the issues below.)

**CRITERIA**

Our review of the Medical Assistance Program (Medicaid) and the State Medicaid Fraud Control Units program identified the following compliance requirements related to special tests and provisions:

The Code of Federal Regulations, Title 42, Part 455, requires the State to have (1) methods or criteria for identifying suspected fraud cases; (2) methods for investigating these cases; and (3) procedures, developed in cooperation with State legal authorities, for referring suspected Medicaid fraud cases to law enforcement officials. Additionally, Part 1007 of that regulation requires that the state fraud-control unit enter into an agreement with the Medicaid agency regarding referrals and requests for information between the entities.

## **CONDITION**

As we discussed in our December 2003 report titled *Department of Health Services: It Needs to Better Plan and Coordinate Its Medi-Cal Antifraud Activities* (Report 2003-112), the Department of Health Services (Health Services) does not always make timely or complete referrals to the Department of Justice (Justice). Our comparison of fiscal year 2002-03 referrals of suspected fraud from Health Services' case-tracking system database to similar records from Justice's case-tracking system database revealed that 63 (41 percent) of the 152 Health Services case referrals to Justice were late, incomplete, or never received. Of the 14 cases we reviewed that resulted in a referral to Justice, Health Services referred 12 an average of nearly five months after the date it had evidence of suspected fraud.

In some instances, Health Services had referred the cases to the U.S. Attorney before referring them to Justice. Although Health Services acknowledged that it no longer refers cases to Justice after indictment by the U.S. Attorney, the investigations branch said it investigates and refers cases to the U.S. Attorney because the U.S. Attorney indicts suspected providers and settles cases quickly. Justice, on the other hand, typically develops cases for trial to pursue sentences that it believes reflect the seriousness of the defendant's conduct. Health Services and Justice have not agreed on when each approach is appropriate and who should make that determination.

These problems concerning case referral result, in part, because Health Services believes the laws surrounding the referral of suspected provider fraud cases to Justice do not specifically define what constitutes suspected fraud. Thus, Health Services and Justice should agree clearly on a standard to assist both agencies in coordinating their respective provider fraud investigation and prosecution efforts. Although they could use the agreement required by federal regulations to clarify this issue, Health Services and Justice have yet to complete negotiations for an update of their 1988 agreement or to define and coordinate their respective roles and responsibilities for investigating and prosecuting suspected cases of Medicaid provider fraud.

## **RECOMMENDATIONS**

As recommended in our December 2003 report, Health Services should do the following:

- Complete its negotiations for a current agreement with Justice as required by law. The agreement should clearly communicate each agency's respective roles and responsibilities to coordinate efforts, define what a preliminary investigation entails and when a case of suspected provider fraud would be considered ready for referral to Justice.
- Promptly refer all cases of suspected provider fraud to Justice, as required by law.

## DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Health Services' Office of Legal Services is in the process of finalizing the memorandum of understanding with Justice. It is anticipated that the draft will be sent to Justice in the next few weeks for their review and approval.

Prior to completion of the December 2003 audit report titled "Department of Health Services: It Needs to Better Plan and Coordinate Its Medi-Cal Antifraud Activities"; Health Services' Audits and Investigations (A&I) had updated its procedures to ensure prompt case referrals to Justice.

Of the cases that the Bureau of State Audits (BSA) identified as incomplete, the majority (34 of the 63) were because Health Services used a modified referral process for the Medi-Cal Fraud Prevention Bureau (MCFPB) cases. A&I met with Justice to discuss the MCFPB process and the contents of their case files. Effective January 23, 2004, A&I and Justice have agreed that a copy of the complete case file from the MCFPB will be mailed with the referral (MC 609) directly from the MCFPB to the Justice Case Intake Unit. The receipt of the case file will be considered by Justice as a complete referral.

In regards to the BSA finding that cases were not received by Justice, A&I has changed its referral procedures to include a monthly reconciliation with Justice to ensure that all cases have been received.

### U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Federal Catalog Number:	93.775
Federal Program Title:	State Medicaid Fraud Control Units
Federal Award Numbers and Calendar Years Awarded:	01-0201- CA-5050; 2001 01-0301- CA-5050; 2002

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Federal Catalog Number:	93.778
Federal Program Title:	Medical Assistance Program
Federal Award Numbers and Calendar Years Awarded:	05-0205CA5028; 2001 05-0305CA5028; 2002

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## **AUDITEE'S SECTION**

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## **Schedule of Federal Assistance**

**Prepared by  
Department of Finance**

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**STATE OF CALIFORNIA  
SCHEDULE OF FEDERAL ASSISTANCE  
FISCAL YEAR ENDED JUNE 30, 2003**

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
<b>Department of Agriculture</b>		
Plant and Animal Disease, Pest Control, and Animal Care	10.025	\$ 118,152
Forestry Incentives Program	10.064	32,980
Market Protection and Promotion	10.163	464,124
Farm Labor Housing Loans and Grants	10.405	5,766,210
Food Distribution	10.550	92,696,058 *
Special Supplemental Nutrition Program for Women, Infants, and Children	10.557	800,051,828
Child and Adult Care Food Program	10.558	226,292,627
State Administrative Expenses for Child Nutrition	10.560	14,504,741
Commodity Supplemental Food Program	10.565	2,348,432
Nutrition Services Incentive	10.570	14,013,872
WIC Farmers' Market Nutrition Program (FMNP)	10.572	2,385,833
Team Nutrition Grants	10.574	91,153
Cooperative Forestry Assistance	10.664	3,273,627
National Forest-Dependent Rural Communities	10.670	539,846
Rural Business Enterprise Grants	10.769	90,825
Soil and Water Conservation	10.902	5,558
Wildlife Habitat Incentive Program	10.914	1,208
Other - U.S. Department of Agriculture	10.999	28,238,893
<b>Total Excluding Clusters</b>		<u>1,190,915,967</u>
<b>Food Stamp Cluster</b>		
Food Stamps	10.551	1,683,973,595 *
State Administrative Matching Grants for Food Stamp Program	10.561	380,076,269
<b>Total Food Stamp Cluster</b>		<u>2,064,049,864</u>
<b>Child Nutrition Cluster</b>		
School Breakfast Program	10.553	211,756,058
National School Lunch Program	10.555	857,949,249
Special Milk Program for Children	10.556	773,288
Summer Food Service Program for Children	10.559	15,344,886
<b>Total Child Nutrition Cluster</b>		<u>1,085,823,481</u>

<b>Emergency Food Assistance Cluster</b>		
Emergency Food Assistance Program (Administrative Costs)	10.568	4,663,383
Emergency Food Assistance Program (Food Commodities)	10.569	<u>48,234,915</u> *
<b>Total Emergency Food Assistance Cluster</b>		52,898,298
 <b>Research and Development Cluster</b>		
Agricultural Research—Basic and Applied Research	10.001	5,000 **
 <b>Schools and Roads Cluster</b>		
Schools and Roads—Grants to States	10.665	<u>60,937,140</u>
 <b>Total U.S. Department of Agriculture</b>		<u><u>4,454,629,750</u></u>
 <b>Department of Commerce</b>		
Economic Development-Support for Planning Organizations	11.302	100,000
Sudden & Severe Economic Dislocation	11.311	880,258 ***
Anadromous Fish Conservation Act Program	11.405	539,840
Interjurisdictional Fisheries Act of 1986	11.407	43,286
Coastal Zone Management Administration Awards	11.419	2,885,695
Coastal Zone Management Estuarine Research Reserves	11.420	391,445
Marine Sanctuary Program	11.429	72,787
Pacific Coast Salmon Recovery-Pacific Salmon Treaty Program	11.438	4,970,644
Habitat Conservation	11.463	32,585
Fisheries Disaster Relief	11.477	1,268,078
Other - U.S. Department of Commerce	11.999	<u>70,382</u>
<b>Total Excluding Clusters</b>		11,255,000
 <b>Research and Development Cluster</b>		
Office of Administration Special Programs	11.470	<u>5,750</u>
 <b>Total U.S. Department of Commerce</b>		<u><u>11,260,750</u></u>
 <b>Department of Defense</b>		
Navigation Projects	12.107	87,964
Planning Assistance to States	12.110	739,254
State Memorandum of Agreement Program for the Reimbursement of Technical Services	12.113	16,583,024

National Guard Military Operations and Maintenance (O&M) Projects	12.401	50,576,996	
National Guard Civilian Youth Opportunities	12.404	3,948,498	
Other - U.S. Department of Defense	12.999	2,546,969	
<b>Total Excluding Clusters</b>		<u>74,482,705</u>	
 <b>Research and Development Cluster</b>			
Aquatic Plant Control	12.100	120,250	
<b>Total U.S. Department of Defense</b>		<u><u>74,602,955</u></u>	
 <b>Department of Housing and Urban Development</b>			
Manufactured Home Construction and Safety Standards	14.171	176,777	
Community Development Block Grants/State's Program	14.228	44,600,761	
Emergency Shelter Grants Program	14.231	5,781,343	
Supportive Housing Program	14.235	5,178,474	***
HOME Investment Partnerships Program	14.239	63,513,260	***
Housing Opportunities for Persons with AIDS	14.241	2,568,210	
Equal Opportunity in Housing	14.400	3,591,847	
Section 8 Rental Voucher Program	14.855	3,116,553	
Section 8 Rental Certificate Program	14.857	345	
Lead-Based Paint Hazard Control Privately-Owned Housing	14.900	1,287,021	
<b>Total Excluding Clusters</b>		<u>129,814,591</u>	
 <b>Section 8 Project-Based Cluster</b>			
Lower Income Housing Assistance Program - Section 8 Moderate Rehabilitation	14.856	58,660	
<b>Total U.S. Department of Housing and Urban Development</b>		<u><u>129,873,251</u></u>	
 <b>Department of the Interior</b>			
Recreation Resource Management	15.225	30,611	
Small Reclamation Projects	15.503	181,504	
Endangered Species Conservation	15.612	232,317	
Clean Vessel Act	15.616	1,263,803	
Wildlife Conservation and Appreciation	15.617	18,734	
Administrative Grants for Federal Aid in Sport Fish and Wildlife Restoration	15.618	495,228	
Sportfishing & Boating Safety Act	15.622	20,000	

U. S. Geological Survey—Research and Data Acquisition	15.808	355,701
Historic Preservation Fund Grants-In-Aid	15.904	1,251,653
Technical Preservation Service	15.915	23,769
Outdoor Recreation-Acquisition, Development and Planning	15.916	2,522,581
Native American Graves Protection and Repatriation	15.922	27,925
Research Information	15.975	488,657
Other - U.S. Department of the Interior	15.999	35,414,482
<b>Total Excluding Clusters</b>		<u>42,326,965</u>
 <b>Fish and Wildlife Cluster</b>		
Sport Fish Restoration	15.605	12,234,023
Wildlife Restoration	15.611	7,163,030
<b>Total Fish and Wildlife Cluster</b>		<u>19,397,053</u>
 <b>Research and Development Cluster</b>		
Anadromous Fish Conservation	15.600	20,903
Fish and Wildlife Management Assistance	15.608	172,854
Coastal Wetlands Planning, Protection and Restoration Act	15.614	2,559,252
Cooperative Endangered Species Conservation Fund	15.615	724,435
<b>Total Research and Development Cluster</b>		<u>3,477,444</u>
 <b>Total U.S. Department of the Interior</b>		<u><u>65,201,462</u></u>
 <b>Department of Justice</b>		
State Domestic Preparedness Equipment Support Program	16.007	14,969,621
Juvenile Accountability Incentive Block Grants	16.523	25,787,688
Juvenile Justice and Delinquency Prevention- Allocation to States	16.540	8,515,959
Juvenile Justice and Delinquency Prevention- Special Emphasis	16.541	4,439,478
Part E-State Challenge Activities	16.549	1,587,265
National Criminal History Improvement Program	16.554	2,789,997
National Sex Offender Registry Assistance	16.555	104,404
National Institute of Justice Research, Evaluation, and Development Project Grants	16.560	214,143
Crime Laboratory Improvement-Combined Offender DNA Index System Backlog Reduction	16.564	1,110,537
Crime Victim Assistance	16.575	38,243,268
Crime Victim Compensation	16.576	49,872,350
Byrne Formula Grant Program	16.579	47,168,933
Edward Byrne Memorial State and Local Law Enforcement Assistance Discretionary Grants Program	16.580	101,645

Drug Court Discretionary Grant Program	16.585	108,338
Violent Offender Incarceration and Truth in Sentencing Incentive Grants	16.586	40,536,321
Rural Domestic Violence and Child Victimization Enforcement Grant Program	16.589	157,886
Grants to Encourage Arrest Policies and Enforcement of Protection Orders	16.590	166,115
Local Law Enforcement Block Grants Program	16.592	980,971
Residential Substance Abuse Treatment for State Prisoners	16.593	7,901,603
Bulletproof Vest Partnership Program	16.607	200,307
Regional Information Sharing Systems	16.610	3,663,987
Public Safety Partnership and Community Policing Grants	16.710	8,099,552
National Incident Based Reporting System	16.733	204,121
Other - U.S. Department of Justice	16.999	756,604
<b>Total Excluding Clusters</b>		<u>257,681,093</u>
 <b>Research and Development Cluster</b>		
Violence Against Women Formula Grants	16.588	<u>12,284,602</u>
 <b>Total U.S. Department of Justice</b>		<u><u>269,965,695</u></u>
 <b>Department of Labor</b>		
Labor Force Statistics	17.002	7,778,125
Compensation and Working Conditions Data	17.005	626,218
Labor Certification for Alien Workers	17.203	8,492,020
Unemployment Insurance	17.225	8,520,998,194
Senior Community Service Employment Program	17.235	7,631,156
Trade Adjustment Assistance-Workers	17.245	13,595,052
Employment Services and Job Training - Pilot and Demonstration Programs	17.249	3,255,950
Welfare-to-Work Grants to States and Localities	17.253	48,249,171
Workforce Investment Act	17.255	62,575,994
Work Incentives Grant	17.266	167,898
Occupational Safety and Health-State Program	17.503	23,250,000
Consultation Agreements	17.504	4,780,374
Mine Health and Safety Grants	17.600	324,548
Veterans' Employment Program	17.802	877,515
Other - U.S. Department of Labor	17.999	1,781,408
<b>Total Excluding Clusters</b>		<u>8,704,383,623</u>

<b>Employment Services Cluster</b>			
Employment Service	17.207	91,389,219	
Disabled Veterans' Outreach Program	17.801	11,401,147	
Local Veterans' Employment Representative Program	17.804	7,385,158	
<b>Total Employment Services Cluster</b>		<u>110,175,524</u>	
<b>WIA Cluster</b>			
WIA Adult Program	17.258	158,590,116	
WIA Youth Activities	17.259	180,225,363	
WIA Dislocated Workers	17.260	235,236,697	
<b>Total WIA Cluster</b>		<u>574,052,176</u>	
<b>Total U.S. Department of Labor</b>		<u><u>9,388,611,323</u></u>	
<b>Department of Transportation</b>			
Boating Safety Financial Assistance	20.005	2,299,718	
Airport Improvement Program	20.106	321,013	
Motor Carrier Safety	20.217	9,416,247	
Local Rail Freight Assistance	20.308	156,049	
High Speed Ground Transportation—Next Generation			
High Speed Rail Program	20.312	1,125,018	
Federal Transit-Metropolitan Planning Grants	20.505	48,421,969	
Pipeline Safety	20.700	1,638,858	
Interagency Hazardous Materials Public Sector Training			
and Planning Grants	20.703	1,228,930	
Other - U.S. Department of Transportation	20.999	15,154	
<b>Total Excluding Clusters</b>		<u>64,622,956</u>	
<b>Highway Planning and Construction Cluster</b>			
Highway Planning and Construction	20.205	2,790,564,562	***
<b>Federal Transit Cluster</b>			
Federal Transit Capital Investment Grants	20.500	6,135,401	
<b>Highway Safety Cluster</b>			
State & Community Highway Safety	20.600	42,384,226	
Alcohol Traffic Safety and Drunk Driving Prevention			
Incentive Grants	20.601	1,607,699	
<b>Total Highway Safety Cluster</b>		<u>43,991,925</u>	

<b>Research and Development Cluster</b>		
Highway Planning and Construction	20.205	23,450,898
Formula Grants for Other Than Urbanized Areas	20.509	15,445,341
State Planning and Research	20.515	1,850,030
<b>Total Research and Development Cluster</b>		<u>40,746,269</u>
<b>Total U.S. Department of Transportation</b>		<u><u>2,946,061,113</u></u>
<b>Equal Employment Opportunity Commission</b>		
Employment Discrimination-State and Local Fair Employment Practices Agency Contracts	30.002	3,033,350
<b>General Services Administration</b>		
Donation of Federal Surplus Personal Property	39.003	5,686,601 **
<b>National Aeronautics and Space Administration</b>		
Technology Transfer	43.002	195,704
Other - National Aeronautics and Space Administration	43.999	96,053
		<u>291,757</u>
<b>Total National Aeronautics and Space Administration</b>		<u><u>291,757</u></u>
<b>National Foundation on the Arts and the Humanities</b>		
Promotion of the Arts-State and Regional Program	45.007	1,130,300
State Library Program	45.310	15,117,785
		<u>16,248,085</u>
<b>Total National Foundation on the Arts and the Humanities</b>		<u><u>16,248,085</u></u>
<b>Small Business Administration</b>		
Small Business Development Center	59.037	9,260,985
<b>Department of Veterans Affairs</b>		
Grants to State for Construction of States Home Facilities	64.005	19,057
Veterans State Domiciliary Care	64.014	8,811,041
Veterans State Nursing Home Care	64.015	9,827,156

Veterans State Hospital Care	64.016	93,932	
Veterans Housing-Guaranteed and Insured Loans	64.114	293,616,500	***
All Volunteer Force Educational Assistance	64.124	40,763	
Other - U.S. Department of Veterans Affairs	64.999	1,146,164	

**Total U.S. Department of Veterans Affairs**

313,554,613

**Environmental Protection Agency**

Air Pollution Control Program Support	66.001	20,661,357	
State Indoor Radon Grants	66.032	130,000	
Water Pollution Control-State and Interstate Program Support	66.419	5,332,464	
State Underground Water Source Protection	66.433	611,494	
Water Quality Management Planning	66.454	1,091,410	
National Estuary Program	66.456	354,445	
Capitalization Grants for Clean Water State Revolving Funds	66.458	127,516,973	
Nonpoint Source Implementation Grants	66.460	10,567,811	
Water Quality Cooperative Agreements	66.463	740,326	
Capitalization Grants for Drinking Water State Revolving Fund	66.468	13,680,970	***
Beach Monitoring and Notification Program			
Implementation Grants	66.472	57,000	
Environmental Protection Consolidated Research	66.500	439,087	
Safe Drinking Water Research and Demonstration	66.506	3,145,109	
State Information Grants	66.608	483,949	
Toxic Substances Compliance Monitoring Cooperative			
Agreements	66.701	246,815	
TSCA Title IV State Lead Grants-Certification of Lead-Based			
Paint Professionals	66.707	682,419	
Hazardous Waste Management State Program Support	66.801	6,979,663	
Superfund State, Political Subdivision, and Indian Tribe			
Site-Specific Cooperative Agreements	66.802	2,046,276	
State and Tribal Underground Storage Tanks Program	66.804	383,071	
Leaking Underground Storage Tank Trust Fund Program	66.805	3,668,140	
Solid Waste Management Assistance	66.808	52,855	
Brownfield Pilots Cooperative Agreements	66.811	8,468	
U.S.-Mexico Border Grants Program	66.930	262,500	
Environmental Education Grants	66.951	79,177	
Other - U.S. Environmental Protection Agency	66.999	36,240	
<b>Total Excluding Clusters</b>		<u>199,258,019</u>	

**Research and Development Cluster**

Wetland Program Development Grants	66.461	269,425	
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Surveys, Studies, Investigations and Special Purpose Grants	66.606	763,011
Consolidated Pesticide Enforcement Cooperative Agreements	66.700	1,162,112
Pollution Prevention Grants Program	66.708	45,191
<b>Total Research and Development Cluster</b>		<u>2,239,739</u>
<b>Total U.S. Environmental Protection Agency</b>		<u><u>201,497,758</u></u>
<b>Office of State and Tribal Programs, Nuclear Regulatory Commission</b>		
Radiation Control–Training Assistance and Advisory Counseling	77.001	54,470
<b>Department of Energy</b>		
State Energy Program	81.041	2,594,651
Weatherization Assistance for Low-Income Persons	81.042	6,902,313
Environmental Restoration	81.092	397,472
National Industrial Competitiveness through Energy, Environment, and Economics	81.105	34,669
Other - U.S. Department of Energy	81.999	209,805
<b>Total U.S. Department of Energy</b>		<u><u>10,138,910</u></u>
<b>Federal Emergency Management Agency</b>		
Community Assistance Program–State Support Services Element (CAP-SSSE)	83.105	333,584
State Disaster Preparedness Grants	83.505	146,628
Earthquake Hazards Reduction Grants	83.521	86,310
Flood Mitigation Assistance	83.536	976,843
Public Assistance Grants	83.544	432,614,238
Hazard Mitigation Grant	83.548	95,366,473
Emergency Management Performance Grants	83.552	9,532,773
File Management Assistance Grant	83.556	7,822,904
Pre-Disaster Mitigation	83.557	301,008
State and Local All Hazards Emergency Operations Planning	83.562	609,322
Emergency Operations Centers	83.563	50,000
Citizen Corps	83.564	195,470
Other - Federal Emergency Management Agency	83.999	1,460,650
<b>Total Federal Emergency Management Agency</b>		<u><u>549,496,203</u></u>

**Department of Education**

Adult Education-State Grant Program	84.002	96,434,320
Title I Grants to Local Educational Agencies	84.010	1,405,875,699
Migrant Education-State Grant Program	84.011	125,948,297
Title I Program for Neglected and Delinquent Children	84.013	3,909,132
Vocational Education-Basic Grants to States	84.048	128,257,366
Vocational Education-State Councils	84.053	332,536
Leveraging Education Assistance Partnership	84.069	9,637,480
Rehabilitation Services - Vocational Rehabilitation Grants to States	84.126	231,457,136
Rehabilitation Services--Service Projects	84.128	1,116,102
Public Library Construction and Technology Enhancement	84.154	759,073
Immigrant Education	84.162	41,122
Independent Living-State Grants	84.169	1,223,455
Rehabilitation Services-Independent Living Services for Older Individuals Who are Blind	84.177	1,941,363
Special Education-Grants for Infants and Families with Disabilities	84.181	47,501,553
Safe and Drug-Free Schools and Communities-- National Programs	84.184	187,774
Byrd Honors Scholarships	84.185	7,380,557
Safe and Drug-Free Schools and Communities-State Grants	84.186	27,397,451
Supported Employment Services for Individuals with Severe Disabilities	84.187	1,159,852
Bilingual Education Support Services	84.194	595,845
Bilingual Education - Professional Development	84.195	105,306
Education for Homeless Children and Youth	84.196	6,285,073
Even Start-State Educational Agencies	84.213	24,121,084
Fund for the Improvement of Education	84.215	448,825
Private School-Capital Expenses	84.216	474,510
Assistive Technology	84.224	702,392
Tech-Prep Education	84.243	11,669,324
Rehabilitation Training-State Vocational Rehabilitation Unit In-Service Training	84.265	154,914
Goals 2000-State and Local Education Systematic Improvement Grants	84.276	27,139,048
School to Work Opportunities	84.278	15,781,938
Eisenhower Professional Development State Grants	84.281	15,565,699
Charter Schools	84.282	21,304,692
Twenty-First Century Community Learning Centers	84.287	217,474

Foreign Language Assistance	84.293	39,189	
Innovative Education Program Strategies	84.298	37,268,087	
Even Start-Statewide Family Literacy Program	84.314	691,769	
Education Technology State Grants	84.318	52,588,964	
Special Education-State Program Improvement Grants for Children with Disabilities	84.323	983,715	
Advanced Placement Program	84.330	1,516,659	
Grants to States for Incarcerated Youth Offenders	84.331	2,212,688	
Comprehensive School Reform Demonstration	84.332	34,567,129	
Teacher Quality Enhancement Grants	84.336	4,558,010	
Reading Excellence	84.338	24,831,559	
Class Size Reduction	84.340	122,549,588	
Preparing Tomorrow's Teachers to Use Technology	84.342	517,289	
Title I Accountability Grants	84.348	16,792,257	
Transition to Teaching	84.350	608,460	
School Renovation Grants	84.352	67,924,370	
Reading First State Grants	84.357	38,999,710	
Rural Education	84.358	2,629,530	
English Language Acquisition Grants	84.365	113,598,685	
Improving Teacher Quality State Grants	84.367	311,112,124	
Grants for State Assessments and Related Activities	84.369	108,156	
<b>Total Excluding Clusters</b>		<u>3,049,224,330</u>	
 <b>Student Financial Aid Cluster</b>			
Federal Family Education Loans	84.032	20,215,856,079	***
 <b>Special Education Cluster</b>			
Special Education - Grants to States	84.027	676,587,222	
Special Education - Preschool Grants	84.173	<u>39,312,808</u>	
<b>Total Special Education Cluster</b>		<u>715,900,030</u>	
 <b>Total U.S. Department of Education</b>		<u><u>23,980,980,439</u></u>	
 <b>Consumer Product Safety Commission</b>			
Other - Consumer Product Safety Commission	87.999	58,822	
 <b>Department of Health and Human Services</b>			
Public Health and Social Services Emergency Fund	93.003	747,849	
Special Programs for the Aging-Title VII, Chapter 3-Programs for Prevention of Elder Abuse, Neglect, and Exploitation	93.041	456,281	

Special Programs for the Aging-Title VII, Chapter 2-Long Term Care Ombudsman Services for Older Individuals	93.042	1,275,639
Special Programs for the Aging-Title III, Part D-Disease Prevention and Health Promotion Services	93.043	2,163,206
Special Programs for the Aging-Title IV, and Title II - Discretionary Projects	93.048	480,567
National Family Caregiver Support	93.052	17,235,544
Food and Drug Administration-Research	93.103	911,192
Maternal and Child Health Federal Consolidated Programs	93.110	95,359
Biological Response to Environmental Health Hazards	93.113	24,964
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	93.116	10,616,909
Emergency Medical Services for Children	93.127	185,781
Primary Care Services - Resource Coordination and Development	93.130	276,664
Injury Prevention and Control Research and State and Community Based Programs	93.136	726,677
Projects for Assistance in Transition from Homelessness	93.150	5,404,493
Health Program for Toxic Substances and Disease Registry	93.161	906,286
Grants for State Loan Repayment	93.165	953,668
Disabilities Prevention	93.184	108,934
Consolidated Knowledge Development and Application Program	93.230	24,198
Traumatic Brain Injury-State Demonstration Grant Program	93.234	35,691
Cooperative Agreements for State Treatment Outcomes and Performance Pilot Studies Enhancement	93.238	72,322
Innovative Food Safety Projects	93.245	33,779
Universal Newborn Hearing Screening	93.251	9,950
Community Access Program	93.252	295,623
Rural Access to Emergency Devices Grant	93.259	10,634
Immunization Grants	93.268	146,811,994
Centers for Disease Control and Prevention-Investigations and Technical Assistance	93.283	36,349,176
Promoting Safe and Stable Families	93.556	40,115,754
Temporary Assistance for Needy Families	93.558	3,852,844,350
Child Support Enforcement	93.563	461,779,280
Refugee and Entrant Assistance-State Administered Programs	93.566	36,707,488
Low-Income Home Energy Assistance	93.568	90,149,618
Community Services Block Grant	93.569	54,585,606
Community Services Block Grant Discretionary Awards - Community Food and Nutrition	93.571	567,062
Refugee and Entrant Assistance-Discretionary Grants	93.576	4,123,982

U.S. Repatriation	93.579	25,000
Refugee and Entrant Assistance-Targeted Assistance	93.584	7,594,843
Empowerment Zones Program	93.585	1,204,121
State Court Improvement Program	93.586	839,746
Community-Based Family Resource and Support Grants	93.590	2,978,140
Welfare Report Research, Evaluations and National Studies	93.595	111,557
Grants to States for Access and Visitation Programs	93.597	800,596
Head Start	93.600	236,194
Adoption Incentive Payments	93.603	17,480,774
Developmental Disabilities Basic Support and Advocacy Grants	93.630	7,322,910
Children's Justice Grants to States	93.643	2,439,237
Child Welfare Services-State Grants	93.645	31,579,911
Social Services Research and Demonstration	93.647	146,357
Adoption Opportunities	93.652	52,567
Foster Care-Title IV-E	93.658	1,214,193,250
Adoption Assistance	93.659	249,850,981
Social Services Block Grant	93.667	259,084,224
Child Abuse and Neglect State Grants	93.669	1,607,188
Family Violence Prevention and Services/Grants for Battered		
Women's Shelters-Grants to States and Indian Tribes	93.671	7,792,355
Chafee Foster Care Independent Living	93.674	30,947,254
State Children's Insurance Program	93.767	526,359,394
Medicaid Infrastructure Grants to Support the Competitive		
Employment of People with Disabilities	93.768	222,498
Medicare-Supplementary Medical Insurance	93.774	5,382,344
Centers for Medicare and Medicaid Services (CMS) Research,		
Demonstrations and Evaluations	93.779	1,334,612
Grants to States for Operation of Offices of Rural Health	93.913	215,189
HIV Care Formula Grants	93.917	116,551,238
Cooperative Agreements for State-Based Comprehensive		
Breast and Cervical Cancer Early Detection Program	93.919	6,731,075
Cooperative Agreements to Support Comprehensive School		
Health Programs to Prevent the Spread of HIV and Other		
Important Health Problems	93.938	1,333,763
HIV Prevention Activities-Health Department Based	93.940	18,426,292
HIV Demonstration, Research, Public and Professional		
Education Projects	93.941	1,475,413
Epidemiologic Research Studies of Acquired Immunodeficiency		
Syndrome (AIDS) and Human Immunodeficiency Virus (HIV)		
Infection in Selected Population Groups	93.943	446,269
Human Immunodeficiency Virus (HIV)/Acquired		
Immunodeficiency Virus Syndrome (AIDS) Surveillance	93.944	2,217,312

Assistance Program for Chronic Disease Prevention and Control	93.945	392,689
Tuberculosis Demonstration, Research, Public and Professional Education	93.947	1,098
Improving EMS/Trauma Care in Rural Areas	93.952	971
Block Grants for Community Mental Health Services	93.958	65,457,608
Block Grants for Prevention and Treatment of Substance Abuse	93.959	250,996,720
Preventive Health Services-Sexually Transmitted Disease Control Grants	93.977	4,774,329
Preventive Health Services- Sexually Transmitted Diseases Research, Demonstrations, and Public Information and Education Grants	93.978	1,180,997
Health Program for Refugees	93.987	852,777
Cooperative Agreements for State-Based Diabetes Control Program and Evaluation of Surveillance Systems	93.988	902,916
Preventive Health and Health Services Block Grant	93.991	8,194,259
Maternal and Child Health Services Block Grant to the States	93.994	52,489,442
Other - Department of Health and Human Services	93.999	18,378,634
<b>Total Excluding Clusters</b>		<u>7,687,691,564</u>
<b>Aging Cluster</b>		
Special Programs for the Aging - Title III, Part B - Grants for Supportive Services & Senior Centers	93.044	35,162,381
Special Programs for the Aging - Title III, Part C - Nutrition Services	93.045	52,765,189
<b>Total Aging Cluster</b>		<u>87,927,570</u>
<b>Child Care Cluster</b>		
Child Care and Development Block Grant	93.575	681,842,152
Child Care Mandatory and Matching Funds of the Child Care and Development Fund	93.596	262,752,868
<b>Total Child Care Cluster</b>		<u>944,595,020</u>
<b>Medicaid Cluster</b>		
State Medicaid Fraud Control Units	93.775	15,255,813
State Survey and Certification of Health Care Providers and Suppliers	93.777	24,047,369
Medical Assistance Program	93.778	16,031,710,326
<b>Total Medicaid Cluster</b>		<u>16,071,013,508</u>
<b>Total U.S. Department of Health and Human Services</b>		<u><u>24,791,227,662</u></u>

**Corporation for National and Community Service**

State Commissions	94.003	1,413,071
Learn and Serve America-School and Community Based Programs	94.004	2,202,623
AmeriCorps	94.006	28,633,913
<b>Total Excluding Clusters</b>		<u>32,249,607</u>

**Foster Grandparent/Senior Companion Cluster**

Foster Grandparent Program	94.011	<u>1,341,662</u>
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**Total U.S. Corporation for National and Community Services**33,591,269**Social Security Administration****Disability Insurance/SSI Cluster**

Social Security-Disability Insurance	96.001	175,258,842
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**Office of National Drug Control Policy**

High Intensity Drug Trafficking Area	See Note 4	5,642,891
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**Miscellaneous Grants and Contracts**

Shared Revenue-Flood Control Lands	98.002	115,793
Shared Revenue-Grazing Land	98.004	151,940
Capital Outlay - Reed Act	98.012	37,862,866
U.S. Department of the Interior-Fire Prevention/ Suppression Agreement	98.014	134,000
U.S. Department of the Interior-Fire Prevention/ Suppression Agreement	98.015	253,289
U.S. Department of Agriculture and Various Other U.S. Department-Fire Prevention/Suppression	98.016	35,090,388
Miscellaneous Federal Receipts	98.099	79,346
Miscellaneous Federal Receipts	98.999	1,180,697
Temporary State Fiscal Relief	99.999	<u>575,906,288</u>

**Total Miscellaneous**650,774,607**Total Federal Awards Received**68,087,003,563

\* Amount includes value of commodities or food stamps

\*\* Amount includes donated property

\*\*\* Amount includes loans and insurance in effect as of June 30, 2003

**NOTES TO THE SCHEDULE OF FEDERAL ASSISTANCE  
FISCAL YEAR ENDED JUNE 30, 2003**

**1. GENERAL**

The accompanying State of California Schedule of Federal Assistance presents the total amount of federal financial assistance programs received by the State of California for the fiscal year ended June 30, 2003. This schedule does not include expenditures of federal grants received by the University of California, the California State University, and the California Housing Finance Agency. The expenditures of the University of California, California State University, and California Housing Finance Agency are audited by other independent auditors in accordance with the U.S. Office of Management and Budget, Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (OMB Circular A-133).

The \$68,087,003,563 in total federal assistance consists of the following:

Cash assistance received	\$45,558,602,798
Noncash federal awards	1,957,972,042
Loans and/or loan guarantees outstanding	20,510,105,463
Insurance in-force	<u>60,323,260</u>
<b>Total</b>	<b><u>\$68,087,003,563</u></b>

**2. BASIS OF ACCOUNTING**

OMB Circular A-133 and the Single Audit Act of 1984 (Amended 1996) require the Schedule of Federal Assistance to present total expenditures for each federal assistance program. However, although the state accounting system separately identifies revenues for each federal assistance program, it does not separately identify expenditures for each program. As a result, the State prepares its Schedule of Federal Assistance on a cash receipts basis. The schedule shows the amount of cash and noncash federal assistance received, loans and loan guarantees outstanding, and insurance in force for the year ended June 30, 2003.

**3. UNEMPLOYMENT INSURANCE**

Of the \$8,520,998,194 in total unemployment insurance funds (federal catalog number 17.225) received by the Employment Development Department during fiscal year 2002-03, \$8,092,000,000 was State Unemployment Insurance funds that were drawn down from the Unemployment Trust Fund in the U.S. Treasury.



#### 4. OTHER

The California Department of Justice (DOJ) receives cash reimbursements from local law enforcement agencies under the Office of National Drug Control Policy's High Intensity Drug Trafficking Area program. During the period July 1, 2002 through June 30, 2003, the DOJ received the following cash reimbursements from pass-through entities:

Federal Agency/Program	Pass-through Entity	Grant Number	Amount
Office of National Drug Control Policy High Intensity Drug Trafficking Area	City of San Diego	2000 IOPSCO575	\$ 79,275
		2001 I1PSCP575	667,730
		2002 I2PSCP575	1,355,653
		2003 I3PSCP575	149,887
	City of Hawthorne	2001 I1PLAP534	385,410
		2001 I1PLAP541	44,273
		2002 I2PLAP534	651,874
		2002 I2PLAP541	83,104
		2003 I3PLAP534	341,459
		2003 I3PLAP541	69,602
		Washington State Patrol	2002I2PNWP505
	County of Stanislaus	2002 I2PLAP534	73,612
	County of San Mateo	2000 IOPLAP534	750
		2002 I1PLAP534	221,727
		2003 I3PLAP534	25,613
	Las Vegas Police Dept.	2001 I1PNVP501	126,162
	Riverside Police Dept.	2001 I1PLAP534	47,703
	COPS - Clallam County, WA	2001 CKWX0177	30,774
	OJP/BJA - Institute for Intergovernmental Research	2003RSCX1002	119,213
	Criminal Information Sharing Alliance	Unknown	<u>1,116,019</u>
		Total	<u>\$5,642,891</u>

The State was also loaned Federal Excess Personal Property (FEPP) from the U.S. Forest Service during the period July 1, 2002 to June 30, 2003. According to the California Department of Forestry and Fire Protection, the amount loaned from July 1, 2002 to June 30, 2003, was \$1,193,678. The U.S. Forest Service and the State maintain the FEPP program at federal acquisition costs of the property.

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# **Summary Schedule of Prior Audit Findings**

**Prepared by  
Department of Finance**

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## SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

Reference Number:	<b>2002-12-1</b>
Federal Program:	All Programs
State Administering Department:	Department of Finance
Fiscal Year Initially Reported:	1995-96
Audit Finding:	<u>Reporting</u> . Because of limitations in its automated accounting systems, the State has not complied with the provision of OMB Circular A-133 requiring a schedule showing total expenditures for each federal program.
Status of Corrective Action:	Uncorrected. The State's accounting system will require substantial modification to comply with federal and State requirements. Given the State's current limited resources, the Department of Finance has no plans at this time to enhance the State's accounting system or to implement a new system. <sup>1</sup>
<hr/>	
Reference Number:	<b>2002-2-2</b>
Federal Program:	10.557
State Administering Department:	Department of Health Services
Fiscal Year Initially Reported:	2000-01
Audit Finding:	<u>Allowable Costs</u> . Although it has procedures in place to ensure that it obtains prior approval from U.S. Department of Agriculture's Food and Nutrition Service (FNS) for ADP project costs exceeding \$24,999, the Department of Health Services (Health Services) does not always adhere to them.
Status of Corrective Action:	Fully corrected.
<hr/>	
Reference Number:	<b>2002-3-3</b>
Federal Catalog Number:	10.557
State Administering Department:	Department of Health Services
Fiscal Year Finding Initially Reported:	2001-02
Audit Finding:	<u>Cash Management</u> . Health Services did not use the agreed-upon method of transferring federal funds to pay for redeemed food vouchers for the WIC Program. Rather than using the "modified zero balance accounting" method as the agreement required, Health Services used the "reimbursement" method.
Status of Corrective Action:	Fully corrected. <sup>2</sup>

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Reference Number: **2002-9-7**

Federal Catalog Number: 10.568, 10.569

State Administering Department: Department of Social Services

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Suspension and Debarment. The Department of Social Services did not require 46 of its 51 subrecipients of the Emergency Food Assistance Program to submit suspension and debarment certifications.

Status of Corrective Action: Fully corrected. <sup>3</sup>

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Reference Number: **2002-13-4**

Federal Catalog Number: 10.558

State Administering Department: Department of Education

Fiscal Year Finding Initially Reported: 2000-01

Audit Finding: Subrecipient Monitoring. The Department of Education (Education) did not adequately fulfill its subrecipient monitoring responsibilities for the food program.

Status of Corrective Action: Partially corrected. Education has taken the following steps to ensure that it reviews new sponsors with five or more sites within the first 90 days of operation.

- Upon receipt of a new CACFP application, Nutrition Services Division's (NSD) Resources and Information Management Unit (RIM) records the number of applicant sites on an application tracking sheet.
- RIM forwards the application and application tracking sheet to the Field Services Unit (FSU) for processing.
- An SFU supervisor evaluates the number of sites listed on the application tracking sheet, determines the review requirements, and enters the application data in the new/pending application log.
- When NSD approves the application, if the sponsor has five or more sites, the FSU supervisor assigns staff to conduct the administrative review within 90 days of the application effective date.
- FSU maintains a spreadsheet on the status of 90-day reviews. At each monthly staff meeting, FSU supervisors review the status of assignments with staff. When appropriate, FSU supervisors assign additional staff to ensure timely completion of the review.
- When the 90-day review is completed, FSU sends a review transmittal form to RIM for input of the sponsor's

name, effective date, number of sites, and date of the 90-day review into the FSU workload tracking database.

The Management System Division will enhance the CACFP sponsor database and the FSU workload tracking database to capture the 90-day review information by December 31, 2003.

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Reference Number: **2002-13-8**

Federal Catalog Number: 10.568, 10.569

State Administering Department: Department of Social Services

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Subrecipient Monitoring. The Department of Social Services (Social Services) did not have an adequate system to ensure it met the OMB Circular A-133 requirements it must follow when it passes federal funds through to subrecipients. Specifically, Social Services did not have procedures for determining whether all of its 46 nonprofit subrecipients were required to submit audit reports.

Status of Corrective Action: Fully corrected. <sup>4</sup>

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Reference Number: **2002-3-7**

Federal Catalog Number: Various

State Administering Department: Department of Finance

Fiscal Year Finding Initially Reported: 2000-01

Audit Finding: Cash Management. The Department of Finance (Finance) requires state departments to report information related to the receipt and disbursement of federal funds of selected federal programs so that it can calculate interest liabilities under the CMIA agreement. Finance uses a daily balance method to calculate interest liabilities on administrative costs. However, we found that Finance did not ensure that it recorded all expenditures to the appropriate dates for 18 programs, 15 of which we audited this year, in its interest-liability calculations.

Status of Corrective Action: Partially corrected. Department of Finance agrees with the finding. The State interest liability adjustment will be reported in the 2002-03 annual report that will be submitted in December 2003 and the interest liability will be adjusted in the March 2004 interest payment. Finance also states that it has implemented procedures that will provide greater accuracy, thus reducing the possibility of errors. Finance will continue its ongoing efforts to reduce errors by improving internal procedures and analyzing the information reported by State departments.

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Reference Number: **2002-3-8**

State Administering Department: Department of Finance  
State Controller's Office

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Cash Management. The State does not always limit transfers of federal funds to the immediate cash needs for those federal grants not covered by the CMIA agreement. Our audit work at four departments revealed that the State averaged nearly six days from the date that a department transferred federal funds into its accounts until the date the State Controller's Office (Controller's Office) issued warrants related to those funds.

Status of Corrective Action: Uncorrected. The Department of Finance (Finance) does not agree with the finding. Finance believes State departments do limit the drawdown of federal funds to the actual, immediate cash requirements of the State. The payment of claims requires the timely coordination of transactions involving at least three State departments. State departments initiate the payment process, the State Treasurer's Office receives the federal funds, and the State Controller's Office (SCO) audits and pays the claims. State departments must estimate when the SCO will process the claim for payment and draw the federal funds as close as possible to the actual disbursement date. Given the State accounting processes and restraints, in addition to the State Constitutional requirement that federal funds be on hand by the time the disbursement is made, we believe the average six day processing time by the SCO is reasonable and within the administratively feasible parameters established for subpart B programs covered under 31 CFR Part 205. In September 2003, Finance met with the SCO to explore improvements in the disbursement of federal funds.

The State Controller's Office (SCO), after much discussion, decided that the only way to shorten the time frame between the draw of the federal funds and the issuance of the payments would be to direct all state agencies to delay the transferring of federal funds by one or two days after the claim for payment has been submitted to the SCO, if it is administratively feasible, as being done by some agencies. However, because claims workload is unpredictable from day to day, it is possible that the claim could be processed before the federal funding is transferred. In that case, an error in processing occurs in which it is identified that there are "not sufficient funds" (NSF) to make the payment. NSF claims have caused delays with the normal daily processing of claims for payment. In addition, it could cause delays in payments for critical social programs. Therefore, while we believe it is appropriate to inform all state agencies that this option is available, we conclude that the state agency should



still determine when to utilize this option. The DOF's FSCU staff has provided this direction to state agencies at the Annual CMIA Forum.

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Reference Number: **2002-3-16**  
Federal Catalog Number: 10.568  
State Administering Department: Department of Social Services  
Fiscal Year Finding Initially Reported: 2001-02  
Audit Finding: Cash Management. The Department of Social Services (Social Services) did not always limit cash advances of federal funds to the minimum amounts needed.  
Status of Corrective Action: Fully corrected.<sup>5</sup>

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Reference Number: **2002-13-5**  
Federal Catalog Number: 10.557, 93.917  
State Administering Department: Department of Health Services  
Fiscal Year Finding Initially Reported: 1998-99  
Audit Finding: Subrecipient Monitoring. The Department of Health Services (Health Services) did not always promptly receive all audit reports from its nonprofit subrecipients.  
Status of Corrective Action: Fully corrected (10.557).

Partially corrected (93.917). Office of AIDS (OA) contracts now include language requiring subrecipients to submit OMB A-133 audit reports when required, and certifications when an OMB A-133 audit is not required. The OA formed a divisionwide workgroup to identify OMB A-133 audit procedures for federally funded OA contracts. OA's HIV Care Branch programs have implemented and included these procedures in their desk reference manuals. In addition to procedures, audit reminder form letters have been developed to send to subrecipients according to a tracking schedule. The audit reminder letters and any follow-up and/or corrective action(s) are logged and monitored in an Audit Tracking database by HIV Care Branch staff. A small portion of HIV CARE Formula Grant funds are included in contracts monitored by other OA branch staff. Divisionwide implementation of these procedures, to include all OA federally funded contracts, is scheduled to begin by 12/31/03. OA and Department of Health Services, Audits and Investigations Section have discussed appropriate procedures and responsibilities for receipt and review of A-133 audit reports. OA will make extra effort to follow-up with late A-133 audit contractors in a timely manner.

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Reference Number: **2002-9-4**

Federal Catalog Number: 14.228

State Administering Department: Department of Housing and Community Development

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Suspension and Debarment. The Department of Housing and Community Development (Housing) does not require subrecipients of CDBG program funds to submit suspension and debarment certifications.

Status of Corrective Action: Fully corrected. <sup>6</sup>

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Reference Number: **2002-12-5**

Federal Catalog Number: 14.228

State Administering Department: Department of Housing and Community Development

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Reporting. We discovered numerous errors in the financial data that the Department of Housing and Community Development (Housing) included in its Consolidated Annual Performance and Evaluation Report (report) for fiscal year 2000-01. Specifically, the table showing the breakdown of the CDBG program grant into its subgrant components misreported 9 of the 10 figures.

Status of Corrective Action: Fully corrected.

---

Reference Number: **2002-13-2**

Federal Catalog Number: 14.239

State Administering Department: Department of Housing and Community Development

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Subrecipient Monitoring. Our review of Department of Housing and Community Development (Housing) subrecipient monitoring for fiscal year 2001-02 found that Housing does not adequately assess the need for monitoring and does not always report the results of its reviews.

Status of Corrective Action: Partially corrected.

- The HOME Program has strengthened monitoring procedures by establishing an annual reporting system for the 215 rental projects, currently consisting of

173 State Recipient (locality) and 42 CHDO (nonprofit) projects. The Program also established tracking procedures and regular meetings to evaluate the status of monitoring activities and assessments.

- HOME completed 104 of the 215 annual report risk assessment reviews to date. HOME conducted 17 on-site inspections in 2003 and plans to complete four additional inspections by December 2003.
- HOME sent 100 letters informing severely delinquent subrecipients that they will be subject to performance penalties if they do not submit the required annual report. HOME will monitor in 2004, the subrecipients not in reporting compliance after December 2003.
- HCD will augment the monitoring team with additional positions. The Department submitted and received approval of a 2003-04 Budget Change Proposal adding five positions to the HOME Program, including two for the monitoring function.

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Reference Number: **2002-13-3**

Federal Catalog Number: 14.239

State Administering Department: Department of Housing and Community Development

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Subrecipient Monitoring. Housing does not have effective procedures to ensure that its nonprofit subrecipients meet audit requirements.

Status of Corrective Action: Fully corrected.

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Reference Number: **2002-13-6**

Federal Catalog Number: 14.228

State Administering Department: Department of Housing and Community Development

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Subrecipient Monitoring. The Department of Housing and Community Development (Housing) disclosed to us that in fiscal year 2001-02, it investigated one employee and disciplined another employee whom it says misinformed subrecipients of program requirements and, in some cases, falsified subrecipient monitoring documents.

Status of Corrective Action: Partially corrected.

- To date, eight months prior to the target date, CDBG has re-monitored approximately 90 percent of the affected funds representing \$28 million of the \$34 million included in the review. HCD prioritized the monitoring or re-monitoring of each of the grants focusing first on the larger open grants to ensure that future expenditures were appropriate and met requirements.
- HCD has disencumbered approximately \$5.4 million. The \$5.4 million includes projects that did not go forward for a variety of reasons, most of which are typical in the field of economic development and are not related to technical assistance provided by the former employee (i.e., businesses deciding not to go forward with expansion, developers dropping out of deals, etc.).
- Approximately \$32,000 has been received from local governments where eligibility of costs could not be documented. HCD has issued demand letters for repayment of approximately \$1.5 million in funds where eligibility has not been documented.

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Reference Number: **2002-14-2**

Federal Catalog Number: 14.228

State Administering Department: Department of Housing and Community Development

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Special Tests and Provisions. Housing is not ensuring that all its subrecipients submit environmental certifications before the subrecipients commit funds.

Status of Corrective Action: Fully corrected.

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Reference Number: **2002-2-4**

Federal Catalog Number: 16.606

State Administering Department: Department of Corrections

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Allowable Costs. The Department of Corrections (Corrections) did not include only allowable salary costs in its federal fiscal year 2002 application for assistance.

Status of Corrective Action: Fully corrected. <sup>7</sup>

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Reference Number: **2002-2-3**

Federal Catalog Number: Various

State Administering Department: Employment Development Department

Fiscal Year Finding Initially Reported: 1998-99

Audit Finding: Allowable Costs (Various). Although EDD has made improvements in its system for allocating expenditures, we found that it did not adjust allocations to reflect actual activity.

Status of Corrective Action: Uncorrected/Disagree with Finding. The EDD stands by its original response to this audit finding regarding allocation codes which stated "EDD considers the costs charged to allocation codes to be direct charges and therefore are actual. All costs are reviewed and if the costs charged do not reflect actual, an adjustment is made." The allocation code percentages are reviewed and revised when a business process change necessitates it. However, the EDD is currently exploring new options for allocating costs. The EDD plans to continue research and discussions on new methodologies for allocation costs and made recommendations for improvements during fiscal year 2003-04.

The EDD is in the process of reiterating its policy for reviewing and signing employee timesheets.<sup>8</sup>

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Reference Number: **2002-3-11**

Federal Catalog Number: 17.207

State Administering Department: Employment Development Department

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Cash Management. The Department of Finance (Finance) requires state departments to submit quarterly worksheets of federal cash receipts and disbursements. Finance uses the information on these worksheets to calculate the State's interest liability under the CMIA agreement. However, during fiscal year 2001-02 the Employment Development Department (EDD) submitted incomplete quarterly worksheets for the Employment Service grant.

Status of Corrective Action: Remains uncorrected. EDD agrees with finding. The finding regarding the Cash Management Improvement Agreement (CMIA) is moot since allotments under the Employment Service grant are no longer reportable due to an increase in the report threshold for CMIA, and were not included in the

2002-03 Treasury-State Agreement. However, the EDD closely examines its reporting practices under the grants which are still reportable (Unemployment Insurance and Workforce Investment Act) to ensure that all relevant expenditures and drawdowns are included.

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Reference Number: **2002-9-2**

Federal Catalog Number: 20.205

State Administering Department: Department of Transportation

Fiscal Year Finding Initially Reported: 2000-01

Audit Finding: Suspension and Debarment, Special Tests and Provisions. The California Department of Transportation (Caltrans) could not always locate its contract files or other documents to show that it obtained the required suspension and debarment certification from a contractor.

Status of Corrective Action: Fully corrected.<sup>9</sup>

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Reference Number: **2002-2-5**

Federal Catalog Number: 66.468

State Administering Department: Department of Health Services

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Allowable Costs/Cost Principles. Testing revealed instances of disagreement between the position codes in CALSTARS and Department of Health Services' Time Accounting System. As a result, the time that these particular employees spent during the month working on various funds may not be recorded appropriately in CALSTARS. A sample revealed that inappropriate recording resulted in a project undercharge to the federal program of approximately \$28,000.

Status of Corrective Action: Fully corrected.

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Reference Number: **2002-3-14**

Federal Catalog Number: 66.468

State Administering Department: Department of Health Services

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Cash Management. Testing revealed that from the date that the draws were received from the EPA on the capitalization

grants to the date the warrants were released from the State Controller's Office was excessive.

Status of Corrective Action: Fully corrected.

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Reference Number: **2002-3-15**

Federal Catalog Number: 66.468

State Administering Department: Department of Health Services

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Cash Management. The Fund is currently reimbursing costs associated with retainage to local entities which have not yet paid out the retainage on the project, i.e., the local entity has not paid the contractor the retainage. The Fund has paid these retainages to the local government, which resulted in paying expenses before payment was due, although the work had been performed. This is a timing issue related to cash management of the program and therefore no questioned costs are associated with the finding.

Status of Corrective Action: Fully corrected.

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Reference Number: **2002-9-3**

Federal Catalog Number: 66.458

State Administering Department: State Water Resources Control Board

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Suspension and Debarment. The State Water Resources Control Board (Water Resources Board) did not obtain the required suspension and debarment certifications from its subrecipients during fiscal year 2001-02.

Status of Corrective Action: Fully corrected.

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Reference Number: **2002-12-4**

Federal Catalog Number: 66.458

State Administering Department: State Water Resources Control Board

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Reporting. In its annual report for fiscal year 2000-01, the State Water Resources Control Board (Water Resources Board) included expenditure information that was not

supported by its accounting records and misstated other amounts.

Status of Corrective Action: Partially corrected. The audited financial statements for the fiscal year 2001-02 were received in June of 2003. As a result, the State Water Resources Control Board will consolidate the annual report for fiscal year 2001-02 with that of 2002-03 due November 28, 2003. The annual report will be submitted with information, which reconciles to the accounting reports.

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Reference Number: **2002-12-2**

Federal Catalog Number: 83.544, 83.548

State Administering Department: Office of Emergency Services

Fiscal Year Finding Initially Reported: 1997-98

Audit Finding: Reporting. In fiscal year 2001-02, the Office of Emergency Services (Emergency Services) did not reconcile the receipts and disbursements reported in its federal cash transaction reports to its official accounting records.

Status of Corrective Action: Remains Uncorrected/Agree with Finding. Given the current budget situation and ongoing workloads, OES will be unable to request additional positions to augment the existing Accounting Office staff. However, OES will initiate a review of the skills needed to accomplish the reconciliation and seek to redirect existing staff within the agency to assist the Accounting Office in resolving this finding.

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Reference Number: **2002-12-3**

Federal Catalog Number: 83.544, 83.548

State Administering Department: Office of Emergency Services

Fiscal Year Finding Initially Reported: 1999-00

Audit Finding: Reporting. Emergency Services' financial status reports do not contain complete and accurate expenditure information. In addition, Emergency Services did not provide separate disclosure of its and the subrecipients' administrative costs in the financial status reports for the Public Assistance and Hazard Mitigation grant programs.

Status of Corrective Action: Remains Uncorrected/Agree with Finding. OES has made several attempts over the years to discuss with FEMA how best to report California disaster activity (which currently involves more than 23,000 individual projects) into a single generic format. Given the repeat nature of this finding, however, OES will initiate a formal request to FEMA management this year to reach a consensus on how to



report on-going disaster assistance activity without creating a burdensome workload for the State.<sup>10</sup>

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Reference Number: **2002-13-1**

Federal Catalog Number: 83.544, 83.548

State Administering Department: Office of Emergency Services

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Subrecipient Monitoring. During fiscal year 2001-02, for the audit reports of its local government subrecipients, the Office of Emergency Services (Emergency Services) did not ensure that a management decision regarding the resolution of audit findings was made within six months after it received an audit report.

Status of Corrective Action: Fully corrected.<sup>11</sup>

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Reference Number: **2002-1-1**

Federal Catalog Number: 84.027, 84.173

State Administering Department: Department of Education

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Activities Allowed. The Department of Education (Education) did not ensure that it disbursed Special Education and Special Education-Preschool Grants funds for allowable purposes.

Status of Corrective Action: Fully corrected.

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Reference Number: **2002-2-1**

Federal Catalog Number: 84.011

State Administering Department: Department of Education

Fiscal Year Finding Initially Reported: 1999-00

Audit Finding: Allowable Costs/Cost Principles. The Department of Education (Education) did not always determine the cost effectiveness of the State's use of Migrant Education funds.

Status of Corrective Action: Partially corrected. The Department of General Services (DGS) approved the TROMIK contract extension on October 2, 2003. The new 2003-04 contract is pending approval of the Special Projects Reports from the

Department of Finance, and approval of the Non-Competitive Bid from the DGS.

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Reference Number: **2002-3-1**

Federal Catalog Number: 84.126

State Administering Department: Department of Rehabilitation

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Cash Management. Rehabilitation does not have an adequate control process for cash management of the Vocational Rehabilitation program. As a result, it did not consistently use the appropriate funding techniques.

Status of Corrective Action: Fully corrected.

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Reference Number: **2002-3-2**

Federal Catalog Number: 84.048, 84.243

State Administering Department: California Community Colleges

Fiscal Year Finding Initially Reported: 1997-98

Audit Finding: Cash Management. The California Community Colleges, Chancellor's Office (Chancellor's Office) does not have adequate procedures to ensure that subrecipients of the Vocational Education-Basic Grants to States program (Vocational Education) and the Tech-Prep Education program (Tech-Prep) minimize the time elapsing between their receipt and use of federal program funds.

Status of Corrective Action: Fully corrected. <sup>12</sup>

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Reference Number: **2002-3-4**

Federal Catalog Number: 84.186

State Administering Department: Department of Alcohol and Drug Programs

Fiscal Year Finding Initially Reported: 1999-00

Audit Finding: Cash Management. The Department of Alcohol and Drug Programs (DADP) lacks adequate procedures to ensure that subrecipients of the Safe and Drug-Free Schools program minimize the time elapsing between receipt and use of program funds.

Status of Corrective Action: Fully corrected.

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Reference Number: **2002-3-6**

Federal Catalog Number: 84.027; 84.173

State Administering Department: Department of Education

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Cash Management. The Department of Education (Education) does not have adequate procedures to ensure that program subrecipients demonstrate the ability to minimize the elapsed time between their receipt and use of federal program funds.

Status of Corrective Action: Partially corrected. The Special Education Division is in the final stages of development and implementation of an interim expenditure form to accompany all 18 grants to the subrecipients to minimize the time elapsing between the receipt and disbursement of federal funds. The subrecipients will be required to submit an interim expenditure form by mid-apportionment cycle.<sup>13</sup>

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Reference Number: **2002-3-9**

Federal Catalog Number: 84.010, 84.298

State Administering Department: Department of Education

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Cash Management. The Department of Education (Education) does not have adequate procedures to ensure that program subrecipients demonstrate the ability to minimize the time elapsing between their receipt and use of federal program funds.

Status of Corrective Action: Partially corrected. Education is amending the corrective action plan to avoid potential significant mandated costs resulting in cumbersome increased financial reporting requirements for local education agencies (LEA). Rather, Education assumes LEAs incur federal expenditures fairly constant through the year and as a corrective action plan, will allocate federal funds in 2003-04 proportionate to the unpaid months that have elapsed prior to and including the month of the current apportionment. This will in effect create a reimbursement process. Education also will check 2002-03 federal fund balances in the annual financial data reported to Education to identify any LEA with significant balances. Education will follow up with the LEA on this exception basis to determine if the district is not allocating funds in a timely manner. Finally, Education will include in all of its federal fund apportionment letters a statement that

LEAs are required to pay to the federal agency any interest greater than \$100 per year that they earned on advances.<sup>14</sup>

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Reference Number: **2002-3-10**

Federal Catalog Number: 84.011

State Administering Department: Department of Education

Fiscal Year Finding Initially Reported: 1999-00

Audit Finding: Cash Management. The Department of Education (Education) does not have adequate procedures to ensure that Migrant Education subrecipients demonstrate the ability to minimize the time elapsing between their receipt and use of federal program funds.

Status of Corrective Action: Partially corrected. The Migrant, Indian Education, International Office has reduced the cash advance payments to migrant education regions to 30 percent. In addition, Migrant Education will include a plan to provide an addendum to the Education's Migrant Fiscal Requirement Manual in alignment with the Code of Federal Regulations Title 43, Section 80.21.<sup>15</sup>

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Reference Number: **2002-5-1**

Federal Catalog Number: 84.126

State Administering Department: Department of Rehabilitation

Fiscal Year Finding Initially Reported: 1996-97

Audit Finding: Eligibility. The Department of Rehabilitation (Rehabilitation) does not always determine applicant eligibility for the Vocational Rehabilitation program within the required time period.

Status of Corrective Action: Partially corrected. Rehabilitation agrees with this finding, and will continue its corrective actions to improve in this area through a collaborative effort with district administrators, rehabilitation supervisors, counselors and cooperative program partners.<sup>16</sup>

A preliminary review reflected that approximately 14 percent of the applications received between July 1, 2002 and April 30, 2003, had overdue eligibility determinations, which is a decrease from BSA's finding of 21 percent for the fiscal year 01-02 audit period. Subsequent reviews indicate that the percentage of overdue eligibility determinations is declining, which Rehabilitation attributes to its increased monitoring and corrective actions.

Specifically, Rehabilitation will continue its previous and ongoing corrective actions until satisfactory compliance is achieved, as follows:

- Action #1 – Share information with district administrators
- Action #2 – Inform and educate rehabilitation staff
- Action #3 – Local level monitoring of eligibility determinations
- Action #4 – Executive level monitoring of eligibility determinations
- Action #5 – Improve eligibility tracking reports
- Action #6 – Provide guidance and monitoring to cooperative program partners

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Reference Number: **2002-7-1**

Federal Catalog Number: 84.298

State Administering Department: Department of Education

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Earmarking. The Department of Education (Education) does not have adequate procedures to ensure that it meets the Title VI program earmarking requirements.

Status of Corrective Action: Fully corrected.<sup>17</sup>

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Reference Number: **2002-7-2**

Federal Catalog Number: 84.048

State Administering Department: Department of Education

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Level of Effort. The Department of Education (Education) did not ensure that it met its level of effort requirement for administration of the Vocational Education program for fiscal year 2001-02.

Status of Corrective Action: Fully corrected.<sup>18</sup>

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Reference Number: **2002-9-1**

Federal Catalog Number: 84.126

State Administering Department: Department of Rehabilitation

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Suspension and Debarment. The Department of Rehabilitation (Rehabilitation) did not obtain the required suspension and debarment certifications from any of the five contractors we reviewed.

Status of Corrective Action: Remains uncorrected. The following standard language has been developed and approved by the Legal Office to be included in all contracts that exceed \$100,000 and use federal funds:

“By signing this contract, contractor certifies that neither it nor its principals is presently debarred, suspended, proposed for debarment, declared ineligible, or voluntarily excluded from participation in this transaction by any federal department or agency.”

Any new or amendments to contracts for the current year will include this language. All contracts entered into after this date will include this language. By the end of fiscal year 2004-05, all contracts will be in compliance.<sup>19</sup>

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Reference Number: **2002-9-6**  
Federal Catalog Number: 84.010, 84.298, 84.340  
State Administering Department: Department of Education  
Fiscal Year Finding Initially Reported: 2000-01

Audit Finding: Suspension and Debarment. In fiscal year 2001-02, the Department of Education (Education) did not require local educational agencies (LEAs) applying to participate in the Title I Grants to Local Educational Agencies (Title I, Part A), Title VI-Innovative Education Program Strategies (Title VI), and Class Size Reduction programs to submit the required suspension and debarment certifications.

Status of Corrective Action: Fully corrected.

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Reference Number: **2002-12-6**  
Federal Catalog Number: 84.048  
State Administering Department: Department of Education  
Fiscal Year Finding Initially Reported: 2000-01

Audit Finding: Reporting. The Department of Education (Education) did not report accurate, complete, and supported data in its Vocational Education performance accountability report.

Status of Corrective Action: Fully corrected.<sup>20</sup>

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Reference Number: **2002-14-1**

Federal Catalog Number: 84.032

State Administering Department: California Student Aid Commission

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Special Tests and Provisions. Student Aid’s auxiliary organization administers the loan program. However, the auxiliary organization has not developed adequate internal controls over its information systems to provide reasonable assurance that it keeps current, complete, and accurate records of each loan.

Status of Corrective Action: Fully corrected.<sup>21</sup>

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Reference Number: **2002-14-4**

Federal Catalog Number: 84.010, 84.011

State Administering Department: Department of Education

Fiscal Year Finding Initially Reported: 1998-99

Audit Finding: Special Tests. The Department of Education (Education) did not require LEAs receiving Migrant Education and Title I, Part A funds to file with Education a specific written assurance stating that the LEAs have established and implemented an LEA-wide salary schedule; a policy to ensure equivalence among schools in teachers, administrators, and other staff; and a policy to ensure equivalence among schools in the provision of curriculum materials and instructional supplies.

Status of Corrective Action: Partially corrected. Education is using the 2002-03 Consolidated Application which contains the revised legal assurances for the Title I, Part A program. The Migrant Education legal assurance language will be revised and added to the 2003-04 program application in accordance with the comparability recommendation.

The School and District Accountability Division has the responsibility for conducting the coordinated compliance reviews for state and federal consolidated programs. As such, Education proposed to include the comparability check in the annual Single Audit. Unfortunately, the State Controller’s Office rejected Education’s proposal. Therefore, Education continues to explore other options to ensure that local education agencies comply with the comparability requirement for Title I, Part A, including the possibility of Education’s Audits and Investigations Division conducting comparability audit checks.

The Chief Deputy Superintendent sent a letter to the migrant regional superintendent and program directors dated June 30, 2003, requiring local educational agencies to develop procedures and maintain records that are updated biennially to document compliance with the requirements in Title I, Subpart C, Migrant Education Comparability. In addition, the Migrant, Indian Education, International Office will conduct program fiscal reviews commencing on November 2003 to determine compliance with the comparability requirements.<sup>22</sup>

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Reference Number: **2002-8-1**

Federal Catalog Number: 84.186, 93.959

State Administering Department: Department of Alcohol and Drug Programs

Fiscal Year Finding Initially Reported: 1999-00, 2000-01

Audit Finding: Period of Availability. The Department of Alcohol and Drug Programs (DADP) lacks adequate procedures to ensure that federal grant awards are obligated and spent within their applicable periods of availability for the Substance Abuse Prevention and Treatment Block Grant.

Status of Corrective Action: Partially corrected. The Department has strengthened its procedures to ensure it obligates and expends funds only during the period of availability. The Accounting Unit has established parameters in CALSTARS which will generate an error if expenditures are posted outside the period of availability. Accounting will review the transaction to determine if the obligations and expenditures were incurred within the period of availability, and for services provided within such period.

The Department has resolved the matter of the \$235,357 in Safe and Drug-Free Schools funds, which was expended outside the periods of availability, with the U.S. Department of Education. The \$235,357 will be offset against the approximately \$500,000 which was due the Department from the resolution of a previous audit finding. The Department will resolve the \$145,000 in Block Grant funds with the U.S. Department of Health and Human Services when it resolves the issue pursuant to OMB Circular A-133, Section 400(c).<sup>23</sup>

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Reference Number: **2002-1-2**

Federal Catalog Number: 93.778

State Administering Department: Department of Health Services

Fiscal Year Finding Initially Reported: 2001-02



Audit Finding: Activities Allowed. During fiscal year 2001-02, Health Services did not always recover overpayments of Medicaid funds paid to health plans as enrollment fees for beneficiaries who were no longer eligible for Medicaid.

Status of Corrective Action: Partially corrected. The Medi-Cal Managed Care Division (MMCD) has been working with ITSD and its staff to determine the extent of the problem, and to determine the total amount that was overpaid. Data has been requested and will be completed in 2004.

The exact amount of the overpayment is unknown; however, there has been a determination of the number of overpaid months for the last two years by health plan. Programming is pending to determine the details necessary to determine and document, the exact amount of the overpayments to each plan for the last two years. It is anticipated that the overpayments for the last two years will be determined by December 15, 2003.

Once computed and the amount per plan known, a collection method will be communicated and implemented. Options are proposed and being reviewed by management. It is anticipated that these amounts will be determined and a collection method implemented for the prior two years, by December 31, 2003. It is estimated that the backlog for overpayments exceeding the last two years will be determined and collections implemented by June 2004. MMCD has met with ITSD to determine the process to prevent overpayments from occurring in the future. These options are being discussed with management and will be implemented by December 31, 2003.<sup>24</sup>

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Reference Number: **2002-1-3**

Federal Catalog Number: 93.778

State Administering Department: Department of Health Services

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Activities Allowed. The Department of Health Services (Health Services) did not always ensure that all services approved for Medicaid beneficiaries are supported by sufficient documentation.

Status of Corrective Action: Fully corrected.<sup>25</sup>

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Reference Number: **2002-3-5**

Federal Catalog Number: 93.959

State Administering Department: Department of Alcohol and Drug Programs

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Cash Management. DADP does not consistently use the appropriate funding technique to ensure that federal funds are deposited into its account no more than two business days before disbursement.

Status of Corrective Action: Fully corrected.

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Reference Number: **2002-3-13**

Federal Catalog Number: 93.667

State Administering Department: Department of Social Services

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Cash Management. Social Services repeatedly failed to meet the two-day deposit requirement described in the agreement.

Status of Corrective Action: Fully corrected.

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Reference Number: **2002-9-5**

Federal Catalog Number: 93.044, 93.045

State Administering Department: Department of Aging

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Suspension and Debarment. The Department of Aging (Aging) does not have a process to determine whether its subrecipients are suspended or debarred from participating in federal programs.

Status of Corrective Action: Fully corrected.

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Reference Number: **2002-12-7**

Federal Catalog Number: 93.994

State Administering Department: Department of Health Services

Fiscal Year Finding Initially Reported: 1999-00

Audit Finding: Reporting. The Department of Health Services (Health Services) does not always use complete data in its annual program report to the U.S. Department of Health and Human Services nor does it always disclose its use of estimates.

Status of Corrective Action: Fully corrected.

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Reference Number: **2002-12-8**

Federal Catalog Number: 93.568

State Administering Department: Department of Community Services and Development

Fiscal Year Finding Initially Reported: 2000-01

Audit Finding: Reporting. In its Low-Income Home Energy Assistance Program Household report (report) for federal fiscal year 2001, the Department of Community Services and Development (Community Services) did not accurately report the number of the households it served and the demographics of these households.

Status of Corrective Action: Fully corrected.

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Reference Number: **2002-13-7**

Federal Catalog Number: 93.569

State Administering Department: Department of Community Services and Development

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Subrecipient Monitoring. Community Services did not always require its subrecipients to develop and implement corrective action plans within 30 days or other agreed-upon times when it identified deficiencies during on-site reviews.

Status of Corrective Action: Fully corrected.

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Reference Number: **2002-14-3**

Federal Catalog Number: 93.778

State Administering Department: Department of Health Services

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Special Tests and Provisions. The Department of Health Services (Health Services) did not review the security of its automatic data processing systems biennially as required.

Status of Corrective Action: Fully corrected.

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Reference Number: **2002-14-5**

Federal Catalog Number: 93.778

State Administering Department: Department of Health Services

Fiscal Year Finding Initially Reported: 1997-98

Audit Finding: Special Tests and Provisions. The Department of Health Services (Health Services) does not have adequate controls over provider agreements. Specifically, our review revealed that Health Services could not provide agreements for 6 of 31 providers we reviewed.

Status of Corrective Action: Partially corrected. Provider Enrollment Branch (PEB) Response/Corrective Action Plan:

Health Services is continuing to re-enroll providers as part of the first phase and has mailed re-enrollment notifications to 314 additional pharmacies and 410 additional physicians. Of the 1,442 providers identified for re-enrollment, 14 pharmacy provider numbers were deactivated and 25 physician provider numbers were deactivated. Health Services will identify, during the second phase of re-enrollment, specific provider types for re-enrollment. Additionally, anti-fraud provider efforts were enhanced with the passage of new legislation (Senate Bill 857) that will require the Department to issue a provisional provider number to all provider types enrolled on or after January 1, 2004.<sup>26</sup>

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Reference Number: **2002-3-12**

Federal Catalog Number: 96.001

State Administering Department: Department of Social Services

Fiscal Year Finding Initially Reported: 2001-02

Audit Finding: Cash Management. The Department of Finance (Finance) requires state departments to report information related to the receipt and disbursement of federal funds so that Finance can calculate the State's interest liability under the CMIA agreement. However, the Department of Social Services did not always accurately report its draw amounts or dates on the quarterly worksheet.

Status of Corrective Action: Fully corrected.

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## ENDNOTES—AUDITOR COMMENTS

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<sup>1</sup> The status of this issue remains unchanged. Please refer to reference number 2003-12-1 for additional information.

<sup>2</sup> We reviewed the status of this issue during our fiscal year 2002-03 audit and found that a similar condition existed for the first three quarters of the fiscal year. Health Services began using the correct funding technique in April 2003. Please refer to reference number 2003-3-4 for additional information.

<sup>3</sup> We reported a similar weakness in our audit of fiscal year 2002-03. Please refer to reference number 2003-9-4 for additional information.

<sup>4</sup> We reported a similar weakness in our audit of fiscal year 2002-03. Please refer to reference number 2003-13-6 for additional information.

<sup>5</sup> We reported a similar weakness in our audit of fiscal year 2002-03. Please refer to reference number 2003-3-6 for additional information.

<sup>6</sup> We reported a similar weakness in our audit of fiscal year 2002-03. Please refer to reference number 2003-9-2 for additional information.

<sup>7</sup> Corrections received no funding under this federal catalog number during fiscal year 2002-03. Consequently, we were unable to verify whether it is including only allowable salary costs in its application for assistance.

<sup>8</sup> We reported a related weakness during our audit of fiscal year 2002-03. Please refer to reference number 2003-2-1 for additional information.

<sup>9</sup> We reported a similar weakness in our audit of fiscal year 2002-03. Please refer to reference number 2003-4-1 for additional information.

<sup>10</sup> We reported a similar weakness in our audit of fiscal year 2002-03. Please refer to reference number 2003-12-2 for additional information.

<sup>11</sup> We reported a similar weakness in our audit of fiscal year 2002-03. Please refer to reference number 2003-13-3 for additional information.

<sup>12</sup> We reported a similar weakness in our audit of fiscal year 2002-03. Please refer to reference number 2003-3-5 for additional information.

<sup>13</sup> We reported a similar weakness in our audit of fiscal year 2002-03. Please refer to reference number 2003-3-1 for additional information.

<sup>14</sup> We reported a similar weakness in our audit of fiscal year 2002-03. Please refer to reference number 2003-3-7 for additional information.

<sup>15</sup> We reported a similar weakness in our audit of fiscal year 2002-03. Please refer to reference number 2003-3-10 for additional information.

<sup>16</sup> We reviewed the status of this issue during our fiscal year 2002-03 audit and found a similar, though less severe, condition. Please refer to reference number 2003-5-1 for additional information.

<sup>17</sup> We reported a similar weakness in our audit of fiscal year 2002-03. Please refer to reference number 2003-7-2 for additional information.

<sup>18</sup> We reported a similar weakness in our audit of fiscal year 2002-03. Please refer to reference number 2003-7-3 for additional information.

<sup>19</sup> We reported a similar weakness in our audit of fiscal year 2002-03. Please refer to reference number 2003-9-1 for additional information.

<sup>20</sup> We reported a similar weakness in our audit of fiscal year 2002-03. Please refer to reference number 2003-12-3 for additional information.

<sup>21</sup> We reported a similar weakness in our audit of fiscal year 2002-03. Please refer to reference number 2003-14-7 for additional information.

<sup>22</sup> We reported a similar weakness in our audit of fiscal year 2002-03. Please refer to reference number 2003-14-9 for additional information.

<sup>23</sup> We reviewed the status of this finding during our audit of fiscal year 2002-03 and found no reportable issue for the Safe and Drug-Free Schools and Communities-State Grants program. However, we found that DADP did not always ensure that charges to federal awards for the Block Grants for Prevention and Treatment of Substance Abuse program are within each award's period of availability. In addition, we found that it had not yet resolved the issue we reported during our audit of fiscal year 2001-02. Thus, we reported a similar weakness in our audit of fiscal year 2002-03. Please refer to reference number 2003-8-1 for additional information.

<sup>24</sup> We reported a similar weakness during our fiscal year 2002-03 audit. Please refer to reference number 2003-1-4 for additional information.

<sup>25</sup> We reported a similar weakness during our fiscal year 2002-03 audit. Please refer to reference number 2003-1-3 for additional information.

<sup>26</sup> We reported a similar weakness during our fiscal year 2002-03 audit. Please refer to reference number 2003-14-2 for additional information.

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Department of Finance  
Office of the Director  
State Capitol, Room 1145  
Sacramento, CA 95814-4998

March 17, 2004

Ms. Elaine M. Howle, State Auditor  
Bureau of State Audits  
555 Capitol Mall, Suite 300  
Sacramento, CA 95814

Dear Ms. Howle:

**State of California: Internal Control and State and Federal Compliance Audit Report for the Year Ended June 30, 2003**

Thank you for the opportunity to respond to the internal control and state and federal compliance audit report. This report was the result of your examination of the State's general purpose financial statements and administration of federal programs for the fiscal year ended June 30, 2003, and will be part of the Single Audit Report covering this period. We accept the reported findings and recommendations. Although our internal controls and administration of federal awards can always be improved, the State is committed to sound and effective fiscal oversight.

California provides its citizens with numerous state and federal programs and activities and is much more complex and vast than most economic entities in the world. Such complexity, along with ever-present budget constraints, challenges us to meet the requirements of those programs and activities efficiently and effectively. Moreover, such operations must exist within a system of internal and administrative control that safeguards assets and resources and produces reliable financial information. Attaining these objectives and overseeing the financial and business practices of the State continues to be an important part of the Department of Finance's leadership.

In meeting our responsibility for financial leadership and oversight, the Department of Finance conducts internal control reviews of State departments and also reviews areas of potential weakness in the State's fiscal systems. In addition, we provide oversight of departmental internal audit units by issuing audit guidelines and conducting quality assurance reviews. Further, we have an ongoing process of issuing Audit Memos to departments that establish statewide policy and provide technical advice on various audit related issues. We will soon issue an Audit Memo concerning the results of the fiscal year 2002-03 Single Audit.

The head of each State department is responsible for establishing and maintaining a system of internal accounting and administrative control within their department. This responsibility includes documenting the system, communicating system requirements to employees, and assuring that the system is functioning as prescribed and is modified for changing conditions.

Ms. Elaine M. Howle  
March 17, 2004  
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Moreover, all levels of State management must be involved in assessing and strengthening their system of internal accounting and administrative controls to minimize fraud, errors, abuse, and waste of government funds.

Individual departments have separately responded to the report's findings and recommendations. Accordingly, their viewpoints and corrective action plans are included in the report. We will monitor the findings and reported corrective actions to identify potential changes in statewide fiscal procedures.

The Department of Finance will continue to provide leadership to ensure the proper financial operations and business practices of the State, and to ensure that internal controls exist for the safeguarding and effective use of assets and resources.

If you have any questions concerning this letter, please contact Samuel E. Hull, Chief, Office of State Audits and Evaluations, at (916) 322-2985.

Sincerely,

*(Signed by: Stephen W. Kessler for Michael C. Genest)*

MICHAEL C. GENEST  
Chief Deputy Director

cc: Members of the Legislature  
Office of the Lieutenant Governor  
Milton Marks Commission on California State  
Government Organization and Economy  
Department of Finance  
Attorney General  
State Controller  
State Treasurer  
Legislative Analyst  
Senate Office of Research  
California Research Bureau  
Capitol Press