

**REPORT BY THE
STATE AUDITOR
OF CALIFORNIA**

**A REVIEW OF THE STATE'S CONTROLS
OVER ITS FINANCIAL OPERATIONS**

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**A Review of the State's Controls
Over Its Financial Operations**

92002, December 1993

California State Auditor
Bureau of State Audits



CALIFORNIA STATE AUDITOR
BUREAU OF STATE AUDITS

KURT R. SJOBERG
State Auditor

MARIANNE P. EVASHENK
Chief Deputy State Auditor

December 31, 1993

92002

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

Dear Governor and Legislative Leaders:

The Bureau of State Audits presents the results of our review of the State's control of its financial activities and its compliance with federal grant requirements and state regulations. This review was made as part of our examination of the State's general purpose financial statements. This review and the report on the general purpose financial statements fully meet the requirements of the 1984 Single Audit Act set forth by the United States Government as a condition of receiving more than \$18 billion in federal funds annually.

Some of the work referred to above was performed by the Office of the Auditor General, which was closed in December 1992. The Bureau of State Audits was created in May 1993, pursuant to California Government Code, Section 8543. The Bureau of State Audits is responsible for performing the annual financial and compliance audit previously conducted by the Office of the Auditor General. The federal government granted the State an extension for submitting the fiscal year 1991-92 annual financial and compliance audit from July 31, 1993, to January 31, 1994.

The State continues to have weaknesses in its accounting, auditing, and administrative control structure. In addition, the State continues to have shortcomings in its financial reporting system that need to be resolved by the State's financial leadership. For example, the State does not have an accounting system that presents the financial condition of the State based on generally accepted accounting principles when reporting on the past execution of its budget. Instead, the state fiscal control departments report the financial condition of the State by using inconsistent accounting practices. This use of inconsistent accounting practices can cause the State's financial decision-makers to be uncertain about the State's true financial condition.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Kurt Sjoberg".

KURT R. SJOBERG
State Auditor

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Summary

Status of Internal Controls

The State has many weaknesses to correct in its accounting, auditing, and administrative control structure. These weaknesses result in inaccurate financial statements, noncompliance with state and federal regulations, and the waste, loss, and misuse of state resources. For fiscal year 1991-92, 12 of the 18 agencies whose internal control structure we reviewed had weaknesses in the controls over their financial activities.

In conducting our audit, we selected agencies we determined to be the most material in relation to the major segments of the various funds in the general purpose financial statements. As a result, we audited 18 agencies, which represented approximately 64 percent of the State's revenues and approximately 60 percent of the State's spending. Other independent auditors audited an additional approximately 29 percent of the State's revenues and an additional approximately 20 percent of the State's spending.

Statewide Concerns

Although the State has corrected numerous weaknesses we have identified in recent years, it continues to have shortcomings in its internal control and financial reporting systems that need to be addressed by its financial leadership. Past weaknesses that the State has corrected include the presentation of the general fixed asset account group for the first time in the State's financial statements for fiscal year 1990-91 and, for fiscal year 1991-92, the recognition of expenses for Medi-Cal services provided but not yet paid for. However, the State did not correct several weaknesses related to its accounting practices, financial reporting, and internal controls. For example, the State Controller's Office and the Department of Finance use different accounting practices. This use of inconsistent practices provides the State's financial decision-makers with conflicting information relative to the State's true financial condition. Further, the State must make adjustments to its financial statements to prepare them in accordance with generally accepted accounting principles (GAAP) so that the statements may be comparable to the financial statements of other states and acceptable to the investment community and the federal

government. GAAP is the preferred method of accounting because it is a nationally recognized set of accounting principles that improves accountability, recognizing costs when they occur, not when they are paid for.

Furthermore, the State currently does not recognize certain costs when reporting on the past execution of the budget. For fiscal year 1991-92, the State did not recognize approximately \$89 million for the cost of earned vacation for certain state faculty and approximately \$94 million in costs the State owed exceeding available appropriations, such as lawsuits.

We noted other weaknesses that the Office of the Auditor General has reported in recent years. For example, the State does not produce audited financial statements within six months of the end of the fiscal year, and it does not include in its audited financial statements the combining statements that provide the financial statements of each of the funds within the fund types. As a result of these two weaknesses, as the Office of the Auditor General reported for the last five years, the State does not qualify for the Certificate of Achievement for Excellence in Financial Reporting. The State also continues to spend unnecessary additional time and effort in preparing the financial statement disclosures required by GAAP for the State's lease commitments because the State does not have a central record of lease commitments that contains all the necessary information. Further, the State's method of accounting for federal assistance does not yet provide sufficient information on expenditures of federal monies because it does not record its expenditures by federal program.

Weaknesses at State Agencies

Many of the agencies we audited had weaknesses in internal controls over financial reporting, revenue, and expenditure activities. We also noted immaterial instances of noncompliance with state and federal regulations at several agencies. Some deficiencies in internal controls were common throughout the State.

Weak Controls Over Financial Activities

Seven of the 18 agencies we audited had weaknesses in their internal controls over financial reporting. Problems we found included incorrect or nonexistent reconciliations, inappropriate accounting practices, and inadequate accounting for property and inventory. In some cases, these problems resulted in inaccurate financial statements. For example, the Department of General Services understated the due to local governments account balances at June 30, 1992, in two of its funds by

approximately \$2.6 million. In a third fund, the department overstated the balance for due to local governments by approximately \$1.0 million. The department did not detect these errors because it does not reconcile its subsidiary project cards with its general ledger account balances each month.

Five of the agencies we audited had weaknesses in internal controls over revenue activities. Problems we found included improper separation of duties, failure to monitor and collect receivables, and failure to follow proper procedures for recognizing revenue earned. These problems resulted in receivables that may be difficult to collect and inaccurate financial statements. For example, the Department of Health Services did not have policies or procedures for monitoring and collecting receivables, totaling approximately \$102 million, related to the Medicaid Drug Rebate Program, thus, increasing the risk that some of these receivables will become uncollectible.

Problems involving expenditure and electronic data processing activities existed at six of the agencies we audited. The problems we found included insufficient controls over access to electronic data processing data files, insufficient monitoring and control over revolving fund activities, insufficient support and analysis of expenditure accruals, and other weaknesses in controls over disbursements. For example, the Department of Health Services did not adequately analyze its expenditure accruals at June 30, 1992. As a result, the department understated the liabilities and expenditures for two of its funds at June 30, 1992, by approximately \$35.7 million.

Lack of Compliance With State Regulations

The State complied in all material respects with its regulations that could significantly affect its financial statements. However, a few agencies had certain immaterial instances of noncompliance in ensuring that all state time deposits were collateralized, receiving approval of contracts before work began, and apportioning funds to school districts. Although these weaknesses did not have a material effect on the financial statements, the weaknesses could result in the State's interests being put at risk because of improper contracting, undercollateralized deposits, and incorrectly calculated apportionments.

Lack of Compliance With Federal Regulations

In fiscal year 1991-92, the State received approximately \$18.8 billion in federal grants. At many state agencies, we noted immaterial instances of noncompliance with federal regulations for administering these federal grants. Adherence to these regulations is a condition of continued federal funding. The State did not fully comply with all federal regulations in 35 of the 48 grants we reviewed.

These 48 grants represent approximately 98 percent of all federal money the State received for fiscal year 1991-92, excluding that received by the University of California. Our review showed that agencies failed to adhere to requirements for reporting, for supporting expenditures, for managing cash, and for monitoring and auditing programs. The federal government could penalize the State because of its failure to comply with federal regulations.

Introduction

As part of our examination of the general purpose financial statements of the State of California for the fiscal year ended June 30, 1992, we studied and evaluated the State's internal control structure. The purpose of our study of this structure was to determine the audit procedures and the extent of testing necessary for the following three reasons:

- Expressing an opinion on the State's general purpose financial statements;
- Determining compliance with federal grant requirements, laws, and regulations; and
- Determining compliance with state laws and regulations that could materially affect the general purpose financial statements.

In conducting our audit, we reviewed and evaluated fiscal controls at 18 of the 325 state agencies included in the general purpose financial statements.

Amounts that we audited at these agencies represented approximately 64 percent of the State's revenues and approximately 60 percent of the State's spending. Further, other independent auditors audited an additional approximately 29 percent of the State's revenues and additional approximately 20 percent of the State's spending. In addition to this audit coverage of the State's revenues and spending, we increased our coverage with centralized testing, which we performed by selecting for review a cross section of items from the State as a whole. For example, we selected a sample of payroll warrants the State processed through its payroll system, and we selected a sample of warrants other than payroll warrants that the State processed through its claims payments system. We also reviewed electronic data processing activities at selected state agencies that have significant data processing operations.

We performed a limited review of the internal audit units at two state agencies. We noted no significant variances from the Standards for the Professional Practices of Internal Auditing. Based on the results of our review, we concluded that we can rely on the internal audit activities relevant to our audit at these agencies.

We reviewed 15 agencies' compliance with state laws and regulations that materially affect the State's financial statements. Compliance with these laws and regulations helps to ensure that the State maintains sufficient control over the budgeting, investing, collecting, and disbursing of state money and that it maintains sufficient control over reporting the results of state financial activities.

Finally, except for the Pell Grant Program, which is reviewed by other independent auditors, we reviewed the State's compliance with federal regulations for all federal grants exceeding \$20 million. In all, we reviewed 48 of the 313 federal grants the State administers. These 48 grants represent approximately 98 percent of the federal funds the State received in fiscal year 1991-92, excluding those funds the University of California received. In addition, as part of our examination of the State's financial statements, we selected transactions related to other federal programs and reviewed these transactions for compliance with applicable federal regulations.

The specific scope of our audit is stated in the following reports that the federal Office of Management and Budget, Circular A-128, requires the State to issue each year:

- The report on the internal control structure used in preparing the general purpose financial statements and in administering federal assistance programs (begins on page 27);
- The report on weaknesses and instances of noncompliance at state agencies (begins on page 33);
- The report on federal assistance programs, including required reports on (1) compliance with laws and regulations related to major and nonmajor federal programs and (2) the resolution of prior year findings related to federal programs (begins on page 179);
- The report on the accuracy of the supplementary schedule of federal assistance (begins on page 185); and
- The report on compliance with state laws and regulations (begins on page 225).

Between July 1, 1991, and December 31, 1992, the Office of the Auditor General issued 45 audit reports, many of which discussed improvements needed in the State's operations. These reports, listed in the Appendix, are available to the public through the Bureau of State Audits.

Statewide Concerns

Summary Although the State has corrected numerous weaknesses that the Office of the Auditor General identified in recent years, it continues to have shortcomings in its internal control and financial reporting systems that need to be addressed by its financial leadership. Weaknesses the State has corrected include the recognition for the first time in the State's financial statements for fiscal year 1991-92 expenses for Medi-Cal services provided but not yet paid for and recognition of the liabilities for tax overpayments identified at the Franchise Tax Board and Board of Equalization. However, the State did not correct several other weaknesses related to its accounting practices, financial reporting, and internal controls. For example, partly because it does not use nationally recognized accounting principles to report on the past execution of the State's budget, the State has inconsistently reported its financial condition. The State also does not provide sufficient instructions to make an efficient and reliable conversion of the financial reports from their presentation in accordance with the State's statutory and regulatory requirements (budgetary basis) to a presentation in accordance with generally accepted accounting principles (GAAP).

Furthermore, the State does not ensure that the charges of internal service funds to federal programs are in compliance with federal regulations. In addition, the State does not yet qualify for the Government Finance Officers Association's Certificate of Achievement for Excellence in Financial Reporting because it does not produce audited financial statements within six months of the end of the fiscal year and because it does not include the combining statements that provide the financial statements of each fund within the fund types. Further, the State does not have a central record of state leases that contains all the information required by GAAP, and it does not have sufficient control over contracts that are not subject to approval by the Department of General Services. Moreover, the State's method of accounting for federal assistance does not provide sufficient information on expenditures of federal money for each federal program. Finally, the State does not require the District Agricultural Associations to submit financial reports to be included in the State's financial statements, and it does not require other agencies to submit certain reconciliations and reports.

**Inconsistent
Financial
Reporting**

The State Controller's Office and the Department of Finance each report on the State's financial condition using different accounting practices. This use of inconsistent accounting practices provides the State's financial decision-makers with conflicting information relative to the State's true financial condition. Further, the State spends additional time and money making adjustments to its financial statements to prepare them in accordance with GAAP so that they may be comparable to the financial statements of other states and acceptable to the investment community and the federal government. GAAP is the preferred method of accounting because it is a nationally recognized set of accounting principles that improve accountability, recognizing costs when they occur, not when they are paid.

Further, although the State accounts for General Fund encumbrances, Medi-Cal expenses, and tax overpayments in accordance with GAAP, it still does not account for other expenses and revenues in accordance with GAAP when reporting on the past execution of its budget. The State still does not recognize expenses such as the cost of earned vacation for certain state faculty and does not recognize liabilities that were not included on a budgetary basis because no money remained in the appropriation to pay for them. Also, the State has historically recognized some events as expenses, even though no cost has been incurred. For example, the State reports loans from its General Fund to other funds as expenses rather than recognizing that money was lent to another fund and will be returned to the General Fund.

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

Adjustments Due to Unreported Expenses:	
Earned Vacation Leave	\$ 89,000
Costs Owed in Excess of Available Appropriations	94,000
<hr/>	
Total Adjustments Due to Unreported Expenses	183,000
Adjustments Due to Loans That Will Be Repaid to the General Fund	(133,856)
<hr/>	
Total Adjustments	\$ 49,144

Adjustments were also necessary to present the fund balances of the State's other fund types (as reported by the State Controller's Office) in accordance with GAAP. For example, the State recognizes as an addition to its fund balance its authorized but unissued bonds. Under GAAP, the proceeds from bonds should not be recognized until the sale occurs. In addition, the State reports as encumbrances grants to local agencies when the commitments are made. Under GAAP, the grants are not reported as encumbrances because the local agencies, not the State, receive the related goods or services. Instead, under GAAP, they are reported in the notes to the financial statements as commitments. Moreover, the State does not consistently recognize expenses such as the cost of earned vacation and worker's compensation claims in its internal service funds, as required by GAAP. If audit adjustments for these expenses were not made in the internal service funds, the State's possible liability to the federal government described on page 8 would be increased by approximately \$5.3 million.

Problems With the State's Conversion to GAAP

The California Government Code, Section 12460, requires the State Controller's Office to prepare an annual report containing a statement of the funds of the State, its revenues, and the public expenditures of the preceding fiscal year on the same basis as that of the governor's budget and the budget act (budgetary basis). This section also requires that the format of the budgetary report be prepared as closely as possible in accordance with GAAP. The State Controller's Office currently issues the Annual Report of the State of California in conformance with the State's budgetary basis of accounting, which is not in accordance with GAAP. The State Controller's Office must then convert the State's financial statements to GAAP to prepare the State's general purpose financial statements. The Department of Finance has not provided agencies with sufficient instructions in the State Administrative Manual to make this conversion from the budgetary basis to GAAP efficient and reliable. As a result, the financial information that agencies provide to the State Controller's Office is frequently insufficient for the State Controller's Office to prepare the State's general purpose financial statements in accordance with GAAP.

In addition, some of the financial information required under GAAP is more extensive than the information provided by the budgetary basis of accounting. As a result, the State must develop additional information for proprietary funds, lease commitments, and the market value of the State's investments in securities to create its general purpose financial statements. The Office of the Auditor General has reported a similar weakness in its audits for the last nine years.

The State is in the process of converting from the budgetary basis to GAAP in certain areas. The Department of Finance has rewritten some sections of the State Administrative Manual covering proprietary funds to bring them into conformance with GAAP. In addition, in the governor's budget, the Department of Finance treats the State's General Fund encumbrances as a reservation of fund balance rather than as expenditures and has extended this treatment to the year-end financial statements. This treatment is consistent with GAAP in that encumbrances are obligations for which goods and services have not been received, and they should not be shown as expenditures. Additionally, in accordance with GAAP, the State now recognizes in its financial statements the cost of Medi-Cal services provided but not yet paid for and the liabilities for tax overpayments. However, until the State incorporates all of the necessary generally accepted accounting principles into state law, the State must continue spending time and money to convert its financial records from the budgetary basis to GAAP so that they are comparable with those of other governmental entities and, therefore, acceptable to the investment community and the federal government under the single audit act.

**Some Internal
Service Funds
Do Not Always
Comply With
Federal
Regulations**

The State has a possible liability to the federal government estimated to be as much as \$20.7 million for profits it has accumulated in its internal service funds between July 1, 1984, and June 30, 1992. This condition exists because the Department of Finance has not ensured that charges to federal programs are in compliance with federal regulations. The State's internal service funds provide goods and services to state agencies and charge them for these goods and services. In turn, the state agencies have passed these charges on to federal programs that the State administers. When the charges of internal service funds exceed the costs for providing services, the State accumulates profits in its internal service funds.

In 1984, the federal Department of Health and Human Services (DHHS) audited the State's rate-setting methods for internal service funds. As a result, the State was required to refund to the federal government approximately \$14.9 million of the profits accumulated in its internal service funds. This amount represented the federal share of profits accumulated by five of the State's internal service funds from July 1, 1969, to June 30, 1984. Because the State's internal service funds continue to accumulate profits, the State may be liable to the federal government for the portion of the additional surplus accumulated between July 1, 1984, and June 30, 1992, that represents charges to federal programs. Currently, the federal DHHS is conducting an audit for July 1, 1984, through June 30, 1991, to determine the amount of

profit accumulated and the related federal share in three of the State's internal service funds. However, as of November 1993, the final audit report has not been issued.

Using procedures similar to those of the Department of Finance and using the same percentages used to determine the federal share of the State's profits in the 1984 audit for four of the five internal service funds mentioned above and a revised percentage for the other, we estimate that, under current federal regulations, the State may owe the federal government as much as \$20.7 million. This amount is the federal share of profits accumulated by four of these funds from July 1, 1984, to June 30, 1992, less audit adjustments and undercharges to federal programs of approximately \$440,000 for the other fund. Since the federal government and the State's executive branch are ultimately responsible for negotiating any final settlement, we did not attempt to determine whether the percentage that the federal government accepted to determine the federal share of the State's accumulated profits in the 1984 audit for four of the five internal service funds is still acceptable for the period from July 1, 1984, to June 30, 1992. Also, we did not verify the accuracy of the revised percentage used in the calculation of profits for the remaining fund. In addition, an October 1988 amendment to the federal Office of Management and Budget's (OMB) Circular A-87, *Cost Principles for State and Local Governments*, which has been proposed but not yet approved, would allow state agencies a reasonable working capital reserve of 60 days' cash expenditures. If approved, this amendment may reduce the liability for three of the funds to approximately \$8.9 million. The Office of the Auditor General has reported a similar weakness in its audits for the last three years.

While the State's internal service funds may be in compliance with state laws that allow them to accumulate surpluses up to certain limits, they may not be in compliance with the current provision of the OMB's Circular A-87. This Circular does not allow the State to charge federal programs for amounts that exceed costs. The California Government Code, Section 13070, provides the Department of Finance with general powers of supervision over all matters concerning the financial and business policies of the State. Therefore, it is the responsibility of the Department of Finance to provide adequate guidelines to the agencies that administer internal service funds to ensure that charges to federal programs are in compliance with federal regulations.

**Delays
Producing
Audited
Financial
Statements**

As we have reported for the last seven years, the State has been unable to produce the necessary financial reports in time to issue audited financial statements within six months of the end of the fiscal year, a time requirement established in 1980 by the Government Finance Officers Association. While major corporations such as IBM, General Motors, and Pacific Gas and Electric are required to issue their audited annual financial reports within 90 days after the close of the fiscal year, the State has 180 days.

As mentioned in this report, the State did not have an independent auditor from December 1992 to May 1993 because of the closure of the Office of the Auditor General. However, even after excluding this period, the State still exceeded the six-month requirement. In addition, the State has repeatedly taken longer than 200 days to issue its audited financial report. The report on the financial statements for fiscal year 1991-92 was dated November 19, 1993.

To address this concern, the Office of the Auditor General contracted with Price Waterhouse to evaluate the State's financial reporting system. In a report issued in May 1987, Price Waterhouse identified shortcomings throughout the State's financial reporting system and made recommendations for correcting them. In response to Price Waterhouse's recommendations, a committee consisting of representatives from various state control agencies has been formed to improve the State's reporting system. The committee has initiated a pilot project to make financial reporting more accurate and prompt. The project involves the development of automated reconciliations of agency records with records of the State Controller's Office, a proposed reduction in the number of reports required from agencies, and a preliminary plan for electronic reporting of year-end financial data to the State Controller's Office.

**Lack of
Combining
Statements
by Fund Type**

As the Office of the Auditor General has reported for the last three years, the State has not included combining statements by fund type in its audited financial statements. These combining statements provide financial statements for each of the individual funds within the fund types shown in the general purpose financial statements. Section 2200.101 of the Governmental Accounting and Financial Reporting Standards, issued by the Governmental Accounting Standards Board, states that every governmental unit should prepare a Comprehensive Annual Financial Report, which includes general purpose financial statements by fund type and account group as well as the combining statements by fund type and individual fund statements.

The State has not prepared combining statements by fund type in accordance with these guidelines issued by the Governmental Accounting Standards Board. The State's system accounts for its funds in a manner that, in some cases, is not in full agreement with GAAP. For example, the State accounts for some of its funds as Trust and Agency and Capital Project Fund Types on the budgetary basis, but reports the same funds in the Special Revenue Fund Type in the general purpose financial statements.

**Ineligibility for
Certificate of
Achievement**

The State does not yet qualify for the Certificate of Achievement for Excellence in Financial Reporting. The Certificate of Achievement Program of the Government Finance Officers Association encourages and recognizes excellence in financial reporting by governments. The State does not qualify for the certificate primarily for two reasons: it does not produce audited financial statements within six months of the end of the fiscal year, and its audited financial statements do not include combining statements by fund type. We discussed these weaknesses in the preceding sections. The Office of the Auditor General has reported a similar weakness for the last six years.

**Insufficient
Reporting
of Leasing
Information**

As the Office of the Auditor General has reported for the last five fiscal years, the State continues to spend unnecessary additional time and effort in preparing the financial statement disclosures required by GAAP for the State's lease commitments because the State does not have a central record of lease commitments that contains all the necessary information. The State's lease commitments totaled approximately \$5.1 billion in fiscal year 1991-92. GAAP requires the State, when it leases space or equipment from outside vendors, to disclose commitments for future minimum lease and rental payments in a summary that separates these future payments by fiscal year. Although the Department of General Services maintains space and equipment lease records for many lease commitments, it established these records for its internal management purposes and did not intend the records to be a complete listing of the State's leases that would meet GAAP requirements. Thus, the records do not provide all the necessary information.

For example, the records maintained by the Department of General Services disclose only the current-year payment for each lease and do not indicate how the payment will change in future years. The records also do not separate future minimum lease and rental payments by fiscal year, and the records do not include information on certain leases for which the Department of General Services does not have oversight

responsibility. For example, because the Department of General Services is not required to approve the California State Lottery Commission's leases, the department's records do not include more than \$2.4 million in commitments that the California State Lottery Commission has entered into for its leasing of space.

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

**Inadequate
Control Over
Some
Contracts**

As the Office of the Auditor General has reported for the last three fiscal years, grants and certain contracts and interagency agreements are not routed through the Department of General Services. The State Administrative Manual, Section 1203, mandates that only those contracts requiring the Department of General Services' approval be transmitted to the Department of General Services. Grants of state funds are not subject to approval by the Department of General Services. Because some agencies consider certain contracts to be grants, they conclude that these contracts also do not require the approval of the Department of General Services. As a result, grants of state funds and some contracts and interagency agreements go directly from the originating agency to the State Controller's Office. Thus, the State Controller's Office does not have assurance that these grants, contracts, and interagency agreements are valid. This weakness would be minimized by having the Department of General Services act as a clearinghouse for all grants, contracts, and interagency agreements. As part of the clearinghouse function, the Department of General Services should establish a statewide vendor list that would contain all entities with which the State contracts. The State Controller's Office would then have more assurance that the grants, contracts, and interagency agreements it receives from the Department of General Services are valid.

In addition, certain contracts between the State and local governments for grants are not being approved by the Department of General Services. Various state agencies believe these contracts are not subject to the Department of General Services' approval. Certain departments have received and relied on legal opinions from the Attorney General's Office and their own departmental legal counsel in determining whether these types of contracts are subject to the Department of General

Services' approval. Based on its interpretation of the present rules, the Attorney General's Office has determined that contracts for federal funds and contracts for grants of state funds are not required to be approved by the Department of General Services.

Whether or not a contract with a local government involves a grant of state or federal funds, we believe there is a weakness in the State's control over these types of contracts when the Department of General Services does not approve them. Therefore, we recommend that the Department of Finance clarify the sections of the State Administrative Manual regarding contract approval requirements. Specifically, contracts for grants of either state or federal funds to local governments should be subject to the same approval requirements established in the State Administrative Manual for other types of contracts.

**Failure To
Account for
Expenditures of
Federal Money
By Each Federal
Program**

The State's method of accounting for federal assistance does not provide sufficient information on expenditures of federal monies because it does not record its expenditures by federal program. The Office of the Auditor General reported a similar weakness for the last six fiscal years. As a result, the State is not able to present a schedule of federal assistance that shows total expenditures for each federal assistance program; therefore, the State is not in compliance with the OMB's Circular A-128. The schedule of federal assistance that we present, beginning on page 189, shows total receipts rather than expenditures.

The OMB's Circular A-128 requires the State to submit an audit report on a schedule of federal assistance that shows the total expenditures for each federal assistance program. The California Government Code, Section 13300, assigns the Department of Finance the responsibility for establishing and supervising a complete accounting system to ensure that all revenues, expenditures, receipts, disbursements, resources, obligations, and property of the State are properly accounted for and reported.

**Improper
Omissions
From the State
Reporting
Process**

As the Office of the Auditor General has reported for the last four fiscal years, District Agricultural Associations, which are organized to hold fairs and expositions, are not treated as part of the state reporting entity. To determine whether the District Agricultural Associations should be treated as such, the Office of the Auditor General requested a legal opinion from the Legislative Counsel. The Legislative Counsel found that the District Agricultural Associations are state agencies and that money they spend is state money. Further, funds for support of the District Agricultural Associations are appropriated in the State's annual

budget. For these reasons, the Legislative Counsel concluded that the State Controller's Office is required to include the financial information of the District Agricultural Associations in the State's general purpose financial statements. Currently, this financial information is not included, and as a result, the State's general purpose financial statements are incomplete.

**Failure
To Require
Agencies
To Submit
Reconciliations**

For approximately 228 funds numbered 500 to 699 and 800 to 999, the State Administrative Manual, Section 7951, does not require agencies to prepare Report 15, Reconciliation of Agency Accounts With Transactions Per State Controller. As a result, the State Controller's Office does not have evidence that agencies have reconciled financial information that appears in the general purpose financial statements with records of the State Controller's Office. The Office of the Auditor General has reported a similar weakness for the last six fiscal years.

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

**Failure
To Require
Agencies
To Prepare
a Report of
Accruals**

The State Administrative Manual, Section 7951, does not require agencies to prepare Report 1, Report of Accruals to the Controller's Accounts, for funds numbered 500 to 699 and 800 to 999. Included among these funds are more than 72 that had budget appropriations for fiscal year 1991-92. As a result of not preparing this report, information needed to distinguish encumbrances from accounts payable and to present financial information in accordance with GAAP is not available for all funds. The Office of the Auditor General has reported a similar weakness for the last six fiscal years.

The California Government Code, Section 12460, requires the State Controller's Office to present the State's financial position in a format that is as close as possible to GAAP. State agencies submit financial reports to the State Controller's Office, which then issues the financial report presenting the State's financial position. In addition, Section 1100.101 of the Governmental Accounting and Financial Reporting Standards, issued by the Governmental Accounting Standards Board, requires that agencies' accounting systems make it possible to present fairly the agencies' financial position and results of operations in accordance with GAAP.

Summary of Audit Results by Area of Government

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

Table 1, which begins on page 16, shows the distribution by state agency of weaknesses in control over financial activities and weaknesses in compliance with state and federal regulations. A more detailed table for weaknesses in federal compliance begins on page 211. The page number column in Table 1 provides the location of the specific report on the indicated state agency. The numbers in the other columns are the item numbers for each weakness as presented in the agency reports.

Beginning on page 19, we present a summary of the most significant findings by area of government. At the beginning of each section, we present additional information regarding our audit work.

TABLE 1

WEAKNESSES IN INTERNAL CONTROL SYSTEMS

		Weaknesses and Item Numbers^a				
Agency	Page Number	Financial Reporting Activities	Revenue Activities	Expenditure and Electronic Data Processing Activities	Compliance With Federal Regulations^b	Compliance With State Regulations
BUSINESS, TRANSPORTATION AND HOUSING						
Housing and Community Development, Department of	47			5	1 - 4	2,4
Motor Vehicles, Department of	50		1	2		1
Stephen P. Teale Data Center	53	2,3	1		4	
Transportation, Department of	59				1 - 4	1
EDUCATION						
California Community Colleges, Chancellor's Office	67				1	
California Postsecondary Education Commission	68				1	
California Student Aid Commission	69				1 - 7	
Education, California Department of	77				1 - 10,12	1,7,11
GENERAL GOVERNMENT						
Economic Opportunity, Department of	95					1 - 3
Industrial Relations, Department of	98	1				
Personnel Administration, Department of	100	1				

Footnotes are presented on page 18

Weaknesses and Item Numbers^a

<u>Agency</u>	<u>Page Number</u>	<u>Financial Reporting Activities</u>	<u>Revenue Activities</u>	<u>Expenditure and Electronic Data Processing Activities</u>	<u>Compliance With Federal Regulations^b</u>	<u>Compliance With State Regulations</u>
HEALTH AND WELFARE						
Alcohol and Drug Programs, Department of	105				1 - 4	
Employment Development Department	109			12	2 - 11	1,4
Health and Welfare Agency Data Center	122	2			1	
Health Services, Department of	125	1	1,2	2	3 - 12	9,11,13
Mental Health, Department of	137				1	
Rehabilitation, Department of	138				1	
Social Services, Department of	140				2 - 7	1,5
LEGISLATIVE, JUDICIAL, AND EXECUTIVE						
Emergency Services, Office of	149					1
Equalization, Board of	150		1,2			
State Controller's Office	153			1		2
State Treasurer's Office	155					1
RESOURCES						
Water Resources, Department of	159	1				

Weaknesses and Item Numbers^a

<u>Agency</u>	<u>Page Number</u>	<u>Financial Reporting Activities</u>	<u>Revenue Activities</u>	<u>Expenditure and Electronic Data Processing Activities</u>	<u>Compliance With Federal Regulations^b</u>	<u>Compliance With State Regulations</u>
STATE AND CONSUMER SERVICES						
Franchise Tax Board	163					1
General Services, Department of	164	4 - 7	7	4	1	2,3
Public Employees' Retirement System	173				1	1
YOUTH AND ADULT CORRECTIONAL						
Youth Authority, Department of the	177				1	

^aThe item number is the number of each weakness as presented in the report on each state agency.

^bThe table on page 211 provides more detail regarding the weaknesses in compliance with federal regulations.

Business, Transportation and Housing

In fiscal year 1991-92, the State spent more than \$6.2 billion, approximately 6 percent of the State's expenditures, on programs in the Business, Transportation and Housing Agency. The agency oversees the operations of 20 departments and other budgeted activities. In addition to our centralized testing and the audits performed by other independent auditors, our financial and compliance audit focused on five departments: the Department of Housing and Community Development, the Department of Insurance, the Department of Motor Vehicles, the Stephen P. Teale Data Center, and the Department of Transportation. For compliance with federal regulations, we audited three federal programs with receipts of approximately \$1.7 billion. Since July 1991, ten special topic reports were released that include issues relating to Business, Transportation and Housing programs. These special topic reports required reviews of selected operations of four additional entities: the California Transportation Commission, the Department of Corporations, the California Housing Finance Agency, and the Department of the California Highway Patrol. (The Appendix lists the reports that the Office of the Auditor General issued from July 1, 1991, to December 31, 1992.)

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

Stephen P. Teale Data Center

The Stephen P. Teale Data Center (data center) does not always charge state agencies for services provided based on its published rate schedule. Specifically, the published rate for telecommunication lines is \$905 per line, but we found that the data center had made an arrangement with the Governor's Office to charge a rate of \$250 per telecommunication line. According to the data center staff, the Governor's Office uses the same type of telecommunication lines as other state agencies, yet the other state agencies are charged the published rate of \$905. As a result, we determined the data center lost revenues totaling \$31,440 during fiscal year 1991-92. In addition, the data center does not always fully recover service costs. For example, during fiscal year 1991-92, the data center provided data processing services to the Department of Housing and Community Development (HCD) worth approximately \$7,000. However, the data center reduced its receivable by approximately \$4,000 to allow the HCD to stay within its budget limits. Moreover, the data center cannot always support reductions of amounts receivable from state agencies.

Department of Transportation

We noted 19 instances when the Department of Transportation (department) did not promptly request reimbursements totaling approximately \$9.9 million for federal aid projects at the highest rate allowed by the federal government. For 17 federal aid projects, the department did not promptly adjust its reimbursement rate to reflect the highest rate allowed by the federal government. For another project, the department did not promptly bill the federal government for \$3.9 million it paid from January to April 1992. Finally, the department did not make a retroactive adjustment for another project that had an increased reimbursement rate. As a result of these delays, we estimated the department lost approximately \$146,000 in interest earnings.

Education

In fiscal year 1991-92, the State spent more than \$39.8 billion, approximately 38 percent of the State's expenditures, on education programs. This area of government consists of 16 departments and other budgeted activities. In addition to our centralized testing and the audits performed by other independent auditors, our financial and compliance audit focused on five departments: the California Postsecondary Education Commission; the California Community Colleges, Chancellor's Office; the California State University; the California Student Aid Commission; and the California Department of Education. For compliance with federal regulations, we audited 15 federal programs with receipts of approximately \$2.2 billion, and other independent auditors audited one federal program with receipts of approximately \$101 million. Further, since July 1991, ten special topic reports were released that include issues relating to education programs. These special topic reports required reviews of selected operations of three additional entities: California Polytechnic State University, San Luis Obispo; the University of California system; and the University of California, San Francisco. (The Appendix lists the reports that the Office of the Auditor General issued from July 1, 1991, to December 31, 1992.)

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

California Department of Education

The California Department of Education has significant weaknesses in the contracting procedures used within its Office of Healthy Kids, Healthy California (office). The office receives both federal and state grants that have restrictions on specific activities. We determined that

the office has entered into contracts that do not ensure these funds are used for the purposes intended by law. For example, we noted that for four contracts, the office combined funding from federal and state grants to sponsor comprehensive health education activities. Sponsoring of these activities is not permitted according to the grant specifications. One of these four contracts was, in part, for state-sponsored health promotion conferences. This contract did not contain a complete description of the amounts to be paid for the services provided. For two other contracts with private organizations, we identified costs totaling \$10,500, paid with federal funds that are not allowable under federal laws and regulations. In addition, the office used federal and state funds in a contract that circumvented state civil service hiring practices. Moreover, the office does not have a systematic method of determining the funding sources for the payment of invoices. Finally, the office allowed two contractors to begin work before the related contracts were approved.

General Government

In fiscal year 1991-92, the State spent more than \$8.4 billion, approximately 8 percent of the State's expenditures, on general government. This area of government consists of 54 departments and other budgeted activities. In addition to our centralized testing and the audits performed by other independent auditors, our financial and compliance audit focused on four departments: the Office of Criminal Justice Planning, the Department of Economic Opportunity, the Department of Finance, and the Department of Industrial Relations. For compliance with federal regulations, we audited four federal programs with receipts of approximately \$142 million. Since July 1991, six special topic reports were released that include issues relating to general government. These special topic reports required reviews of selected operations of two additional entities: the Public Utilities Commission and the Board of Control. (The Appendix lists the reports that the Office of the Auditor General issued from July 1, 1991, to December 31, 1992.)

We reported weaknesses for three of the departments that we audited within the area of general government. See Table 1 on page 16 for the classification of these weaknesses.

Health and Welfare

In fiscal year 1991-92, the State spent more than \$38.4 billion, approximately 37 percent of the State's expenditures, on programs in the Health and Welfare Agency. The agency oversees the operations of 20 departments and other budgeted activities. In addition to our centralized testing, our financial and compliance audit focused on eight

departments: the Department of Aging, the Department of Alcohol and Drug Programs, the Employment Development Department, the Health and Welfare Agency Data Center, the Department of Health Services, the Department of Mental Health, the Department of Rehabilitation, and the Department of Social Services. For compliance with federal regulations, we audited 25 federal programs with receipts of approximately \$13.9 billion. Further, since July 1991, 12 special topic reports were released that include issues relating to Health and Welfare Agency programs. These special topic reports required reviews of selected operations of two additional entities: the Camarillo State Hospital and Developmental Center and the Office of Statewide Health Planning and Development. (The Appendix lists the reports that the Office of the Auditor General issued from July 1, 1991, to December 31, 1992.)

We reported weaknesses for seven departments within the Health and Welfare Agency. In the following section, we discuss the most significant weaknesses we reported.

Department of Health Services

The Department of Health Services (department) did not follow procedures that the State Administrative Manual requires to account for and to collect receivables, totaling approximately \$102 million, related to the Medicaid Drug Rebate Program. For example, the department did not maintain appropriate separation of duties. The employee who mailed the invoices and recorded the invoiced amounts in the accounts receivable ledger also received, deposited, and recorded the invoiced remittances. Failure to maintain proper separation of duties can result in errors and irregularities that may go undetected. In addition, the department did not have policies or procedures for monitoring and collecting receivables for the Medicaid Drug Rebate Program. Without adequate procedures for monitoring and collecting accounts receivable, the department increases the risk that some receivables will become uncollectible. Finally, the department did not perform a monthly reconciliation between the subsidiary accounts receivable ledger and the general ledger account. Without properly prepared reconciliations, the department lacks assurance that the transactions have been adequately recorded and that the financial records are complete.

Legislative, Judicial, and Executive

In fiscal year 1991-92, the State spent more than \$1.9 billion, approximately 2 percent of the State's expenditures, on the legislative, judicial, and executive area of government. This area of government consists of 41 departments and other budgeted activities. In addition to

our centralized testing and the audits performed by other independent auditors, our financial and compliance audit focused on five departments: the Office of Emergency Services, the Board of Equalization, the Department of Justice, the State Controller's Office, and the State Treasurer's Office. For compliance with federal regulations, we audited two federal programs with receipts of approximately \$186 million. Further, since July 1991, eight special topic reports were released that include issues relating to the legislative, judicial, and executive areas of government. These special topic reports required reviews of selected operations of two additional entities: the Secretary of State and the California State Lottery Commission. (The Appendix lists the reports that the Office of the Auditor General issued from July 1, 1991, to December 31, 1992.)

We reported weaknesses for four departments within the legislative, judicial, and executive areas of government. In the following section, we discuss the most significant weakness we reported.

Board of Equalization

The Board of Equalization (board) should seek a change in the Vehicle Fuel License Tax Law that would allow the board to assess penalties on prepayments that do not meet the minimum requirement as stipulated by law. Currently, the Vehicle Fuel License Tax Law requires that motor vehicle fuel distributors whose estimated tax liability averages \$900,000 or more per month make a prepayment of at least 95 percent of either the tax liability for the month to which the prepayment applies or at least 95 percent of the tax liability reported for the previous month. Currently, the board assesses a penalty of 6 percent on late payments. However, there is no provision for assessing penalties on prepayments that are made promptly but that do not meet the 95 percent requirement. Based on our testing of revenue for the Motor Vehicle Fuel Account, we calculated that the board could have collected additional revenues of \$128,000 in fiscal year 1991-92 and \$138,000 in fiscal year 1992-93 if the board could have assessed penalties on prepayments that did not meet the 95 percent requirement.

Resources In fiscal year 1991-92, the State spent more than \$2.4 billion, approximately 2 percent of the State's expenditures, on programs in the Resources Agency. The agency oversees the operations of 27 departments and other budgeted activities. In addition to our centralized testing and the audits performed by other independent auditors, our financial and compliance audit focused on four departments: the Department of Parks and Recreation, the State Lands

Commission, the State Water Resources Control Board, and the Department of Water Resources. For compliance with federal regulations, we audited one federal program with receipts of approximately \$120 million. Further, since July 1991, four special topic reports were released that included issues relating to programs in the Resources Agency. These special topic reports required reviews of selected operations of three additional entities: the California Conservation Corps, the Department of Forestry and Fire Protection, and the Energy Resources Conservation and Development Commission. (The Appendix lists the reports that the Office of the Auditor General issued from July 1, 1991, to December 31, 1992.)

We reported weaknesses for one department within the Resources Agency. See Table 1 on page 16 for the classification of these weaknesses.

State and Consumer Services

In fiscal year 1991-92, the State spent more than \$4.1 billion, approximately 4 percent of the State's expenditures, on programs in the State and Consumer Services Agency. The agency oversees the operations of 13 departments and other budgeted activities. In addition to our centralized testing and the audits performed by other independent auditors, our financial and compliance audit focused on three departments: the Franchise Tax Board, the Department of General Services, and the Public Employees' Retirement System. Further, since July 1991, ten special topic reports were released that include issues relating to programs for the State and Consumer Services Agency. These special topic reports required reviews of selected operations of five additional entities: the State Athletic Commission, the Department of Consumer Affairs, the Contractors' State License Board, the Department of Fair Employment and Housing, and the Board of Vocational Nurse and Psychiatric Technician Examiners. (The Appendix lists the reports that the Office of the Auditor General issued from July 1, 1991, to December 31, 1992.)

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

Department of General Services

As of the end of fiscal year 1991-92, the Office of Local Assistance (OLA) of the Department of General Services did not have adequate procedures to identify and report interest earned by school districts on funds received from the State for participating in the state school

building lease-purchase program. Because procedures were not implemented, as of June 30, 1992, the OLA did not record in its accounting records or report to the State Controller's Office approximately \$58.4 million of interest earned by school districts on lease-purchase funds not yet spent. As a result, the amount due to local governments that the OLA reported to the State Controller's Office on its year-end financial reports was overstated by approximately \$58.4 million.

Youth and Adult Correctional

In fiscal year 1991-92, the State spent more than \$3.4 billion, approximately 3 percent of the State's expenditures, on programs in the Youth and Adult Correctional Agency. The agency oversees the operations of six departments and other budgeted activities. In addition to our centralized testing and the audits performed by other independent auditors, our financial and compliance audit focused on three departments: the Board of Corrections, the Department of Corrections, and the Department of the Youth Authority. We audited one program for compliance with federal regulations. Since July 1991, six special topic reports were released that include issues relating to programs for the Youth and Adult Correctional Agency. These special topic reports required reviews of selected operations of four additional entities: the California Institution for Men, the California Institution for Women, the California Rehabilitation Center, and the California Correctional Institution at Tehachapi. (The Appendix lists the reports that the Office of the Auditor General issued from July 1, 1991, to December 31, 1992.)

We reported one weakness for one department within the Youth and Adult Correctional Agency. See Table 1 on page 16 for the classification of this weakness.

Report on the Study and Evaluation of Internal Controls



CALIFORNIA STATE AUDITOR

BUREAU OF STATE AUDITS

KURT R. SJOBERG
State Auditor

MARIANNE P. EVASHENK
Chief Deputy State Auditor

Independent Auditors' Report on the Study and Evaluation of Internal Controls

The Governor and Legislature of
the State of California

We have audited the general purpose financial statements of the State of California as of and for the year ended June 30, 1992, and have issued our report thereon dated November 19, 1993. We did not audit the financial statements of the pension trust funds, which reflect total assets constituting 78 percent of the fiduciary funds. We also did not audit the financial statements of certain enterprise funds, which reflect total assets and revenues constituting 92 percent and 93 percent, respectively, of the enterprise funds. In addition, we did not audit the University of California funds. The financial statements of the pension trust funds, certain enterprise funds, and the University of California funds referred to above were audited by other auditors who furnished their reports to us, and our opinion, insofar as it relates to the amounts included for the pension trust funds, certain enterprise funds, and the University of California funds, is based solely upon the reports of other independent auditors. We have also audited the State of California's compliance with requirements applicable to major federal financial assistance programs and have issued our report thereon dated November 19, 1993.

We conducted our audits in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Circular A-128, *Audits of State and Local Governments*. Those standards and OMB Circular A-128 require that we plan and perform the audit to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement and about whether the State of California complied with laws and regulations, noncompliance with which would be material to a major federal financial assistance program.

In planning and performing our audits for the year ended June 30, 1992, we considered the internal control structure of the State of California in order to determine our auditing procedures for the purpose of expressing our opinions on the general purpose financial statements of the State of California and on its compliance with requirements applicable to major federal financial assistance programs and to report on the internal control structure in accordance with OMB Circular A-128, but not to provide assurance on the internal control structure.

The Department of Finance and the State's management are responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control

structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of general purpose financial statements in accordance with generally accepted accounting principles, and that federal financial assistance programs are managed in compliance with applicable laws and regulations. Because of inherent limitations in any internal control structure, errors, irregularities, or instances of noncompliance may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal control structure policies and procedures in the following categories: financial activities, including electronic data processing controls; state compliance; and federal compliance. We did not study the internal control structures for the pension trust funds, certain enterprise funds, or the University of California funds.

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and determined whether they have been placed in operation, and we assessed control risk.

During the year ended June 30, 1992, the State of California received 98 percent of its total federal financial assistance through major federal financial assistance programs. We performed tests of controls, as required by OMB Circular A-128, to evaluate the effectiveness of the design and operation of internal control structure policies and procedures that we considered relevant to preventing or detecting material noncompliance with specific requirements, general requirements, and requirements governing claims for advances and reimbursements and amounts claimed or used for matching that are applicable to each of the State of California's major federal financial assistance programs, which are identified in the accompanying schedule of federal financial assistance. Our procedures were less in scope than would be necessary to render an opinion on these internal control structure policies and procedures. Accordingly, we do not express such an opinion.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the State's ability to record, process, summarize, and report financial data consistent with the assertions of management in the general purpose financial statements or to administer federal financial assistance programs in accordance with applicable laws and regulations.

We discuss the reportable conditions and present recommendations to correct them on pages 43 through 177 of our report. Management's comments regarding the recommendations appear on page 233 of this report. Additionally, beginning on page 221, we present a schedule listing instances of noncompliance that we consider to be minor. Specific responses to the reportable conditions identified at each state agency are on file with the Bureau of State Audits and the Department of Finance. The reportable conditions identified in the State's single audit report for fiscal year 1990-91 that have not been corrected are included in the section beginning on page 43.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the general purpose financial statements or noncompliance with laws and regulations that would be material to a federal financial assistance program 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 structure policies and procedures used in relation to the general purpose financial statements or in administering federal financial assistance would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe none of the reportable conditions described above is a material weakness.

In addition to the work we performed in accordance with OMB Circular A-128 and the Single Audit Act of 1984, the Office of the Auditor General performed other reviews related to federal programs. A schedule of the pertinent reports issued from July 1, 1991, to December 31, 1992, begins on page 216 of this report.

This report is intended for the information of the Governor and Legislature of the State of California and the management of the executive branch. However, this report is a matter of public record and its distribution is not limited.

BUREAU OF STATE AUDITS



SALLY L. FILLIMAN, CPA
Deputy State Auditor

November 19, 1993

Detailed Description of Weaknesses at State Agencies

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Deficiencies Common to Various Agencies

Summary Certain deficiencies in internal control are common to more than one agency. For example, many state agencies do not comply with the California Public Contract Code in establishing and maintaining contracts with vendors. Furthermore, many state agencies do not promptly use federal funding that has already been received. Additionally, not all state agencies promptly return undelivered salary warrants to the State Controller's Office.

We have reported these and other systemic deficiencies to the Department of Finance, which is the agency that has general supervisory responsibility over all matters concerning the financial and business policies of the State. In the following paragraphs, we discuss the deficiencies we found.

Deficiencies in Administering State Contracts State agencies do not always comply with the California Public Contract Code in establishing and maintaining contracts with vendors. In our reviews of 84 nonconsultant contracts at 17 departments, we found 23 contracts that were not approved before the beginning of contract work. When agencies do not ensure that contracts are approved before work begins, the State cannot be assured that its interests are protected. In addition, if these contracts had not been subsequently approved, the State might still have been liable for the work performed and might have incurred litigation costs regarding the State's obligation to pay for that work. Table 2 on page 38 indicates the departments at which we reviewed nonconsultant contracts, the number of contracts reviewed at each department, and the number of reviewed contracts for which work began before contract approval.

TABLE 2
DEFICIENCY IN ADMINISTERING STATE NONCONSULTANT
CONTRACTS AT VARIOUS AGENCIES
FISCAL YEAR 1991-92

Agency Name	Contracts Tested	Lack of Approval Before Start of Contract Work
Health and Welfare Agency Data Center	5	4
Department of Motor Vehicles	5	4
California Department of Education	4	3
Department of Social Services	5	3
State Treasurer's Office	5	3
Teale Data Center	5	2
Franchise Tax Board	5	1
Department of General Services	5	1
Department of Health Services	5	1
Department of Water Resources	5	1
California Community Colleges, Chancellor's Office	5	0
Department of Transportation	5	0
State Controller's Office	5	0
Department of Corrections	5	0
Employment Development Department	5	0
Board of Equalization	5	0
California State Universities, Office of the Chancellor	5	0
Total	84	23

The California Public Contract Code, Section 10295, states that all contracts, unless otherwise exempt, entered into by any state agency for the purchase of equipment, supplies, materials, services, or construction are void unless or until approved by the department. In addition, Section 10335 states that, unless specifically exempted, a service contract is not effective until the date of its approval. Moreover, the State Administrative Manual, Section 1209, requires state agencies to submit each contract in sufficient time for the Department of General Services to review and comment on it before work on the contract begins, except in emergency cases to protect human life or state property. This section of the manual also states that a contractor who begins work before receiving notice of the contract's approval may be considered to have performed the work at the contractor's own risk and may not be paid.

Table 2 above pertains specifically to our review of nonconsultant contracts. We plan to release a report in February 1994 that addresses our review of consultant contract for fiscal years 1991-92 and 1992-93.

Improper Cash Management

During fiscal year 1991-92, many state agencies maintained balances of federal funds that exceeded their immediate cash needs in appropriations related to prior years. For example, the Department of Social Services retained approximately \$800,000 for seven months during fiscal year 1991-92 of excess federal funds in the state treasury for certain prior year appropriations. Further, the Department of Economic Opportunity retained between \$244,000 and \$1.8 million during fiscal year 1991-92 of excess federal funds in the state treasury for certain prior year appropriations.

The State as a whole had on deposit approximately \$148.4 million in federal funds as of June 30, 1992, for all fiscal years' appropriations. Table 3 on page 40 provides bimonthly end-of-month balances of these deposits during fiscal year 1991-92 by year of appropriation. Some of the balances, particularly those for fiscal year 1991-92, may be amounts representing the State's cash needs to make payments in the immediate future. Also, some of the balances represent amounts that have not been transferred to the State's General Fund even though the General Fund is entitled to the money. For example, the Department of Parks and Recreation had approximately \$472,000 of federal funds on deposit even though the money should have been transferred to the General Fund. In addition, some of the balances represent settlements received by the State, such as Outer Continental Shelf funds, that the State is allowed to maintain until it uses the funds. For example the Department of Transportation had approximately \$4.2 million of Outer Continental Shelf funds on deposit as of June 30, 1992. However, we believe many of the balances, particularly those for prior years' appropriations, represent pools of federal funds that exceed the immediate needs of the State.

TABLE 3
BALANCES OF FEDERAL FUNDS ON DEPOSIT
DURING FISCAL YEAR 1991-92
(In Thousands)

Appropriation Fiscal Year	August 1991	October 1991	December 1991	February 1992	April 1992	June 1992	12-Month Annual Average
1984-85				\$ 18			\$ 2
1985-86	\$ 4,009	\$ 4,009	\$ 4,009	4,054	\$ 4,033	\$ 4,150	4,060
1986-87	1,839	1,648	1,604	1,642	412	268	1,264
1987-88	2,983	6,725	2,788	3,383	1,672	31	2,733
1988-89	22,003	34,681	7,512	3,319	2,039	1,555	10,983
1989-90	11,777	10,135	8,692	9,147	9,170	6,119	9,311
1990-91	35,795	13,165	24,907	25,902	21,580	13,023	24,716
1991-92	63,084	121,831	125,582	139,483	86,696	43,917	174,734
Continuously Appropriated	165,462	137,578	63,607	64,686	99,506	79,369	106,115
Total	\$306,952	\$329,772	\$238,701	\$251,634	\$225,108	\$148,432	

Because the State did not properly limit its request for federal funds to its immediate cash needs, the federal government lost interest that it could have earned on these funds. In addition, maintaining excess cash may result in the termination of advanced financing by the federal government.

The Code of Federal Regulations, Title 31, Section 205.4, requires that cash advances be limited to the actual immediate cash needed for carrying out the purpose of the program. This section also stipulates that the timing and amount of cash advances be as close as administratively feasible to the actual disbursement by the recipient organization.

**Salary Warrants
Are Not Always
Promptly
Returned**

State agencies do not always return undelivered salary warrants to the State Controller's Office within 90 calendar days of receipt. We performed tests for undelivered salary warrants more than 90 days old at 63 locations and found that 24 locations did not return a total of 286 salary warrants to the State Controller's Office within 90 days of receipt. These warrants ranged in amount from \$0.29 to \$2,630.98. The oldest warrant found was dated October 24, 1985, and amounted to \$227.96. Failure to return the undelivered warrants to the State Controller's Office increases the risk of their loss or misappropriation. Table 4 on page 41 provides, by agency, the number of undelivered salary warrants that were more than 90 days old.

TABLE 4
SALARY WARRANTS NOT RETURNED
WITHIN 90 DAYS

Agency	Number of Warrants More Than 90 Days Old
California State University (Three campuses)	35
Corrections, Department of (One division and eight institutions)	33
Developmental Services, Department of (Two hospitals)	27
Fish and Game, Department of	6
General Services, Department of	2
Health Services, Department of (Two divisions)	31
Justice, Department of	26
Mental Health, Department of (Three hospitals)	107
Motor Vehicles, Department of	17
Youth Authority, Department of (One institution)	2
Total	286

The State Administrative Manual, Section 8580.5, specifies that salary warrants not delivered within 90 calendar days of receipt must be returned to the State Controller's Office for monthly deposit in the special deposit fund.

Management Letters by Area of Government

Business, Transportation and Housing

Department of Housing and Community Development

The Office of the Auditor General reviewed the Department of Housing and Community Development's (department) administration of the U.S. Department of Housing and Urban Development grants, Federal Catalog Numbers 14.228 and 14.857.

Item 1. Overspending for Federal Funds for the Costs of Administering the Community Development Block Grant

Finding

For fiscal year 1991-92, the department spent \$619,076 of federal funds in administering the Community Development Block Grant (CDBG). This amount was \$42,536 more than the \$576,540 that it was allowed to spend for this purpose.

Criteria

The United States Code, Title 42, Section 5306(d)(3)(A), allows state-level expenditures for administrative costs of \$100,000 plus 2 percent of the grant amount.

Recommendation

The department should reimburse the appropriate federal account as soon as practical.

Item 2. Required Reports Not Always Obtained From Grantees

Finding

In a sample of ten CDBG grantees who were required to submit to the department 24 quarterly narrative reports during fiscal year 1991-92, five grantees failed to submit nine reports. In addition, five grantees were between one and 59 days late in submitting quarterly reports. Finally, as of October 13, 1992, one grantee had not submitted the annual grantee performance report due on July 31, 1992. Late or unsubmitted reports reduce the department's ability to assist grantees in resolving problems and to promptly detect inappropriate activities.

The Office of the Auditor General reported a similar weakness in its financial audit for fiscal year 1989-90.

Criteria

The Code of Federal Regulations, Title 24, Section 85.40, requires a state that administers CDBG funds to monitor grantees' performance. In addition, the California Code of Regulations, Title 25, Section 7108(e), requires that grantees submit to the department quarterly reports no later than 30 days after the end of the quarter. Further, the department's Grant Management Manual requires grantees to submit an annual performance report no later than July 31 of each year.

Recommendation

The department should ensure that grantees submit their quarterly narrative reports and their annual performance reports by the required due dates.

**Item 3.
Slow
Disbursement of
Federal Funds for
the Section 8
Rental Certificate
Program**

Finding

We reviewed the disbursement of approximately \$2.3 million of Section 8 Rental Certificate Program (RCP) funds disbursed in June 1992. Of this amount, approximately \$1.6 million had been requisitioned by the department and received in the state treasury from one to four months before it was disbursed to subrecipients. According to the RCP manager, these delays occurred because the State Controller's Office would not release warrants payable to subrecipients until the department amended its contracts with them.

Criteria

According to the United States Department of the Treasury, Circular 1075, Section 205.4, the timing and amount of cash advances to a recipient organization must be as close as administratively feasible to the actual disbursements by that organization.

Recommendation

The department should ensure its contracts with program subrecipients are current and support the amounts payable to the subrecipients before requisitioning funds from the federal government.

**Item 4.
Lack of
Documentation
To Support the
Balance Sheet
Report for the
Section 8 Rental
Certificate
Program**

Finding

The department could not produce support for or demonstrate the accuracy of the data in its Balance Sheet report (HUD-52595) for the RCP. Without such information, the federal Department of Housing and Urban Development could have difficulty in evaluating the department's financial management of the RCP.

Criteria

Circular A-102, Subpart C, of the federal Office of Management and Budget, requires states to account for grant funds in accordance with state laws and procedures. The California State Administrative Manual, Section 20014, requires agencies receiving federal funds to reconcile federal financial reports with official accounting records.

Recommendation

The department should reconcile its Balance Sheet report with its accounting records.

**Item 5.
Weaknesses in
Control Over the
Revolving Fund**

Finding

The department has weaknesses in control over its revolving fund. For fiscal year 1991-92, we noted the following deficiencies:

- The department did not promptly request reimbursement for its revolving fund. As of June 30, 1992, the department had 62 unreimbursed travel, expense, and salary advances that had been outstanding for more than 60 days. According to the department's records, these unreimbursed advances totaled approximately \$397,000 and included approximately \$364,000 that was part of one advance made from the revolving fund in fiscal year 1989-90.
- The department improperly used its revolving fund to pay for certain items. For 5 of the 24 revolving fund payments we reviewed, the department made payment by revolving fund check rather than using the normal claims processing procedure through the State Controller's Office. Improper use of the revolving fund circumvents state controls over disbursements and could result in a misuse of state funds.

The Office of the Auditor General reported similar weaknesses in the department's control over the revolving fund in its audit for fiscal year 1989-90. Although weaknesses still exist, the department has significantly improved its management of its revolving fund since the last audit.

Criteria

The State Administrative Manual, Section 8047, requires that state agencies schedule claims for reimbursement of office revolving funds promptly. In addition, the State Administrative Manual, Sections 8100 et seq., specifies permissible uses of revolving funds.

Recommendation

The department should immediately file a claim with the State Board of Control seeking reimbursement to its revolving fund for the outstanding balance of approximately \$364,000 on an advance it made in fiscal year 1989-90. The department should also immediately schedule claims or seek reimbursement for other advances made from the revolving fund that have been outstanding for more than 60 days. Finally, the department should restrict its use of the office revolving fund to the permissible uses set forth in the State Administrative Manual.

Department of Motor Vehicles

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

Item 1. Inadequate Control Over Dishonored Checks

Finding

The department does not have sufficient control over the collection of dishonored checks. As of June 30, 1992, the department had approximately \$18.6 million in checks that banks had not honored. According to the department's fiscal officer, the department had approximately 87,000 dishonored checks on its records as of June 30, 1992. During our review of the controls over dishonored checks, we found that:

- Dishonored checks are not always properly recorded in the accounting system. Although the revenue collection unit is responsible for updating the dishonored check system with subsequent payment information, two of the three units responsible for the collection of dishonored checks are not notifying the revenue collection unit when they receive payment on these checks. As a result, individuals could receive a collection notice even though the department has received payment on the dishonored checks.
- We also found that dishonored checks are not always submitted to the State Controller's Office for relief of accountability when collection efforts have been exhausted. None of the three units responsible for the collection of dishonored checks notify the revenue collection unit when they determine that certain checks are uncollectible. Consequently, these uncollectible checks are not added to the relief of accountability listing that is submitted to the State Controller's Office for write-off. During our current audit, we reviewed 15 checks from the department's listing of dishonored checks. These checks were dated from July 1990 through June 1992. For five of these checks, totaling \$1,388, we determined that collection efforts had been exhausted. However, the department had not submitted any of the dishonored checks to the State Controller's Office for write-off or the Franchise Tax Board for offset.
- Further, only the revenue collection unit participates in the Franchise Tax Board's (FTB) Offset Program, which offsets the amount owed to a state agency by reducing an individual's tax refund for the amount owed. Because of this limited use, the department may not recover amounts due from dishonored checks. The FTB Offset

Program is not consistently used because the FTB requires agencies to provide social security numbers (SSN) for each dishonored check before they can offset the dishonored checks against tax refunds due. In response to the fiscal year 1990-91 management letter, the department stated that recent legislation passed requires the department to obtain SSNs from persons registering vehicles and applying for drivers licenses beginning January 1, 1992. The department does not expect to complete their collection of SSNs until 1995.

A lack of centralized control over the collection of dishonored checks has caused these weaknesses. The department has not given primary responsibility for the processing of dishonored checks to any one of the units involved in the collection of dishonored checks. In response to the management letter for fiscal year 1990-91, the department stated that the process for identification and collection of dishonored checks would be in place by September 30, 1992, and that written procedures regarding the proper processing of dishonored checks would be developed and distributed by October 1992. To date, none of the above responses have been implemented.

Criteria

The California Government Code, Section 13403(a)(3), states that the elements of a satisfactory system of internal accounting and administrative control should include, but are not limited to, a system of authorization and recordkeeping procedures that effectively control assets, liabilities, revenues and expenditures. Moreover, the State Administrative Manual, Section 8776.6, states that departments must develop collection procedures that will ensure prompt follow-up on receivables.

Recommendation

The department should centralize the process for identifying and collecting dishonored checks. In addition, the department should establish written procedures to ensure that the units responsible for the collection of dishonored checks notify the revenue collection unit when they receive payment on dishonored checks and the appropriate unit submits dishonored checks to the State Controller's Office for relief of accountability. Moreover, the department should continue its effort to participate in the FTB's Offset Program and ensure that staff involved in the collection of dishonored checks are aware of these procedures.

**Item 2.
Insufficient
Control Over
Access to
Electronic Data
Processing Data
Files**

Finding

The department's electronic data processing (EDP) programming personnel have unrestricted access to data files. For example, EDP personnel can access confidential and restricted data files that are unrelated to their job duties.

In response to the fiscal year 1990-91 management letter, the director stated that the department would implement an automated process to restrict access to data files by August 1993. However, the automated process has not been implemented. According to the department's information security officer, this automated process will allow the department manager who is responsible for certain data files to limit access by EDP personnel to the specific EDP personnel who must have access to the data files in order to serve the department manager's information needs. However, until this plan is implemented, the programmers still have unrestricted read capabilities. As of October 1993, a targeted implementation date has not been established. Failure to restrict access to data files could result in possible disclosure or misuse of confidential and restricted information.

Criteria

The California Government Code, Section 11771, requires agencies to maintain strict controls over EDP systems to prevent unauthorized access to data files. In addition, the State Administrative Manual, Section 4841.3, states that automated files and data bases must be given appropriate protection from loss, inappropriate disclosure, and unauthorized modification.

Recommendation

The department should ensure that only authorized personnel are allowed access to EDP systems and only during the performance of authorized duties.

Stephen P. Teale Data Center

We reviewed the financial operations and related internal controls of the Stephen P. Teale Data Center (data center).

Item 1. Inequitable Charges to State Agencies

Finding

The data center does not always charge state agencies for services provided based on its published rate schedule. Specifically, the published rate for telecommunication lines is \$905 per line, but we found that the data center had made an arrangement with the Governor's Office to charge a rate of \$250 per telecommunication line. According to data center staff, the Governor's Office uses the same type of telecommunication lines as other state agencies, yet the other state agencies are charged the published rate of \$905 per line.

The Governor's Office has four telecommunication lines. As a result of the decreased rate, we determined that the data center lost revenues totaling \$31,440 during fiscal year 1991-92.

Also, the data center does not always fully recover service costs. Specifically, the data center reduced its receivable from the Department of Housing and Community Development (HCD) by approximately \$4,000 for processing charges billed to the HCD during fiscal year 1991-92. The charges billed by the data center were valid, but the HCD initially requested a \$7,000 reduction because the charges would result in a cost overrun of their fiscal year 1991-92 interagency agreement budget. However, the data center waited until all processing charges had been accumulated related to fiscal year 1991-92, and then reduced its receivable by approximately \$4,000 to allow the HCD to stay within budget limits.

Further, the data center cannot always support reductions of amounts receivable from state agencies. For example, during fiscal year 1991-92, the data center reduced its receivable for the Department of Justice by approximately \$2,500. However, the data center was unable to provide any documentation or explanation for the credit.

The Office of the Auditor General reported similar findings during its audits for fiscal years 1988-89 through 1990-91. In its response in May 1992, the data center stated that effective July 1991, all clients would be paying for services under the published rates. However, we determined that this deficiency was not corrected during fiscal year 1991-92.

Criteria

The State Administrative Manual, Section 4982.2, requires the State's data centers to charge their users for units of service based on their published service rate schedules. Also, the State Administrative Manual, Section 8752, specifies that state policy requires agencies to recover full costs. All state agencies, regardless of funding sources, are required to follow this policy in all cases, except where statutes prohibit full cost recovery.

Recommendation

The data center should consistently charge its users for services provided based on its published service rate schedule.

**Item 2.
Errors in
Accounting for
Equipment****Finding**

The data center does not always accurately account for its equipment. During our review, we found that while several of the issues identified in the Office of the Auditor General's fiscal year 1990-91 audit have either been corrected or are in the process of being corrected, many of the issues have not been addressed. Specifically, we noted the following conditions:

- The data center does not ensure that its equipment identification numbers listed in the property records agree with the identification numbers assigned to the equipment. We could not trace any of the six items we tested to the property records; and could not trace 10 of the 33 items selected from the property records to equipment items. The Office of the Auditor General reported a similar weakness in its financial audits for fiscal years 1987-88 through 1990-91.
- The data center does not always ensure that its acquisition of equipment by installment contract is recorded correctly. For example, equipment acquisitions worth approximately \$173,000 were recorded in the equipment account at a cost of approximately \$73,000. The Office of the Auditor General reported a similar weakness during its financial audits for fiscal years 1988-89 through 1990-91.
- The data center improperly recorded in its equipment account approximately \$285,000 of equipment, which was installed at and billed to another state agency at the full cost of the equipment plus an administrative fee.

- The data center improperly included software costs totaling approximately \$20,000 in the equipment account. These software costs should have been recorded as expenses because the individual software purchases cost under \$5,000 each. The Office of the Auditor General reported a similar weakness during its financial audits for fiscal years 1988-89 through 1990-91.

In its response in May 1992, the data center stated that, "the accuracy of the reported information in the equipment balance records has now been corrected" and that issues relating to identification of equipment would be addressed and new procedures would be implemented by the end of fiscal year 1991-92.

The data center's failure to properly account for its equipment increases the risks of material misstatements in its fixed assets and depreciation expense accounts.

Criteria

The California Government Code, Section 13401, requires state agencies to maintain a system of internal accounting and administrative controls. The California Government Code, Section 13403, states that a satisfactory system of internal accounting and administrative controls includes a system of procedures adequate to provide effective accounting controls over assets, liabilities, revenues, and expenditures. Also, the State Administrative Manual, Section 5293 states that equipment purchased by a consolidated data center becomes the property of the agency requesting the procurement provided that the agency reimburses the consolidated data center for all costs associated with the procurement.

Recommendation

The data center should comply with the requirements contained in the California Government Code and the State Administrative Manual to improve its accounting over equipment.

Item 3. Failure To Record Software Costs as Intangible Assets

Finding

The data center records the cost of the software it purchases as an operating expense rather than as an intangible asset. Intangible assets are assets that lack physical substance but give valuable rights to the owner. State regulations require state agencies to record software costs that exceed \$5,000 as intangible assets and to systematically allocate the cost of the software to expenses over its useful life. We identified two agencies that employ a useful life of five years for software. Because the data center recorded its software purchases as expenses, it

overstated its operating expenses for fiscal year 1991-92 by approximately \$1.5 million. In addition, the cumulative effect of not recording intangible assets in the past was an understatement of assets (net of amortization) at June 30, 1992, by approximately \$4.8 million.

The Office of the Auditor General reported a similar weakness during its financial audits for fiscal years 1988-89 through 1990-91. In its response in May 1992, the data center stated that it would establish a system to identify all software in a separate inventory system by January 1993. However, as of October 1993, this system had not been developed and a targeted completion date had not been established.

Criteria

The State Administrative Manual, Section 8615.1, requires state agencies to record intangible assets that have an expected life of at least four years and cost at least \$5,000. Section 8615 describes the cost of purchasing software as an intangible asset. Finally, the State Administrative Manual, Section 8621, requires proprietary funds such as the Stephen P. Teale Revolving Fund to record amortization. The State Administrative Manual, Section 8617, describes amortization as allocation of the cost of software, less its estimated residual value, to expense over the periods benefited.

Recommendation

The data center should record software costs that exceed \$5,000 as intangible assets and should allocate those costs to expenses over the periods that it expects to use software to generate revenues.

Item 4. Possible Liability to the Federal Government

Finding

The data center has a possible liability to the federal government estimated to be as much as \$5.2 million for profits it has accumulated in its Teale Data Center Revolving Fund (revolving fund) between July 1, 1984, and June 30, 1992. The data center's revolving fund is an internal service fund that accounts for centralized electronic data processing services to state agencies. The data center has charged these agencies more than its costs for providing services. In turn, state agencies have passed these charges on to federal programs. The revolving fund accumulates profits when the data center's charges for services exceed its costs. Federal regulations prohibit the State from charging federal programs for more than its costs.

In addition, the data center may also owe the federal government for interest costs incurred by the data center in financing its equipment acquisitions. The unallowable interest charges totaled approximately \$1.3 million during fiscal year 1987-88 through 1991-92.

In 1984, the federal Department of Health and Human Services audited the State's rate-setting methods for internal service funds. As a result of the audit, the State was required to refund to the federal government approximately \$14.9 million of the profits accumulated in internal service funds. This amount represented the federal share of profits accumulated in five of the State's internal service funds from July 1, 1969, to June 30, 1984. The Department of Finance calculated that 14.8 percent of the revolving fund's accumulated profits of approximately \$8 million at June 30, 1984, resulted from charges to federal programs and, thus, the revolving fund owed the federal government approximately \$1.2 million.

Using procedures similar to those of the Department of Finance, and using the same ratio of 14.8 percent, we estimate that, under current federal regulations, the State may owe the federal government approximately \$5.2 million.¹ However, an October 1988 proposed amendment to the federal Office of Management and Budget, Circular A-87, would allow state agencies a reasonable working capital reserve of 60 days' worth of cash expenditures. This amendment, if approved, may further reduce the liability to the federal government.

The data center also charged other state agencies for interest costs for equipment acquisitions. Federal regulations prohibit the State from charging interest costs to federal programs. We used the same ratio of 14.8 percent to estimate charges to federal programs for unallowable interest costs for equipment acquisitions during fiscal years 1987-88 through 1991-92. We concluded that the State may have an additional liability to the federal government, under current regulations, of approximately \$1.3 million for the federal share of interest costs for equipment acquisitions incurred by the data center during these fiscal years. For fiscal years 1984-85 through 1986-87, the data center did not separately disclose in its records interest costs for equipment acquisitions. Therefore, we did not calculate the State's potential liability to the federal government for the federal share of interest costs for those years.

¹Since the federal government and the State's executive branch are ultimately responsible for negotiating any final settlement, we did not attempt to determine whether the percentage of federal participation the federal government accepted in its 1984 audit is still acceptable in 1992.

The Office of the Auditor General reported a similar finding during its financial audits for the three previous fiscal years. The Office of the Auditor General recommended that the Department of Finance ensure state agencies comply with federal regulations. In his response of March 18, 1991, the director of the Department of Finance stated that, in some cases, state laws and regulations differ from those of the federal government and that the State is working with the federal government to minimize the differences. He stated that guidelines will be developed as soon as such differences are resolved.

Currently, the federal Department of Health and Human Services is conducting an audit for the period of July 1, 1984, through June 30, 1991, to determine the amount of profits (surplus) accumulated by the data center and the federal government's share of the surplus. As of November 1993, the final audit report has not been issued.

Criteria

The federal Office of Management and Budget, Circular A-87, "Cost Principles for State and Local Governments," does not allow the State to charge federal programs for amounts that exceed costs. In addition, the California Government Code, Section 13070, provides the Department of Finance with general powers of supervision over all matters concerning the financial and business policies of the State.

Recommendation

The data center should comply with the federal Office of Management and Budget, Circular A-87, when establishing billing rates for charges to state agencies receiving federal support. Further, the Department of Finance should ensure that the data center complies with federal regulations. For example, compliance could be ensured by developing guidelines for the data center and state agencies receiving services from the data center. In addition, the Department of Finance should monitor the proposed amendment to Circular A-87 to determine the effects the amendment may have on state charges to federal programs.

Department of Transportation

The Bureau of State Audits and the Office of the Auditor General reviewed the financial operations and related internal controls of the Department of Transportation (department) and the department's administration of the U.S. Department of Transportation grant, Federal Catalog Number 20.205.

Item 1. Some Federal Reimbursements Not Promptly Requested at Highest Rates Allowed

Finding

We noted 19 instances when the department did not promptly request reimbursements totaling approximately \$9.9 million for federal aid projects at the highest rate allowed by the federal government. Specifically, we found the following:

- The department did not promptly adjust its reimbursement rate to reflect the highest rate allowed by the federal government for 17 federal aid projects. During our review, we identified one of these projects for which the department had not adjusted its rates. After we informed the department of this condition, the department identified the remaining 16 projects. The department received authorization from the federal government to increase the reimbursement rate for these projects from 80 percent to 88.53 percent in March 1992. However, because of employee oversight, the department did not revise its rates for the projects to reflect this increase, and it did not bill the federal government for the increased amounts until July and August 1992, after we informed them of this condition. As a result, the department did not promptly request reimbursement from the federal government of approximately \$6 million.
- The department did not promptly bill the federal government for \$3.9 million it paid from January to April 1992, for a federal aid project. Because of an erroneous coding in its automated accounting system, the department did not correct this error and bill the federal government until June 1992, after we informed the department of this condition.
- For a project we reviewed at the department's headquarters, the department increased the reimbursement rate to the highest rate allowed by the federal government, but because of employee oversight, it did not make a retroactive adjustment. As a result, the department did not promptly request reimbursement from the federal government for approximately \$5,700.

When the department does not promptly bill the federal government, it loses interest earnings. We estimate that the department lost approximately \$146,000 in interest because it did not promptly bill the federal government for the 3 of 83 projects that we reviewed and the 16 projects that the department identified. After we informed the department, the department corrected the above errors. The Office of the Auditor General reported similar weaknesses in its audit reports for fiscal years 1989-90 and 1990-91. In its May 1992 plan to address weaknesses identified in the fiscal year 1990-91 report, the department stated that it intends to establish a system by which it monitors the reimbursement rates it uses to bill the federal government to ensure billings are at the correct rate.

Criteria

A Federal Highway Administration (FHWA) notice, dated January 24, 1991, requires that the reimbursement rates initially agreed upon by the FHWA and the State be retained throughout the life of the project, except that the State may choose to revise rates for active projects by amending agreements between the FHWA and the State. In addition, the State Administrative Manual, Section 0911.4, requires state agencies to secure prompt reimbursement from federal grant funds for goods and services provided.

Recommendation

The department should ensure that it promptly requests reimbursement for federal aid projects at the highest rates allowed by the federal government.

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

Finding

The department did not promptly submit some final claims to the FHWA to close completed federal aid projects.

In August 1987, the department and the FHWA agreed the department should submit the final claim for a project within 24 months of project completion. For 3 of the 18 federal aid projects completed after August 1987 that we reviewed, the department did not submit the final claim within 24 months of project completion. These 3 final claims were submitted 32, 33, and 38 months after project completion and totaled approximately \$1,046,000. In addition, we found that the department submitted final claims between 58 and 117 months after project completion for four of six federal aid projects we reviewed that were completed before or during August 1987. These four projects represent a group of long-outstanding projects for which the department continues to process final claims. Before the department and the

FHWA's agreement in 1987, the department had a large backlog of projects awaiting final claims processing. Since that time, the department has reduced its backlog of projects to a level considered acceptable by the FHWA and continues to process final claims for long-outstanding projects. Although the department generally receives reimbursement for eligible project costs before it submits the final claim, the FHWA will not consider a project closed until it reviews and approves a final claim.

The Office of the Auditor General reported a similar weakness in its audit report for fiscal year 1990-91. In its May 1992 plan to address weaknesses identified in the report, the department stated that there are certain factors that make it impossible to submit final claims for some projects within 24 months of project completion. Therefore, the department stated in its plan that it is attempting to work with the FHWA to establish a new agreement to allow the department to resolve exceptions that occur that may delay processing a final claim.

Criteria

The Code of Federal Regulations, Title 23, Section 140.107, requires federal aid recipients to submit final claims promptly to the FHWA when the recipients complete projects. In addition, the department and the FHWA agreed the department should submit the final claim for a project within 24 months of project completion.

Recommendation

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

Item 3. Receipt of Less Than Fair Market Value for Rented Airspace

Finding

The department is not receiving the fair market value for the rent of property located beneath a freeway. Such property is referred to as airspace. The department entered into three separate lease agreements in the 1970's with the Department of General Services (DGS) for the DGS to rent airspace beneath a freeway for state employee parking and vehicle storage. One of these leases expired in 1988 and the other two leases expired in 1989. Negotiations for renewing the leases have been on-going since 1987. In August 1992, officials of the department and the DGS met to discuss the negotiations. However, the department and the DGS have not yet agreed on the amount of rent the DGS will pay for the airspace. The department had determined the total fair market value for rental of the airspace to be \$27,305 per month. However, the DGS continues to use the property and continues to pay a total of only \$8,359 per month, the total of the rates in effect at the end of the leases.

Because the department is receiving less than the fair market value for the airspace, it cannot use the amount of the full fair market value for federal aid highway projects, as required by federal law. The Office of the Auditor General reported a similar condition in its audit report for fiscal year 1990-91.

Criteria

The United States Code, Title 23, Section 156, requires states to charge, as a minimum, fair market value, for the sale, use, lease, or lease renewals of airspace acquired as a result of a project funded in whole or in part with federal assistance. Further, the section requires states to use the federal share of revenues received from such sales or leases for federal aid highway projects.

Recommendation

The department should take steps to ensure that it receives the fair market value rate for the airspace it leases to the DGS.

**Item 4.
Noncompliance
With Federal
and State
Requirements**

Finding

The department did not comply with the administrative requirements of the federal government and the State. The Los Angeles district office was required to complete expenditure reports for 50 federal aid projects during fiscal year 1991-92. However, for 6 of the 50 projects, the district office had not prepared preliminary or final expenditure reports within 120 days of completing the project, as required by the department Accounting Manual. The department cannot submit final claims to the FHWA for project costs until the district offices submit the preliminary or final expenditure reports. Although individually this instance of noncompliance may not appear to be significant, it does represent noncompliance with the State's system of internal controls or noncompliance with federal regulations, designed to protect the public's resources from abuse.

Criteria

The Code of Federal Regulations, Title 23, Section 140.107, requires the department to promptly submit its request for reimbursement for a project after the project is completed. Additionally, the department Accounting Manual, Chapter 8, states that the district offices should submit the final expenditure report to the department's headquarters within 120 days of a project's completion.

Recommendation

The department should improve its compliance with federal and state requirements.

Education

California Community Colleges, Chancellor's Office

The Bureau of State Audits and the Office of the Auditor General reviewed the financial operations and related internal controls of the California Community Colleges, Chancellor's Office (office) and the office's administration of the U.S. Department of Education grant, Federal Catalog Number 84.048.

Item 1. Weaknesses in Cash Management Corrected by Year End

Finding

The office did not always minimize the time between receiving vocational education funds and disbursing the funds to the subrecipients. Specifically, the office held approximately \$10.2 million in cash advances for 16 working days before disbursing the fund to the subrecipients. The Office of the Auditor General reported a similar weakness in its audits of the last five fiscal years. In its response to the fiscal year 1990-91 audit report dated July 8, 1992, the office stated it had implemented procedures to improve its cash management system. Except for the instance noted above, we noted that the office had improved its cash management during the last half of fiscal year 1991-92.

Criteria

The Code of Federal Regulations, Title 31, Section 205.4(a), requires that cash advances be limited to the minimum amounts needed and timed to be in accord with the actual and immediate cash requirements of the funded programs. This section also stipulates that the timing and amount of cash be as close as administratively feasible to the actual disbursement by the recipient organization.

Recommendation

The office should continue to perform the procedures it implemented to improve its cash management system.

California Postsecondary Education Commission

The Office of the Auditor General reviewed the California Postsecondary Education Commission's (commission) administration of the U.S. Department of Education grant, Federal Catalog Number 84.164.

Item 1.
Lack of a Formal Process for Monitoring Grantees Participating in the Eisenhower Mathematics and Science Education–State Grants Program

Finding

The commission does not have a formal process for conducting reviews of grantees under the Eisenhower Mathematics and Science Education–State Grants program. According to the program manager, commission staff do perform limited monitoring visits of grantees. These visits consist of observing activities and interviewing grant staff and participants. However, the commission has not formalized how monitoring will be recorded, and has not documented how compliance and program areas will be reviewed. Also, the commission has not documented how corrective action will be ensured when problems are found. Instead, commission staff resolve problems on a case-by-case basis and implement any necessary corrective action. Without a formal monitoring process, the commission lacks assurance that grantees are complying with federal requirements and that they are achieving project goals. Also, the commission requires that grantees submit program and fiscal reports each quarter. However, for one of the four grantees we reviewed who were required to submit these reports, the commission had not yet received the reports for the quarters ending December 31, 1991; March 31, 1992; and June 30, 1992.

Criteria

The Code of Federal Regulations, Title 34, Section 80.40(a), requires the State to monitor activities to ensure that grantees comply with applicable federal requirements and achieve performance goals.

Recommendation

The commission should develop a formal monitoring process that defines how monitoring will be documented, how compliance and program areas will be reviewed, and how corrective action will be ensured when problems are found. Also, the commission should promptly follow up on grantees who are late in submitting their required reports.

California Student Aid Commission

The Office of the Auditor General reviewed the California Student Aid Commission's (commission) administration of the U.S. Department of Education grant, Federal Catalog Number 84.032.

Item 1. Failure To Ensure That Defaulted Student Loans Met Federal Requirements for Reimbursement

Finding

The commission did not ensure that all of the defaulted student loans it submitted for reimbursement to the federal government met federal requirements for reimbursement. Before the commission purchases defaulted student loans from lenders, it must ensure the lenders meet the federal requirements for submitting default claims to the commission. Additionally, the commission must meet federal deadlines for paying lenders for defaulted loans and for requesting payment from the federal government. Of the 40 loans purchased by the commission that we reviewed, we found that 6 loans did not meet one of these federal requirements for reimbursement. We found the following specific problems:

- Of the six loans, the commission did not pay five lender claims within the required 90 days of the date the lender submitted the default claim. In four of the five instances when claims were paid late, the commission paid the lender one to three days after the required deadline.

In the fifth instance involving a late claim payment, the commission paid the lender 29 days past the 90-day deadline. In each of its audits of the last four years, the Office of the Auditor General also reported instances when the commission did not pay the lender within the required 90 days.

- For one other loan, the commission's service contractor accepted a default claim the lender had submitted after the required 90-day deadline. The loan was accepted one day after the deadline. We considered the date that the default claim was received by the service contractor as the submission date because the postmark was not available. The Office of the Auditor General noted a similar weakness in its audit for fiscal year 1990-91. Failure to ensure that loans meet federal requirements could jeopardize federal reimbursements.

Criteria

The Code of Federal Regulations, Title 34, Section 682.406(a), lists the conditions that must be met to qualify a defaulted student loan for

federal reimbursement. These conditions include requirements that the commission pay the lender within 90 days of the date the lender submits the claim and that the lender submit the claim within 90 days of the default.

Recommendation

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

**Item 2.
Insufficient
Procedures and
Documentation
To Ensure That
Bankruptcy,
Death, and
Disability Claims
Met Federal
Reimbursement
Requirements**

Finding

The commission did not ensure or could not provide evidence that all bankruptcy, death, and disability claims that it purchased from lenders met federal requirements for reimbursement.

A lender submits a bankruptcy claim to the commission for reimbursement if a borrower files a petition for relief of payment of a student loan with the bankruptcy court. If the student loan is discharged by the bankruptcy court, the commission submits a claim to the federal government for reimbursement. In turn, a lender submits a disability or death claim to the commission if a borrower is determined to be unable to continue loan payments because of a medical disability or death. In these instances, too, the commission submits a claim to the federal government for reimbursement. For a bankruptcy, disability, or death claim to be eligible for federal reimbursement, the commission must follow certain procedures before it pays the lender's claim.

In our review of 20 lenders' bankruptcy claims, we found that, in paying one of these claims, the commission did not follow at least one requirement for federal reimbursement.

Moreover, in our review of 10 lenders' disability claims, we found that in paying one of these claims, the commission did not follow a requirement for federal reimbursement. Finally, in our review of 10 death claims, we could not determine whether one death claim a lender submitted should have been paid because the documentation was not provided to us. Therefore, the commission's payments to lenders for these loans did not meet the federal requirements for reimbursement. We found the following specific problems:

- The commission improperly paid approximately \$5,000 for a lender's bankruptcy claim submitted 296 days after the 30-day deadline. We considered the date the claims were received as the received date the commission stamped on the claim. Our assumption is consistent with the provisions of the commission's instruction manual. In

addition, the commission did not file a proof of claim with the bankruptcy court on behalf of the lender until 67 days after the required 30-day deadline. Once a lender determines that a borrower has filed a bankruptcy petition, the lender, or the commission on the lender's behalf, must file a proof of claim against the borrower with the bankruptcy court within 30 days after the lender receives notice of the first meeting with creditors. The Office of the Auditor General observed a similar weakness in its audit for fiscal year 1990-91.

- For another loan, the commission paid approximately \$5,500 to a lender who submitted a disability claim 16 days after the required 60-day deadline. Further, the lender's claim package did not include the borrower's approved loan application or, in the application's place, an affidavit or indemnification. On this basis alone, the commission should have rejected the claim.
- Finally, in our review of 10 lenders' death claims, we could not determine whether one claim should have been purchased because the commission could not provide us the lender's documents that it should have used to pay the claim. The loan principal was \$4,000. Failure to ensure that the loans the commission purchases from lenders meet federal requirements could jeopardize federal reimbursement.

Criteria

The Code of Federal Regulations, Title 34, Section 682.402(e)(2)(ii), states that, as a condition for obtaining payment, a lender must file a bankruptcy claim either within 30 days after the lender determines the borrower has filed a hardship petition or within 30 days after receiving notice of the first meeting of creditors.

The Code of Federal Regulations, Title 34, Section 682.402(d)(3), states that, once a lender determines a borrower has filed a bankruptcy petition, the lender must file a proof of claim with the bankruptcy court within 30 days after the lender receives notice of the first meeting of creditors. Further, Section 682.402(e) requires that the lender provide the guarantee agency specific documents, including the loan application.

The Code of Federal Regulations, Title 34, Section 682.402(e)(2)(i), states that, as a condition for obtaining payment, a lender must file a disability claim within 60 days after the lender determines a borrower is totally and permanently disabled.

Recommendation

The commission should implement procedures and maintain sufficient documentation to ensure that bankruptcy, death, and disability claims meet federal reimbursement requirements.

Item 3. Guaranteed Student Loans Appeared To Exceed Allowable Loan Limits

Finding

During fiscal year 1991-92, the commission guaranteed student loans that appeared to exceed allowable federal loan limits. We performed a computer search of the commission's borrower files for fiscal year 1991-92 to help identify individual loans guaranteed in excess of allowable federal loan limits. Federal regulations specify the maximum amount loans can be guaranteed based on the student's grade level, the length of the course, and the total outstanding principal of all the student's loans.

For the 61 borrower files we selected for review during our computer search, the commission guaranteed loans that, according to its records, appeared to exceed allowable limits for four borrowers. The four loan guarantees appeared to exceed the limits by a total of approximately \$7,900. We noted the following specific problems:

- For three of the four loans, the commission manually combined two loan accounts into one account. For each of these three loans, information had previously been reported incorrectly under two different account numbers, including the loan amounts. When the commission manually combines accounts, its computer system does not perform a subsequent review of the loan limits. As a result, the system does not automatically cancel the loan amounts entered under the incorrect account numbers.
- For the fourth loan that appeared to exceed guarantee limits, the commission had incorrectly entered information into the system. Initially, the commission had approved an override to the guaranteed amount of the loan limit. However, according to the commission, there was a duplicate application keyed into the system resulting in an apparent excess guarantee of \$2,625.

All four of these loans involved duplicate amounts entered into the system. The commission corrected the system once we brought the exceptions to its attention. The Office of the Auditor General reported a similar weakness in fiscal years 1989-90 and 1990-91.

Criteria

The United States Code, Title 20, Sections 1078, 1078-1, and 1078-2, provides for specific loan limits for guaranteeing Stafford, Supplemental Loans for Students (SLS), and Parent Loan Program loans. The required limits are based on the student's grade level, the length of the course in which the student is enrolled, and the total outstanding principal for each loan program.

Recommendation

The commission should ensure that it guarantees only loans that are within the applicable federal limits.

**Item 4.
Insufficient
Documentation
That Defaulted
Loans Are
Properly
Reported to
National Credit
Bureaus and
Insufficient
Reporting to
National Credit
Bureaus****Finding**

There was insufficient documentation that the commission had reported defaulted loans to all three of the national credit bureaus with which the commission contracts to ensure sufficient geographical coverage. In fact, the commission's records indicate that information has been sent to credit bureaus but does not indicate the specific credit bureaus the commission reported to. It is the commission's policy to report defaulted loans to all the credit bureaus it contracts with. However, because the commission did not document this information sufficiently, we reviewed the credit bureaus' records. We found the following specific problems:

- Although we noted at least one credit bureau had a record of the 12 defaulted loans we reviewed, for 5 of the loans we reviewed, either one or two of the credit bureaus did not have any record of the defaulted loans. Without such documentation, we cannot conclude the commission properly reported the loans.
- We also found the commission did not report the date of loan default as required by federal regulations for any of the 12 loans we reviewed.

The Office of the Auditor General reported a similar weakness in fiscal years 1988-89, 1989-90, and 1990-91. If defaulted loans are not properly reported or if information reported is not properly documented, a lender or other guarantee agency could use incorrect information when making or insuring loans.

Criteria

The Code of Federal Regulations, Title 34, Section 682.410(b)(3), requires the commission to report to all national credit bureaus the

default date, loan collection information, and the date the loan is fully repaid or discharged.

Recommendation

The commission should maintain records sufficient to document that it has properly reported defaulted loans to all appropriate credit bureaus.

**Item 5.
Federal
Quarterly Report
Not Reconciled
With Accounting
Records**

Finding

The commission's federal quarterly report for April through June 1992 contains information that does not reconcile with the commission's accounting records. Specifically, the commission reported in the quarterly report \$26,956 more in lender claims paid and \$197,237 less in collections received than it recorded in its accounting records. The commission did not provide us with a reconciliation between the quarterly report and the accounting records, and we could not determine whether the quarterly report, the accounting records, or both were inaccurate.

The Office of the Auditor General reported a similar weakness in its audits for each of the last six years. In its March 4, 1991 response to the audit for fiscal year 1989-90, the commission reported that when full implementation of its Financial Aid Processing System occurred, the federal reports would reconcile with its accounting records. However, as of August 1992, the commission had not yet fully implemented its new system.

Criteria

Circular A-102, Subpart C, of the federal Office of Management and Budget, requires the State to account for grant funds in accordance with state laws and procedures. The State Administrative Manual, Section 20014, requires agencies receiving federal funds to reconcile federal financial reports with the official accounting records.

Recommendation

The commission should reconcile its quarterly reports with its accounting records.

**Item 6.
Incorrect
Amounts Paid
to Lenders on
Defaulted Loans**

Finding

The commission paid incorrect amounts for defaulted loans purchased from lenders. For 3 of the 40 loans we reviewed, the commission paid lenders incorrect amounts of interest on the defaulted loans it purchased. The incorrect amounts were insignificant for the first 2 loans although, in the third instance, the commission overpaid the lender

\$706.22. In this particular instance, the commission appears to have based its interest calculation and payment on an incorrect principal amount.

Because the commission requests reimbursement from the federal government for both the amount of the defaulted loan and the related interest paid to the lender, these errors caused the commission to request incorrect reimbursements. In its audits of the two previous fiscal years, the Office of the Auditor General reported similar instances of the commission paying lenders incorrect amounts of interest on defaulted loans it purchased.

Criteria

The Code of Federal Regulations, Title 34, Sections 682.404 and 682.405, provides that the federal government will reimburse a guarantee agency up to 100 percent for its losses. Section 682.404(a)(2) defines losses as the amount of unpaid principal and accrued interest the commission pays for a default claim filed by a lender on a reinsured loan. These losses do not include payments made by, or on behalf of, the borrower after the lender's claim is paid and before the federal government reimburses the commission.

Recommendation

The commission should ensure it pays lenders the correct amount of interest so that it can request the correct reimbursement from the federal government.

Item 7. Noncompliance With Additional Federal Requirements

Findings and Criteria

We noted the following instances when the commission did not always comply with administrative requirements of the federal government:

- The commission did not report at least \$31,143 of the total collections of defaulted student loans within the required 60 days. However, the commission eventually did report these collections. The Code of Federal Regulations, Title 34, Section 682.404(e)(4), requires the commission to submit the federal share of borrower payments within 60 days of receipt. The Office of the Auditor General reported a similar weakness for fiscal year 1990-91.
- We reviewed 24 loan collection calculations for fiscal year 1991-92. For one of these, the commission did not correctly calculate the dollar amount of the equitable share for the secretary of the United States Department of Education. The commission calculated the federal share to be \$39.60 less than the amount the federal

government was entitled to. The Higher Education Act, Section 428(c)(6), as amended, requires the commission to pay the secretary an equitable share of any payment made by a defaulted borrower after reinsurance has been paid.

- The commission improperly paid approximately \$28 in accrued interest to a lender who submitted a disability claim 16 days after the required 60-day deadline, yet the commission did not limit the interest it paid to the lender because of the late filing. The United States Department of Education, Bulletin 88-G-138, requires that, if a lender files a late disability claim, the claim will be paid but the interest that accrues on the loan after the 60-day deadline is ineligible for reinsurance.

Recommendation

The commission should improve its compliance with the federal requirements.

California Department of Education

The Bureau of State Audits and the Office of the Auditor General reviewed the financial operations and related internal controls of the California Department of Education (department) and the department's administration of the U.S. Department of Agriculture grants, Federal Catalog Numbers 10.550, 10.553, 10.555, and 10.558; the U.S. Department of Labor grant, Federal Catalog Number 17.250; the U.S. Department of Education grants, Federal Catalog Numbers 84.010, 84.011, 84.027, 84.048, 84.151, 84.164, 84.173, and 84.186; and the U.S. Department of Health and Human Services grant, Federal Catalog Number 93.025.

**Item 1.
Weaknesses in
Contracting
Procedures
Within the Office
of Healthy Kids,
Healthy
California**

Finding

The department has significant weaknesses in the contracting procedures used within its Office of Healthy Kids, Healthy California (office). The office receives funding from the Drug-Free Schools and Communities--State Grants program, a grant of federal funds whose use is restricted to illegal drug and alcohol abuse education and prevention. The office also receives funding from taxes collected under Proposition 99, a proposition that established a surtax on cigarette and tobacco products. The department is restricted to use Proposition 99 funds for education on tobacco use prevention. However, the office has entered into contracts that do not ensure these funds are used for the purposes intended by law. In our review of ten contracts, we found the following weaknesses:

- In four contracts with local educational agencies, the office combined federal drug funds of approximately \$522,000 and state tobacco funds of approximately \$797,000 to sponsor comprehensive health education activities. The department defines comprehensive health education as including the following elements: health education, physical education, health services, counseling services, nutrition services, a safe and healthy environment, health promotion, and parent and community involvement. Since at least a portion of each contract was not for illegal drug, alcohol, and tobacco abuse education and prevention, the office should have used other state funds to support a portion of each contract. We could not determine the amount of federal drug funds and state tobacco funds used for unallowable purposes in these contracts because the office did not identify the amount of effort allotted to each of the health education elements.

- In addition, one of these four contracts was in part for state-sponsored health promotion conferences. This contract did not contain a complete description of the amounts to be paid for the services provided. Specifically the contract excluded the fact that the conference attendees were to pay registration fees. The contract also excluded any information on how the local educational agency was to use these registration fees. These registration fees could have totaled up to \$54,000; however, the department has not received information from the local educational agency on the amount of registration fees collected and how they were used.
- The office used federal drug funds and state tobacco funds in a contract that circumvented state civil service hiring practices. The office initiated an interagency agreement for \$35,000 with the California State University to specifically hire two former student assistants so that they could continue to work in the office. In turn, the California State University contracted with the San Jose State University Foundation to fulfill the interagency agreement. Because the interagency agreement was not greater than \$35,000, the contract did not require the Department of General Services' approval. We, along with the department, requested the State Personnel Board to review this contract to determine whether it met the legal requirements under state civil service laws. The State Personnel Board concluded that the contract circumvented the hiring of civil service employees and therefore, was not an approvable contract. However, the services provided under the contract were for allowable purposes under federal law, based on our review.
- The office also does not have a systematic method of determining the funding sources for the payment of invoices. We reviewed six contracts that were split-funded between state and federal funds. For three contracts, the office had received one invoice for each contract and had charged each invoice to state tobacco funds. In two additional contracts, the office charged invoices to both federal drug funds and state tobacco funds. Finally, in one contract, the office charged three invoices to state tobacco funds and one invoice to federal drug funds. However, the basis used to determine the funding source to pay these invoices was not apparent from the invoice or the contract file.
- In two other contracts with private organizations, we identified costs totaling \$10,500, paid with federal drug funds, that are not allowable under federal laws and regulations. Approximately \$8,600 of these unallowable costs were related to the department's purchase

of the California Medical Association's Health Tips publication. However, most of this publication was not related to illegal drug, alcohol, and tobacco abused education and prevention. The remaining costs, totaling approximately \$1,900, were for a contractor's professional development costs, which were not included in the contract and are not allowable under federal regulations.

- The office allowed two contractors to begin work before the related contracts were approved.

Criteria

The United States Code, Title 20, Section 3194(b), allows the department to use the program development funds available under the Drug-Free Schools and Communities--State Grants program for training and technical assistance programs concerning drug abuse education and prevention, the development and distribution of material teaching that illicit drug use is harmful, demonstration projects in drug abuse education and prevention, special financial assistance to enhance resources available for drug abuse education and prevention in certain areas, and for administrative costs of the State. Also, the draft nonregulatory guidance for the Drug-Free Schools and Communities--State Grants program states that agencies may choose to include drug and alcohol abuse education and prevention as part of a comprehensive health education program; however, the expenditure of Drug-Free Schools and Communities--State Grants program funds must be limited to that part of the program dealing with drug and alcohol abuse education and prevention. In addition, the California Revenue and Taxation Code, Section 30122(b)(1), states that funds within the Health Education Account within the Cigarette and Tobacco Products Surtax Fund shall only be available for appropriation to programs for the prevention and reduction of tobacco use, primarily among children, through school and community health education programs. Moreover, the State Administrative Manual, Section 1205, states that each contract shall contain a clear and complete statement of the services provided and specify the amount to be paid, including the basis for payment. Additionally, the Office of Management and Budget, Circular A-87, states that, for costs to be allowable under a grant program, costs must be authorized or not prohibited under the state's laws and regulations, and be necessary and reasonable for the proper and efficient administration of the federal grant. Further, the Code of Federal Regulations, Title 34, Section 80.20(b)(2), requires that the state and its

subgrantees maintain records which identify the source and application of funds provided for federally supported activities. Finally, the State Administrative Manual, Section 1203, states that contracts are effective from the date of the Department of General Services' approval.

Recommendation

The department should ensure that its Office of Healthy Kids, Healthy California administers contracts in accordance with federal state laws and regulations. Further, the department should ensure that its Office of Healthy Kids, Healthy California only uses Drug-Free Schools and Communities—State Grants funds and state tobacco funds for purposes that are specifically allowable under federal and state law.

Item 2. Possible Incorrect Interpretation of the Federal Regulations for the Drug-Free Schools and Communities— State Grants Program

Finding

The department may have incorrectly interpreted federal regulations for the Drug-Free Schools and Communities—State Grants program when it calculated the maximum amount it could use for program development and administrative costs for fiscal year 1991-92. Based on its interpretation of federal regulations, the department calculated the maximum amount it could use for program development and administrative costs as 10 percent of the total grant award or approximately \$4.2 million. However, in a memorandum from the United States Department of Education (USDOE), the federal government has calculated the maximum allowable program development and administrative costs as 10 percent of only a portion of the grant award called the "base allocation." Since the base allocation was approximately \$22 million, the USDOE calculates the allowable program development and administrative costs as approximately \$2.2 million. As a result, if the department has incorrectly calculated the amount it could use for program development and administrative costs, it withheld approximately \$2 million that it should have used for entitlements to local educational agencies.

The Office of the Auditor General reported a similar weakness during its audit for fiscal year 1990-91. On July 10, 1992, the department responded to the management letter that it is seeking written clarification from the USDOE on the correct interpretation of these federal regulations. In addition, the department believes its interpretation of the administrative and program development costs is correct. According to the program administrator, the department distributed 90 percent of the base allocation to local educational agencies (LEAs), the amount required by federal law. However, the program administrator states that the department distributed a portion of these funds to ten LEAs that established ten statewide "Healthy Kids

Regional Centers." The purpose of these regional centers is to provide technical assistance to LEAs within their region. Therefore, the program administrator feels the needs of LEAs are served. However based on our interpretation of federal law, the department's method is incorrect. Federal law requires that the department distribute these funds directly to LEAs based on a prescribed formula. The department directly contracted with the ten LEAs to sponsor the regional centers. We found no evidence in the contracts that they were based on a formula. Instead, the contract award and future amendments appear to be based on the funds available at the time the original contracts and amendments were entered into.

Criteria

The United States Code, Title 20, Section 3194(b), states that not more than 10 percent of the amounts available under Section 3191(b) may be used for program development and administrative costs. Section 3191(b) states that the amounts allocated to the department shall be used to carry out its responsibilities in accordance with Section 3194 and for grants to local and intermediate educational agencies. The department interprets Section 3191(b) as referring to the entire grant award whereas the memorandum from the USDOE, dated July 15, 1991, interprets this section as referring only to a portion of the grant award called the "base allocation."

Recommendation

The department should continue its efforts to obtain clarification from the USDOE of the correct interpretation of the federal codes.

Item 3. Inadequate Procedures for Limiting Cash Advances to Local Education Agencies Participating in the Drug-Free Schools and Communities– State Grants Program

Finding

The department does not have adequate procedures to ensure that cash advanced to LEAs participating in the Drug-Free Schools and Communities–State Grants program is limited to the LEA's immediate cash requirements. Specifically, rather than making payments to the LEAs periodically as the department does for other federal programs, the department paid the LEAs the entire amount of their fiscal year 1991-92 entitlements in one payment at the beginning of the year.

The Office of the Auditor General reported a similar weakness during its audit for fiscal year 1990-91. Beginning in fiscal year 1992-93, the department intends to issue entitlements to the LEAs in several payments throughout the fiscal year. The department is also now requiring the LEAs to provide additional information on the amount of cash they have on hand.

Criteria

The Code of Federal Regulations, Title 34, Section 80.20(b)(7), requires that the timing and amount of cash advances be as close as possible to the actual disbursements by the recipient organization.

Recommendation

The department should continue with its plan to implement procedures to limit cash advances to the immediate needs of the LEAs.

**Item 4. Finding
Incorrect
Formula for
Determining
Amount of
Federal Funds
Carried Over by
Local Educational
Agencies
Participating in
the Drug-Free
Schools and
Communities—
State Grants
Program**

Finding

The department's formula for calculating the maximum amount of unused federal funds that the LEAs can carry over from the current fiscal year to the following fiscal year is incorrect. The formula calculates the maximum carry-over as 25 percent of the sum of the current year's grant amount and any carry-over from the previous year. However, federal law restricts the carry-over to 25 percent of the current fiscal year's allocation only. LEAs must return any federal funds in excess of the 25 percent limitation to the department so that it can distribute these unused funds to other LEAs. We identified one LEA that had excess carry-over funds of approximately \$431,000 during fiscal year 1991-92.

Criteria

The United States Code, Title 20, Section 3194(a)(4)(A)(i) and (ii) requires that the LEAs return to the department any unused funds from the current fiscal year's grant amount and that the department reallocate these funds to other LEAs that plan to use the funds on a timely basis. However, Section 3194(a)(4)(B)(i) states that in any fiscal year, the LEAs may retain for obligation in the succeeding fiscal year no more than 25 percent of the allocation it receives during the current fiscal year.

Recommendation

The department should change its procedures to ensure that the LEAs retain no more than 25 percent of the current fiscal year's grant amount for use in the succeeding fiscal year.

Item 5. Insufficient Monitoring of Local Educational Agencies Participating in the Drug-Free Schools and Communities–State Grant Programs

Finding

In August 1989, the USDOE reported that the department did not formally monitor the LEAs participating in the Drug-Free Schools and Communities–State Grants program. The department responded that it plans to design a dual monitoring system that would include a district-level progress reporting system and a school-site visit monitoring system. As a result, the department now requires the LEAs to include in their application for funding an annual progress report of their previous year's activities. However, the department could not provide us documentation showing that it performed on-site monitoring visits during fiscal year 1991-92.

The Office of the Auditor General reported a similar weakness during its audit for fiscal year 1990-91. Beginning in fiscal year 1992-93, the department plans to include a review of approximately 50 LEAs for compliance with the Drug-Free Schools and Communities Act in the department's Consolidated Compliance Review monitoring process.

Criteria

The Code of Federal Regulations, Title 34, Section 80.40(a), requires grantees to monitor activities to ensure that the LEAs comply with applicable federal requirements and achieve performance goals.

Recommendation

The department should continue with its efforts to implement on-site monitoring procedures to ensure that the LEAs comply with applicable federal requirements and achieve performance goals.

Item 6. Insufficient Monitoring of Local Educational Agencies Participating in the Eisenhower Mathematics and Science Education–State Grants Program

Finding

In June 1992, the USDOE reported that the department did not systematically monitor the LEAs participating in the Eisenhower Mathematics and Science Education–State Grants program. The USDOE recommended that the department develop a plan to systematically monitor the LEAs for compliance and for program quality, which could include statewide or regional meetings, a selected sample of on-site reviews, and systematic telephone contact. When the department does not sufficiently monitor the LEAs, it cannot ensure that they are complying with federal requirements.

Criteria

The Code of Federal Regulations, Title 34, Section 80.40(a), requires grantees to monitor activities to assure the LEAs comply with applicable federal requirements and achieve performance goals.

Recommendation

The department should implement a plan to monitor the LEAs to ensure that they comply with applicable federal requirements and that they achieve performance goals.

Item 7. Finding Insufficient Control Over Expenditure Reports From Local Educational Agencies Participating in the Eisenhower Mathematics and Science Education--State Grants Program

The department does not ensure that all LEAs submit expenditure reports and does not promptly bill school districts for unused funds for the Eisenhower Mathematics and Science Education--State Grants program. We selected for review 30 LEAs that should have submitted expenditure reports during fiscal year 1991-92 and found the following:

- As of September 30, 1992, three LEAs had not submitted expenditure reports for fiscal year 1990-91 even though the expenditure reports were due on January 17, 1992. In total, for fiscal year 1990-91, the department had advanced the three LEAs approximately \$1,800. If the expenditure reports are not submitted promptly, the department cannot determine whether the LEAs spent all funds paid or should return unused funds.
- The department uses the expenditure reports to identify unused funds that should be returned to the department and, in turn, to the federal government. For six school districts whose expenditure reports for fiscal year 1990-91 were dated between December 16, 1991, and May 29, 1992, the department identified approximately \$6,100 in unused funds. As of September 30, 1992, or between four to nine months after the date of the expenditure reports, the department had yet to bill these school districts for the unused funds. As a result, the LEAs are holding excess federal funds that should be returned to the federal government.

Criteria

The Code of Federal Regulations, Title 34, Section 76.722, states that a state may require an LEA to furnish reports that the state needs to carry out its responsibilities under the program. The department required that the LEAs submit an expenditure report for fiscal year 1990-91 with a due date of January 17, 1992. Additionally, the Code of Federal Regulations, Title 31, Section 205.4(a), requires that the timing and amount of cash advances be as close as administratively feasible to the actual disbursement by the recipient organization. Once the department recognizes that the recipient organization has not used its entire cash advance, the State Administrative Manual, Section 8776.2, requires agencies to prepare and send out an invoice or other type of claim document as soon as possible after the recognition of a claim.

Recommendation

The department should ensure that all LEAs submit an expenditure report. Additionally, the department should promptly bill the LEAs for any unused funds.

Item 8. Inadequate Procedures To Ensure That Private, Nonprofit Agencies Comply With Federal Regulations

Finding

The department does not sufficiently monitor the audit reports that private, nonprofit agencies submit to the department for the National School Lunch and School Breakfast (NSLB) programs and the State Legalization Impact Assistance Grants (SLIAG) program. We found the following specific problems:

- The department was not able to provide us with a list of private, non profit agencies of the NSLB programs that were required to submit an audit report for fiscal year 1990-91. Additionally, the department could not provide us with 5 of 20 audit reports we selected for review related to the NSLB programs. As a result, we could not conclude the department properly monitored the receipt of the required audit reports for the NSLB programs or that it resolved instances of noncompliance included in the audit reports. The Office of the Auditor General observed a similar weakness during its financial audit for fiscal year 1990-91.
- The department did not obtain audit reports from 15 of the 44 private, nonprofit agencies participating in the SLIAG program that were required to submit audit reports in fiscal year 1990-91. The department is responsible for ensuring that subrecipients meet the federal requirement to obtain independent audits. Unless the department receives the audit reports, it cannot be sure that subrecipients participating in the SLIAG program complied with this requirement. Further, the department cannot determine if the subrecipients complied with the terms and conditions of the SLIAG program. The Office of the Auditor General observed a similar weakness during its financial audit for fiscal years 1989-90 and 1990-91.

Criteria

According to the federal Office of Management and Budget, Circular A-133, state or local governments that allocate \$25,000 or more of federal financial assistance to nonprofit institutions must ensure that the nonprofit institutions obtain an independent audit that determines whether federal financial assistance was spent in accordance with applicable laws and regulations. Additionally, Circular A-133 states that audits shall usually be performed annually but not less frequently than

every two years. Finally, a departmental policy directed to all school nutrition program sponsors requires that private, nonprofit agencies submit annual audits to the department.

Recommendation

The department should sufficiently monitor the audit reports submitted by private, nonprofit agencies and ensure that they obtain independent audits at least every two years.

**Item 9.
Inadequate
Procedures To
Ensure That
Local Educational
Agencies Comply
With Federal
Regulations**

Finding

The department did not adequately review the audit reports submitted by the LEAs for fiscal year 1989-90. Additionally, the department did not ensure the LEAs resolved within six months all instances of noncompliance with federal laws and regulations identified in the fiscal year 1990-91 audit reports. We reviewed the department's procedures for resolving instances of noncompliance identified in audit reports submitted by the LEAs and found the following specific deficiencies:

- For its review of the fiscal year 1989-90 audit reports, the department implemented new procedures for resolving instances of noncompliance. These new procedures required that the department only resolve those instances of noncompliance that were included in the audit reports for two consecutive years or that had a financial impact. Thus, among the approximately 1,400 instances of noncompliance in all audit reports, the department identified almost 250 instances of noncompliance, and the new procedures required the department to resolve those instances. However, because the department did not require the LEAs to resolve the remaining 1,150 instances of noncompliance identified in the audit reports, the department cannot be certain the LEAs complied with federal laws and regulations.
- For its review of the fiscal year 1990-91 audit reports, the department implemented new procedures designed to ensure that the LEAs resolve all instances of noncompliance with federal laws and regulations. We found that 21 of 30 audit reports we reviewed identified instances in which the LEA did not comply with federal laws and regulations. For 19 of these 21, the department did not ensure that the LEAs resolved within six months the instances of noncompliance with federal laws and regulations identified in these reports. As of October 1, 1992, the department had resolved the instances of noncompliance identified in 12 of the 19 audit reports and has begun to resolve the instances of noncompliance in the remaining seven audit reports.

Criteria

According to the federal Office of Management and Budget, Circular A-128, state or local governments that allocate \$25,000 or more of federal financial assistance to a subrecipient must determine whether subrecipients spent federal financial assistance in accordance with applicable laws and regulations. Circular A-128 requires that state or local governments ensure that appropriate corrective action is taken within six months of receipt of the audit reports.

Recommendation

The department should ensure that it requires the LEAs to correct all instances of noncompliance with federal laws and regulations identified in the audit reports within six months.

**Item 10.
Delay in
Disbursing
Federal Grant
Monies****Finding**

The department's cash management system does not minimize the amount of time between receiving federal funds and disbursing them to subrecipients. We tested 207 claims to determine the amount of time between receipt and disbursement. We found that, for 14 claims, the State was from one to eight days late in disbursing the funds, for an average delay of 3.14 days. The Office of the Auditor General observed similar weaknesses during its financial audit for fiscal years 1987-88 through 1990-91.

Criteria

The Code of Federal Regulations, Title 31, Section 205.4(a), requires that the timing and amount of cash advances be as close as administratively feasible to the actual disbursement by the recipient organization. We consider a delay of no more than five working days as administratively feasible.

Recommendation

The department should improve its compliance with federal requirements by minimizing the delay between the receipt of federal funds and the actual disbursement.

**Item 11.
Incorrect
Calculation of
Apportionment****Finding**

The department's Education Finance Division (EFD) did not sufficiently document information used in the calculation and did not properly calculate the Economic Impact Aid (EIA) entitlement. In some cases, the department, when calculating the EIA entitlements to school districts, did not follow the applicable Education Codes. The EIA entitlement provides funds to school districts for programs for

educationally disadvantaged youth and for bilingual education. The funding for the EIA entitlement is based on a complex formula that uses transiency, poverty, and bilingual student ratios. The computation of each of these three ratios for a particular year uses data from the three most recent available fiscal years. We noted the following deficiencies:

Poverty Ratio

The poverty ratio represents the ratio of the number of children living below the poverty level as a percentage of a district's total student population compared to the same ratio for the entire state.

- The department used the enrollment data—that is, the number of students enrolled in a school district—rather than the average daily attendance (ADA) data when calculating the poverty ratio in fiscal year 1990-91. The enrollment data is generally higher than the ADA data. As a result, the department calculated smaller poverty ratios, thus lessening the influence of the poverty ratio as compared to the transiency and ethnicity ratios for each district's EIA entitlements. The department corrected the problem by using the ADA data in fiscal year 1991-92. However, in fiscal year 1992-93, the department used the enrollment data for years 1 and 2, and the ADA data for year 3 in the calculation. The department is aware of this problem and plans to rectify it in the fiscal year 1993-94 calculation by using ADA data for all three years.
- For fiscal years 1991-92 and 1992-93, the department did not sufficiently document the calculation of the EIA entitlement. To calculate a portion of the EIA entitlement, the department uses data about those school age children living in poverty in a school district who do not receive Aid to Families with Dependent Children. This data was reported in the 1980 United States Census, which reported the data by county, not by school district. Therefore, the department had to convert the data from county to school district. The department could not provide documentation to support its conversion of the 1980 census data from county to school district. The Office of the Auditor General reported a similar finding during its financial audits for fiscal years 1989-90 and 1990-91. The department plans to establish a documented format for the data it will be using in future year apportionments. Also, the department will be using 1990 census data for future apportionments beginning with fiscal year 1993-94.

Limited-English Proficiency (LEP) Calculation

When recalculating the fiscal year 1992-93 EIA factors, we noted that the LEP data had not been correctly calculated. The department reviewed the data base program and determined that the formula calculation which summarized the LEP detail had inadvertently excluded a column of data which resulted in an incomplete fiscal year 1992-93 LEP total. According to the department, the excluded column represents approximately 2 percent of the LEP total. A majority of the districts were not affected by the exclusion of data since their respective column total was zero. Because the LEP figure is used in the calculation of the EIA entitlements, some of the EIA entitlements are incorrect. The department is aware of the problem and has corrected the formula for the fiscal year 1993-94 calculation.

Criteria

The California Government Code, Sections 13402 and 13403, requires agencies to ensure that a satisfactory system of internal accounting and administrative controls, including a system of authorization and recordkeeping procedures, is in place to provide effective accounting control over assets, liabilities, revenues, and expenditures. Additionally, the California Education Code, Section 54203(a)(3), states that the average daily attendance will be used when calculating the poverty ratio.

Recommendation

The department should document all information used to calculate the EIA entitlement. Additionally, the department should use the ADA data rather than the enrollment data in the poverty ratio calculation. Finally, the department should ensure that the programmers review or verify the formulas used in compiling and summarizing data used in the calculation of the EIA entitlement.

Item 12. Noncompliance With Other Federal Requirements

Findings and Criteria:

In the following instances, the department did not always comply with administrative requirements of the federal government:

- We reviewed 30 applications from the LEAs for the Drug-free Schools and Communities--State Grants program. We found that one application was substantially incomplete, one application had no evidence of approval, three applications did not contain required progress reports, one application did not contain required program assurances, and two applications' budget summary amounts did not agree with the amount received under the grant. The United States Code, Title 20, Section 3196(a)(2)(R), requires the LEAs to submit

applications and provide information and assurances that the State educational agency responsible for distributing the grant funds reasonably determines to be necessary.

- The department could not provide us with one of 30 applications we selected for review for the Eisenhower Mathematics and Science Education--State Grants program. The Code of Federal Regulations, Title 34, Section 208.22 requires the LEAs to submit applications in order to receive funds for the Eisenhower Mathematics and Science Education--State Grants program.
- Each year, the department reports to the USDOE the state's average per pupil expenditure data on the National Public Education Financial Survey form (survey). Of ten LEAs we selected for testing, the department was not able to locate documentation to support the expenditure information included in the survey for one LEA and the revenue information for another one. Additionally, the department overstated total revenues of approximately \$22 billion by approximately \$11.9 million because it made input errors when accumulating the revenue information included in the survey. The United States Code, Title 20, Section 2711(a)(2)(A), requires that the state's average per pupil expenditure data be used for the allocation of Chapter 1 funds. The USDOE requests that the department submit this information on the National Public Education Financial Survey form. Finally, good accounting practice dictates that the information included in the survey be supported and accurate.
- The department did not review the required 50 percent of all processors participating in the Food Distribution program for fiscal year 1991-92. Instead, the department reviewed only 8 of 32, or 25 percent of all processors. However, even though only 8 processors were reviewed during fiscal year 1991-92, the department had reviewed the other 24 processors during fiscal year 1990-91 and thus had reviewed all processors within two years. The Code of Federal Regulations, Title 7, Section 250.19(b)(ii), requires the department to perform an on-site review of all processors at least once every two years with no fewer than 50 percent being reviewed each year.

Although individually these deviations may not appear to be significant, they do represent noncompliance with federal regulations, which are designed to protect the public's resources from abuse.

Recommendation

The department should improve its compliance with each of the federal requirements.

General Government

Department of Economic Opportunity

The Office of the Auditor General reviewed the Department of Economic Opportunity's (department) administration of the U.S. Department of Health and Human Services grants, Federal Catalog Numbers 93.028 and 93.031.

Item 1. Incorrect Payments to HEAP Applicants

Finding

The department did not correctly calculate payment amounts for all applicants for assistance under the Home Energy Assistance Program (HEAP). The department uses a computer system to calculate the proper amount of HEAP assistance, relying in its calculation on factors such as an applicant's county of residence, the applicant's family size, and the applicant's annual income. The computer system uses the applicant's zip code to determine the county of residence, which in turn is used to determine the relative costs of energy. During the calendar years 1991 and 1992, records indicate that the department paid \$53.9 million to almost 700,000 applicants. However, department records also indicate that, for 1,056 applicants, the department's computer system incorrectly determined the applicant's county of residence. As a result, we estimate that the department underpaid \$2,869 to 146 applicants and overpaid \$12,095 to 910 applicants. These errors were caused by the department's failure to update its computer system with current zip code information. When it does not properly calculate payment amounts for HEAP assistance, the department is not appropriately assisting those applicants with the highest need.

Criteria

The department's State Plan for the HEAP sent to the U.S. Department of Health and Human Services for fiscal year 1991-92 states that the department will provide the highest level of assistance to those applicants who have the lowest incomes and the highest energy costs.

Corrective and Other Actions

The department has corrected the incorrect zip code information in its computer system. Furthermore, the department has modified its procedures for updating zip code information in its computer system. Finally, the department is considering whether to seek reimbursement of the overpayments from the applicants and whether to issue additional payments to those applicants it underpaid.

Recommendation

The department should, as soon as possible, determine whether it is cost-effective to seek reimbursement from those applicants it overpaid and take appropriate action. Furthermore, the department should determine whether it will issue additional payments to those applicants that it underpaid.

**Item 2.
Improper Cash
Management**

Finding

During fiscal year 1991-92, the department maintained balances of federal funds that exceeded its immediate needs. The department retained these excess federal funds in the state treasury from certain prior year appropriations. Specifically, the beginning balance for these appropriations on July 1, 1991, was approximately \$1.8 million. Subsequent receipts and disbursements reduced the balance to \$244,000 on June 30, 1992. However, this amount was still in excess of the department's immediate cash needs. The Office of the Auditor General reported a similar weakness in its audits for fiscal years 1987-88, 1988-89, 1989-90, and 1990-91. Maintaining excess cash may cause the federal government to cease advancing funds.

Criteria

The Code of Federal Regulations, Title 31, Section 205.4, requires that cash advances be limited to the actual immediate cash needed for carrying out the purpose of the program. This code section also stipulates that the timing and amount of cash advances be as close as administratively feasible to the actual cash disbursement by the recipient organization.

Recommendation

The department should analyze the balances provided by the State Controller and identify any appropriations that have excess cash balances. It should then spend those funds first before drawing down additional federal funds.

**Item 3.
Improper
Subrecipient
Cash
Management**

Finding

From March through May 1992, the department allowed subrecipients of grants for the Weatherization Program and the Energy Crisis Intervention Program to maintain balances of federal funds that exceeded their immediate needs. Specifically, the department allowed four of the nine subrecipients in our sample to maintain cash balances in excess of one-sixth of their contract amounts. The department allowed these subrecipients to maintain the excess balances because, in subsequent months after it advanced 25 percent of the contract amounts

to these subrecipients, the department reimbursed the subrecipients for all of their claimed costs without withholding any funds for repayment of the advances. Allowing subrecipients to maintain excess cash balances may cause the federal government to cease advancing funds to the department.

Criteria

The Code of Federal Regulations, Title 31, Section 205.4, requires that cash advances to recipient organizations be limited to the actual immediate cash needed for carrying out the purpose of the program. This section also stipulates that the timing and amount of cash advances be as close as administratively feasible to the actual cash disbursement by the recipient organization. These requirements also apply to subrecipients.

Recommendation

After it has advanced program funds to a subrecipient, the department should, in subsequent months, begin withholding a portion of the subrecipient's reimbursement to repay the advance.

Department of Industrial Relations

The Office of the Auditor General reviewed the Department of Industrial Relations' (department) administration of the U.S. Department of Labor grant, Federal Catalog Number 17.500.

Item 1. Insufficient Controls Over Equipment Inventory

Finding

The department does not properly control its inventory of equipment items. The department purchases numerous items of equipment each year that are used in carrying out its regulatory responsibilities. Examples of such equipment items include air flow meters, audio meters, and gas detectors. However, department personnel do not always follow appropriate procedures for updating the department's property ledger. Also, the department does not always document, as required, equipment that has been lost, stolen, destroyed, or has been disposed of. As a result, the department cannot account for all of the equipment that it has purchased. In a review of 45 equipment items, we found the following specific deficiencies:

- For 12 of 45 items of equipment, the department's property ledger did not accurately present the location of the piece of equipment throughout the department's numerous statewide field locations.
- For 5 of these 12 items of equipment, the department was not able to locate the items of equipment at all. And, the department has no record that these five items have been properly disposed of.

Criteria

The Government code, Section 13401(b)(1), requires agencies to maintain an effective system of internal control. Effective internal control requires management to ensure that employees who control the department's equipment inventory properly notify the employees who maintain the property ledger as to additions or deletions or interoffice transfers of equipment items. It is then the responsibility of the employee who maintains the property ledger to promptly update the property ledger.

Also, it is the responsibility of the custodian of the item of equipment to properly document instances in which equipment has been lost, destroyed, stolen, or otherwise disposed of.

Recommendation

The department should take steps to locate the missing items of equipment. If these items cannot be found, the circumstances surrounding such loss should be reviewed by the department. Furthermore, the department should immediately update its property ledger so that it accurately reflects, by location, the department's equipment.

Department of Personnel Administration

We reviewed certain transactions within the deferred compensation program administered by the Department of Personnel Administration (department).

Item 1. The Department's Progress in Resolving Accounting Weaknesses

Finding

The department is attempting to resolve weaknesses in accounting for the State's deferred compensation program. However, the department continues to be unable to reconcile its balances with those reported by the trustees or the recordkeeper. In May 1992, the Office of the Auditor General issued a letter to the department that discussed the weaknesses. The letter stated that 21 months after it contracted with a firm to provide recordkeeping services, the department was not able to ensure that it received sufficient information to monitor the recordkeeping of the program. Specifically, the department was not able to reconcile financial information it received. During the limited review that we recently conducted, we assessed the department's progress in resolving the weaknesses.

The department has taken steps to improve the accounting for the program. The department contracted with the State Controller's Office to perform certain audit procedures; the auditors issued the report in June 1993. Although the overall objective of the audit was to provide information on certain account balances because of the termination of a contract with one of the investment firms, the audit provided information that was useful in understanding the nature of the problems that existed. According to the department's plan administrator, the State Controller's Office will continue to monitor the account balances on a quarterly basis throughout fiscal year 1993-94. Further, the department plans to have annual financial audits performed beginning with June 30, 1994.

Additionally, the department recently decided that it would terminate its contract with its current recordkeeper and award a new contract that would better fit the department's needs. Currently, a single firm provides recordkeeping services and various investment firms provide custodial and trustee services. Under the new contract, one firm will provide all custodial, trustee, and recordkeeping services. As part of its responsibilities, the firm will provide a monthly reconciliation of financial information to the department. The department issued its requests for proposal for the contract in October 1993 and plans to award the new contract in March 1994.

Criteria

The California Government Code, Sections 13402 and 13403, requires departments to ensure that a satisfactory system of internal accounting and administrative control is in place to provide effective accounting control over assets, liabilities, revenues, and expenditures.

Recommendation

The department should continue its efforts to ensure that it properly accounts for the State's deferred compensation program. After the new contract is issued, the department should ensure that the recordkeeper appropriately reconciles the program's financial information.

Health and Welfare

Department of Alcohol and Drug Programs

The Office of the Auditor General reviewed the Department of Alcohol and Drug Programs' (department) administration of the U.S. Department of Education grant, Federal Catalog Number 84.186, and the U.S. Department of Health and Human Services grant, Federal Catalog Number 93.992.

Item 1. Lack of Independent Peer Reviews of Providers

Finding

The department does not always conduct independent peer reviews of alcohol and drug treatment providers receiving funds from the Alcohol and Drug Abuse and Mental Health Services (ADMS) block grant. The purpose of an independent peer review is to assess the quality and appropriateness of treatment services provided by entities receiving those funds. We found that the department had not performed independent peer reviews for 13 (26 percent) of the 50 treatment providers we reviewed.

The Office of the Auditor General reported a similar finding in its audits for fiscal years 1989-90 and 1990-91. In its May 28, 1992 response to the latter audit, the department stated it was in the process of resolving the issue with the federal Department of Health and Human Services.

Criteria

The United States Code, Title 42, Section 300x-4(c)(5), requires the department to provide periodic independent peer reviews to assess the quality and appropriateness of treatment services provided by entities receiving funds from the ADMS block grant.

Recommendation

The department should conduct periodic independent peer reviews of providers of alcohol and drug treatment services.

Item 2. Failure to Fully Monitor the Drug-Free Schools and Communities-- State and Local Programs Grant

Finding

The department does not fully monitor the subrecipients of the Drug-Free Schools and Communities--State and Local Programs (DFSC) grant. The department's subrecipients include counties, nonprofit organizations, and state agencies. During our review of a state agency subrecipient, the Office of Criminal Justice Planning (OCJP), we noted that, although the OCJP submitted a biannual report to the department, the report did not provide sufficient information to identify the proportion of high-risk youths participating in its community-based

programs. Consequently, the department did not have enough information to determine whether at least 90 percent of the programs' participants are high-risk youth.

The Office of the Auditor General reported a similar weakness in its audits for fiscal years 1989-90 and 1990-91. In its May 28, 1992 response to the latter audit, the department stated it had taken steps to better document compliance with the requirement that 90 percent of the participants in the community-based programs be high-risk youths.

Criteria

The Code of Federal Regulations, Title 34, Subtitle A, Section 80.40, requires recipients of federal grants to monitor grant-supported activities to ensure compliance with applicable federal requirements. The United States Code, Title 20, Section 3192(b)(1), requires the State to spend at least 50 percent of the DFSC grants on youths. Finally, the United States Code, Title 20, Section 3192(b)(3), requires the State to ensure that at least 90 percent of the participants in the community-based programs be high-risk youths.

Recommendation

The department should ensure that reports submitted by subrecipients contain the specific data necessary to demonstrate compliance with applicable federal requirements.

Item 3. Failure to Adequately Monitor Cash Balances

Finding

The department does not have adequate procedures to monitor the cash balances of subrecipients of the ADMS block grant and the DFSC grant. During our review of the quarterly reports of 35 counties submitted for these grants, we noted that 4 of the counties reported cash balances that would last more than 30 days. We found no instance in which the department withheld or adjusted subsequent monthly advances to these 4 counties. We also noted in a test of quarterly reports 18 counties submitted, that 15 counties submitted inaccurate quarterly reports. Without adequate procedures to monitor cash balances, the deficiencies described above could extend to other federal programs because all quarterly reports are processed by the same departmental unit.

The Office of the Auditor General reported a similar weakness in its reports for fiscal years 1989-90 and 1990-91. In its May 28, 1992 response to the latter audit, the department indicated that, during fiscal year 1992-93, it would implement procedures for monitoring subrecipients' cash balances and for advancing them money for federally funded programs.

Because the department does not adequately monitor the cash balances of subrecipients, it cannot be sure that monthly cash advances are limited to the minimum and immediate cash needs of the subrecipients. Consequently, the State may be advancing federal funds to subrecipients before they need the money. If the department fails to limit cash advances to minimum and immediate needs, it could jeopardize future advances of federal ADMS and DFSC grant funds.

Criteria

The Code of Federal Regulations, Title 31, Section 205.4(a), requires that cash advances to a primary recipient be limited to the minimum amounts needed and be timed to be in accord with only the actual, immediate cash requirements of the recipient. The timing and amount of cash advances must be as close as is administratively feasible to the actual disbursements by the recipient for direct program costs and the proportionate share of any allowable indirect costs. The Code of Federal Regulations, Title 31, Sections 205.4(e), requires that advances by primary recipients to subrecipients conform substantially to these same standards of timing and amount.

Recommendation

The department should ensure that quarterly cash reports submitted by subrecipients are accurate. Also, it should use the reports to adjust cash advances to subrecipients so that cash on hand is limited to amounts required for immediate needs.

Item 4. Finding Lack of Documentation to Support the Basis for Fixed-Rate Allocations

The department lacks sufficient documentation to support the fixed rates used to allocate costs to certain programs. During our review of the department's cost allocation plan and its cost allocation table, we noted that the department could not provide statistical data or other documentation to justify the basis for the fixed percentage used to allocate costs to certain programs. As a result, the department cannot demonstrate that the costs allocated are equitable relative to the benefits the programs receive.

The Office of the Auditor General noted a similar weakness in its audit for fiscal year 1990-91. In its May 28, 1992 response to that year's audit, the department stated that it would maintain documentation to support the fixed percentages used to allocate costs beginning in fiscal year 1992-93.

Criteria

The Code of Federal Regulations, Title 45, Subtitle A, part 92, Section 92.22 and Title 34, Subtitle A, Part 80, Section 80.22, requires that allowable costs be determined by using the cost principles contained in the Office of Management and Budget, Circular A-87. According to Circular A-87, costs should be allocated to grant programs in accordance with the benefits received.

Recommendation

The department should clearly document and regularly update the basis it uses to determine fixed-rate allocations to ensure that costs are allocated to programs based upon the benefits the programs receive.

Employment Development Department

The Bureau of State Audits and the Office of the Auditor General reviewed the financial operations and related internal controls of the Employment Development Department (department) and the department's administration of the U.S. Department of Labor grants, Federal Catalog Numbers 17.207, 17.225, 17.246, and 17.250; the U.S. Federal Emergency Management Agency grant, Federal Catalog Number 83.516; and the U.S. Department of Health and Human Services grant, Federal Catalog Number 93.025.

Item 1. Deficient Controls in the Unemployment Benefit Payment System

Finding

The department's control over its automated system for processing unemployment benefit payments has deficiencies. During our testing of benefit payments under the Unemployment Insurance program, we found that for 2 of the 45 items we tested, the claimants were paid in excess of the benefit amount allowable under the program guidelines. The 45 items we tested reflect only a small portion of the 18.6 million unemployment benefit payments to claimants that totaled more than \$4.6 billion for fiscal year 1991-92. Thus, although the amount of the individual errors we found are relatively small, the total amount of undetected errors could be significant. We found the following incidents of deficient controls in the automated benefit payment system:

- The department overpaid a claimant more than \$1,700 in regular and emergency unemployment compensation. The overpayment occurred because duplicate wages were recorded in the claimant's account on the department's base wage file. This file determines the amount of weekly benefits payable to unemployment insurance claimants. The department discovered the duplicate wages recorded in the base wage file and stripped the duplicate wages from the system. However, the department's automated benefit payment system did not generate a "recomputation flag" to notify appropriate units to recompute any benefit awards to claimants affected by the change in the base wage file. As a result, this overpayment was not identified until we brought it to the department's attention. The department is currently unable to estimate how many similar errors may have occurred. However, the department has initiated corrective action to ensure that changes to the base wage file will generate flags in the system to notify the appropriate units when to recompute benefit awards to claimants.

- The department overpaid a claimant \$76 in regular unemployment compensation. The overpayment occurred when the department issued a replacement check to the claimant. The technical staff in the Automation Administration Division (AAD) concluded that the overpayment was caused by an override feature in the benefit payment subsystem. When a replacement check is issued, the override feature will automatically bypass edit functions that prevent payments processed through the automated benefit payment system from exceeding the allowable benefit award. This error was compounded when the automated benefit payment system did not recognize the negative balance generated by the overpayment. The department did not correct the overpayment until we notified it of the error. The overpayment occurred in the department's old automated benefit payment system, and the department's staff is aware that similar errors have occurred. According to the technical staff in the AAD, the department's new Single Client Data Base system will recognize negative balances recorded in the on-line system, and it also limits the automatic override feature when replacement checks are issued.

Criteria

The California Government Code, Section 13402, requires agencies to maintain an effective system of internal accounting and administrative control. In addition, Section 13403 requires that the system of internal control include a system of recordkeeping procedures to provide effective accounting control over revenues and expenditures.

Recommendation

The department should continue to implement corrective action to ensure that all benefit awards to claimants are recomputed when changes to the base wage file are made. In addition, the department should put tight limits on the override capability in the automated benefit payment system. Finally, the department should determine the number of instances where the controls discussed above may have allowed additional overpayments. The department should then collect the overpayments.

Item 2. Insufficient Monitoring of Subrecipients' Cash Balances

Finding

The department does not have documentation to show it properly monitored the cash balances of secondary recipients of the Job Training Partnership Act (JTPA) program. Although the department requires its subrecipients to submit monthly status of cash reports, we identified the following weaknesses:

- The procedures of the Fiscal Programs division (FPD) do not require that the monthly status of cash reports be reviewed for accuracy. As a result, the section of the report that shows whether or not the subrecipient has excess cash may be incorrect and the problem may go undetected. For example, for 2 of the 24 reports we reviewed, the subrecipients prepared the report incorrectly. In one of the two reports, the amount was misstated by nearly \$50,000. The department was unable to provide evidence that the subrecipients were notified about the errors, and if necessary, instructed on the proper way to prepare the reports.
- The FPD does not follow its own procedures when there is a problem with the monthly status of cash reports. The FPD's procedures require that monthly reports from subrecipients that show excess cash be forwarded to the Job Training Partnership Division (JTPD) for further action. In addition, if the FPD forwards a case to the JTPD for follow-up and the FPD does not receive a response from the JTPD within 30 days, the FPD's procedures require it to follow up with the JTPD to determine the status of the case. However, the FPD was unable to provide evidence that it followed up with the JTPD when no response was reviewed within the 30 days. Three of the 24 cases we reviewed were forwarded to the JTPD for follow-up. We were unable to determine the resolution of two of the three cases since the JTPD does not maintain records of action taken and the FPD was unable to provide evidence of further follow-up with the JTPD.
- The JTPD does not have a system to ensure proper follow-up on the monthly status of cash reports referred to them by the FPD. In addition, the JTPD does not currently maintain records indicating which monthly status of cash reports were received from the FPD. Therefore, the department is unable to adequately monitor which reports have been received, followed up, or resolved.
- The subrecipients are not currently required to maintain interest-bearing accounts for JTPA funds. According to a list provided by the department, only 33 of the 52 subrecipients currently maintain JTPA program funds in interest-bearing accounts. Since the amount of interest that these 33 subrecipients submitted to the department in fiscal year 1991-92 totaled approximately \$200,000, it appears that the interest not earned by the other 19 subrecipients could be significant.

Criteria

The Code of Federal Regulations, Title 31, Section 205.4(a), requires that cash advances to primary recipients be limited to the minimum amounts needed and be timed to accord with the actual, immediate cash requirements of the recipient in carrying out the purpose of the approved program or project. The Code of Federal Regulations, Title 31, Section 205.4(e), requires that advances made to secondary recipients are to conform substantially to the same standards of timing and amount as apply to federal advances to primary recipients. In our opinion, proper compliance with federal regulations requires that primary recipients regularly monitor the cash balances of secondary recipients.

The FPD's Monthly Status of Cash Review Procedures require that the FPD refer excess cash problems to the JTPD. Furthermore, if the FPD does not receive a response from the JTPD within 30 days regarding resolution of the problem, the FPD is required to follow up with the JTPD.

The Job Training Partnership Office Policy and Procedure, Bulletin 84-11, requires that the subgrantee hold in trust any income generated as a result of the receipt of JTPA funds and remit the interest earnings to the department quarterly.

Recommendation

The department should improve its compliance with the federal requirements and its own established procedures. In addition, the department should require subrecipients to maintain interest-bearing accounts for JTPA funds.

Item 3. Relevant Sections of Federal Expenditure Reports Do Not Reconcile

Finding

The department did not properly reconcile two sections of quarterly reports showing the expenditures of federal funds for unemployment compensation for federal employees and ex-servicemembers. None of the four quarterly reports for fiscal year 1991-92 reconciled the two relevant sections in the reports. In one of the quarterly reports, the difference between the two sections totaled more than \$1 million.

The quarterly report is a summary of expenditures charged to federal unemployment programs for unemployment compensation paid to federal employees and ex-servicemembers. Section A of the report summarizes total expenditures charged to federal agencies for the quarter. Section B should provide a detail of the same total, broken down by charges to each individual civilian and military agency for the

quarter. Therefore, the total of the expenditures reported in Section A should equal the total expenditures reported in Section B. The department stated that because of different data processing systems used to compile expenditure information, they are not able to reconcile the two sections of the report. Failure to properly assign expenditures in the federal report may result in overcharges or undercharges to certain federal agencies. In addition, charges not properly assigned to federal agencies may affect the cash solvency of the federal fund that reimburses the State for unemployment compensation benefits paid to federal employees and ex-service members.

According to a deputy director of the department, the reporting differences will be eliminated when the department's single client data base is fully implemented in December 1992.

Criteria

The United States Department of Labor's Employment Security Manual, Part V, Section 9336, D. 3., requires that the report totals assigned to federal agencies in Section A be equal to the totals generated from the assigned charges in Section B.

Recommendation

The department should continue to integrate its data processing systems so it can submit reports free of any differences between the two sections of the report.

Item 4. Finding Insufficient Procedures To Ensure Federal Receipts Are Credited to the Appropriate Federal Grant or State Appropriation

The department did not properly record some federal funds received in the State Treasury for the Employment and Training Assistance - Dislocated Workers program. Specifically, during our review of 49 drawdowns for the Employment and Training Assistance - Dislocated Workers program and the Job Training Partnership Act program, we found that the department drew down \$159,000 from the Employment and Training Assistance - Dislocated Workers program but incorrectly requested the funds be deposited to the credit of the Job Training Partnership Act program.

In addition, the department did not ensure that all federal receipts were credited to the proper state appropriation. We found that the department credited to the wrong state appropriation more than \$632,000 in receipts for the two programs.

The department is in the process of implementing recently developed procedures that should prevent similar errors in the future. In addition,

the department plans to perform an internal reconciliation to ensure that no other receipts are misclassified.

Criteria

The Code of Federal Regulations, Title 20, Section 629.35(a)(2), requires that the department establish accounting procedures sufficient to allow the tracing of funds to ensure the funds are not misspent. In addition, the California Government Code, Section 13402, requires agencies to maintain an effective system of internal accounting and administrative control. Further, Section 13403 requires that a system of internal control include a system of recordkeeping procedures adequate to provide effective accounting controls over revenues and expenditures.

Recommendation

The department should implement procedures designed to avoid misclassification of receipts. It should also ensure that the State Controller's Office is notified if any additional misclassified receipts are identified when the department completes its internal reconciliation process.

**Item 5.
No Procedures
To Ensure
Subrecipients
Submit Audit
Reports Within
Required
Timeframes**

Finding

The department has not established procedures that outline actions it will take when subrecipients of the Job Training Partnership Act (JTPA) grant do not submit audit reports within one year after the end of the grant award period. The department has assumed the responsibility for monitoring the nonprofit subrecipients of JTPA funds. During our review of the dates for eight audit reports of nonprofit subrecipients, we found that five of the reports were submitted to the department more than one year after the end of the grant award period. One of these five audit reports was received more than two years after the end of the grant award period. If the department does not receive audit reports within one year after the end of the grant award period, it may not be notified of major instances of noncompliance with federal laws and program regulations. Thus, the department may be delayed in implementing corrective action.

Criteria

The United States Code, Title 29, Section 1574(a)(2), requires that the State prepare or have another entity prepare an independent financial and compliance audit of each subrecipient receiving Job Training Partnership Act funds. In addition, the Office of Management and Budget, Circular A-128, Section 13(f), requires that audit reports be submitted within one year after the end of the grant award period.

Further, Section 17 states that agencies must consider sanctions that may include withholding a percentage of assistance payments or suspending the federal assistance until the audit is satisfactorily completed.

Recommendation

The department should establish written procedures to outline the various steps it will take when subrecipients do not submit audit reports within one year after the end of the grant award period. These procedures should ensure that the program funds are audited, either by sending the department's own auditors to do the work, or by contracting with outside auditors.

**Item 6.
Noncompliance
With Prompt
Payments
Standards for
Interstate
Unemployment
Benefits**

Finding

For the 12 months ended March 31, 1992, the department did not comply with federal prompt payment standards for first-time payments of unemployment benefits for interstate claims. On average, the department paid promptly only 43 percent of first-time unemployment benefit payments for all interstate claims. The federal prompt payment standard is 70 percent. According to the manager in the unit that pays interstate unemployment's claims, the department had a very large backlog in claims over an extended period, along with an increase in the number of new claimants entering the system. In addition, the manager stated that the department depends on the claims processing of other states who, because of the general state of the economy, may be experiencing a similar increase in case loads. Failure to comply with federal regulations for first-time benefit payments may cause the federal government to impose fiscal sanctions on the department.

Criteria

The Code of Federal Regulations, Title 20, Section 640.5, requires that the State pay at least 70 percent, measured annually, of all first-time interstate claims within 14 days following the end of the first compensable week of unemployment.

Recommendation

The department should ensure that first-time unemployment benefit payments are made promptly in compliance with federal regulations.

**Item 7.
Failure To
Ensure Adequate
Collection Efforts
of Outstanding
Receivables From
Subrecipients**

Finding

The department does not always make adequate efforts to collect outstanding receivables from subrecipients of the Job Training Partnership Act and the Employment and Training Assistance–Dislocated Workers programs. During our review of these programs, we found that some of the receivables have been outstanding for more than two years. Nonetheless, according to the department's assistant chief legal counsel, the only collection effort attempted for four accounts that total more than \$28,000 in receivables was to send three letters requesting payment.

Because the department has not taken aggressive action to collect these accounts, it may be unable to collect some of the amounts owed. These funds must be returned to the federal government because the State no longer has the authority to spend them.

Criteria

The Code of Federal Regulations, Title 20, Section 629.44(d)(3), requires the department to take prompt, appropriate, and aggressive action to recover any funds misspent by secondary recipients. In addition, the Standard Operating Procedure (91-4) memorandum issued by the department requires that all affected units work together to ensure that amounts owed are promptly collected.

Recommendation

The department should ensure that it takes prompt and aggressive action to collect any outstanding receivables.

**Item 8.
Late Resolution
of Audit Reports**

Finding

In fiscal year 1991-92, the department did not resolve questioned costs in 11 of 81 audit reports for subgrantees of the Job Training Partnership Act program within the required six months after the cognizant federal agency received the final audit report. Failure to resolve questioned costs can result in additional questioned costs if the subgrantees do not correct deficiencies in their internal controls within a reasonable time.

The Office of the Auditor General reported a similar weakness during its financial audits for the seven previous fiscal years. Last year, the Office of the Auditor General reported that the number of audit reports resolved late had almost doubled. For fiscal year 1991-92, although the number of audit reports increased by 25 percent, late resolution of the reports decreased by 31 percent from the prior year.

Criteria

The Office of Management and Budget, Circular A-128, Section 14, requires the department to ensure that subgrantees take appropriate corrective action within six months after the cognizant federal agency receives the subgrantees' audit reports.

Recommendation

The department should continue its efforts to reduce delays in the resolution of audits, so it can resolve questioned costs in all subgrantees' audit reports within the required timeframe.

**Item 9.
Incorrect
Charges to the
Employment
Service Program****Finding**

The department did not always correctly charge or allocate costs to the federal Employment Service program. Specifically, we found the department often did not correctly charge the costs associated with employee training. Ten of the 20 operating expenses tested were costs associated with employee training, such as class registration fees, conference fees, and travel expenses. We found that three of the 10 items were incorrectly charged to the Employment Service program. For one item, the department incorrectly charged the full amount of training time and training registration fees associated with out-service training for one employee to the Employment Service program rather than proportionately to the programs on which the employee worked.

For another item, the department incorrectly split costs for one employee's expenses related to training costs, travel, and other expenses to attend meetings and make presentations. These costs were incorrectly split between the Employment Service and Unemployment Insurance programs when the full amount should have been charged to the Employment Service program. During the month in which these expenses occurred, and also during the two months before and after, this employee only worked in the Employment Service program.

For the third item, the department charged the Employment Service program for an employee's travel and lodging costs associated with attending two separate conferences. The employee did not charge any of the time during the conferences to the Employment Service program.

In addition, of the ten personal service charges we tested, we noted one improper charge to the Employment Service program. The full amount of the overtime hours of an employee was charged to the Employment Service program instead of being split correctly between the two programs that the employee worked on during the overtime hours and

that the employee normally charges to. This employee worked on both the Employment Service and Disability Insurance programs.

The Office of the Auditor General reported a similar weakness during its financial audit for fiscal year 1990-91. On July 17, 1992, in response to the finding, the department issued an administrative circular on procedures for charging training costs. The administrative circular instructs employees to charge time and training costs consistently and to the program, or programs, that benefit from the training. The administrative circular also states that, in all cases when time and training costs are not charged consistently, justification must be documented and approved by a supervisor. This circular will clarify departmental policy and strengthen controls to ensure that the department properly charges the costs to the correct programs. Because the Office of the Auditor General did not issue its management letter for fiscal year 1990-91 until May 1992, the department's corrective action will not become evident until our audit of fiscal year 1992-93.

Criteria

The Office of Management and Budget, Circular A-87, states that, for costs to be allowable under a grant program, costs must be consistent with the department's policies and procedures that apply uniformly to both federal and state programs. Further, these costs must not be allocable to any other federally funded programs. The department's Employee Time Reporting Handbook, Section 9-0800, states that time employees spend in general training should be charged to the training activity code for the program in which the employee normally works. It also states that if the employee normally has substantial charges to two or more programs, then the training time should be prorated among the training activity codes for those programs.

Further, a department official stated that training costs that cannot be directly charged to a specific program are generally allocated among programs based on reasonable and equitable methods. The official further stated that these methods may include allocating the costs proportionately between the programs the employee charges time to during the training period.

Recommendation

The department should ensure all employees are made aware of the policy stated on the administrative circular. The department should also strengthen its controls to ensure that charges for costs associated with employee training are made in accordance with the department's new policy.

**Item 10.
Late Federal
Financial Reports**

Finding

The department did not submit its monthly Unemployment Insurance Financial Transactions Summary reports within ten business days after the end of the month, as required, for any of the months during fiscal year 1991-92. The department submitted the reports as late as 29 business days after the deadline. In addition, the department did not submit its quarterly reports showing the expenditures of federal funds for unemployment compensation for federal employees and ex-servicemembers within 25 days, as required, for the four quarters in fiscal year 1991-92. The reports were as late as 45 calendar days after the deadline. The department stated that it cannot promptly submit the reports because it cannot summarize the information within the required timeframe. Failure to promptly submit these reports may place the department in jeopardy of fiscal sanctions imposed by the federal government.

The Office of the Auditor General reported a similar weakness during its financial audits for the eight previous fiscal years. The department reports that, once it has fully implemented its single client data base, in December 1992, it will be able to submit the reports within the required timeframe.

Criteria

The United States Department of Labor's Employment Security Manual, Part V, Section 9320, requires the department to submit the Unemployment Insurance Financial Transaction Summary report within ten business days after the end of each month. In addition, the Employment Security Manual Part V, Section 9336(4), requires the department to submit the report showing the expenditures of federal funds for unemployment compensation for federal employees and ex-servicemembers by the 25th day after the end of each quarter.

Recommendation

The department should continue to automate its accounting systems so it can submit reports within the required timeframe.

**Item 11.
Delay in
Follow-up of
Potential
Receivable**

Finding

The department did not always comply with the administrative requirements of the federal Job Training Partnership Act. Specifically, the department did not promptly follow-up a letter it sent to a subrecipient notifying it of a preliminary assessment that the subrecipient had exceeded the federal limit for administrative expenditures by more than \$222,000. The letter also requested that the

subrecipient submit a corrective action plan within 30 days. However, more than two months after the 30-day period had expired, the corrective action plan had not been received, and the department had not taken action to ensure the corrective action plan would be submitted. As a result of the delay, the department was unable to promptly make a final determination concerning the possibility of establishing a receivable for this amount. After our discovery of this issue, the department proposed changes to its procedures so that the situation would not recur.

Criteria

The Code of Federal Regulations, Title 20, Section 629.44(d)(3), requires that the department take prompt, appropriate, and aggressive action to recover any funds misspent by secondary recipients.

Recommendation

The department should continue to monitor its letters identifying potential receivables and ensure that corrective action plans are promptly submitted. If the corrective action plans are not promptly submitted, the department should initiate collection procedures.

Item 12. Overstated Liabilities and Expenditures

Finding

The department's Employment Training Panel did not adequately analyze its employment training contracts outstanding on June 30, 1992. The term for 11 of the 75 contracts we reviewed ended on or before June 30, 1992. The Employment Training Panel later determined that no additional payments would be made on three of these contracts. As a result, the department overstated the liabilities and expenditures in its Employment Training Fund as of June 30, 1992, by approximately \$200,000.

The Office of the Auditor General reported a similar weakness during its financial audit of fiscal year 1990-91. In its response dated May 19, 1992, the department stated that in March of each year, Employment Training Panel staff will analyze contracts funded with monies that will revert on June 30 of that year. Further, the department stated that it will estimate the expenditures that it expects to incur on these contracts. However, the department should not limit its analysis to contracts funded with monies that will revert on June 30. The department should also analyze contracts funded with monies that will revert in future fiscal years.

Criteria

When state agencies prepare their year end liability accruals, the State Administrative Manual, Section 10544, requires them to analyze their contracts and adjust the amounts of their liabilities to approximate the actual expenditures they will incur.

Recommendation

The department's Employment Training Panel should analyze all employment training contract balances to ensure that the June 30 liability accrual approximates the actual expenditures it will incur.

Health and Welfare Agency Data Center

We reviewed the financial operations and related internal controls of the Health and Welfare Agency Data Center (data center).

Item 1. Possible Liability to the Federal Government

Finding

The data center has a possible liability to the federal government estimated to be as much as \$8.2 million for profits it has accumulated in its Health and Welfare Data Center Revolving Fund (revolving fund) between July 1, 1984, and June 30, 1992. The data center's revolving fund is an internal service fund that accounts for centralized electronic data processing services to state agencies. The data center has charged these agencies more than its costs for providing services. In turn, state agencies have passed these charges on to federal programs. The revolving fund accumulates profits when the data center's charges for services exceed its costs. Federal regulations prohibit the State from charging federal programs for more than its costs.

In 1984, the federal Department of Health and Human Services audited the State's rate-setting methods for internal service funds. As a result of the audit, the State was required to refund to the federal government approximately \$14.9 million of the profits accumulated in internal service funds. This amount represented the federal share of profits accumulated in five of the State's internal service funds from July 1, 1969, to June 30, 1984. The Department of Finance calculated that 57.8 percent of the revolving fund's accumulated profits of approximately \$5.1 million at June 30, 1984, resulted from charges to federal programs and, thus, the revolving fund owed the federal government approximately \$3 million.

In 1992, the data center estimated the federal share of accumulated profits to be approximately 38 percent of accumulated profits. We did not verify the accuracy of the estimate. Using the same ratio of 38 percent, we estimate that, under current federal regulations, the State may owe the federal government approximately \$8.2 million. However, an October 1988 proposed amendment to the federal Office of Management and Budget, Circular A-87, would allow state agencies a reasonable working capital reserve of 60 days' worth of cash expenditures. This amendment, if approved, may further reduce the liability to the federal government.

The Office of the Auditor General reported a similar finding during its financial audits for the three previous fiscal years. The Auditor General recommended that the Department of Finance ensure state agencies

comply with federal regulations. In his response of March 18, 1991, the director of the Department of Finance stated that, in some cases, state laws and regulations differ from those of the federal government and that the State is working with the federal government to minimize the differences. He stated that guidelines will be developed as soon as such differences are resolved.

Currently, the federal Department of Health and Human Services is conducting an audit for the period July 1, 1984, through June 30, 1991, to determine the amount of profits (surplus) accumulated by the data center and the federal government's share of the surplus. As of November 1993, the final audit report has not been issued.

Criteria

The federal Office of Management and Budget, Circular A-87, "Cost Principles for State and Local Governments," does not allow the State to charge federal programs for amounts that exceed costs. In addition, the California Government Code, Section 13070, provides the Department of Finance with general powers of supervision over all matters concerning the financial and business policies of the State.

Recommendation

The data center should comply with the federal Office of Management and Budget, Circular A-87, when establishing billing rates for charges to state agencies receiving federal support. Further, the Department of Finance should ensure that the data center complies with federal regulations. For example, compliance could be ensured by developing guidelines for the data center and state agencies receiving services from the data center. In addition, the Department of Finance should monitor the proposed amendment to Circular A-87 to determine the effects the amendment may have on state charges to federal programs.

Item 2. Weaknesses in Accounting for Equipment

Finding

The data center has weaknesses in its accounting for equipment. Specifically, we noted the following conditions:

- The data center overstated its fixed assets by approximately \$1.5 million when it incorrectly recorded equipment acquired in a purchase with a trade-in at the market value of the old asset plus additional installment contract debt incurred.
- The data center did not record 19 software purchases, totaling approximately \$500,000 and two equipment purchases, totaling

approximately \$100,000, in its accounting records even though the items were received prior to June 30, 1992.

- The data center did not attach property tags to 5 of the 18 items of equipment we tested.

As a result, the data center's financial statements were misstated and the data center did not maintain adequate control over all equipment.

Criteria

The State Administrative Manual, Section 8621, requires that the recorded value of equipment acquired in a purchase with trade-in be the book value of the old equipment plus any other consideration parted with. Also, the State Administrative Manual, Section 10544, requires state agencies to review their records to ensure that they have accurately recorded all amounts owed to others. In addition, the State Administrative Manual, Section 8651, requires that all property be identified as state property with property tag decals.

Recommendation

The data center should comply with the requirements contained in the State Administrative Manual to improve its accounting over equipment.

Department of Health Services

The Bureau of State Audits and the Office of the Auditor General reviewed the financial operations and related internal controls of the Department of Health Services (department) and the department's administration of the U.S. Department of Agriculture grant, Federal Catalog Number 10.557, and the U.S. Department of Health and Human Services grants, Federal Catalog Numbers 93.025, 93.026, 93.777, 93.778, and 93.994.

Item 1. Weaknesses In Controls Over Receivables

Finding

The department did not follow procedures that the State Administrative Manual requires to account for and collect receivables related to the Medicaid Drug Rebate Program. According to the department's records at June 30, 1992, these receivables totaled approximately \$102 million. We found the following specific deficiencies:

- The department did not maintain appropriate separation of duties. The employee who mailed the invoices and recorded the invoiced amounts in the accounts receivable ledger, also received, deposited, and recorded the invoiced remittances. Failure to maintain proper separation of duties can result in errors and irregularities that may go undetected.
- The department did not have policies or procedures for monitoring and collecting accounts receivable. Without adequate procedures for monitoring and collecting accounts receivable, the department increases the risk that some receivables will become uncollectible.
- The department did not perform a monthly reconciliation between the subsidiary accounts receivable ledger and the general ledger account. Without properly prepared reconciliations, the department lacks assurance that the transactions have been properly recorded and that the financial records are complete.

In March 1993, in a response to the department's Internal Audit Division, and again in November 1993 in response to an audit report submitted by federal auditors, the department agreed with similar findings and stated that the establishment of an effective and proper accounts receivable system was a department priority. The department has received Department of Finance approval to increase staff in order to separate the incompatible duties. Additionally, in July 1993, a department accounting administrator assumed responsibility for

establishing proper accounts receivable procedures related to the Drug Rebate Program. The accounting administrator expects this system to be operational and in compliance with required internal control and collection procedures by December 1993.

Criteria

The California Government Code, Sections 13402 and 13403, requires agencies to ensure that a satisfactory system of internal accounting and administrative control, including a system of authorization and recordkeeping procedures, is in place to provide effective accounting control over assets, liabilities, revenues, and expenditures. More specifically, the State Administrative Manual, Section 8080, states that preferably no books of original entry concerning cash receipts, cash disbursements, or invoices should be kept by employees assigned to receive and deposit remittances. Additionally, Section 7800 requires subsidiary ledgers to be reconciled with the general ledger each month. Finally, Section 8776.6 states that each department will develop collection procedures that will assure prompt follow-up on receivables.

Recommendation

The department should continue to develop and implement a comprehensive policy for monitoring and collecting accounts receivable.

Item 2. Inaccurate Financial Reports

Finding

The department did not accurately prepare its financial reports for fiscal year 1991-92 for its General Fund, Cigarette and Tobacco Products Surtax Fund–Health Education Account, Federal Trust Fund, and Health Care Deposit Fund. During our audit, we noted the following conditions:

- The department did not accrue all receivables due to its Health Care Deposit Fund at June 30, 1992. In addition, the department did not analyze its accounts receivable balance to identify the amounts it expected to collect in the ensuing 12 months. Because it did not properly accrue and analyze its receivables, the department understated its accounts receivable and overstated its expenditures balances by approximately \$78 million.
- The department did not accurately analyze and report its encumbrances at June 30, 1992, in three of four departmental funds for which we reviewed encumbrances. Encumbrances represent goods and services ordered but not received by June 30. For its General Fund and Cigarette and Tobacco Products Surtax Fund–Health Education Account, the department overstated

encumbrances by approximately \$19.3 million and \$16.4 million, respectively. For its Federal Trust Fund, the department understated its encumbrances by approximately \$863,000.

- The department could not provide supporting documentation for four items accrued in the General Fund at year end. These consisted of an accrual of a due from other funds for approximately \$12.0 million, an accrual of a due to other governments for approximately \$10.7 million, and two separate accounts payable accruals for approximately \$3.2 million and \$1.2 million. Additionally, our review indicated that the first three accruals appeared to be invalid, thus overstating the account balances.
- The department did not accurately analyze the due from other funds and due to other funds accounts in three of its departmental funds to ensure that the correct amounts were accrued at June 30, 1992. For example, the department recorded in its General Fund as due from other funds and as due to other funds, amounts that were approximately \$4.7 million and \$618,000, respectively, greater than the corresponding amounts recorded as due to other funds and due from other funds in the Health Care Deposit Fund. Additionally, the department recorded in its Health Care Deposit Fund as due from other funds an amount that was approximately \$6.1 million less than the corresponding amount recorded as due to other funds in the Federal Trust Fund.

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

Criteria

The State Administrative Manual, Section 8776.2, requires the department to record as valid receivables all receivables which are due and payable and, at June 30, to accrue those abatements that were not previously billed or accrued but which are expected to be collected within the ensuing year. Section 10544 requires agencies to analyze their encumbrances to determine which are valid as of June 30 of each fiscal year. Section 7950 requires that agencies retain lists of all accrual documents and amounts accrued on the basis of estimates as permanent accounting records for audit purposes. Finally, the California Government Code, Section 13403(a)(3), states that the elements of a satisfactory system of internal accounting and administrative control

should include, but are not limited to, a system of authorization and recordkeeping procedures that effectively control assets, liabilities, revenues, and expenditures.

Recommendation

The department should ensure that its financial reports are complete and accurate.

**Item 3.
Audit Reports
for Nonprofit
Subrecipients
Not Received
Promptly**

Finding

The department did not ensure that it promptly received required biennial audit reports for nonprofit subrecipients for two programs we reviewed. Specifically, the department could not provide us with current audit reports for four of the six subrecipients we reviewed in the primary care clinics program. One of these biennial reports was due for the end of fiscal year 1989-90, and five reports were due for the end of fiscal year 1990-91. In addition, one of the six prior audit reports we reviewed for these subrecipients was not conducted in accordance with federal Office of Management and Budget requirements. These clinics received federal funding from the State Legalization Impact Assistance Grants.

For the 15 nonprofit subrecipients we reviewed for the federal Maternal and Child Health Services Block Grant, only one audit report was clearly received within the deadlines established both in departmental contracts with subrecipients and the federal Office of Management and Budget, Circular A-133. Eight reports clearly did not meet the contractual deadline, and, of these eight, three also did not meet the Circular A-133 deadline. The remaining six of the fifteen audit reports either were not date-stamped upon receipt, so the department could not demonstrate the timeliness of submission of the reports, or were not due as of the end of our field work. For one audit report we reviewed, the department failed to require the subrecipient to provide the audit management letter that described audit findings. As a result, the department did not ensure the subrecipient corrected identified problems. Without the appropriate audit reports, the department lacks assurance that the nonprofit subrecipients are complying with federal laws and regulations.

The Office of the Auditor General reported a similar weakness for the Maternal and Child Health Services Block Grant during its audits for fiscal years 1989-90 and 1990-91. In its response to the fiscal year 1990-91 management letter, dated May 27, 1992, the department stated that the Maternal and Child Health Branch and the Audits and Investigations unit were working together to ensure that future audits

would be submitted and reviewed promptly. Since then, the department has developed procedures for monitoring the receipt of required audit reports. These procedures, if followed, are adequate for monitoring the receipt of the reports.

Criteria

The contractual agreements between the State and nonprofit subrecipients establish a deadline of 5 months and 15 days after the end of the subrecipient's fiscal year of the submission of the required audit reports. The federal Office of Management and Budget, Circular A-133, which describes audit requirements for nonprofit agencies, requires the State to ensure that its nonprofit subrecipients submit audit reports no later than 13 months after the end of the subrecipients' fiscal year. Circular A-133 also requires the State to resolve audit findings within six months after the receipt of the report.

Recommendation

The department should ensure that nonprofit subrecipients promptly submit the required audit reports and correct any deficiencies the audit reports identify.

**Item 4.
Excess Federal
Cash on Hand**

Finding

The department maintained a balance of federal funds for the Medical Assistance Program that exceeded the department's immediate cash needs. This condition existed because the department inadvertently duplicated a request to the federal government for \$37 million to cover program costs. The department held the excess federal money for approximately one month, from early August to early September 1992, when it offset this balance against federal drawdowns for other program costs.

Criteria

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

Recommendation

The department should ensure that its requests for federal funds are limited to its immediate cash needs.

**Item 5.
Unapproved
Indirect Cost
Allocation System**

Finding

During fiscal year 1991-92, the department allocated indirect costs for all federal programs using a method that was not approved by the federal government. Before fiscal year 1991-92, the department allocated indirect costs using provisional rates contained in the Indirect Cost Rate Proposal. The department would subsequently amend the original rates when actual costs for the applicable fiscal year were available. In January 1991, the department submitted a Cost Allocation Plan (CAP) to the federal Department of Health and Human Services. The CAP, effective for fiscal year 1991-92, described a four-step process by which indirect costs would be allocated, based on actual costs, to all federal programs. Although the federal government rejected the CAP, the department used it to allocate indirect costs to its federal programs during fiscal year 1991-92. Because the department used a cost allocation system that the federal government did not approve, the federal government may disallow indirect costs allocated to the department's federal programs.

Criteria

The federal Office of Management and Budget, Circular A-87, requires the department to prepare a plan for the allocation of costs required to support the distribution of any joint costs related to the grant program. Circular A-87 also states that the department's cognizant federal agency will approve the allocation plan before the department incurs specific costs.

Recommendation

The department should confer with federal Department of Health and Human Services to determine what action is necessary to obtain federal approval of its indirect cost allocation system.

**Item 6.
Lack of Site
Reviews**

Finding

The department did not conduct all required biennial site reviews for the administration of its federal Special Supplemental Food Program for Women, Infants, and Children (WIC). Specifically, the department did not conduct biennial site reviews during the two years ending September 30, 1992, for seven of 80 local agencies. In addition, of the eight local agencies we chose to examine for the federal fiscal year ended September 30, 1992, the department did not conduct a nutrition assessment for two of the agencies.

Without such site visits, which include reviews to determine whether the local agencies provide appropriate nutrition assessments, the department

lacks assurance that the local agencies are complying with requirements of the WIC program.

Criteria

The Code of Federal Regulations, Title 7, Section 246.6(b), states that local agencies providing WIC services should meet specific requirements in dispensing services to beneficiaries. As part of the department's procedures to ensure that local agencies meet these requirements, the California State Plan for operation of the special Supplemental Food Program for Women, Infants, and Children requires the department to conduct a biennial site review at each local agency. The review process must include an evaluation of nutrition assessment.

Recommendation

The department should complete the required site reviews of local agencies.

**Item 7.
Food Vouchers
Not Reconciled
Promptly**

Finding

For fiscal year 1991-92, the department was late in reconciling approximately 20 percent of the food vouchers it issued with the food vouchers participants redeemed through the WIC program. The department did not complete the reconciliations within 150 days of the first day of authorized use. Failure to promptly reconcile the vouchers may delay detection of irregularities, such as the redemption of fraudulent food vouchers.

The Office of the Auditor General reported a similar weakness during its audits for fiscal years 1987-88 through 1990-91. In its response to the fiscal year 1990-91 management letter, dated May 27, 1992, the department stated that the way in which food vouchers are reconciled had been modified, and as a result, the reconciliations are now being performed within 150 days. While the department is still not reconciling all the vouchers issued with vouchers paid within 150 days, we did note a significant improvement during the last nine months of fiscal year 1991-92. Specifically, during this period, the department was late in reconciling only 0.24 percent of the food vouchers issued with the food vouchers redeemed.

Criteria

The Code of Federal Regulations, Title 7, Section 246.12(n)(1), requires the department to reconcile the food vouchers it issues with the food vouchers participants redeem within 150 days of the first date of authorized use.

Recommendation

The department should continue its efforts to reconcile food vouchers redeemed within 150 days of the vouchers' issue dates.

**Item 8.
Suspension of
Procedures for
Detecting and
Resolving Dual
Enrollment**

Finding

In July 1987, the department suspended its procedures for detecting dual enrollment in the WIC program because the procedures did not operate as intended and produced inaccurate reports. These reports were intended to detect WIC participants who may have enrolled at more than one location. The department's failure to produce accurate reports reduced its ability to detect and resolve participant abuses.

The Office of the Auditor General reported a similar weakness in its audit for fiscal years 1987-88 through 1990-91. The department is developing procedures to detect dual enrollment for staff at the department and the local agencies. According to the chief of the WIC's Education, Standards, and Surveillance Unit, the department expects to implement these procedures in February 1993.

Criteria

The Code of Federal Regulations, Title 7, Section 246.7(k), requires the department to detect instances of dual participation.

Recommendation

The department should increase its efforts to establish reliable procedures to detect instances of dual participation.

**Item 9.
Inaccurate
Federal Financial
Reports**

Finding

The department does not always accurately prepare its federal financial reports. Specifically, we noted the following conditions:

- The department's annual close out report for the WIC program, for the federal fiscal year ended September 30, 1991, does not reconcile to the accounting records. Specifically, the department reported in the close out report approximately \$3.6 million more in administrative expenditures and approximately \$5.6 million less in food expenditures than it recorded in its accounting records. Further, as of October 20, 1992, the department could not provide us with a reconciliation between the close out report and the accounting records.
- The federal financial status reports the department prepared for the State Legalization Impact Assistance Grants (SLIAG) for the

quarter ended June 30, 1992, reported approximately \$1.5 million in expenditures for which the department had no firm documentation. In addition, the reports misclassified approximately \$1 million of administrative costs as program costs. Finally, the department reported approximately \$5.8 million more in authorized federal funds than related records showed at the Department of Social Services, which monitors the grant allocations for all departments with SLIAG costs.

Criteria

The Code of Federal Regulations, Title 7, Section 246.13(c), requires the department to maintain records that adequately identify the source and use of funds spent for program activities. Further, the State Administrative Manual, Section 20014, requires agencies receiving federal funds to reconcile federal financial reports with the official accounting records. The Code of Federal Regulations, Title 45, Section 402.51(c)(1), requires the department to prepare financial status reports that indicate the amount of grant funds obligated and spent. The prescribed federal format for financial status reports also requires the department to report authorized federal funds.

Recommendation

The department should ensure that federal reports contain accurate information and are reconciled to official accounting records.

Item 10. Insufficient Documentation of Nutrition Education Expenditures Reported to the Federal Government

Finding

The department did not adequately document the nutrition expenditures for the WIC program. In addition, the department did not ensure that the year-end nutrition education expenditures reported by local agencies were correctly recorded in the department's records. Specifically, we found the following problems:

- The department was unable to provide year-end nutrition education expenditure reports for 7 of the 83 local agencies and was unable to provide alternative supporting documentation for these expenditures.
- Of the 76 local agency reports the department had on file, 6 did not agree with the department's records.

Without sufficiently documenting and recording year-end nutrition expenditures, the department cannot ensure the information it reports to the federal government is complete and accurate.

Criteria

The Code of Federal Regulations, Title 7, Section 246.13(c), requires the department to maintain records that adequately identify the source and use of funds spent for program activities.

Recommendation

The department should maintain adequate documentation of nutrition education expenditures, and it should ensure the expenditures reported by local agencies are correctly recorded in its records.

**Item 11.
Uncertainty in
How Often
Certain Health
Care Providers
Are To Be
Surveyed for
Health and Safety
Certifications****Finding**

The department and the Health Care Financing Administration (HCFA) did not have a clear agreement about how often the department was to perform the health and safety certifications of facilities other than long-term care facilities that provide health care services for the Medicare program and the Medical Assistance Program. Annually, the HCFA approves budgets for the department specifying the percentage of providers the HCFA expects the department to survey. However, the HCFA does not clarify how often each provider is required to be surveyed. As a result, the department is not sure how often it must survey the various types of providers to meet federal requirements. Therefore, the department has established and uses its own requirements, which may or may not satisfy the required federal percentages specified in the annual budget letters. Without regular surveys and certifications, participants of the Medicare program and the Medical Assistance Program cannot be assured that providers are meeting required health and safety requirements.

Criteria

The Code of Federal Regulations, Title 42, Section 488.20, states that the federal determinations of compliance with health and safety requirements extend for 12 months, and the State is responsible for resurveying as frequently as necessary to determine continued compliance and confirm the correction of deficiencies. The annual federal budget letters, which indicate the percentage of providers the HCFA expects the department to survey, do not specify how often the department must survey each provider. The California Health and Safety Code, Section 1279, requires surveys every two or three years, depending on the nature of the provider, and as often as necessary to ensure the quality of care being provided.

Recommendation

The department and the HCFA should work together to clarify how often the different types of health care providers participating in the

Medicare program and the Medical Assistance Program should be surveyed for compliance with health and safety requirements.

**Item 12.
Noncompliance
With Certain
Federal
Requirements**

Finding and Criteria:

In the following instances, the department did not always comply with administrative requirements of the federal government:

- The Legal Services unit allocated approximately \$267,000 to various programs in November 1991, using percentages based on personal service hours from August 1991. Because the department did not use the current rates, the unit's costs were not correctly allocated to the programs benefited. Specifically, ten programs were undercharged a total of approximately \$20,000 and four programs were overcharged for the same amount. The Office of Management and Budget, Circular A-87, Attachment A, Paragraph F(1), states that indirect cost pools should be distributed on a basis that will result in a fair allocation of costs to the programs benefited.
- For the quarter ending March 31, 1992, the department overcharged the State Survey and Certification of Health Care Providers and Suppliers funded by the Health Insurance for Aged and Disabled (Medicare) by \$1,815 and undercharged the Medical Assistance Program (Medicaid) and the State by \$910 and \$905, respectively. The error occurred because the department did not follow the HCFA guidelines. In its letter dated September 10, 1991, HCFA requires the department to split the costs of the department's Nurse Aide Certification program based on the number of nursing facilities participating in Medicare or Medicaid.
- Three vouchers we examined for the WIC program were redeemed before the authorized dates. In addition, departmental records indicate that, for each month of fiscal year 1991-92, vouchers were redeemed before the authorized issue date. This is possible because some food vouchers can be issued two to three months in advance to qualified recipients. The Code of Federal Regulations, Title 7, Sections 246.12(r)(2)(i) and (ii), requires food vouchers to be redeemed on or after the authorized date.
- One voucher we examined for the WIC program was not deposited within 60 days of the date of issuance. The Code of Federal Regulations, Title 7, Section 246.12(r)(2)(iii), requires food vendors to submit vouchers for payment by the expiration date identified on the voucher. The department's WIC program manual,

Section 310-40, states that vendors have 60 days from the issue date to submit vouchers for payment.

- For one of the 77 automated Medi-Cal payments we tested, the department overpaid one provider by \$26. The overpayment occurred because a long-term care provider billed Medi-Cal at its regular daily rate while holding a bed open for a patient who had been temporarily moved to a hospital. The Code of Federal Regulations, Title 22, Section 51535.1(d), requires that payments to long-term care facilities for beneficiaries who are on bed hold should be made at the appropriate facility daily rate less \$3.78 for raw food costs.

Although individually these deviations may not appear to be significant, they do represent noncompliance with federal regulations, which are designed to protect the public's resources from abuse.

Recommendation

The department should improve its compliance with federal requirements.

**Item 13.
Noncompliance
With State
Requirements**

Finding and Criteria

In the following instance, the department did not always comply with administrative requirements of the State and the department.

- For 6 out of 21 Revolving Fund checks that were greater than \$15,000 and payable to vendors outside the state system, the department did not require two signatures on the checks. The State Administrative Manual, Section 8001.2, requires two signatures on checks over \$15,000 unless payable to another state agency or special dispensation is received.

Although individually this deviation may not appear to be significant, it does represent noncompliance with state regulations which are designed to protect the public's resources from abuse.

Recommendation

The department should improve its compliance with state requirements.

Department of Mental Health

The Office of the Auditor General reviewed the Department of Mental Health's (department) administration of the U.S. Department of Health and Human Services grants, Federal Catalog Numbers 93.025 and 93.992.

Item 1. Delayed Cash Payments to Subrecipients

Finding

The department did not make prompt initial cash payments to subrecipients of the Alcohol and Drug Abuse and Mental Health Services Block Grant (ADAMHA grant). Although the department mailed the ADAMHA grant renewal applications to the subrecipients in late April 1991, the department did not mail the first payments to the subrecipients until January 1992, more than six months after the start of the state fiscal year. During these first six months, the subrecipients reported that they spent \$9,559,233 for the ADAMHA grant without receiving payments for services provided.

After providing the first payment in January 1992, the department improved its timeliness for paying subrecipients. In April 1992 and June 1992, the department made payments to subrecipients for their expenditures.

Criteria

The Code of Federal Regulations, Title 31, Section 205.4(a), requires that cash advances to a recipient be timed to match the actual, immediate cash requirements of the recipient in completing the project. The timing and amount of the cash advances should be as close as is administratively feasible to the actual disbursements by the recipient for program costs. In addition, Section 205.4(e) requires that cash advances made by primary recipients to subrecipients conform substantially to the same requirements.

Recommendation

The department should improve its procedures so that the department makes initial payments to the subrecipients within a reasonable period of time after the start of the fiscal year.

Department of Rehabilitation

The Office of the Auditor General reviewed the Department of Rehabilitation's (department) administration of the U.S. Department of Education grant, Federal Catalog Number 84.126.

Item 1. Inaccurate Federal Financial Reports

Finding

The department overstated the federal share of disbursements for the Basic Support Grant (grant) for fiscal year 1990-91. The overstatement was included in the federal cash transaction report for the quarter ending June 30, 1992. The total amount spent for the grant included in the cash transaction report did not agree with the amount reported in the department's financial status report for the same period. According to a senior accounting officer for fiscal systems, the expenditure amount listed in the cash transaction report was taken from a worksheet prepared for the financial status report. Although the worksheet contained the correct amount for the grant, the senior accounting officer transferred the wrong figure from the worksheet. As a result, the department overstated the total federal share of disbursements for all of its grants and understated the cash on hand by \$872,538 in the federal cash transaction report. However, on August 25, 1992, the department submitted a monthly federal cash transaction report for July 1992 and made the adjustment to correct the error reported.

In addition, the department's financial status report for June 30, 1992, contained two minor clerical errors for the previously reported expenditures and the current month's expenditures. However, the two errors offset each other in the two categories and did not affect the cumulative expenditures reported for that period. Also, when we identified the errors, the department's accounting analyst corrected them and revised the financial status report to send to the federal government.

The Office of the Auditor General reported similar errors during its audit for fiscal year 1987-88, 1988-89, and 1989-90. During the fiscal year 1989-90 audit, the Office of the Auditor General noted that the department corrected the errors in subsequent financial reports.

Criteria

The Code of Federal Regulations, Part 80, Section 80.20 (b)(1), requires the department to submit accurate and current financial reports. These reports should also include complete disclosure of the financial results of financially assisted activities made according to the financial reporting requirements of the grant.

Recommendation

The department should ensure that its financial reports contain accurate and reliable information.

Department of Social Services

The Bureau of State Audits and the Office of the Auditor General reviewed the financial operations and related internal controls of the Department of Social Services (department) and the department's administration of the U.S. Federal Emergency Management Agency grant, Federal Catalog Number 83.516; the U.S. Department of Agriculture grants, Federal Catalog Numbers 10.551 and 10.561; and the U.S. Department of Health and Human Services grants, Federal Catalog Numbers 93.020, 93.021, 93.023, 93.025, 93.026, 93.658, 93.659, 93.667, and 93.802.

Item 1. Improvement in Cash Management

Finding

The department has improved its cash management system for requesting federal funds for the federal share of the department's administrative and local assistance expenditures. In fiscal year 1990-91, the State lost approximately \$144,300 in potential interest income. For fiscal year 1991-92, the State lost approximately \$46,800 in potential interest income. Specifically, we noted the following conditions:

- The department was eight months late in requesting federal funds to reimburse the State for administrative expenditures incurred during fiscal year 1991-92 for the Employment Services program. The department initially pays the State's portion of these administrative expenditures from the department's general fund and subsequently requests federal funds from the Employment Development Department to reimburse the department's general fund. As a result of not promptly requesting federal funds, the State lost approximately \$38,900 in interest income.
- The department did not promptly request federal funds to reimburse the State for expenditures incurred during fiscal year 1991-92. The department initially pays In-Home Supportive Services expenditures from the department's general fund and subsequently requests federal funds from the Social Services Block Grant to reimburse the general fund. Allowing the department five working days to request and receive reimbursement for the date the department initially paid the expenditure or from the date the department was subsequently notified that federal funds were available, the department was one to five days late in receiving reimbursement for the transactions we tested. As a result, the State lost approximately \$7,900 in interest income.

The Office of the Auditor General reported similar weaknesses in its financial audits for fiscal years 1985-86 through 1990-91. In its response to the audit for fiscal year 1990-91, the department said it will continue to look at improving its procedures to minimize the amount of time that state funds are used "in lieu of" disbursing federal funds.

Criteria

The State Administrative Manual, Section 0911.4, requires state agencies to secure prompt reimbursement from grant funds for goods and services provided.

Recommendation

The department should promptly request federal funds to reimburse its general fund for federally eligible expenditures.

**Item 2.
Delays in
Disbursing
Federal Monies**

Finding

During fiscal year 1991-92, the department maintained balances of federal monies that exceeded its immediate cash needs. These monies are used to pay for the federal government's share of the department's expenditures. Maintaining excess cash may result in the termination of advance financing by the federal government. During our audit, we noted the following:

- The department did not properly analyze its cash on hand for the Job Opportunities and Basic Skills program when requesting additional federal monies. As a result, the department held an average monthly balance of \$496,000 in excess federal monies, ranging from approximately \$116,000 to \$564,000, between March 31, 1991 and May 31, 1992.
- The department did not ensure that state spending authority, necessary for disbursing federal monies, was sufficient before it requested and received approximately \$5 million in federal monies for the Foster Care program. The department did not receive spending authority until 13 days after it had received the federal monies.

Criteria

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

Recommendation

The department should ensure that its request for federal monies are limited to its immediate cash needs.

**Item 3.
Failure To
Recover Cash
Advances for the
Refugee
and Entrant
Assistance--State
Administered
Program****Finding**

The department failed to recover cash advances it made to one contractor participating in the Refugee and Entrant Assistance--State Administered program. As of October 16, 1992, the department failed to recover approximately \$111,000 advanced to the contractor that it should have recovered in October, November, and December 1991. When subrecipients, in this case the contractor, maintain excess cash, the federal government could end advance financing.

Criteria

The Code of Federal Regulations, Title 31, Section 205.4(e), requires that advances by primary recipients to subrecipients be limited to the minimum amounts needed and timed to meet the actual, immediate cash requirements of the subrecipient in carrying out the purpose of the program.

Recommendation

The department should ensure that subrecipients do not maintain excess cash balances.

**Item 4.
Insufficient
Monitoring of
Federal
Programs****Finding**

The department suspended its monitoring of the counties participating in the refugee cash assistance and unaccompanied minor element of the Refugee and Entrant Assistance--State Administered program during fiscal year 1991-92. Further, the department provided us with documentation of only one monitoring review of counties participating in the State Legalization Impact Assistance Grants program during fiscal year 1991-92. The purpose of monitoring is to ensure that the counties properly determine a recipient's eligibility to participate in the program and that the counties serve the recipient for the time period allowed and in the proper amount. Also, in the case of the unaccompanied minor element, monitoring ensures that counties develop and implement an appropriate plan for the care and supervision of services provided to each unaccompanied minor. Without monitoring, the State cannot ensure that the counties properly administer federal programs.

Criteria

The Code of Federal Regulations, Title 45, Section 74.81, requires the department to monitor the performance of grant supported activities and to review each program, function, or activity to ensure that adequate progress is made towards achieving the goals of the grant. The Code of Federal Regulations, Title 45, Section 400.117(b), states that if a state arranges for the care and services of unaccompanied minors through a public or private agency, it must retain oversight responsibility for the appropriateness of the unaccompanied minor's care.

The Code of Federal Regulations, Title 45, Section 94.40, requires the department to monitor activities of the State Legalization Impact Assistance Grants program to ensure compliance with applicable federal requirements.

Recommendation

The department should conduct the required monitoring of the Refugee and Entrant Assistance--State Administered program and the State Legalization Impact Assistance Grants program.

**Item 5.
Lack of
Control Over
Disbursements
for the Child
Support
Enforcement
Program****Finding**

The department lacked control over its disbursements for the Child Support Enforcement program. We reviewed four county claims paid during August 1991 and February 1992 that did not contain audit approvals from the department's Fiscal Policy Unit. If the department does not audit the county claims, it has no assurance these claims are accurate.

Criteria

The Code of Federal Regulations, Title 45, Section 74.61(c), requires that effective control and accountability be maintained for all grant cash. It requires recipients to adequately safeguard its cash and ensure that it is used solely for authorized purposes. The California Government Code, Section 13401, requires state agencies to maintain an effective system of internal accounting and administrative control to minimize error.

Recommendation

The department should resume audits of county administrative claims to ensure claims are accurate.

**Item 6.
Federal Financial
Reports Not
Reconciled With
Accounting
Records**

Finding

The department did not reconcile its federal financial reports prepared during fiscal year 1991-92 with departmental accounting records. Failure to reconcile federal financial reports with the accounting records can result in misstatements of claims that may go undetected.

The Office of the Auditor General reported a similar weakness in its financial audits for fiscal years 1985-86 through 1990-91. The department is developing automated processes designed to ensure that the data contained in federal reports are consistent with the accounting records maintained in the California State Accounting and Reporting System. The department estimates it will complete this process during fiscal year 1992-93.

Criteria

The Office of Management and Budget, Circular A-102 revised, Subpart C, paragraph 883(b) (1), requires grantee financial management systems to provide accurate, current, and complete disclosure of each grant program. Further, the State Administrative Manual, Section 20014, requires agencies receiving federal funds to reconcile federal financial reports with the official accounting records and retain all supporting schedules and worksheets for a minimum of three years.

Recommendation

The department should implement a reconciliation system so that it can reconcile its federal financial reports with departmental accounting records.

**Item 7.
Delays in
Collecting
Disallowed Costs
or Adjusting for
Incorrectly
Claimed Costs**

Finding

The department did not promptly collect disallowed costs from the county welfare departments. Before January 1, 1992, the department contracted with the Division of Audits of the State Controller's Office to conduct audits of the administrative expenditure claims records of county welfare departments. While conducting these audits, the State Controller's Office was responsible for determining whether county welfare departments adhered to regulations and instructions set forth by the federal government and the department. The department is responsible for analyzing and resolving any audit protest between the county welfare departments and the State Controller's Office. In addition, the department is responsible for collecting from the county welfare departments disallowed costs that the State Controller's Office identified as a result of the audits.

We reviewed 10 of the 100 audits in the "application process." In the application process, staff determine, among other things, the type of funding, fiscal period, and program to which the disallowed costs or incorrectly claimed costs relate. After allowing time for the department to resolve any audit protest or appeal and place the item in the application process, we found one item was in the application process for approximately three years before it was completed. The other nine items have been in the application process from approximately eight months to approximately four years without being completed. For the ten test items, the disallowed costs totaled approximately \$1.6 million and incorrectly claimed costs totaled approximately \$1.8 million. Because nine of the ten items are still in the application process, we are not able to determine what portion of the \$1.6 million in disallowed costs applies to federal funding.

The Office of the Auditor General reported similar weaknesses in its audits for fiscal years 1985-86 through 1990-91. The department responded to the audit for fiscal year 1990-91 that its Administrative Claims Unit lost five of nine audit staff from July 1, 1991 through October 30, 1991. It also said it had filled the positions by February 1992, and staff are being trained to complete the very technical tasks assigned to the unit.

Criteria

The Code of Federal Regulations, Title 45, Section 74.61(h), requires each state to follow a systematic method to ensure prompt and appropriate resolution of audit findings and recommendations.

Recommendation

The department should promptly offset the disallowed costs of the county welfare departments against the current county claims or adjust for incorrectly claimed costs to ensure that excess funds are not held by the county welfare departments.

Legislative, Judicial, and Executive

Office of Emergency Services

The Office of the Auditor General reviewed the Office of Emergency Services' (office) administration of the U.S. Federal Emergency Management Agency grant, Federal Catalog Number 83.516.

Item 1. Delay in Appealing Denied Costs

Finding

The office has not promptly appealed the Federal Emergency Management Agency's (FEMA) denial of approximately \$7.7 million of claimed expenses related the Loma Prieta earthquake. The Office of the Auditor General also observed this weakness during its audit of the office for fiscal year 1990-91. As of September 15, 1992, the office had not appealed this determination although the office previously indicated that it planned to make its appeal by May 29, 1992.

In addition, our review of grants for two disasters, the Loma Prieta earthquake and the Oakland Hills wildfire, the office has not claimed at least \$47,989 in indirect costs that it should have for fiscal year 1991-92.

Criteria

The State Administrative Manual, Section 0911.4, requires state agencies to secure prompt reimbursement from grant funds for goods and services provided. Consequently, if it believes the FEMA erred in its determination, the office should promptly appeal the FEMA's denial of its claims. The Code of Federal Regulations, Title 44, Section 206.206, describes the process for appealing denied costs.

Recommendation

The office should appeal at least \$7.7 million in denied claims for fiscal year 1990-91, and claim its indirect costs for fiscal year 1991-92.

Board of Equalization

We reviewed the financial operations and related internal controls of the Board of Equalization (board).

Item 1. There Is No Provision In the Vehicle Fuel License Tax Law for Assessing Penalties On Underpayments of Required Fuel Tax Prepayments

Finding

Under Section 7659.1 of the Vehicle Fuel License Tax Law, motor vehicle fuel distributors whose estimated tax liability averages \$900,000 or more per month, as determined by the board, are required to make a prepayment of taxes each month. The prepayment requirement may be satisfied by making a prepayment of at least 95 percent of the tax liability for the month to which the prepayment applies or at least 95 percent of the amount of the tax liability reported for the previous month. Sections 7659.6 and 7659.7 of the law describe the penalties which are to be assessed on late prepayments. The penalty rate is 6 percent on late prepayments and 10 percent on such prepayments if the untimely payment or deficiency in payment amount is due to negligence or intentional disregard. However, there is no provision for assessing penalties on prepayments which are made timely but which are underpaid.

During our testing of revenue for the Motor Vehicle Fuel Account, we noted instances where taxpayers made their prepayments on time, but the amount they prepaid did not meet the 95 percent requirement that is stipulated in the law. We asked the senior auditor of the fuel taxes division whether the board assesses penalties on underpayments of prepayments, and he stated that they do not assess such a penalty since there is no provision for it in the law.

We calculated the amount of additional revenue that could have been collected by the board's fuel taxes division had the vehicle fuel license tax law allowed penalties to be assessed on insufficient prepayments during fiscal years 1991-92 and 1992-93. We used a penalty rate of 6 percent, which is consistent with the rate charged on late prepayments. Based on our calculations, the board could have collected at least \$128,000 in penalties during fiscal year 1991-92, and at least \$138,000 for fiscal year 1992-93.

Criteria

Section 7653 of the Revenue and Taxation Code gives the board the authority and responsibility for the collection of vehicle fuel license tax.

Recommendation

We recommend that the board seek a change in the Vehicle Fuel License Tax Law that would allow the Board of Equalization to assess penalties on prepayments that are made on time but are for less than the amount stipulated in the law. By implementing and enforcing such a law, taxpayers would be encouraged to make their prepayments on a timely basis and for the required amounts. This would allow the State to have access to this revenue sooner, and to collect additional penalties for insufficient prepayments.

Item 2. The Board Still Has Some Unnecessary Delays In Applying Credit Balances or Refunding Overpayments

Finding

We noted several instances where the board did not promptly apply credit balances in order to reduce taxpayers' liabilities.

The Office of the Auditor General reported a similar weakness related to resolving credit balances during its financial audit of fiscal year 1990-91. At that time, the board had 785 credit balances totaling \$2.1 million that were three years old or more. The board has since intensified its efforts to apply any long-outstanding credit balances. As a result of the board's efforts, as of July 1993, the number of credit balances over three years old have been reduced to 283, amounting to approximately \$600,000. Moreover, the board has recently drafted a policy memorandum to further improve its performance regarding the prompt and accurate application of credit balances. This policy draft provides for the review of all credit balances over 24 months old. The draft also includes an action request form used to obtain information from the board's district offices. However, without aggressive follow-up by the board, there is little assurance that district offices will comply with requests for information concerning long-outstanding credit balances.

Without a formally adopted board policy requiring prompt review of long-outstanding credit balances and a requirement that district offices promptly respond to requests for information from headquarters regarding credit balances, there is an increased likelihood that tax overpayments will not be applied or refunded within the time prescribed by law.

Criteria

The California Revenue and Taxation Code, Section 6901, requires that when the board determines that any amount collected or received from a taxpayer is not owed to the board, it must credit the taxpayer's account for any amount owed by the taxpayer and refund the balance, if any. In addition, Section 6902 of the Code only allows the board three years

from the time it receives a taxpayer's payment to make a refund, unless the taxpayer either files a claim or enters into an agreement with the board, thereby extending the time period.

Recommendation

To ensure that all credit balances are promptly applied or refunded, the board should:

- Amend the draft policy regarding credit balances to require that all district offices respond to requests for information within a set time limit and aggressively enforce this requirement; and,
- Formally adopt and follow the draft policy.

State Controller's Office

We reviewed the financial operations and internal controls of the State Controller's Office (office).

Item 1. Improper Accrual of Liabilities

Finding

The office accrued a liability related to the University of California (UC) for which there was no budget authority. The 1991-92 Budget Act included an appropriation of \$55 million for support of the UC. However, the funds were not available for expenditure or encumbrance until July 1, 1992, after the end of fiscal year 1991-92. The office established the appropriation in its Appropriation Control Ledger (ACL) with a description indicating the amount was not available until fiscal year 1992-93. Even though the office included the restrictive language on the ACL, the \$55 million appeared as an available balance on the Agency Reconciliation Report for UC and was accrued in error as a liability at June 30, 1992. As a result, expenditures and liabilities of the State's General Fund were overstated by \$55 million.

Criteria

Item 6440-002-001 of the 1991-92 Budget Act appropriates \$55 million for support of the University of California and states that the funds are not available for expenditure or encumbrance until July 1, 1992.

Recommendation

The office should ensure that there is budget authority for liabilities it accrues.

Item 2. Delays In Reimbursing the General Fund

Finding

The office did not promptly transfer to the General Fund amounts available in the State School Building Aid Fund to reimburse the General Fund for principal and interest on state school building aid general obligation bonds (bonds). During 1991-92, the General Fund paid approximately \$51 million in principal and interest on the bonds but was not reimbursed by the State School Building Aid Fund until October 28, 1992, almost four months after the end of the fiscal year.

Criteria

Section 16403 of the Education Code requires the office to transfer to the General Fund available monies in the State School Building Aid Fund for payment of principal and interest on the several dates of maturity of the bonds in each fiscal year.

Recommendation

The office should ensure compliance with Section 16403 of the Education Code.

State Treasurer's Office

We reviewed the financial operations and internal controls of the State Treasurer's Office (office).

Item 1. Noncompliance With State Collateral Requirements

Finding

The State Treasurer's Office did not ensure that all state time deposits were collateralized as required by the Government Code. The State Treasurer's Office is responsible for ensuring that the State's time deposits with banks and savings and loans are adequately collateralized at all times. We reviewed the collateral on deposit for the State's time deposits of \$150 million as of June 30, 1992, and noted two instances in which collateral was less than that required. Specifically, two banks with deposits totaling \$1.30 million that required collateral of \$1.37 million had on deposit \$1.34 million, or 2 percent less collateral than required.

Criteria

The California Government Code, Sections 16521, 16522, 16611, and 16612, requires that banks and savings and loans deposit with the State Treasurer specified amounts of collateral as security for state time deposits.

Recommendation

The State Treasurer's Office should ensure that it complies with the state requirements for collateral.

Resources

Department of Water Resources

We reviewed the financial operations and related internal controls of the Department of Water Resources (department).

Item 1. Noncompliance With the State's Capitalization Policy

Finding

The department's policy for the capitalization of costs related to its office refurbishment project is not consistent with the State's policy. Specifically, the department included approximately \$78,000 of costs to acquire miscellaneous office furniture in its office refurbishment account. Because the per-unit-cost of these items was below the \$500 unit-cost criteria set forth in state regulations, the costs should have been treated as expenses for fiscal year 1991-92 and should not have been capitalized.

Criteria

The State Administrative Manual, Section 8602, states that items must have a unit acquisition cost of at least \$500 in order to be capitalized.

Recommendation

The department should reevaluate its policy for the capitalization of office refurbishment costs to ensure that it meets state requirements regarding the capitalization of assets.

State and Consumer Services

Franchise Tax Board

We reviewed the financial operations and related internal controls of the Franchise Tax Board (board).

Item 1. Noncompliance With State Requirements

Finding and Criteria

In the following instances, the board did not always comply with administrative requirements of the State:

- Through an oversight, the board did not issue a refund of bank and corporation taxes previously collected in the amount of \$2,147, and now has no statutory authority to issue the refund. The Office of the Auditor General identified the money as being owed to the taxpayer during its audit of fiscal year 1990-91. The Revenue and Taxation Code, Section 26073, states that, except for specified circumstances, no credit or refund shall be allowed or made after four years from the original or extended due date of the return or one year from the date of the overpayment, whichever is later.
- Also, the board could not locate a tax return to support why it issued one of 48 personal income tax refunds that we reviewed. The California Government Code, Section 13402, requires agencies to maintain an effective system of internal accounting and administrative control.
- The board did not ensure the individuals preparing and reviewing the reconciliation of the general checking account to sign and date it. The State Administrative Manual, Section 7908, requires the preparer and reviewer to sign and date all reconciliations.

Recommendation

The board should improve its compliance with each of the state requirements.

Department of General Services

We reviewed the financial operations and related internal controls of the Department of General Services (department).

Item 1. Possible Liability to the Federal Government

Finding

The department has a possible liability to the federal government estimated to be as much as \$7.7 million for profits it has accumulated in its Service Revolving Fund (SRF) between July 1, 1984, and June 30, 1992. The department's SRF is an internal service fund that accounts for printing and procurement services to state agencies. The department has charged these agencies more than its costs for providing services. In turn, state agencies have passed these charges on to federal programs. The SRF accumulates profits when the department's charges for services exceed its costs. Federal regulations prohibit the State from charging federal programs for more than its costs.

In 1984, the federal Department of Health and Human Services audited the State's rate-setting methods for internal service funds. As a result of the audit, the State was required to refund to the federal government approximately \$14.9 million of the profits accumulated in internal service funds. This amount represented the federal share of profits accumulated in five of the State's internal service funds from July 1, 1969, to June 30, 1984. The Department of Finance calculated that 15.5 percent of the SRF's accumulated profits of approximately \$66.8 million at June 30, 1984, resulted from charges to federal programs and, thus, the SRF owed the federal government approximately \$10.3 million.

Using procedures similar to those of the Department of Finance, and using the same ratio of 15.5 percent, we estimate that, under current federal regulations, the State may owe the federal government approximately \$7.7 million.¹ However, an October 1988 proposed amendment to the federal Office of Management and Budget, Circular A-87, would allow state agencies a reasonable working capital reserve of 60 days' worth of cash expenditures. This amendment, if approved, may eliminate any liability to the federal government.

¹Since the federal government and the State's executive branch are ultimately responsible for negotiating any final settlement, we did not attempt to determine whether the percentage of federal participation the federal government accepted in its 1984 audit is still acceptable in 1992.

If the department has a liability, it may not be able to reimburse the federal government because then the SRF's fund balance may be reduced to the point at which it does not have sufficient working capital to operate. At the end of fiscal year 1991-92, the department's working capital for the SRF was approximately \$18.8 million. This amount is only enough to cover approximately 20 days of the department's cash expenditures in the SRF.

The Office of the Auditor General reported a similar finding during its financial audits for the three previous fiscal years. The Auditor General recommended that the Department of Finance ensure state agencies comply with federal regulations. In his response of March 18, 1991, the director of the Department of Finance stated that, in some cases, state laws and regulations differ from those of the federal government and that the State is working with the federal government to minimize the differences. He stated that guidelines will be developed as soon as such differences are resolved.

Criteria

The federal Office of Management and Budget, Circular A-87, "Cost Principles for State and Local Governments," does not allow the State to charge federal programs for amounts that exceed costs. In addition, the California Government Code, Section 13070, provides the Department of Finance with general powers of supervision over all matters concerning the financial and business policies of the State.

Recommendation

The department should comply with the federal Office of Management and Budget, Circular A-87, when establishing billing rates for charges to state agencies receiving federal support. Further, the Department of Finance should ensure that the department complies with federal regulations. For example, compliance could be ensured by developing guidelines for the department and state agencies receiving services from the department. In addition, the Department of Finance should monitor the proposed amendment to Circular A-87 to determine the effects the amendment may have on state charges to federal programs.

Item 2. Finding
Inadequate Procedures for Identifying and Reporting Interest Earned on Deposits of School Districts

As of the end of fiscal year 1991-92, the department's Office of Local Assistance (OLA) did not have adequate procedures to identify and report interest earned by school districts on funds received from the State for participating in the state school building lease-purchase program.

The OLA administers grants to school districts for construction projects under the lease-purchase program. Frequently, the OLA disburses the grant funds to school districts before the school districts begin the construction projects. The school districts then deposit the funds into interest bearing accounts at their county treasuries. The county offices of education should report to the OLA the interest earned on the school districts' deposits.

For fiscal year 1990-91, the Office of the Auditor General reported deficiencies in the process the OLA used to identify and report the interest earnings. For example, the OLA did not require the prompt reporting of interest earned and had not established reasonable controls to ensure amounts reported were accurate. In July 1992, in its response to the fiscal year 1990-91 report, the department indicated that the OLA had established procedures to ensure compliance with the requirements in the California Code of Regulations for reporting interest. However, we noted that implementation of the procedures did not begin until 1993, when the OLA began to require and monitor the reporting of interest at specified intervals.

According to the manager of the OLA's fiscal services section, the OLA did not implement recommended procedures during fiscal year 1991-92 because the State Allocation Board, which is the OLA's oversight entity, and the OLA requested clarification from the Attorney General about the appropriate disposition of the school districts' interest earnings. The manager of the fiscal services section stated further that it was not prudent or economical for the fiscal services section to expend staff resources to verify and record reported interest until these issues were resolved. As of June 30, 1992, the interest issue had not been resolved.

Because the procedures were not implemented during fiscal year 1991-92, as of June 30, 1992, the OLA did not record in its accounting records or report to the State Controller's Office approximately \$58.4 million of interest earned by school districts on lease-purchase funds not yet spent. As a result, the amount due to local governments that the OLA reported to the State Controller's Office in its year-end financial reports was overstated by approximately \$58.4 million.

Criteria

The California Code of Regulations, Title 2, Section 1865.52, states that interest earnings on school districts' deposits are due and payable on September 15 following the date of the execution of the lease-purchase agreement and on each successive September 15 thereafter during the life of the agreement. The California Government Code, Section 13401, requires agencies to maintain an effective system of internal control. In addition, the Government Code, Section 13403, requires that the system of internal control include recordkeeping procedures sufficient to provide effective accounting control over assets, liabilities, revenues, and expenditures.

Recommendation

The OLA should continue its implementation of procedures to ensure that the county offices of education promptly and accurately report the amount of interest earned on deposits of school districts and that these amounts are promptly and accurately posted in the State's accounting records.

**Item 3.
Completed School
Construction
Projects Not
Audited Promptly****Finding**

The department's Office of Local Assistance (OLA) did not complete close-out audits of school construction projects promptly. According to data provided by the OLA, as of November 1993, approximately 1,400 school construction projects were ready for close-out audits. Because it has not reviewed these projects, the OLA has not determined the amount of the districts' allowable expenditures and has not determined whether the State owes districts additional funds or whether any funds that may have been apportioned to these projects in excess of actual costs are to be returned to the State and made available for other projects. According to data provided by the OLA, 251 close-out audits completed between January 1, 1992, and October 29, 1993, disclosed that certain school districts owed the State approximately \$1.6 million and the State owed other school districts approximately \$9 million of the districts' remaining apportioned amounts.

The Office of the Auditor General reported a similar weakness in the January 1991 report, "Some School Construction Funds Are Improperly Used and Not Maximized." The department has submitted a request for 7.5 additional, temporary audit positions for work on the close-out audits.

Criteria

The Government Code, Section 13401, requires agencies to maintain an effective system of internal control. The Government Code,

Section 13403, requires the system of internal control to include recordkeeping procedures sufficient to provide effective accounting control over assets, liabilities, revenues, and expenditures. The State Administrative Manual, Section 8776.6, requires each department to develop procedures that will ensure prompt follow-up on Receivables. Prompt close-out audits would enable the department to determine whether the school districts owe the State money for amounts distributed in excess of actual construction costs.

Recommendation

The OLA should ensure the prompt audit of closed construction projects.

Item 4. Inadequate Control Over Accounting Records

Finding

The department's Office of Local Assistance (OLA) maintained inadequate controls over its accounting records for the State School Building Lease-Purchase Fund (fund 344); the School Facilities November 1990 Bond Account, State School Building Lease-Purchase Fund (fund 708); the School Facilities June 1990 Bond Account, State School Building Lease-Purchase Fund (fund 774); the School Facilities November 1988 Bond Account, State School Building Lease-Purchase Fund (fund 776); and the School Facilities June 1988 Bond Account, State School Building Lease-Purchase Fund (fund 789). The Office of the Auditor General reported similar weaknesses during the financial audits for fiscal years 1987-88 through 1990-91. We identified the following deficiencies:

- For 27 of the 341 projects we reviewed, the OLA's subsidiary project records, which document the detailed funding history of each project, differed from the amounts reflected on the budget report for the projects. The budget report supports the general ledger. In 8 instances, the project records were in error, and in 17 instances, the budget report was in error. In addition, for 2 of the 27 projects, both the project records and the budget report were in error. As of June 30, 1993, the project records for 10 of the 27 projects still differed from the amounts reflected on the budget report for the project.

When project records were in error, the OLA did not have accurate information readily available about the remaining funds for projects before distributing funds to the school districts. When the budget report was in error, the account balances reported to the State Controller's Office as of June 30, 1992, were incorrect. For example, the account balances for due to local governments in funds

344 and 776 were understated by approximately \$1.2 million and \$1.4 million, respectively. The balance for due to local governments in fund 789 was overstated by approximately \$1.0 million.

- The OLA could not provide supporting documentation for approximately \$2.4 million in the due from school districts account balance in fund 344 as of June 30, 1992. As a result, the department cannot be sure the balances in the expenditure and due from other governments accounts reported to the State Controller's Office are correct or that the remaining spending authority for fund 344 is accurately determined.
- The records in which the OLA records expenditures and remaining spending authority for fund 344 do not agree with similar records maintained by the State Controller's Office. As of June 30, 1992, the records of the OLA differed from the records of the State Controller's Office by approximately \$1.2 million. The differences occurred because in past fiscal years, the OLA recorded transactions incorrectly. As of June 30, 1992, the OLA had not completed documentation to correct the errors.

Criteria

The California Government Code, Section 13401, requires agencies to maintain an effective system of internal control. In addition, the Government Code, Section 13403, requires that the system of internal control include recordkeeping procedures sufficient to provide effective accounting control over assets, liabilities, revenues, and expenditures. Furthermore, the State Administrative Manual, Section 7800, requires subsidiary ledgers to be reconciled with the general ledger each month, and the State Administrative Manual, Section 7900, discusses the importance of making regular reconciliations. Properly prepared reconciliations represent an important element of internal control because they provide a high level of confidence that the financial records are complete.

Recommendation

The OLA should reconcile its subsidiary project cards with its general ledger each month. In addition, the OLA should monitor its commitments to ensure that there are available funds to meet the commitments. The OLA should promptly correct any recording differences between its records and those of the State Controller's Office. Finally, the OLA should maintain complete accounting records.

**Item 5.
Weakness in
Accounting for
Inventory**

Finding

The Telecommunications Division (division) does not ensure that its method of pricing inventory results in a recorded value that reflects the actual costs of the inventory on hand. The Office of the Auditor General reported a similar weakness during its financial audits for fiscal years 1988-89, 1989-90, and 1990-91.

After its staff counts and prices items for the annual physical inventory, the division notifies the accounting office of the new inventory balance. Using this information, the accounting office records the change from the previous year's balance. Because the department does not have a system that informs the accounting office of changes in the inventory account throughout the year, the accounting office relies on the accuracy of the division's inventory balance for the amount it reports in the financial statements for the Service Revolving Fund. However, the division's method of pricing does not result in a recorded value that reflects the actual cost of the inventory on hand. For central stores, the division records inventory value from the purchase orders. For the Area 3 inventory, the division updates inventory prices and quantities annually, determining values from the current catalogue prices or the price from central stores. Neither method of valuation reflects sales tax.

Criteria

The California Government Code, Section 13401, requires agencies to maintain an effective system of internal control. In addition, the California Government Code, Section 13403, requires that the system of internal control include recordkeeping procedures sufficient to provide effective accounting control over assets, liabilities, revenues, and expenditures. The State Administrative Manual, Section 7620, states that inventory is shown at cost.

Recommendation

The department should use a consistent, documented method of pricing inventory that ensures the recorded inventory reflects the acquisition costs.

**Item 6.
Weaknesses in
Accounting for
Fixed Assets**

Finding

The department did not have adequate procedures to ensure that fixed assets were always properly safeguarded or accounted for in the Service Revolving Fund. We found the following specific problems:

- The California State Police Headquarters had not consistently updated its property records. As a result, the division's staff were not able to locate any of the three fixed assets that we selected for review at the police headquarters, and the staff could not provide

assurance that the assets were still available for state use. The total original cost of these three items was approximately \$26,000.

- The department did not always remove the value of fixed assets and related accumulated depreciation from the accounting records after the assets were sold. As a result, the department's financial reports that the State Controller's Office used to prepare the State's financial statements overstated the fixed assets, accumulated depreciation, and depreciation expense accounts by approximately \$218,000, \$130,000 and \$39,000, respectively.
- The Office of State Printing did not immediately assign property numbers to computer equipment after acquisition. Although the department received the equipment, totaling approximately \$50,000, in June 1991, it had not tagged the equipment with identification numbers or included the equipment in its inventory of assets as of June 1993. As a result, the department could not ensure that it was protecting the equipment from theft or misuse.

Criteria

The State Administrative Manual, Section 8600, states that the combination of accurate accounting records and strong internal controls must be in place to protect against and detect the unauthorized use of state property. For proprietary funds, the State Administrative Manual, Section 8621, requires the department to record purchased equipment in the fixed asset account and remove the asset from the accounting records when sold. The Service Revolving Fund is a proprietary fund. In addition, the State Administrative Manual, Section 8651, requires the department to tag all property after acquisition, designating the assets as state property. Finally, the State Administrative Manual, Section 4989.7, requires the department to implement appropriate safeguards to secure personal computer systems.

Recommendation

The department should ensure the proper recording and safeguarding of assets by updating its property records, recording in the Service Revolving Fund assets that the department has purchased and removing assets that the department has sold, and promptly tagging assets with state identification numbers.

**Item 7.
Noncompliance
With State
Requirements for
the Architecture
Revolving Fund**

Finding and Criteria

In the following instances, the department did not always comply with state requirements related to the Architecture Revolving Fund (ARF):

- The department did not always bill for services or collect receivable amounts promptly. In September 1993, we reviewed 10 construction projects. For 5 of the 10 construction projects, the department did not promptly collect the June 30, 1992, receivables totaling \$4.6 million. For 4 of these projects, the department failed to bill promptly or had not yet billed for approximately \$3.8 million. The State Administrative Manual, Section 8776.3, requires agencies to prepare and send an invoice as soon as possible after recognition of a claim.
- The department did not always return unencumbered funds within three years from the time the funds were originally transferred to the ARF, as required by the Government Code, Section 14959. Specifically, the department did not return approximately \$155,000 promptly for 3 of the 17 projects we reviewed for which funds were transferred to the ARF before June 30, 1989.
- The department did not always return unencumbered funds to depositing agencies within the three months after the completion of projects, as required by the Government Code, Section 14959. Specifically, for 14 of the 21 projects we reviewed, the department took approximately four to eight months to return the unencumbered funds totaling approximately \$140,000. For two additional projects, the department applied the unencumbered funds totaling approximately \$51,000 to other projects 8 months and 20 months after the projects were completed. In 11 of the 16 instances, the department requested the return of funds from the ARF within the required three months. However, the Department of Finance and the State Controller's Office took up to 3 months to process these 11 requests totaling approximately \$131,000.

Recommendation

The department should ensure that it returns encumbered funds promptly. In addition, the department should promptly bill and collect amounts receivable.

Public Employees' Retirement System

The Office of the Auditor General reviewed the Public Employees' Retirement System's (PERS) compliance with federal and state regulations in administering the Statewide Cost Allocation Plan (SWCAP) and its compliance with state regulations in administering the Prorata Allocation Plan (Prorata).

Item 1. Finding Error in Expenditure Data Reported to the Department of Finance

The PERS provided the Department of Finance with inaccurate expenditure data for the health benefits for retired annuitants for fiscal year 1991-92. The Department of Finance used this expenditure data to compute both SWCAP and Prorata costs. The PERS understated the SWCAP expenditures for health benefits for retired annuitants by approximately \$694,000 and understated the prorata expenditures by approximately \$667,000. Approximately \$585,000 of each of these amounts resulted from errors in identifying costs of District Agriculture Association employees. The remaining understatements resulted from miscellaneous clerical errors. The understatements could result in undercollections from the federal government of approximately \$57,000 and undercollections from the State's special funds of approximately \$229,000.

The Office of the Auditor General observed a similar weakness during its financial audit for fiscal year 1990-91. In a letter dated August 28, 1991, the PERS responded that it had developed a method for accurately identifying the number of district agriculture annuitants it uses to calculate the expenditures for this group, and it also stated that it had reported the actual 1990-91 expenditures to the Department of Finance in accordance with its new method. However, because of the nature of the SWCAP and Prorata calculations, in this audit we tested actual 1989-90 expenditures used to determine the 1991-92 SWCAP and Prorata charges. We will test the actual 1990-91 expenditures in our 1992-93 audit.

Criteria

The State Administrative Manual, Section 8752, requires state agencies to recover full costs for goods or services provided for other state agencies.

Recommendation

The PERS should report the corrected expenditures for the health benefits for retired annuitants to the Department of Finance so that the Department of Finance can include the adjustments in the SWCAP and Prorata for fiscal year 1993-94. Further, the PERS should ensure that the expenditures it reports to the Department of Finance for health benefits for retired annuitants are accurate.

Youth and Adult Correctional

Department of the Youth Authority

The Office of the Auditor General reviewed the Department of the Youth Authority's (department) administration of the U.S. Department of Agriculture grant, Federal Catalog Number 10.555.

Item 1. Follow-up On-Site Reviews Not Always Performed

Finding

During fiscal year 1991-92, the department's Nutrition Services Bureau (bureau) conducted on-site reviews of the food service operations at all of its institutions and camps. Of the 12 site visits conducted, one was not conducted before February 1 as required by federal regulations. Instead, this on-site review was conducted on February 4, 1992, four days after the deadline. In addition, the bureau identified problems with meal counting or claiming procedures at six sites and requested corrective action plans from them. Although the bureau received corrective action plans from all six sites, it did not conduct required follow-up on-site reviews at three sites to determine that the corrective action resolved the problems. Further, the three follow-up on-site reviews the bureau did conduct were not done within 45 days of the initial review. These follow-up on-site reviews were conducted from 47 days to 50 days after the initial reviews.

Criteria

The Code of Federal Regulations, Title 7, Section 210.8(a), requires each school food authority to perform, before February 1 of each school year, no less than one on-site review of each school under its jurisdiction. Further, if the review discloses problems with a school's meal counting or claiming procedures, the school food authority must ensure that the school develops and implements a corrective action plan, and within 45 calendar days of the review, conduct a follow-up on-site review to determine that the corrective action resolved the problems.

Recommendation

The department should ensure that the bureau conducts all on-site reviews before February 1 of each school year and that the bureau conducts follow-up on-site reviews of all schools requiring them within 45 calendar days of the initial review.

Report on Compliance With Federal Grant Requirements



CALIFORNIA STATE AUDITOR

BUREAU OF STATE AUDITS

KURT R. SJOBERG
State Auditor

MARIANNE P. EVASHENK
Chief Deputy State Auditor

Independent Auditors' Report on Compliance With Federal Grant Requirements

The Governor and the Legislature of
the State of California

We have audited the general purpose financial statements of the State of California as of and for the year ended June 30, 1992, and have issued our report thereon dated November 19, 1993.

We have also audited the State of California's compliance with the requirements governing types of services allowed or not allowed; eligibility; matching, level of effort, or earmarking; reporting; special tests and provisions; federal financial reports and claims for advances and reimbursements; and amounts claimed or used for matching that are applicable to each of its major federal financial assistance programs, which are identified in the accompanying schedule of federal assistance, for the year ended June 30, 1992. The Department of Finance and state management are responsible for the State's compliance with those requirements. Our responsibility is to express an opinion on compliance with those requirements based on our audit.

We conducted our audit of compliance with those requirements in accordance with generally accepted auditing standards, *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget's (OMB) Circular A-128, *Audits of State and Local Governments*. Those standards and OMB Circular A-128, require that we plan and perform the audit to obtain reasonable assurance about whether material noncompliance with the requirements referred to above occurred. An audit includes examining, on a test basis, evidence about the State of California's compliance with those requirements. We believe that our audit provides a reasonable basis for our opinion.

The scope of our audit did not extend to programs administered by the University of California because the University of California contracts with independent certified public accountants for a financial and an OMB Circular A-133 audit. In addition, our audit of charges made by subrecipients of federal funds was limited to a review of the State's system for monitoring those subrecipients because subrecipients have OMB Circular A-128 audits or OMB Circular A-133 audits performed by independent auditors.

In connection with our audit of the State of California's general purpose financial statements and with our consideration of the State's control structure used to administer federal financial assistance programs, as required by OMB Circular A-128, we selected certain transactions applicable to certain nonmajor federal financial assistance programs for the year ended June 30, 1992. As required by Circular A-128, we have performed auditing procedures to test compliance with the requirements governing types of services allowed, eligibility, and special tests and provisions that are applicable to those transactions. Our procedures were substantially less in scope than an audit, the objective of which is the expression of an opinion on the State's compliance with these requirements. Accordingly, we do not express such an opinion.

Further, we have applied procedures to test the State of California's compliance with the following requirements applicable to each of its major federal financial assistance programs, which are identified in the schedule of federal assistance, for the year ended June 30, 1992: political activity, Davis-Bacon Act, civil rights, cash management, relocation assistance and real property acquisition, federal financial reports, allowable costs/cost principles, Drug-Free Workplace Act, and administrative requirements.

Our procedures were limited to the applicable procedures described in the OMB's, *Compliance Supplement for Single Audits of State and Local Governments*. Our procedures were substantially less in scope than an audit, the objective of which is the expression of an opinion on the State of California's compliance with the requirements listed in the preceding paragraph. Accordingly, we do not express such an opinion.

With respect to the items tested, the results of those procedures disclosed no material instances of noncompliance with the general and specific requirements identified in the preceding paragraphs. With respect to the items not tested, nothing came to our attention that caused us to believe that the State of California had not complied, in all material respects, with those requirements. However, the results of our audit procedures disclosed immaterial instances of noncompliance with those requirements. We discuss those instances of noncompliance and present recommendations to correct them on pages 43 through 177 of our report. Additionally, beginning on page 221, we present a schedule listing instances of noncompliance that we consider to be minor. The instances of noncompliance identified in the State's single audit report for fiscal year 1990-91 that have not been corrected are included in the section beginning on page 43. We considered these instances of noncompliance in forming our opinion on compliance, which is expressed in the following paragraph.

In our opinion, the State of California complied, in all material respects, with the requirements governing types of services allowed or unallowed; eligibility; matching, level of effort, or earmarking; reporting; special tests and provisions that are applicable; federal financial reports and claims for advances and reimbursements; and amounts claimed or used for matching that are applicable to each of its major federal financial assistance programs for the year ended June 30, 1992.

This report is intended for the information of the Governor and Legislature of the State of California, and the management of the executive branch. However, this report is a matter of public record, and its distribution is not limited.

BUREAU OF STATE AUDITS

A handwritten signature in black ink that reads "Sally L. Filliman". The signature is written in a cursive style with a large, stylized initial 'S'.

SALLY L. FILLIMAN, CPA
Deputy State Auditor

November 19, 1993

**Report on the
Schedule of Federal Assistance**



CALIFORNIA STATE AUDITOR

BUREAU OF STATE AUDITS

KURT R. SJOBERG
State Auditor

MARIANNE P. EVASHENK
Chief Deputy State Auditor

Independent Auditors' Report on the Schedule of Federal Assistance

The Governor and the Legislature of
the State of California

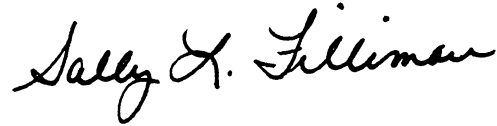
We have audited the general purpose financial statements of the State of California as of and for the year ended June 30, 1992, and have issued our report thereon dated November 19, 1993. These general purpose financial statements are the responsibility of management of the State of California. Our responsibility is to express an opinion on these general purpose financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the general purpose financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Our audit was made for the purpose of forming an opinion on the general purpose financial statements of the State of California, taken as a whole. The accompanying schedule of federal assistance is presented for purposes of additional analysis and is not a required part of the general purpose financial statements. The information in that schedule has been subjected to the auditing procedures applied in the audit of the general purpose financial statements and, in our opinion, is fairly presented in all material respects in relation to the general purpose financial statements taken as a whole.

This report is intended for the information of the Governor and Legislature of the State of California, and the management of the executive branch. However, this report is a matter of public record, and its distribution is not limited.

BUREAU OF STATE AUDITS

A handwritten signature in black ink that reads "Sally L. Filliman". The signature is written in a cursive style with a large initial 'S'.

SALLY L. FILLIMAN, CPA
Deputy State Auditor

November 19, 1993

**Schedule of Federal Assistance for the
Fiscal Year Ended June 30, 1992**

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>		
Department of Agriculture:				
Agricultural Conservation Program	10.063	\$ 25,000		
Forestry Incentives Program	10.064	13,000		
Farm Labor Housing Loans and Grants	10.405	2,781,120		
Food Distribution	10.550	85,149,237	A	*
Food Stamps	10.551	1,725,087,740	A	*
School Breakfast Program	10.553	107,917,636	A	
National School Lunch Program	10.555	488,788,657	A	
Special Milk Program for Children	10.556	957,823		
Special Supplemental Food Program for Women, Infants, and Children	10.557	264,590,591	A	
Child and Adult Care Food Program	10.558	127,166,623	A	*
Summer Food Service Program for Children	10.559	100,014	**	
State Administrative Expenses for Child Nutrition	10.560	8,195,958		
State Administrative Matching Grants for Food Stamp Program	10.561	195,489,418	A	
Nutrition Education and Training Program	10.564	714,886		
Temporary Emergency Food Assistance (Administrative Costs)	10.568	4,133,392		

Footnotes are presented on page 210

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Forestry Research	10.652	784
Cooperative Forestry Assistance	10.664	114,004
Resource Conservation and Development	10.901	39,365
Other—U.S. Department of Agriculture	10.999	1,033,824
Department of Commerce:		
Economic Development—Support for Planning Organizations	11.302	57,000
Special Economic Development and Adjustment Assistance Program—Sudden and Severe Economic Dislocation and Long-Term Economic Deterioration	11.307	142,437
Anadromous Fish Conservation Act Program	11.405	361,034
Interjurisdictional Fisheries Act of 1986	11.407	245,997
Coastal Zone Management Administration Awards	11.419	2,471,166
Coastal Zone Management Estuarine Research Reserves	11.420	137,765
Other—U.S. Department of Commerce	11.999	252,087
Department of Defense:		
Flood Control Projects	12.106	5,293
Navigation Projects	12.107	124,872
Planning Assistance to States	12.110	707,704

Footnotes are presented on page 210

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>	
Payments to States in Lieu of Real Estate Taxes	12.112	2,535,741	
State Memorandum of Agreement Program for the Reimbursement of Technical Services	12.113	2,154,931	
Other—U.S. Department of Defense	12.999	1,226,737	
Department of Housing and Urban Development:			
Community Development Block Grants/ Small Cities Program	14.219	97,298	
Community Development Block Grants/ State's Program	14.228	22,558,701	A
Rental Housing Rehabilitation	14.230	262,109	
Emergency Shelter Grants Program	14.231	2,005,115	
Supportive Housing Demonstration Program	14.235	1,537,708	
Equal Opportunity in Housing	14.400	266,150	
Section 8 Rental Voucher Program	14.855*** (14.177)	1,417,498	
Lower Income Housing Assistance Program—Section 8 Moderate Rehabilitation	14.856*** (14.156)	335,374	
Section 8 Rental Certificate Program	14.857*** (14.180)	21,052,297	A

Footnotes are presented on page 210

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>	
Department of Interior:			
Small Reclamation Projects	15.503	587,842	O
Fishery Research–Information	15.604	1,247,594	
Sport Fish Restoration	15.605	10,714,379	
Wildlife Restoration	15.611	5,239,410	
Endangered Species Conservation	15.612	304,196	
Geological Survey–Research and Data Acquisition	15.808	75,540	
Historic Preservation Fund Grants-In-Aid	15.904	878,914	
Outdoor Recreation–Acquisition, Development and Planning	15.916	2,686,041	
Shared Revenues–Potash/Sodium Lease	15.999	23,264,638	A
Other–U.S. Department of the Interior	15.999	3,567,684	
Department of Justice:			
Juvenile Justice and Delinquency Prevention–Allocation to States	16.540	5,862,681	
Criminal Justice Statistics Development	16.550	27,921	
Mariel–Cubans	16.572	610,416	
Criminal Justice Discretionary Grant Program	16.574	3,574,850	

Footnotes are presented on page 210

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>	
Crime Victim Assistance	16.575	5,479,316	
Crime Victim Compensation	16.576	35,325,000	A
Drug Control and System Improvement– Formula Grant	16.579	37,601,872	A
Corrections–Technical Assistance/ Clearinghouse	16.603	61,503	
Other–Department of Justice	16.999	1,834,503	
Department of Labor:			
Labor Force Statistics	17.002	4,995,729	
Employment Service	17.207	88,069,157	A
Unemployment Insurance	17.225	370,371,467	A
Senior Community Service Employment Program	17.235	6,375,572	
Employment and Training Assistance– Dislocated Workers	17.246	44,295,613	A
Job Training Partnership Act	17.250	267,059,070	A
Occupational Safety and Health	17.500	20,034,303	A
Mine Health and Safety Grants	17.600	456,385	
Disabled Veterans Outreach Program (DVOP)	17.801	9,321,766	
Veterans Employment Program	17.802	731,380	
Local Veterans Employment Representative Program	17.804	6,496,644	

Footnotes are presented on page 210

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>	
Other–U.S. Department of Labor	17.999	20,280	
Department of Transportation:			
Boating Safety Financial Assistance	20.005	1,709,166	
Airport Improvement Program	20.106	223,716	
Highway Planning and Construction	20.205	1,608,594,193	A
Motor Carrier Safety	20.217	2,214,591	
Federal Transit Capital Improvement Grants	20.500	10,818,277	
Federal Transit Technical Studies Grants	20.505	200,687	
Federal Transit Capital and Operating Assistance Formula Grants	20.507	489,291	
Public Transportation for Nonurbanized Areas	20.509	1,168,880	
State and Community Highway Safety	20.600	13,387,701	
Pipeline Safety	20.700	339,771	
State Marine Schools	20.806	100,000	
Other–U.S. Department of Transportation	20.999	75,679	
Department of Treasury:			
Other–U.S. Department of Treasury	21.999	20,381	
Equal Employment Opportunity Commission:			

Footnotes are presented on page 210

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Employment Discrimination–State and Local Fair Employment Practices Agency Contracts	30.002	2,669,110
National Aeronautics and Space Administration:		
Aerospace Education Services Program	43.001	117,742
National Foundation on the Arts and the Humanities:		
Promotion of the Arts–Design Arts	45.001	32,783
Promotion of the Arts–Arts in Education	45.003	168,000
Promotion of the Arts–Media Arts: Film/Radio/Television	45.006	37,871
Promotion of the Arts–State and Regional Program	45.007	942,750
Promotion of the Arts–Locals Program	45.023	110,000
Promotion of the Arts–Summer Seminars for College Teachers	45.116	6,978
Promotion of the Humanities–Division of Preservation and Access	45.149	24,500
Promotion of the Humanities–NEH/Reader's Digest Teacher-Scholar Program	45.154	19,250
National Science Foundation:		
Engineering Grants	47.041	84,730

Footnotes are presented on page 210

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Mathematical and Physical Sciences	47.049	426,111
Geosciences	47.050	197,343
Biological, Behavioral, and Social Sciences	47.051	39,335
Materials, Development, Research, and Informal Science Education	47.067	134,303
Science and Technology Centers	47.073	61,769
Social, Behavioral, and Economic Sciences	47.075	65,951
Education and Human Resources	47.076	714,239
Small Business Administration:		
Business Development Assistance to Small Business	59.005	10,400
Small Business Development Center	59.037	1,570,933
Department of Veterans Affairs:		
Veterans State Domiciliary Care	64.014	2,294,099
Veterans State Nursing Home Care	64.015	4,525,267
Veterans State Hospital Care	64.016	301,252
All-Volunteer Force Education Assistance	64.124	37,127
Other—U.S. Department of Veterans Affairs	64.999	1,276,391

Footnotes are presented on page 210

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Environmental Protection Agency:		
Air Pollution Control Program Support	66.001	4,309,138
Air Pollution Control–National Ambient Air and Source Emission Data	66.007	31,135
State Indoor Radon Grants	66.032	244,998
Construction Grants for Wastewater Treatment Works	66.418	937,745
Water Pollution Control State and Interstate Program Support	66.419	3,786,566
State Underground Water Source Protection	66.433	86,053
Water Pollution Control–Lake Restoration Cooperative Agreements	66.435	33,261
Construction Management Assistance	66.438	2,967,050
Water Quality Management Planning	66.454	1,762,157
National Estuary Program	66.456	849,946
Capitalization Grants for State Revolving Funds	66.458	120,031,161 A
Nonpoint Source Reservation	66.459	817,079
Nonpoint Source Implementation	66.460	2,397,468
Wetlands Protection–State Development Grants	66.461	5,677
Air Pollution Control Research	66.501	20,178
Safe Drinking Water Research and Demonstration	66.506	2,359,443

Footnotes are presented on page 210

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Toxic Substances Compliance Monitoring Program	66.701	141,808
Hazardous Waste Management State Program Support	66.801	5,795,785
Hazardous Substance Response Trust Fund	66.802	5,878,362
State Underground Storage Tanks Program	66.804	284,995
Underground Storage Tank Trust Fund Program	66.805	3,673,484
Pollution Prevention Grants Program	66.900	171,628
Other—U.S. Environmental Protection Agency	66.999	2,075,093
Action:		
Foster Grandparent Program	72.001	1,338,724
Volunteers in Service to America	72.003	35,000
Senior Companion Program	72.008	7,459
Department of Energy:		
Energy-Related Programs	81.036	18,365
State Energy Conservation	81.041	487,786
Weatherization Assistance for Low-Income Persons	81.042	4,648,848
Energy Extension Service	81.050	324,034

Footnotes are presented on page 210

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>	
Energy Conservation for Institutional Buildings	81.052	268,272	
Regional Biomass Programs	81.079	3,538	
Science and Engineering Research Semester	81.097	70,913	
Federal Emergency Management Agency:			
Flood Insurance	83.100	113,211	
Civil Defense–State and Local Emergency Management Assistance	83.503	4,925,039	
Other State and Local Direction, Control and Warning	83.504	14,274	
State Disaster Preparedness Grants	83.505	48,723	
Facility Survey, Engineering and Development	83.509	51,760	
State and Local Warning and Communication Systems	83.513	31,193	
Population Protection Planning	83.514	551,304	
Disaster Assistance	83.516	185,513,433	A
Hazard Mitigation Assistance	83.519	10,430	
Earthquake Hazards Reduction Grants	83.521	1,258,760	
Radiological Defense	83.522	532,897	
Emergency Management Institute–Field Training Program	83.528*** (83.403)	317,400	
Other–Federal Emergency Management Agency	83.999	25,000	

Footnotes are presented on page 210

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>	
Department of Education:			
Adult Education–State Administered Basic Grant Program	84.002	14,115,118	
Bilingual Education	84.003	1,387,275	
Desegregation Assistance, Civil Rights Training, and Advisory Services	84.004	484,225	
Supplemental Educational Opportunity Grants	84.007	4,427,251	
Education of Handicapped Children in State Operated or Supported Schools	84.009	2,066,157	
Chapter 1 Programs–Local Educational Agencies	84.010	511,387,662	A
Migrant Education–Basic State Formula Grant Program	84.011	98,217,954	A
Educationally Deprived Children–State Administration	84.012	5,153,243	
Chapter 1 Program for Neglected and Delinquent Children	84.013	3,257,473	
Disabled–Innovation and Development	84.023	115,627	
Services for Children With Deaf-Blindness	84.025	697,354	
Special Education–State Grants	84.027	173,179,993	A
Special Education–Special Education Personnel Development and Parent Training	84.029	471,513	
Guaranteed Student Loans	84.032	353,190,481	A
College Work-Study Program	84.033	3,677,512	

Footnotes are presented on page 210

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>	
Public Library Services	84.034	7,460,751	
Interlibrary Cooperation and Resource Sharing	84.035	2,040,084	
National Defense/National Direct/ Perkins Loans Cancellations	84.037	525,272	
Perkins Loan Program–Federal Capital Contributions	84.038	786,668	
Student Support Services	84.042	94,232	
Vocational Education–Basic Grants to States	84.048	83,205,230	A
Vocational Education–Consumer and Homemaking Education	84.049	2,516,103	
Vocational Education–State Councils	84.053	518,956	
Pell Grant Program	84.063	45,062,875	B
Higher Education–Veterans Education Outreach Program	84.064	5,007	
Grants to States for State Student Incentives	84.069	9,087,000	
Special Education–Severely Disabled Program	84.086	243,672	
Indian Education–Fellowships for Indian Students	84.087	804	
Fund for the Improvement of Postsecondary Education	84.116	39,706	
Rehabilitation Services–Basic Support	84.126	136,733,112	A
Rehabilitation Services–Service Projects	84.128	1,215,186	
Rehabilitation Training	84.129	383,611	

Footnotes are presented on page 210

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>	
Centers for Independent Living	84.132	774,459	
National Institute on Disability and Rehabilitation Research	84.133	72,277	
Migrant Education—Coordination Program	84.144	110,624	
Transition Program for Refugee Children	84.146	1,665	
Federal, State, and Local Partnerships for Educational Improvement	84.151	48,209,434	A
Public Library Construction and Technology Enhancement	84.154	2,014,386	
Secondary Education and Transitional Services for Youth With Disabilities	84.158	569	
Disabled—Special Studies and Evaluation	84.159	16,501	
Emergency Immigrant Education	84.162	13,680,681	
Eisenhower Mathematics and Science Education—State Grants	84.164	21,471,148	A
Library Literacy	84.167	32,408	
Dwight D. Eisenhower National Program for Mathematics and Science Education	84.168	29,940	
Comprehensive Services for Independent Living	84.169	1,093,149	
Jacob K. Javits Fellowships	84.170	16,000	
Special Education—Preschool Grants	84.173	36,506,984	A
Vocational Education—Community Based Organizations	84.174	602,355	
Douglas Teacher Scholarships	84.176	1,794,687	

Footnotes are presented on page 210

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>	
Infants and Toddlers With Disabilities	84.181	8,138,001	
Robert C. Byrd Honors Scholarships	84.185	994,525	
Drug-Free Schools and Communities— State Grants	84.186	50,111,749	A
Supported Employment Services for Individuals With Severe Handicaps	84.187	3,276,223	
Adult Education for the Homeless	84.192	506,481	
Education for Homeless Children and Youth—Grants for State and Local Activities	84.196	535,146	
College Library Technology	84.197	44,253	
Jacob K. Javits Gifted and Talented Students Education Grant Program	84.206	165,516	
Even Start—Migrant Education	84.214	14,225	
The Secretary's Fund for Innovation in Education	84.215	2,400	
Capital Expenses	84.216	2,306,809	
State Program Improvement Grants	84.218	1,186,706	
English Literacy Program	84.223	1,165,749	
Mid-Career Teacher Training	84.232	40,327	
National Science Scholars	84.242	618	
Tech-Prep Education	84.243	414	
Grant Back Awards	84.995	353,022	
Other—Department of Education	84.999`	98,890	

Footnotes are presented on page 210

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>	
Consumer Product Safety Commission:			
Other—Consumer Product Safety Commission	87.999	6,250	
Department of Health and Human Services:			
State Comprehensive Mental Health Service Planning Development Grants	13.158	74,359	
Family Support Payments to States—Assistance Payments	93.020	3,122,473,685	A
Job Opportunities and Basic Skills Training	93.021	103,261,625	A
Assistance Payments—Research	93.022	113,231	
Child Support Enforcement	93.023	151,656,836	A
State Legalization Impact Assistance Grants	93.025	306,592,064	A O
Refugee and Entrant Assistance—State Administered Programs	93.026	95,191,122	A
Low-Income Home Energy Assistance	93.028	56,937,003	A
Community Services Block Grant	93.031	28,185,278	A
Community Services Block Grant Discretionary Awards—Community Food and Nutrition	93.033	139,653	
Emergency Community Services for the Homeless	93.034	2,817,086	
Payments to States for Child Care Assistance	93.037	1,469,249	

Footnotes are presented on page 210

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Food and Drug Administration– Research	93.103	170,078
Maternal and Child Health Federal Consolidation Programs	93.110	10,000
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	93.116	563,000
Acquired Immunodeficiency Syndrome (AIDS) Activity	93.118	11,190,417
Mental Health Planning and Demonstration Projects	93.125	620,236
Emergency Medical Services for Children	93.127	3,993
Injury Prevention and Control Research Projects	93.136	397,200
Demonstration Grants for the Prevention of Alcohol and Other Drug Abuse Among High-Risk Youth	93.144	31,086
Temporary AIDS Drug Reimbursements	93.146	1,596,500
Mental Health Services for the Homeless Block Grant	93.150	3,728,796
Health Program for Toxic Substances and Disease Registry	93.161	323,800
Community Youth Activity Demonstration Grants	93.170	349,089
Community Youth Activity Program Block Grants	93.171	78,889
Drug Abuse Treatment Waiting List Reduction Grants	93.175	5,745,541

Footnotes are presented on page 210

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
State Data Collection–Uniform Alcohol and Drug Abuse Data	93.179	415,316
Scholarships for the Undergraduate Education of Professional Nurses	93.182	13,922
Disaster Relief Assistance Grants for Drug Abuse Treatment	93.195	4,262
Cooperative Agreements for Drug Abuse Treatment Improvement Projects in Target Cities	93.196	4,330,586
HIV Home and Community-Based Health Services	93.199	1,727,400
Mental Health Research Grants	93.242	829,659
Mental Health Clinical or Service Related Training Grants	93.244	36,654
Childhood Immunization Grants	93.268	2,127,935
Centers for Disease Control–Investigations and Technical Assistance	93.283	956,765
Biomedical Research Support	93.337	300,541
Professional Nurse Traineeships	93.358	176,153
Nursing Student Loans	93.364	25,450
Cancer Detection and Diagnosis Research	93.394	105,100
Cancer Control	93.399	142,598
Special Programs for the Aging–Title III, Part G–Prevention of Abuse, Neglect, and Exploitation of Older Individuals	93.552	295,023

Footnotes are presented on page 210

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>	
Special Programs for the Aging–Title III, Part A–Long-Term Care Ombudsman Services for Older Individuals	93.553	308,563	
Emergency Protection Grants–Substance Abuse	93.554	6,168	
Developmental Disabilities Basic Support and Advocacy Grants	93.630	4,861,231	
Special Programs for the Aging–Title III, Part B–Grants for Supportive Services and Senior Centers	93.633	28,947,406	A
Special Programs for the Aging–Title III, Part C–Nutrition Services	93.635	40,376,721	A
Special Programs for the Aging–Title III, Part D–In-Home Services for Frail Older Individuals	93.641	628,220	
Child Welfare Services–State Grants	93.645	14,820,848	
Temporary Child Care and Crisis Nurseries	93.656	543,533	
Foster Care–Title IV-E	93.658	367,698,273	A
Adoption Assistance	93.659	25,575,926	A
Social Services Block Grant	93.667	330,867,467	A
Special Programs for the Aging–Title IV–Training, Research and Discretionary Projects and Programs	93.668	74,506	
Child Abuse and Neglect Discretionary Activities	93.670	13,593	
Family Violence Prevention and Services	93.671	911,698	

Footnotes are presented on page 210

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>	
Child Abuse Challenge Grants	93.672	642,214	
Grants to States for Planning and Development of Dependent Care Programs	93.673	1,420,242	
Independent Living	93.674	10,402,443	
Medicare–Hospital Insurance	93.773	1,802,114	
Medicare–Supplementary Medical Insurance	93.774	9,975,171	
State Medicaid Fraud Control Units	93.775	6,763,741	
State Survey and Certification of Health Care Providers and Suppliers	93.777	20,573,880	A
Medical Assistance Program	93.778	5,947,501,512	A O
Social Security–Disability Insurance	93.802	118,790,295	A
Digestive Diseases and Nutrition Research	93.848	12,914	
Microbiology and Infectious Diseases Research	93.856	45,954	
Cellular and Molecular Basis of Disease Research	93.863	252,018	
Model Comprehensive Drug Abuse Treatment Programs for Critical Populations	93.902	6,766,484	
Model Criminal Justice Drug Abuse Treatment–Incarcerated Populations–Nonincarcerated Populations–Juvenile Justice Populations	93.903	345,120	
HIV Care Formula Grants	93.917	4,522,600	

Footnotes are presented on page 210

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>	
Cooperative Agreements for State-Based Comprehensive Breast and Cervical Cancer Control Programs	93.919	290,800	
Scholarships for Health Professions Students from Disadvantaged Backgrounds	93.925	29,372	
Preventive Health Services—Sexually Transmitted Diseases Control Grants	93.977	2,311,600	
Mental Health Disaster Assistance and Emergency Mental Health	93.982	477,929	
Health Programs for Refugees	93.987	1,012,000	
Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation of Surveillance Systems	93.988	169,150	
Preventive Health and Health Services Block Grant	93.991	6,665,074	
Alcohol and Drug Abuse and Mental Health Services Block Grant	93.992	171,097,252	A
Maternal and Child Health Services Block Grant	93.994	25,921,286	A
Other—Department of Health and Human Services	93.999	9,500,313	
Miscellaneous Grants and Contracts:			
Shared Revenue—Flood Control Lands	98.002	218,183	
Shared Revenue—Forest Resources	98.003	56,045,154	A
Shared Revenue—Grazing Land	98.004	159,954	

Footnotes are presented on page 210.

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Federal Unemployment Benefits and Allowances	98.010	1,466,156
U.S. Department of Housing and Urban Development—College Housing Debt Service Government Program	98.013	1,250,974
U.S. Department of the Interior—Fire Prevention/Suppression Agreement	98.014	942,579
U.S. Department of Agriculture and Various Other U.S. Departments—Fire Prevention/Suppression Agreements	98.016	8,070,614
Miscellaneous Federal Receipts	98.099	403,209
Miscellaneous Federal Receipts	98.999	<u>1,486,907</u>
Total Grants Received		<u>\$18,839,191,111</u>
Total Major Grants Audited in Compliance With OMB, Circular A-128		<u>\$18,392,930,214</u>

Note: In addition, the State received \$21,434,524 in Petroleum Violation Escrow Funds that can be used to supplement five federal energy-related conservation and assistance programs. The funds used to supplement these programs were audited to the extent required by the OMB's, Circular A-128.

A - The Bureau of State Audits or the Office of the Auditor General reviewed these major grants for fiscal year 1991-92 in compliance with the OMB's, Circular A-128.

B - Other independent auditors audited this grant. The grant amount is not included in the amount of total major grants audited on this page.

O - The Office of the Auditor General[†] reviewed these grants in conjunction with various reports issued from July 1, 1991 to December 31, 1992. See the Schedule of Audit Reports Involving Federal Grants from July 1, 1991 to December 31, 1992, beginning on page 216 for a description of these reports.

* - This amount includes cash, food stamps, and the value of commodities.

** - This amount represents the value of commodities only.

*** - The federal government changed the federal catalog number for fiscal year 1991-92. The number in parentheses represents the former federal catalog number.

+ - The Office of the Auditor General was closed in December 1992. The California Government Code, Section 8543, creates the Bureau of State Audits. The Bureau of State Audits is responsible for performing the annual financial and compliance audit of the State and other audits formerly conducted by the Office of the Auditor General.

**Weaknesses in Compliance With Federal Regulations
by Grant Program**

Weaknesses and Item Numbers ^a								
Federal Catalog Number	Grantor Agency/Program Title	Administering State Agency	Page Number	Inadequate/Late Reports	Insufficient Support for Expenditures	Insufficient Monitoring/Auditing	Early Request/Late Disbursement of Federal Funds	Other
Department of Agriculture								
10.550	Food Distribution	California Department of Education	77			12		
10.553	School Breakfast Program	California Department of Education	77			8	10	
10.555	National School Lunch Program	California Department of Education	77			8	10	
		Department of the Youth Authority	177			1		
10.557	Special Supplemental Food Program for Women, Infants, and Children	Department of Health Services	125	9	10	6		7,8,12
10.558	Child and Adult Care Food Program	California Department of Education	77				10	
10.561	State Administrative Matching Grants for Food Stamp Program	Department of Social Services	140	6				
Department of Housing and Urban Development								
14.228	Community Development Block Grants/State's Program	Department of Housing and Community Development	47	2				1
14.857	Section 8 Rental Certificate Program	Department of Housing and Community Development	47	4			3	
Department of Labor								
17.207	Employment Service	Employment Development Department	109					9

^aThe item number is the number of each weakness as presented in the report on each state agency.

Weaknesses and Item Numbers ^a									
Federal Catalog Number	Grantor Agency/Program Title	Administering State Agency	Page Number	Inadequate/Late Reports	Insufficient Support for Expenditures	Insufficient Monitoring/Auditing	Early Request/Late Disbursement of Federal Funds	Other	
17.225	Unemployment Insurance	Employment Development Department	109	3,10				6	
17.246	Employment and Training Assistance—Dislocated Workers	Employment Development Department	109					4,7	
17.250	Job Training Partnership Act	Employment Development Department	109			2,5,8		2,7,11	
Department of Transportation									
20.205	Highway Planning and Construction	Department of Transportation	59	2,4				1,3	
Department of Education									
84.010	Chapter 1 Programs—Local Educational Agencies	California Department of Education	77		12				
84.011	Migrant Education—Basic State Formula Grant Program	California Department of Education	77				10		
84.032	Guaranteed Student Loans	California Student Aid Commission	69	5	2			1,3,4,6,7	
84.048	Vocational Education—Basic Grants to States	California Community Colleges, Chancellor's Office	67				1		
84.126	Rehabilitation Services—Basic Support	California Department of Education	77				10		
84.164	Eisenhower Mathematics and Science Education—State Grants	Department of Rehabilitation	138	1					
		California Department of Education	77		12	6,7		10	

^aThe item number is the number of each weakness as presented in the report on each state agency.

Weaknesses and Item Numbers^a

Federal Catalog Number	Grantor Agency/Program Title	Administering State Agency	Page Number	Inadequate/Late Reports	Insufficient Support for Expenditures	Insufficient Monitoring/Auditing	Early Request/Late Disbursement of Federal Funds	Other
		California Postsecondary Education Commission	68		1			
84.186	Drug-Free Schools and Communities--State Grants	California Department of Education	77		12	5	3	1,2,4
		Department of Alcohol and Drug Programs	105		4	2,3		
Department of Health and Human Services								
93.020	Family Support Payments to States--Assistance Payments	Department of Social Services	140	6				
93.021	Job Opportunities and Basic Skills Training	Department of Social Services	140	6			2	
93.023	Child Support Enforcement	Department of Social Services	140	6		5		
93.025	State Legalization Impact Assistance Grants	Department of Social Services	140	6		4		
		California Department of Education	77			8	10	
		Department of Health Services	125	9		3		
93.026	Refugee and Entrant Assistance--State Administered Programs	Department of Social Services	140	6		4	3	
93.028	Low-Income Home Energy Assistance	Department of Economic Opportunity	95			3	2	1
93.031	Community Services Block Grant	Department of Economic Opportunity	95				2	
93.645	Child Welfare Services--State Grants	Department of Social Services	140	6				

^aThe item number is the number of each weakness as presented in the report on each state agency.

Weaknesses and Item Numbers^a

Federal Catalog Number	Grantor Agency/Program Title	Administering State Agency	Page Number	Inadequate/Late Reports	Insufficient Support for Expenditures	Insufficient Monitoring/Auditing	Early Request/Late Disbursement of Federal Funds	Other
93.658	Foster Care--Title IV-E	Department of Social Services	140	6			2	
93.659	Adoption Assistance	Department of Social Services	140	6				
93.777	State Survey and Certification of Health Care Providers and Suppliers	Department of Health Services	125					12
93.778	Medical Assistance Program	Department of Health Services	125				4	11,12
93.802	Social Security--Disability Insurance	Department of Social Services	140	6				
93.992	Alcohol and Drug Abuse and Mental Health Services Block Grant	Department of Alcohol and Drug Programs	105		4	1,3		
93.994	Maternal and Child Health Services Block Grant	Department of Mental Health	137				1	
		Department of Health Services	125			3		
Various Federal Departments								
	Numerous Federal Programs	Stephen P. Teale Data Center	53					4
	Numerous Federal Programs	Department of General Services	164					1
	Numerous Federal Programs	Health and Welfare Agency Data Center	122					1
	Numerous Federal Programs	Public Employees' Retirement System	173					1
	Numerous Federal Programs	California Department of Education	77				9	
	Numerous Federal Programs	Department of Social Services	140				7	
	Numerous Federal Programs	Department of Social Services	140					5,12

^aThe item number is the number of each weakness as presented in the report on each state agency.

**Schedule of Audit Reports
Involving Federal Grants From
July 1, 1991 to December 31, 1992**

From July 1, 1991 to December 31, 1992, the Office of the Auditor General* issued reports on audits involving federal grants. The following schedule lists the reports issued and presents a summary of the report findings. The agencies' responses to these findings are included in each of the separate audit reports.

Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Report Title and Description
Alcohol and Drug Programs, Department of	Medical Assistance Program 93.778	A Review of the Department of Alcohol and Drug Programs' Drug/Medi-Cal Claims Process (P-965, 7-17-91)
		(1) A small number of providers of methadone maintenance services submitted and were paid for duplicate claims in fiscal year 1989-90.
		(2) One county submitted and was paid for claims representing incompatible drug treatment services in at least 32 instances in fiscal year 1989-90.
		(3) In several instances, providers did not submit to the department disallowances of claims for drug treatment services.
Education, California Department of Employment Development Department	State Legalization Impact Assistance Grants 93.025	Status of Costs Identified and Reimbursed for the State Legalization Impact Assistance Grants (F-132, 10-23-91)
Fair Employment and Housing, Department of Health Services, Department of Housing and Community Development, Department of Mental Health, Department of Social Services, Department of		(1) As of June 30, 1991, the State had identified and paid almost \$1.15 billion in costs for the State Legalization Impact Assistance Grants (SLIAG) program and received reimbursements from the federal government for approximately the same amount. As of the same date, almost \$310 million remained from the federal grant allocations through federal fiscal year 1991.

* The Office of the Auditor General was closed in December 1992. The California Government Code, Section 8543, creates the Bureau of State Audits. The Bureau of State Audits is responsible for performing the annual financial and compliance audit of the State and other audits formerly conducted by the Office of the Auditor General.

- (2) The State is currently identifying and claiming additional costs incurred as of June 30, 1991, that were unclaimed at that date. We estimate that, by the end of the federal fiscal year 1991, the State will have exhausted the \$310 million that remained in the federal allocation as of June 30, 1991.
- (3) The State has improved its ability to identify and claim costs under the SLIAG program.

Health Services, Department of
 Medical Assistance Program
 93.778

How Medi-Cal and Other Health Care Providers Manage Their Pharmaceutical Expenditures (P-062, 8-30-91)

- (1) California Medical Assistance Program (Medi-Cal) drug expenditures grew from \$231 million in 1984 to an estimated \$516 million in 1989, or by 124 percent. This growth in expenditures is due to both an expanded use of the Medi-Cal drug benefit and also an increase in the average cost per prescription.
- (2) In an attempt to stem increases in Medi-Cal expenditures, Medi-Cal uses most of the same utilization and price strategies as those identified by the major pharmaceutical purchasers we surveyed.
- (3) For a sample of six prescription drugs, we surveyed six pharmacists on what amounts they would bill Medi-Cal and we determined what amounts they would be reimbursed. We found that for the same prescription drug, a significant difference exists in the amounts pharmacies would have billed Medi-Cal and the amounts Medi-Cal would have reimbursed the six pharmacies.
- (4) The variation in amounts or reimbursements among the six pharmacies revealed that a significant difference exists in what Medi-Cal would have reimbursed the six pharmacies for the same drug.

Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Report Title and Description
Health Services, Department of	Medical Assistance Program 93.778	<p>The Department of Health Services' Information on Drug Treatment Authorization Requests: Second, Third, and Fourth Monitoring Reports (P-117, 7-24-91; P-144, 2-5-92; and P-213, 7-22-92)</p> <p>(1) During the six-month period from December 1991 through May 1992, the Department of Health Services (department) received approximately 91,000 drug treatment authorization requests (TARs) by mail, telephone facsimile machine, and the department's automated voice response system. This represents an increase of more than 12,500 drug TARs since our first review, which covered June 1990 through November 1990.</p> <p>(2) The department's backlog of drug TARs received by mail increased to approximately 8,900 by the end of May 1992. In comparison, at the end of November 1990, the department's backlog of unprocessed drug TARs was approximately 2,300 and, at the end of November 1991, approximately 5,500.</p>
Lake Elsinore Municipal Water District	Small Reclamation Projects 15.503	The Lake Elsinore Management Project (P-042, 8-1-91)
		<p>(1) Since the United States Bureau of Reclamation approved funding for the Lake Elsinore Management Project in 1985, the design of the project has changed in part because the City of Lake Elsinore requested modifications to accommodate its redevelopment plan for the lake.</p> <p>(2) Our review of the project's documents indicates that expenditures for the project totaled \$25 million through June 1990.</p>

Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Report Title and Description
University of California	Various Federal Grants	<p>A Review of the University of California's Executive Compensation, Benefits, and Offices (P-215, 8-26-92)</p> <p>(1) In an attempt to improve the University of California's (UC) executive compensation to make it more competitive with the compensation of other executives, the Regents of the University of California (regents) have approved a number of salary increases since 1983. For example, of ten executives in our sample, one had an increase of 10 percent, and nine had increases ranging from 21.3 percent to 40 percent between July 1983 and July 1984. Additionally the regents may have approved some salary increases for fiscal year 1984-85 that were actually larger than they may have believed because the information presented in the document used to propose the increases lacked sufficient detail.</p> <p>(2) In addition to the regular contributions to the University of California Retirement Plan, the UC has provided a number of special retirement programs to the UC executives including nonqualified deferred income plans (NDIPS). Although the regents have approved all the NDIPs, we found that materials presented to the regents were not always specific as to the amounts that would actually be paid. Consequently, we could not conclude that the regents knew the full extent of what they were approving or whether the UC staff correctly interpreted the regent's intent when they implemented the NDIP programs.</p> <p>(3) We noted several other areas of concern regarding policies and procedures for benefits to UC executives. Such areas included reimbursement of moving expenses, allowable entertainment costs, travel expenses, and others.</p>

Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Report Title and Description
Various Long-Term Care Facilities	Medical Assistance Program 93.778	<p>Long-Term Care in California: A Comparison of Financial and Utilization Data for Investor-Owned and Nonprofit Facilities (P-120, 4-22-92)</p> <p>(1) A total of 125 out of 1,177 long-term care facilities in California did not serve Medi-Cal patients. Facilities cited several reasons for not serving Medi-Cal patients, including low reimbursement rates, excessive Medi-Cal requirements, and designing and marketing facilities to serve only the affluent.</p> <p>(2) For facilities not serving Medi-Cal patients or reporting less than 30 percent of their patient days to Medi-Cal, 153 facilities provided educational, religious, hospital, or charitable services and activities to their patients or communities.</p>
Various Public Education Agencies	Various Special Education Grants	<p>Special Education for Pupils with Learning Disabilities (P-125, 4-30-92)</p> <p>(1) One hundred seventy-nine school districts and county offices of education reported to the California Department of Education (department) that on April 1, 1991, they had 1,358 learning disabled pupils enrolled in nonpublic schools. We estimate that the total cost of educating learning disabled pupils in nonpublic schools was approximately \$20,100,000 for fiscal year 1990-91.</p> <p>(2) Pupils with exceptional needs who are ordered to juvenile hall must also be provided with a free appropriate education. These pupils are provided special education services in juvenile court schools administered and operated by county offices of education. Data compiled from 42 local plan areas for special education indicate that they spent approximately \$2,570,000 in special education funds during fiscal year 1990-91 to provide special education services for 1,730 pupils in juvenile courts schools. Approximately \$2,035,000 of the total was used to provide special education programs for 1,231 pupils with learning disabilities.</p>

**Schedule of Minor Federal Issues for the
Fiscal Year Ended June 30, 1992**

<u>Agency Receiving Federal Funds</u>	<u>Federal Grant and Federal Catalog Number</u>	<u>Description of Issue</u>
All	All	<p>(1) The Department of Finance did not always comply with administrative requirements of the federal government. Specifically, we noted that the department made minor errors resulting in an overstatement totaling about \$300 in calculating the costs of its central service function. Additionally, the department made an error of 80 hours in accumulating its workload for fiscal year 1991-92 for its budget operations support unit, understating time the unit devoted to the Department of Health Services.</p>
California Post Secondary Education	Eisenhower Mathematics and Science Education-State Grants 84.164	<p>(1) The commission does not have an ongoing policy for ensuring that its employees are aware of the requirements of the Drug-Free Workplace Act.</p>
Economic Opportunity, Department of	Low-Income Home Energy Assistance Program 93.028	<p>(2) In our review of applications for Eisenhower grants, we noted that for two applicants the budgets were not revised to agree with the amount received under the grant.</p>
Health Services, Department of	Refugee and Entrant Assistance-State Administered Programs 93.026	<p>(1) The department did not fully comply with certain federal reporting requirements.</p> <p>(2) The department did not ensure that all warrants were properly endorsed.</p> <p>(1) The department made a clerical error when preparing the federal financial status report for the quarter ended September 30, 1991, and, as a result, overstated by \$7,583 the total reported expenditures of approximately \$5.8 million.</p>

Housing and Community Development,
Department of

Community Development Block Grant, Section 8
Rental Certificate Program

14.228
14.857

(1) In a 1989 memo, the department distributed its drug-free workplace policy. However, not all department employees that we interviewed could confirm receipt of the policy.

Section 8 Rental Certificate Program

14.857

(2) The department submitted seven of ten financial reports that were from three to ten days late.

Community Development Block Grant

14.228

(3) One of the five subrecipients that we reviewed maintained unjustified cash balances that exceeded \$5,000 at the end of two reporting periods.

(4) The department took longer than seven days to disburse drawn down funds for 2 of the 61 claim schedules that we reviewed. In these 2 instances, the department took 29 and 55 days respectively to disburse the funds.

(5) The department did not review Equal Employment Opportunity as part of its on-site monitoring for one of the six grantees we reviewed.

(6) The department did not send a monitoring letter within the required 45 days to one of the six grantees we reviewed that had on-site monitoring visits from the department.

Office of Emergency Services

Disaster Assistance
83.516

(1) The office did not provide a copy of the policy statement as required by the Drug-Free Workplace Act to two of the ten employees that we surveyed. However, as of June 1992, the office distributed its Drug-Free Workplace policy to each employee, requesting that it be read, signed, returned, and maintained in the employee's personnel folder.

(2) For fiscal year 1991-92, the office submitted three federal cash transaction reports to the Federal Emergency Management Agency from 7 to 29 days late.

(3) The office submitted the final financial status report for a disaster grant declared in 1978 and completed in fiscal year 1991-92 more than five months late.

Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Description of Issue
Rehabilitation, Department of	Rehabilitation Services Basic Support 84.126	<p>(1) Of the 25 open client files we reviewed, one file did not indicate whether the client was eligible for or received similar benefits under another program. Specifically, the client was receiving benefit services from the department while attending a college/training program.</p> <p>(2) In addition, another client file was not reviewed within 90 days while the client was in Extended Evaluation. Specifically, at the time of our review, the file had not been reviewed within 120 days.</p>
Social Services, Department of	Disaster Assistance 83.516	<p>(1) The department did not deduct an amount a recipient received from other sources from the amount awarded to the recipient from an individual family grant. As a result, the department overpaid the recipient by \$100.</p>
	Family Support Payments to States-Assistance Payments 93.020	<p>(2) In the financial report for the quarter ending March 31, 1992, the department overstated the total federal share of the adjusted expenditures by \$1,122. The department corrected this error by submitting a revised report dated August 31, 1992.</p>
	Job Opportunity and Basic Skills Training 93.021	<p>(3) For the quarters ending September 30, and December 31, 1991 and March 31, 1992, the department overcharged the federal government by \$450, \$454, and \$251, respectively, and undercharged the State by the same amounts. These differences resulted from improperly rounding expenditures funded at a 50 or 60 percent rate.</p>
	Child Support Enforcement 93.023	<p>(4) The department understated the federal share of program costs for the quarter ended March 31, 1992, by approximately \$25,200. The department subsequently corrected this understatement.</p>
	Refugee and Entrant Assistance-State Administered 93.026	<p>(5) For 2 of the 21 cases that we reviewed, the department did not receive required progress or change of status reports from counties for unaccompanied minors served in the program.</p>

Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Description of Issue
Transportation, Department of	Temporary Emergency Food Assistance (Administration Costs) 10.568	(6) The department charges indirect costs as allowed by Circular A-87 rather than charging for only direct costs as required by the Code of Federal Regulations, Title 7, Sections 251.8(d) and 251.3 (f).
Transportation, Department of	Highway Planning and Construction Program 20.205	(1) For one of the five construction material purchases that we reviewed, the department's Los Angeles District office paid \$11.04 for more accumulated materials than was allowed in the contract specifications.
Youth Authority, Department of the	School Breakfast Program and National School Lunch Program 10.553 10.555	(1) The department made 23 clerical errors that resulted in charging the federal government incorrectly for 97 meals of the 89,423 meals we tested. However, the department also made 12 clerical errors that resulted in not charging the federal government for 23 meals for which it was entitled to reimbursement. As a result of these inaccurate meal counts, the department overcharged the federal government by \$108.84.
National School Lunch Program	National School Lunch Program 10.555	(2) All three of the institutions we visited served their wards fluid unflavored lowfat milk. However, only one institution offered wards fluid whole milk as an alternative to fluid unflavored lowfat milk as required by federal regulations.

Report on Compliance With State Laws and Regulations



CALIFORNIA STATE AUDITOR

BUREAU OF STATE AUDITS

KURT R. SJOBERG
State Auditor

MARIANNE P. EVASHENK
Chief Deputy State Auditor

Independent Auditors' Report on Compliance With State Laws and Regulations

The Governor and the Legislature of
the State of California

We have audited the general purpose financial statements of the State of California as of and for the year ended June 30, 1992, and have issued our report thereon dated November 19, 1993. We did not audit the financial statements of the pension trust funds, which reflect total assets constituting 78 percent of the fiduciary funds. We also did not audit the financial statements of certain enterprise funds, which reflect total assets and revenues constituting 92 percent and 93 percent, respectively, of the enterprise funds. In addition, we did not audit the University of California funds. The financial statements of these pension trust funds, certain enterprise funds, and the University of California funds referred to above were audited by other auditors who furnished their reports to us, and our opinion, insofar as it relates to the amounts included for the pension trust funds, certain enterprise funds, and the University of California funds, is based solely upon the reports of other independent auditors.

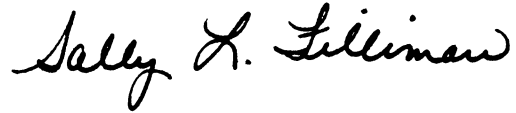
We conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement.

The management of state agencies is responsible for compliance with laws, regulations, contracts, and grants applicable to the State of California. As part of obtaining reasonable assurance about whether the general purpose financial statements are free of material misstatement, we performed tests of the State of California's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests indicate that, with respect to the items tested, the State of California complied, in all material respects, with the provisions referred to in the preceding paragraph. With respect to items not tested, nothing came to our attention that caused us to believe that the State of California had not complied, in all material respects, with those provisions. However, we noted certain immaterial instances of noncompliance that we have reported to the management of agencies of the State of California. We discuss these on pages 43 through 177 of this report.

This report is intended for the information of the Governor and Legislature of the State of California, and the management of the executive branch. However, this report is a matter of public record, and its distribution is not limited.

BUREAU OF STATE AUDITS

A handwritten signature in black ink that reads "Sally L. Filliman". The signature is written in a cursive, flowing style.

SALLY L. FILLIMAN, CPA
Deputy State Auditor

November 19, 1993

**Appendix Reports Issued by the
Office of the Auditor General* From
July 1, 1991 to December 31, 1992**

<u>Date of Issue</u>	<u>Report Title</u>	<u>Report No.</u>
<u>1991</u>		
Jul 03	A Review Concerning Allegations of Conflict of Interest By a Board Member of the Bay Area Rapid Transit District (Letter Report)	P-036
Jul 17	A Review of the Department of Alcohol and Drug Programs' Drug/Medi-Cal Claims Process	P-965
Jul 24	The Department of Health Services' Information on Drug Treatment Authorization Requests (Letter Report)	P-117
Jul 25	The Office of State Printing Needs To Strengthen Controls Over Its Data Processing Resources	T-973
Jul 31	The California Housing Finance Agency Has Generally Complied With Statutory Requirements in Financing Single-Family Homes and Multifamily Rental Projects	P-950
Aug 01	The Lake Elsinore Management Project (Letter Report)	P-042
Aug 07	A Review of the Division of Labor Standards Enforcement's Handling of the <i>Crowe vs. Simpson</i> Attorney Fees Dispute (Letter Report)	P-033
Aug 14	California's Efforts To Meet Participation Goals for Minorities' and Women's Businesses in State Contracts	P-131
Aug 15	A Review of the Board of Equalization's Travel Claims (Letter Report)	P-026

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Date of Issue	Report Title	Report No.
Aug 21	An Analysis of Sanctions in the General Relief/General Assistance Programs of Six Counties	P-009
Aug 28	A Review of the Inglewood Unified School District's Management Practices and Student Academic Records	F-028
Aug 29	Some Institutions Within the California Department of Corrections Need To Improve Their Disability Payroll Procedures	F-059
Aug 30	How Medi-Cal and Other Health Care Providers Manage Their Pharmaceutical Expenditures	P-062
Sep 05	The State Athletic Commission Needs To Improve Its Controls Over the Professional Boxers' Pension Plan	P-027
Oct 03	The Department of General Services' Administrative Oversight of State Agencies That Award Contracts (Letter Report)	P-014
Oct 18	A Review of the Department of Corrections' Implementation of Its Substance Abuse Treatment and Education Services (Letter Report)	P-122
Oct 23	Status of Costs Identified and Reimbursed for the State Legalization Impact Assistance Grants	F-132
Oct 30	The Department of Toxic Substance Control Has Not Taken Sufficient Action To Bill and Recover Hazardous Waste Cleanup Costs From Responsible Parties (Letter Report)	F-426.1
Nov 27	A Review of the California State University's Disabled Student Services	P-054
Dec 19	A Review of the Usefulness of Domestic Disclosure Spreadsheets to the Franchise Tax Board (Letter Report)	F-864
<u>1992</u>		
Jan 08	The California Public Utilities Commission Can Improve Aspects of Its Program To Compensate Intervenors	P-069

Date of Issue	Report Title	Report No.
Jan 23	Compensation, Retirement Benefits, and Employment Contracts At School Districts, Community College Districts, County Offices of Education, and Special Districts	P-119
Jan 29	An Analysis of the State's Compliance With Requirements for Consulting Contracts (Letter Report)	F-066
Feb 05	The Department of Health Services' Information On Drug Treatment Authorization Requests (Letter Report)	P-144
Feb 20	A Review of the Board of Vocational Nurse and Psychiatric Technician Examiners of the State of California	P-064
Feb 26	A Review of the State's Allocations and Expenditures at the State Level of the Additional Transportation Funds Made Available by the 1989 Transportation Blueprint Legislation	F-030
Mar 04	A Review of the State-Mandated County Voter Outreach Programs	P-118
Mar 25	The Board of Equalization Needs to Adjust Its Model for Setting Reimbursement Rates for Special Tax Jurisdictions	F-133
Mar 31	State of California, Financial Report, Year Ended June 30, 1991	F-101
Apr 23	Long-Term Care in California: A Comparison of Financial and Utilization Data for Investor-Owned and Nonprofit Facilities	P-120
Apr 29	Special Education for Pupils with Learning Disabilities (Letter Report)	P-125
Apr 29	A Review of the Food Services at the California Correctional Institution at Tehachapi (Letter Report)	P-143
May 06	The State's Disaster Relief Fund Has Insufficient Revenues To Cover All State Costs From the Loma Prieta Earthquake	P-123

Date of Issue	Report Title	Report No.
May 28	The Department of Corporations Can Improve Its Management of Medical Surveys and Consumer Complaints in Its Health Care Service Plan Division	P-115
Jun 03	The Department of General Services' Office of Procurement Needs To Improve Its Purchasing and Materials Management Practices	P-135
Jun 11	A Review of the State's Controls Over Its Financial Operations	F-105
Jun 24	State of California Statement of Securities Accountability of the Treasurer's Office as of June 30, 1991	F-104
Jun 25	The Department of Insurance Needs To Make Significant Improvements in Its Regulatory Practices Aimed at Controlling Insurers' Insolvencies	P-029
Jul 01	A Review of Court Services in San Bernardino County	P-134
Jul 02	A Review of Selected Areas of the Chino Unified School District's Building Program	P-142
Jul 23	The Department of Health Services' Information on Drug Treatment Authorization Requests (Letter Report)	P-213
Aug 05	A Fiscal Impact Analysis of Undocumented Immigrants Residing in San Diego County	C-126
Aug 06	Public Reports of Investigation Completed by the Office of the Auditor General From January 1, 1991 Through July 31, 1992	I-214
Aug 26	A Review of the University of California's Executive Compensation, Benefits, and Offices	P-215
Sept 02	Some Counties Are Not Promptly Remitting to the State Fees Collected for the Judges' Retirement System	P-141

DEPARTMENT OF FINANCE

OFFICE OF THE DIRECTOR
STATE CAPITOL, ROOM 1145
SACRAMENTO, CA 95814-4998



December 24, 1993

Kurt R. Sjoberg
State Auditor
660 J Street, Suite 300
Sacramento, CA 95814

Dear Mr. Sjoberg:

REPORT 92-002--A REVIEW OF THE STATE'S CONTROLS OVER ITS FINANCIAL OPERATIONS

Thank you for the opportunity to respond to your draft report, which was prepared as part of your examination of the State's general purpose financial statements for the Fiscal Year ended June 30, 1992. The findings in this report will be incorporated into the Single Audit Report filed by the State of California covering Fiscal Year 1991-92.

I am pleased that you have identified that the State has corrected numerous weaknesses previously reported, including some major issues related to Generally Accepted Accounting Principles. I am also pleased to note that no new statewide issues have arisen during the past year. Although our systems can always be improved, the fact that the cumulative findings do not adversely affect the State's general purpose statements is evidence that the State's operations are generally working.

California is a complex entity with numerous programs and activities being carried out for its citizens. Such complexity and the unprecedented budget constraints that we face challenge us to carry out those programs while considering the benefits and costs of controls. Regardless, the State's internal control structure is important and will continue to be the responsibility of the financial leadership of the State.

Each department where you have identified internal control weaknesses is responsible for its own corrective action. Our department, however, will continue to provide the leadership necessary to ensure the appropriate structure and practices over controls, fiscal operations and program functions. We will monitor the corrective actions of the other departments as necessary.

The following is our response to each of the statewide concerns that you have identified in your draft.

INCONSISTENT FINANCIAL REPORTING AND PROBLEMS WITH THE STATE'S CONVERSION TO GAAP

We continue to address the issue of Generally Accepted Accounting Principles (GAAP) in several areas and have established a committee that includes a representative from your office. As you've reported, we have made changes to account for some major revenues and expenditures in a

manner more consistent with GAAP. We will make additional changes where it is in the best interest of the State. However, as we've previously informed you, there are some areas where GAAP treatment may not be practical, and where the cost and benefit of establishing the necessary systems need to be considered.

The State Controller converts the legal basis information that state agencies submit in order to issue year-end financial statements. We are not aware of difficulties encountered by the State Controller in making this conversion.

SOME INTERNAL SERVICE FUNDS DO NOT ALWAYS COMPLY WITH FEDERAL REGULATIONS

The administrative processes for the State's Internal Service Funds meet the State's needs, and laws and regulations. In some cases, such laws and regulations differ from those of the Federal government. The Federal government has been developing changes to its cost principles, including the allowance of reasonable working capital reserves. When those changes are finalized, the State will review the guidelines for its Internal Service Funds.

DELAYS IN PRODUCING AUDITED FINANCIAL STATEMENTS

We are continuing our efforts to reduce the time required by several state agencies to prepare and submit the year-end statements to the State Controller's Office for incorporation into the Annual Report. State agencies generally submit correct statements no later than the first of September.

LACK OF COMBINING STATEMENTS BY FUND TYPE

The State continues to review the process necessary to prepare a comprehensive annual report in accordance with GAAP. The State Controller is currently issuing both an annual report in accordance with the State's legal basis of accounting and an annual report containing general purpose financial statements in accordance with Chapter 1286, Statutes of 1984 (AB 3372).

INELIGIBILITY FOR CERTIFICATE OF ACHIEVEMENT

We recognize the desirability of the Certificate of Achievement for Excellence in Financial Reporting. We continue to address issues that preclude us from qualifying for this award.

INSUFFICIENT REPORTING OF LEASING INFORMATION

The development of a central record of all lease commitments is an enormously difficult task. The Department of General Services is now the central depository for the bulk of the leasing information but does not have access to the lease for the University of California or the Department of Transportation.

INADEQUATE CONTROL OVER SOME CONTRACTS

Because there is a legal basis for not requiring the Department of General Services to process all contracts, legislation may be required to have the department act as a clearinghouse for all contracts, grants and interagency agreements.

FAILURE TO REQUIRE ACCOUNTING FOR EXPENDITURES OF FEDERAL MONEYS BY EACH FEDERAL PROGRAM

The accounting system used to record Federal moneys needs to be changed to one that will meet all Federal and State requirements, and will be addressed as other priorities and resources allow.

IMPROPER OMISSIONS FROM THE STATE REPORTING PROCESS

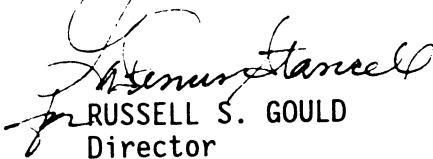
Legislation may be required to include the District Agriculture Fairs into the State reporting entity.

FAILURE TO REQUIRE AGENCIES TO SUBMIT RECONCILIATIONS AND FAILURE TO REQUIRE AGENCIES TO PREPARE A REPORT OF ACCRUALS

The Department of Finance continues to review the proposed requirements for State agencies to complete a full set of year-end reports for Non-Governmental Cost Funds (including the Report of Accruals and the Reconciliation of Agency Accounts with transaction per State Controller). We will be addressing this issue as other priorities permit.

We appreciate the recommendations that you have identified regarding the state's operations. Our own efforts, as well as those of departmental internal auditors, have also identified similar areas. We are aware that in many areas efforts are already underway to correct and strengthen those weaknesses. We will continue to provide the leadership to ensure the proper financial operations of the State.

Sincerely,


RUSSELL S. GOULD
Director

cc: Sally Filliman, Deputy State Auditor

**cc: Members of the Legislature
Office of the Lieutenant Governor
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps**