

# **State of California:**

**Financial and Compliance Weaknesses  
Have a Cumulative Effect on the  
State's Operations**

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# CALIFORNIA STATE AUDITOR

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June 21, 1995

94002

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 report fully meets the requirements of the 1984 Single Audit Act set forth by the United States Government as a condition of receiving almost \$26 billion in federal funds annually. The Bureau of State Audits, which was created in May 1993, pursuant to the California Government Code, Section 8543, is responsible for performing the annual financial and compliance audit previously conducted by the Office of the Auditor General.

The State continues to need improvement in its accounting, auditing, and administrative control structure. For example, we found numerous inadequacies in the State's monitoring of recipients of state and federal moneys. As a result, the State cannot ensure that the recipients are complying with regulations or laws governing the receipt or use of these moneys. In addition, we noted instances in which the State failed to promptly bill for costs incurred, resulting in lost interest earnings or an impairment in the State's ability to collect amounts owed to the State.

In responding to weaknesses we have reported in an earlier audit, the State has made some improvements in its internal control structure. For example, for fiscal years 1988-89 through 1992-93, the Office of the Auditor General or the Bureau of State Audits reported that the Stephen P. Teale Data Center recorded the cost of software purchases as an operating expense rather than an intangible asset. The cumulative effect of not recording intangible assets in the past was to understate assets (net of amortization) at June 30, 1993, by approximately \$4.8 million. The data center now records software costs that exceed \$5,000 and that have a useful life of four years as intangible assets and allocates the cost of the software to expense over its useful life.

Respectfully submitted,

KURT R. SJOBERG  
State Auditor

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# Summary

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The State continues to have many weaknesses in its accounting, auditing, and administrative control structure. The weaknesses, which we found in numerous departments, result in noncompliance with state and federal regulations, inefficient use of state resources, and inaccurate departmental financial statements. Individually, most of these weaknesses have a minor effect on the State's operations, but cumulatively, their effect can be significant. The following are some of the more significant weaknesses we found:

- The Department of Motor Vehicles had approximately \$9.2 million in cash collections at the end of the fiscal year in its uncleared collections account remaining unallocated to programs supported by department revenue. This problem originated before fiscal year 1985-86 when it appears the department deposited cash in the uncleared collections account of the State Controller's Office (SCO), but the department either did not request the SCO to transfer those deposits to the correct revenue accounts or the SCO did not process the department's request to transfer the deposits.
- The Department of Alcohol and Drug Programs spent at least \$195,900 in federal grant funds to plan, promote, manage, and attend the National Association of State Alcohol and Drug Abuse Directors, Inc. conference held in San Diego, California, in June 1994. We question the propriety of certain expenditures related to the conference. For example, the department paid \$50,000 to the Hotel del Coronado because it reserved too many rooms.
- The Department of Health Services did not have adequate procedures for monitoring and collecting approximately \$421 million in accounts receivable. In addition, the department did not adequately distribute responsibilities among its staff for activities related to accounts receivable.
- The Department of Housing and Community Development is not able to reconcile a difference of approximately \$25.4 million between its accounting records and program records for housing loans distributed from three loan funds. Further, the department has not properly identified correct names, addresses, and account numbers for borrowers of loans totaling approximately \$28 million.
- The State does not recognize the liability for earned vacation credit in its budgetary basis financial statements. As of June 30, 1994, the liability was approximately \$1.3 billion.

- The State has numerous deficiencies in its monitoring of recipients of federal or state moneys. We found 17 federal programs and 2 state programs at 12 departments deficient in required monitoring practices. Without adequate monitoring of recipients of state and federal moneys, the State cannot ensure that the recipients are complying with regulations or laws governing the receipt or use of these moneys.
- State departments have numerous deficiencies in preparing accurate state and federal financial reports. We found at least five departments that inaccurately prepared state financial reports, and eight departments with discrepancies in federal reports submitted. Failure to correctly report financial information reduces the State's ability to prepare the State's financial statements in accordance with generally accepted accounting principles, and failure to complete accurate federal reports can result in misstated claims that are not supported and may go undetected.
- The State Controller's Office (SCO) does not have an adequate system for identifying all special districts that are required to submit annual single audit reports to the SCO for review. As part of its responsibility for coordinating the single audit activities of local governments, the SCO reviews the special districts' single audit reports for adequacy and for compliance with federal regulations and standards. However, the SCO does not ensure that other state departments notify it of all special districts to which they distribute federal funds. Although it has an adequate system for monitoring the audit reports that it is aware it should receive, without a complete list of reports, the SCO cannot be assured that all special districts receiving federal moneys are complying with federal requirements.
- The Department of Motor Vehicles had approximately 83,000 checks, totaling approximately \$23 million, that banks had not honored. The department has transferred the responsibility and authority for the collection of delinquent vehicle registration fees in excess of \$250 to the Franchise Tax Board (FTB). However, the department does not reconcile the checks transferred to the FTB to the checks collected or pursued. As a result, the department cannot ensure that it collects on all the dishonored checks for vehicle registration.
- The Department of Housing and Community Development has commingled approximately \$258 million in cash from nine federal programs in its Federal Trust Fund since at least fiscal year 1989-90. Consequently, the department cannot determine actual cash balances for specific federal grants during the period of commingling.

We noted these deficiencies during our annual financial and compliance audit of the State. Procedures we perform during this audit include evaluating internal controls over activities that can directly affect the financial statements or controls required for receiving federal funds. The audit does not directly deal with the economy, efficiency, or effectiveness of the State's administration, although such issues may arise during our audit.

Although these weaknesses exist in the State's control structure, the State has also made significant improvements in certain areas. These improvements results from the State's response to weaknesses the Bureau of State Audits and the Office of the Auditor General reported. Following are examples of some of these improvements:

- For fiscal years 1988-89 through 1992-93, the Office of the Auditor General or the Bureau of State Audits reported that the Stephen P. Teale Data Center recorded the cost of software purchases as an operating expense rather than an intangible asset. The cumulative effect of not recording intangible assets was to understate assets (net of amortization) at June 30, 1993, by approximately \$4.8 million. The data center now records software that exceeds \$5,000 and that has a useful life of four years as an intangible asset and allocates its cost to expense over the software's useful life.
- During fiscal years 1990-91 through 1992-93, the Office of the Auditor General or the Bureau of State Audits reported that the Governor's Office of Emergency Services (office) had not appealed all of the approximately \$7.7 million in claimed costs related to the Loma Prieta earthquake that the Federal Emergency Management Agency denied. Since we reported this issue in last year's audit, the office has resolved approximately \$7.1 million of its claimed costs.



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# *Introduction*

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As part of our examination of the general purpose financial statements of the State of California for fiscal year ended June 30, 1994, we studied and evaluated the State's internal controls. This study is necessary for the following three reasons:

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

Before conducting our audit, we determined the audit procedures and the extent of testing necessary. During our audit, we reviewed and evaluated fiscal controls at 23 of the 194 state agencies included in the general purpose financial statements.

Amounts that we audited at these agencies represented approximately 76 percent of the State's revenues and approximately 70 percent of the State's expenditures. Further, other independent auditors audited an additional 14 percent of the State's revenues and an additional 10 percent of the State's expenditures. We increased our coverage with centralized testing, for which we selected 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 the internal audit activities were reliable.

We reviewed 18 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 financial aid programs administered by the California State University and federal grants administered by the University of California, which are 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 51 of the 345 federal grants the State administers. These 51 grants represent approximately 97 percent of the federal funds the State received in fiscal year 1993-94, excluding most financial aid funds the California State University received and 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 33);
- The reports on weaknesses and instances of noncompliance at state agencies (begin on page 39);
- The report on federal assistance programs, including required reports on compliance with laws and regulations related to major and nonmajor federal programs (begin on page 187) and reports on the resolution of prior year findings related to federal programs (begin on page 187);
- The report on the accuracy of the supplementary schedule of federal assistance (begins on page 193); and
- The report on compliance with state laws and regulations (begins on page 243).

Between July 1, 1993, and December 31, 1994, the Bureau of State issued 37 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.

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# *Statewide Concerns*

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## **Summary**

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In its control system, the State has numerous weaknesses that warrant statewide concern. Such weaknesses exist at numerous departments throughout the State, arise from current statewide policies that do not satisfactorily address the State's needs, or have a potentially significant fiscal impact on either the State as a whole or on a segment of the State.

Generally, the statewide concerns fall into two main categories by subject: problems with financial reporting and problems with compliance with state or federal requirements. Problems with financial reporting can result in inaccurate financial statements. The following issues are examples of problems with financial reporting:

- Problems with the State's conversion of its accounting policies to generally accepted accounting principles;
- Inadequate or late reporting of financial information; and
- Failure to require departments to submit important financial reports to the State Controller's Office to improve the reliability of the State's general purpose financial statements.

Problems with compliance with federal and state policies can result in a lack of assurance that the State or its subrecipients comply with state and federal laws and regulations. The following issues are examples of these problems:

- Deficiencies in administering nonconsulting contracts;
- Inability to account for expenditures of federal moneys by each federal program;
- Lack of monitoring of cash advances to subrecipients; and
- Lack of monitoring of recipients of federal and state moneys.

The Department of Finance (DOF) is responsible for ensuring that the State maintains a system of internal accounting and administrative controls that safeguard the State's resources. Additionally, the DOF is responsible for providing guidance to other state agencies when weaknesses and problems, such as those discussed in this section, arise.

Many of the statewide concerns have been reported by the Bureau of State Audits for fiscal years 1991-92 and 1992-93 and by the Office of the Auditor General for prior years. Some of the statewide concerns remain unresolved because they require the coordinated efforts of many agencies or require the expenditure of scarce resources. Four issues are reported as a statewide concern for the first time this year: the deficiencies in administering and accounting for state equipment, the improper accounting for construction in progress, the incomplete statewide real property inventory, and the errors identified in the calculation of the interest liability for federal cash management.

## **Financial Reporting Problems**

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The first six statewide concerns are financial reporting problems that relate to the State's general inability to produce financial statements that are timely, complete, and consistent with generally accepted accounting principles.

### **Problems With the State's Conversion to GAAP**

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The State prepares financial statements on a budgetary basis and on a basis consistent with generally accepted accounting principles (GAAP). The State Controller's Office (SCO) currently issues the Annual Report of the State of California in general conformity with the State's budgetary basis of accounting, which is not in accordance with GAAP. The State's budgetary statements must then be converted to GAAP for the State's general purpose financial statements. The Bureau of State Audits reported this issue during its audits for fiscal years 1991-92 and 1992-93, and the Office of the Auditor General reported a similar issue during its audits for fiscal years 1982-83 through 1990-91.

The budgetary basis financial statements are required by the California Government Code, Section 12460, which states that the SCO will 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. This section also requires that the format of the budgetary report be prepared as closely as possible in accordance with GAAP. 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.

Several differences between the budgetary basis and GAAP basis financial statements exist because the State's budgetary accounting practices are not in accordance with GAAP. The following are examples of existing budgetary basis accounting practices that the State should change to bring the budgetary basis financial statements closer to GAAP.

### ***General Fund***

The Department of Finance (DOF) should modify its accounting practices so that it can report the revenues and expenditures of the State's General Fund in accordance with GAAP in the governor's budget. For example, expenditures related to earned vacation for certain state faculty should be included in the governor's budget. Additionally, the DOF should recognize expenditures in the fiscal year that the liabilities occur. Currently, some expenditures are not recognized because the appropriations have no remaining funds. These expenditures are paid from subsequent fiscal year appropriations even though the liability was incurred in the prior year. Further, the DOF should ensure that certain General Fund expenditures as reported in the governor's budget agree with the State's financial statements issued by the SCO. Finally, the DOF should ensure that loans made by the State's General Fund to other funds or to other governments are recorded as assets. Currently, these loans are recorded as expenditures.

### ***Other Fund Types***

In addition to the accounting changes for the State's General Fund, the DOF should modify the budgetary accounting practices for other fund types. For example, the State currently reports as encumbrances grants made to local agencies when the commitments are made. However, using the GAAP basis of accounting, the grants are not reported as encumbrances because the local agencies, not the State, receive the goods or services. Rather, these encumbrances are reported in the notes to the financial statements. Similarly, at least one internal service fund includes encumbrances in its liability balance. Under GAAP, encumbrances are not reported as liabilities. Finally, the State currently recognizes its authorized but unissued bonds as an addition to fund balance; however, under GAAP, the proceeds from the sale of bonds should not be recognized until the sale occurs.

In addition to the differences in accounting practices described above, 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 differences exist primarily because the DOF has not converted the preparation of the annual governor's budget to a basis that is consistent with GAAP and has provided only limited instruction in the State Administrative Manual to make the conversion from the budgetary basis to GAAP efficient and reliable. Because of the limitations inherent in the State's financial information system, agencies provide reports to the SCO that are insufficient for preparing the State's general purpose financial statements in accordance with GAAP.

However, the State is in the process of converting from the budgetary basis to GAAP in certain areas. The DOF has rewritten some sections of the State Administrative Manual covering proprietary funds to bring them into conformity with GAAP under certain conditions. In addition, in the governor's budget, the DOF currently 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 changes earlier practices and 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 liability for Medi-Cal services provided but not yet paid for and the liability for tax overpayments.

Nevertheless, until the State incorporates all the necessary generally accepted accounting principles into its policies and practices, the State must continue spending time and money to convert its financial records from the budgetary basis to GAAP so that the financial statements are comparable to those of other governmental entities, and therefore, acceptable to the investment community and the federal government under the Single Audit Act.

### **Inadequate Reporting of Leasing Information**

The State does not have centralized records that contain all the necessary information required by GAAP for financial statement disclosures on lease commitments. Without centralized records, the State spends unnecessary time and effort in gathering and summarizing the required information. The State's lease commitments of the primary government and its component units totaled approximately \$5.7 billion in fiscal year 1993-94.

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 SCO to present the State's financial position in a format that is as close as possible to GAAP. When the State leases space or equipment from outside vendors, GAAP requires the State 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 records for many lease commitments, it established these records for its internal management purposes, rather than for maintaining a complete listing of the State's leases that would meet GAAP requirements. As a result, the records do not provide all the required information. For example, the records disclose only the current-year payments for each lease and do not indicate either the changes in payments in future years or the separate future lease and rental payments by fiscal year.

Although the Department of General Services has converted to a new system to maintain space and equipment records, additional programming work is required before the new system is able to provide the information required by GAAP. Also, the records of both the new and the old system do not include information on those leases that the Department of General Services does not oversee. For example, the department's records do not include more than \$1.6 billion in lease commitments with the State Public Works Board or \$2.3 million in lease commitments for the California State Lottery Commission.

The Bureau of State Audits reported this weakness in its audits for fiscal year 1991-92 and 1992-93, and the Office of the Auditor General reported this weakness for fiscal years 1986-87 through 1990-91.

### **Omissions From the State Reporting Process**

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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 part of the state entity, the Office of the Auditor General requested a legal opinion from the Legislative Counsel. In December 1988, the Legislative Counsel found that the District Agricultural Associations are state agencies and that money they spend is state money. Further, funds for the support of the District Agricultural Associations are appropriated in the State's annual budget. For these reasons, the Legislative Counsel concluded that the SCO is required to include the financial information of the District Agricultural Associations in the State's general purpose financial statements. Additionally, the Governmental Accounting Standards Board, Statement 14, requires the State to present financial information of component units, such as District Agricultural Associations, in its general purpose financial statements. Currently, this information is not included, and as a result, the State's general purpose financial statements are incomplete.

The Bureau of State Audits reported a similar finding for fiscal years 1991-92 and 1992-93, and the Office of the Auditor General reported a similar finding for fiscal years 1987-88 through 1990-91.

### **Agencies Are Not Required To Prepare All Reconciliations or Reports of Accruals**

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At the end of each fiscal year, state agencies submit financial reports to the SCO, which then issues a combined financial report presenting the State's financial position and results of operations. However, the State Administrative Manual, Section 7951, does not require agencies to submit to the SCO two important financial reports for more than 240 funds numbered 500 to 699 and 800 to 999. We found the following:

- Report 15, Reconciliation of Agency Accounts With Transactions Per State Controller, is not submitted. As a result, the SCO does not have evidence that agencies have reconciled financial information that appears in the general purpose financial statements with SCO records. The State Administrative Manual, Section 7900, discusses the importance of making regular reconciliations. Reconciliations represent an important element of internal control because they provide a high level of confidence that transactions have been processed properly and that the financial records are complete. The reconciliation with the records of the SCO is an important step in ensuring the accuracy of the agencies' financial statements.

- Report 1, Report of Accruals to the Controller's Accounts, also is not submitted. As a result, information needed to distinguish encumbrances from accounts payable and to present financial information in accordance with GAAP is not available for all funds. The California Government Code, Section 12460, requires the SCO to present the State's financial position in a format that is as close as possible to GAAP. In addition, Section 1100.101 of the *Governmental Accounting and Financial Reporting Standards*, issued by the Governmental Accounting Standards Board, requires that agencies' accounting systems make it possible to present fairly the agencies' financial positions and results of operations in accordance with GAAP.

Included among these funds are 75 that had budget appropriations for fiscal year 1993-94. Without the reconciliation and accrual information for these funds, the SCO cannot be assured that expenditures for these funds are within the budgeted limits. The Bureau of State Audits reported similar weaknesses for fiscal years 1991-92 and 1992-93, and the Office of the Auditor General reported similar weaknesses during its audits for fiscal years 1985-86 through 1990-91.

### **Deficiencies in Accounting for and Controlling State Equipment**

State agencies do not consistently comply with the State Administrative Manual in accounting for and controlling their equipment. Specifically, some departments do not include the full purchase price of equipment, such as tax and shipping, when recording the cost of additions in the general ledger or do not include the cost of the equipment in the inventory listing. Also, departments do not always properly authorize deletions of equipment. Furthermore, we were not always able to trace items from the departments' inventory listings to the physical locations of the items. In addition, we could not trace some items from the physical locations back to the listings. A number of departments did not prepare monthly equipment reconciliations as required by the State Administrative Manual. Also, a number of departments have not conducted a physical count of equipment within the last three years. Although four agencies performed the physical inventory, they did not adjust the general ledger for the difference between the physical count and their inventory listing. Finally, a number of departments do not adequately separate the duties over equipment inventory and the equipment records.

Table 1 below lists the departments we tested during fiscal year 1993-94. It shows the number of items tested for additions, deletions, and inventory tracing and the number of items found in noncompliance. For the physical inventory count, the monthly equipment reconciliation, and separation of duties, the table shows the departments that were in noncompliance with provisions of the State Administrative Manual. The State Administrative Manual, Section 8600 et seq., defines equipment and provides guidelines for state agencies to follow for accounting and controlling equipment, including conducting physical inventories and having adequate separation of duties. In addition, Section 7969 requires agencies to reconcile the equipment expenditures to the property ledger at the end of each month, or quarter, if the volume of property transactions is small.



Table 1

Deficiencies In Accounting for and Controlling  
State Equipment at Various Agencies  
Fiscal Year 1993-94

Agency Name	Additions			Deletions			Inventory Tracing			Item Not On Inventory Listing	Reconciliation Not Prepared Monthly or Quarterly	No Physical Inventory In Last Three Years	Inadequate Separation of Duties
	Number Tested	Not Recorded Correctly In General Ledger Or Inventory	Number Tested	Number Tested	Not Correctly Authorized	Number Tested	Item Not Located In Field	Number Tested					
Judicial Council													
Department of Justice	10		5	2		5		5	1		X	X	
Board of Equalization	10	1	5			5		5					
Franchise Tax Board	10		10			10	2	10	8				X
Department of Insurance	10		5			5		6	1		X		
Department of Transportation													
(2 districts)	10		10	5		5		5	1		X		
California Highway Patrol	10		10	1		5	1	5	5				
Department of Motor Vehicles	10		5			5	1	5	1		X		
Department of Forestry and Fire Protection													
Department of Fish and Game	10		5			5	5	5	5		X	X	
Department of Parks & Recreation	10		5			5		5			X	X	
Air Resources Board	10		5			5		5			X	X	
Department of Health Services	10	5	10			5		5	5		X	X	
Employment Development Department	10	10	10			5		5	1		X		
Department of Social Services	10	7	5			5		5	1		X		
Department of Corrections	10		5			5		5			X	X	
Central California Women's Facility	10		10			10		10	2				
Department of Education	10		10	1		10		10	1				X
CSJ Chancellor's Office	10		10			10		10			X		
CSJ Dominguez Hills	10	4	10			5		5					
CSJ Fresno	10		10			5		5					
CSJ Hayward	5		5			5		5				X	
CSJ Long Beach	10		10			5		5					
CSJ Los Angeles	10		10			5		5					
CSJ Sacramento	10		10			5		5					
San Diego State University	10		10			5		5					X
San Francisco State University	5		5			5		5	1		X	X	
San Jose State University	5		5			5		5	1		X	X	
Cal Poly State University-SLO	10	5	10			5		5			X	X	
CSJ San Marcos	10		10			5		5					
Department of Food and Agriculture	10		5			5		5					
<b>Total</b>	<b>235</b>	<b>32</b>	<b>120</b>	<b>9</b>	<b>165</b>	<b>12</b>	<b>167</b>	<b>22</b>	<b>12</b>	<b>8</b>	<b>7</b>	<b>7</b>	

## **Ineligibility for Certificate of Achievement**

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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 the following two reasons:

### ***Late Audited Financial Statements***

The State has not been able to produce the necessary financial reports in time to issue audited financial statements within six months of the end of the fiscal year. Before the State can develop the financial reports, departments must submit financial information for each of its funds to the SCO. The State Administrative Manual, Section 7990, generally requires departments to submit the financial information to the SCO approximately one month after the end of the fiscal year. Further, the SCO generally allows departments an additional month after the published deadlines before it considers departments late in submitting their reports. During fiscal year 1993-94, the SCO considered General Fund reports late if departments had not submitted them by August 30 and reports for other funds late if departments had not submitted them by September 22. Of the 218 General Fund reports and 2,038 other fund reports due, approximately 18 and 103, respectively, were from one day to more than three months late. Section 12461.2 of the California Government Code states that the SCO may withhold any or all operating funds from agencies, departments, boards, or commissions, except state and local retirement systems, that fail to furnish required financial reports or statements within 20 days of the date prescribed.

In addition, audited information for three building authorities that are component units of the State was not available for the State's financial statements. For two of the three building authorities, the joint power agreements that created the building authorities established audit deadlines that are too late for the audited information to be included in the State's financial statements. Specifically, the audit deadline for the Los Angeles State Building Authority is 12 months after the end of the State's fiscal year, and the deadline for the San Francisco State Building Authority coincides with the recommended issue date for the State's financial statements. The completion date for the remaining building authority, the East Bay State Building Authority, was September 30, 1994.

The SCO contracted to perform these audits for the authorities. However, as of April 1995, the fiscal year 1992-93 audit for the East Bay State Building Authority had not been completed although it was due by September 30, 1993. In addition, the fiscal year 1993-94 audits for the East Bay State Building Authority and the San Francisco State Building Authority had not been completed as of April 1995, even though the audit deadlines were September 30, 1994, and December 31, 1994, respectively.

The Government Finance Officers Association established the time requirements for issuing audited financial statements in 1980. While major corporations such as IBM, General Motors, and Pacific Gas and Electric are required to issue their audited financial statements within 90 days after the close of the fiscal year, the State is allowed 180 days. However, the State has repeatedly taken longer than 200 days to issue its audited financial statements. The report on the financial statements for fiscal year 1993-94 was dated April 27, 1995, more than 300 days after the fiscal year ended.

To address this concern, the Office of the Auditor General contracted with Price Waterhouse to evaluate the State's financial reporting system. In its 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, the State formed a committee consisting of representatives from various control agencies 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 the following:

- Automated reconciliations of agency records with the SCO's records;
- 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 SCO.

However, the committee has not completed the development of these items in the eight years since the Price Waterhouse report. As a result, the shortcomings continue to exist throughout the State's financial reporting system.

### ***Lack of Combining Statements by Fund Type***

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. Generally, the report should include, for the primary government and its component units, general purpose financial statements by fund type and account group, combining statements by fund type, and individual fund statements of the primary government and its blended component units.

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

However, the SCO has made progress toward preparing combining statements by fund type for the primary government, including its blended component units. Specifically, the SCO has organized the funds within each fund type into categories that have a similar purpose for presentation in the Comprehensive Annual Financial Report. In addition, the SCO has modified its automated system that produces the financial statements. The system summarizes the budgetary basis statements into GAAP classifications for presentation in the Comprehensive Annual Financial Report.

The Bureau of State Audits reported a similar issue during its audits for fiscal years 1991-92 and 1992-93, and the Office of the Auditor General reported a similar issue during its audits for fiscal years 1985-86 through 1990-91.

## **State and Federal Compliance Issues**

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The remaining statewide concerns are state or federal compliance problems. Generally, the issues relate to the State's lack of guidance in the State Administrative Manual and the State's failure to ensure that departments comply with existing state and federal requirements.

### **Confusion Over Requirements for Approval for Some Contracts**

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The State Administrative Manual does not provide adequate guidance about which agreements for services require the approval of the Department of General Services (DGS). The Public Contract Code, Section 10295, states that all contracts entered into by any state agency for services are void unless and until approved by the DGS. In addition, the Health and Safety Code, Section 38012, requires DGS's approval of direct service contracts entered into by departments in the Health and Welfare Agency. The Attorney General's Office has issued two opinions that precede the effective date of the direct service contract legislation, one in 1975 and one in 1980. The opinions distinguish grants from contracts, and they state that certain grants are not contracts for services and are, therefore, not subject to the DGS's review and approval.

Some departments have relied on the opinions of the Attorney General's Office as their rationale for not obtaining DGS's approval of agreements for services. For example, the Office of the Auditor General reported in 1989 that the Department of Aging and the Department of Health Services did not always obtain DGS's approval of contracts when it was required. The departments, both of which are in the Health and Welfare Agency, responded that they considered the contracts in question to be grants, basing their positions on the opinions of 1975 and 1980. However, a more recent opinion of the Legislative Counsel, obtained during the Office of the Auditor General's audit, determined that some of these contracts did not meet the legal definition of a grant.

In our current review of similar contracts at these two departments, we found that the Department of Health Services continues to cite the opinions of the Attorney General's Office in classifying Indian Health Program contracts as grants, even though the Legislative Counsel concluded that an agreement for this program was a direct services contract and, therefore, subject to DGS's review and approval. During fiscal year 1993-94, the Department of Health Services entered into approximately \$1.4 million in agreements for the Indian Health Program. In contrast to the Department of Health Services' response to the 1989 audit, the Department of Aging reviewed its contracts to determine if they met the legal definition of a grant. The Department of Aging concluded that many contracts that it had previously classified as grants were actually contracts subject to the DGS's review and approval.

The DGS provides an independent review of contracts to ensure that state agencies are complying with laws and regulations and that the financial interests of the State are preserved and protected. If a department incorrectly classifies a contract as a grant, the State's system of controls is circumvented, and the State has less assurance that its financial interests are being protected.

The DGS should solicit a current opinion from the Attorney General's Office that clearly identifies the factors distinguishing grants from contracts and that clearly identifies when an agreement is subject to the DGS's review and approval. The DGS should then ensure that the State Administrative Manual accurately provides this information.

### **Deficiencies in Administering State Nonconsultant Contracts**

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State departments and the California State University (CSU) do not consistently comply with the California Public Contract Code and the California State University Administrative Manual (SUAM), respectively, and other applicable state regulations in establishing and reviewing contracts. We reviewed fiscal year 1993-94 nonconsultant contracts at 21 state departments and calendar year 1994 nonconsultant contracts at the CSU. We found that work began on some contracts before the contracts were approved and that some contracts that were not competitively bid (sole-source) did not have sufficient documentation to justify the lack of competitive bidding or the cost of such contracts. In addition to these deficiencies, the Department of General Services (DGS) did not always conduct required audits of state agencies to which purchasing authority has been delegated.

In our review of 231 nonconsultant contracts at 21 departments and the CSU, we found that 59 contracts (26 percent) were not approved before the beginning of contract work. When departments do not ensure that contracts are approved before work begins, the State cannot be assured that its interests are protected. Further, 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. The Bureau of State Audits reported this weakness for fiscal years 1991-92 and 1992-93, and the Office of the Auditor General reported this same problem for fiscal years 1986-87 through 1990-91.

In addition, for 129 contracts, excluding the CSU, that were not competitively bid, 15 (12 percent) did not have sufficient documentation to justify the cost of the contract. At the CSU, 17 contracts we reviewed were not competitively bid. Of the 17 contracts, 11 did not contain documentation justifying costs; however, as of January 1, 1994, CSU contracts were exempt from requirements outlined in the Public Contracts Code. Further, the SUAM, which outlines contracting requirements for the CSU campuses, does not require campuses to justify costs for sole-source contracts. The CSU campuses let the remaining 6 contracts before January 1, 1994, and these contracts did contain sufficient justification of the costs.

The State uses the competitive bidding process as a means of protecting the public from the misuse of state funds, to stimulate competition in a manner conducive to sound state fiscal practices, and to eliminate favoritism, fraud, and corruption in the awarding of state contracts. When the competitive bidding process is circumvented, the State cannot ensure that these objectives are being met without further explanation from the parties involved.

Table 2 identifies the two areas of noncompliance in handling contracts and lists the CSU and the 21 departments at which we reviewed nonconsultant contracts, the number of nonconsultant contracts reviewed at each department, and the number of instances of noncompliance observed for each area.

**Table 2**

***Deficiencies in Administering State Nonconsultant  
Contracts at Various Departments and the CSU  
Fiscal Year 1993-94 and Calendar Year 1994 (CSU)***

<b>Department Name</b>	<b>Number of Contracts Tested</b>	<b>Contracts That Lacked Approval Before Start of Work</b>	<b>Number of Contracts Not Competitively Bid</b>	<b>Contracts That Lacked Sufficient Cost Justification</b>
Board of Governors	9	4	9	1
California State University	33	13	17	
Department of Conservation	5	1	2	1
Department of Corrections	10		2	
Department of Developmental Services	5	1	1	
Department of Education	10	2	7	
Employment Development Department	10	2	4	
Board of Equalization	10		8	1
Franchise Tax Board	10		6	
Department of General Services	13	4	10	3
Department of Health Services	10	7	10	
Health and Welfare Agency Data Center	10		9	
Department of Justice	5	3	5	1
Department of Mental Health	10	5	6	4
Department of Motor Vehicles	10		4	
Department of Rehabilitation	10	3	7	
Department of Social Services	10	4	7	
State Controller's Office	10	1	5	1
State Treasurer's Office	10	2	6	
Stephen P. Teale Data Center	10	5	8	2
Department of Transportation	10	1	7	
Department of Water Resources	10	1	6	
<b>Total</b>	<b>230</b>	<b>59</b>	<b>146</b>	<b>14</b>

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 DGS. In addition, Section 10335 states that, unless specifically exempted, a service contract is not effective until the date of the DGS's approval. Moreover, the State Administrative Manual, Section 1209, requires state agencies to submit each contract in sufficient time for the DGS 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. When contracts are exempt from the DGS's approval, the issuing department should approve the contract before work begins.

The CSU contracts are exempt from the DGS's review and approval. Furthermore, the CSU is not required to comply with the Public Contract Code articles that relate to service contracts. The Chancellor's Office, therefore, provides service contract management guidance to its campuses in Sections 2400 and 2500 of its SUAM. Generally, the SUAM mirrors the State Administrative Manual for the requirements for establishing and reviewing contracts. Specifically, the SUAM, Section 2510.03, states that, except in cases of emergency to protect human life or state property, work must not commence on any contract until the contract has been approved by the appropriate authority. This section of the manual also states that any work the contractor performs before the approval date should be considered as the contractor's own risk and as voluntary.

The California Public Contract Code, Section 10340(a), requires that, unless otherwise exempt, state agencies must secure at least three competitive bids or proposals for each contract. The State Administrative Manual, Section 1235, requires that in those instances where three bids or proposals cannot be obtained, full explanation and justification must accompany the contract. Specifically, the State Administrative Manual, Section 1236, requires that contracts awarded without competitive bids include a justification of the appropriateness or reasonableness of the cost. Similarly, the SUAM, Section 2530, requires that if the contract is a sole-source contract, then information should be provided in sufficient detail to support and justify the approval of a sole source for the service or why the State's interests are better served by approving a sole source for the service.

In another departure from control procedures over the State's contracting process, the DGS did not always conduct required audits of state departments to which the authority to purchase materials, supplies, and equipment has been delegated. The Public Contract Code, Section 10333(b), requires the DGS to audit each state agency to which the department has delegated purchasing authority at least once every three years. As of April 1995, the DGS delegated purchasing authority valued at more than \$251 million to 156 departments. However, it has not audited 58 of these departments within the required three years. As a result, the DGS cannot ensure that almost \$98 million in delegated purchasing authority is properly managed and controlled.

### **State Agencies Did Not Properly Account for Construction in Progress**

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State agencies do not properly account for construction in progress after a project is completed. Initially, projects in the construction phase are accounted for as construction in progress in the General Fixed Assets Account Group. When the construction phase ends, the costs should be transferred from the construction in progress account to the building account. We found that the Department of Corrections and the California State University Chancellor's Office did not transfer the costs from the construction in progress account to the building account when the construction phase ended and the buildings were occupied. Further, the Department of Corrections and the California State University Chancellor's Office did not notify the state correctional institutions and the state university campuses, respectively, of the cost of the completed projects so that they could account for the projects in their building accounts.



As of June 30, 1994, the Department of Corrections reported construction in progress totaling approximately \$626 million. Since December 1991, the Department of Corrections has not notified the various correctional institutions of this information. In addition, at June 30, 1994, the Chancellor's Office still reported construction in progress that we previously identified as completed projects as of June 30, 1993. These projects totaled approximately \$169 million.

As a result, construction costs of completed projects are misclassified in the State's financial statements. Further, a delay in transferring the costs from the construction in progress account to the building account delays the reporting of building additions to the DGS for inclusion in the statewide real property inventory.

The State Administrative Manual, Section 8600 et seq., defines property, including buildings, and outlines the requirements for property reporting. Also, Section 6501 et seq. provides guidance for capital outlay. Further, Section 6561 states that the construction phase ends when a Completion Notice is filed with the County Recorder. Moreover, Section 6750 states that the completion date of any project should be construed as being the date of final inspection or date of occupancy of the project, whichever is earliest. In addition, the State University Administrative Manual, Section 9000, states that the California State University policies and procedures for property generally parallel those of the State. Finally, in a memorandum dated July 2, 1991, the Department of Corrections stated that information necessary for the proper recording of fixed assets would be provided to the correctional institutions annually.

### **Incomplete Statewide Real Property Inventory**

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The State has inadequate procedures to ensure that the Department of General Services' (DGS) Statewide Real Property Inventory incorporates all real property transactions as recorded in the state agency accounting records. Specifically, state agencies do not consistently ensure that all additions and deletions of buildings, as reported in their year-end Statements of Changes in General Fixed Assets, are reported to the DGS's Office of Real Estate and Design Services (OREDS). Further, state agencies do not consistently provide the OREDS with cost information related to their buildings. Unless state agencies report all changes to their building accounts, provide cost data, and reconcile the amount reported in the statewide real property inventory to their Statement of Changes in General Fixed Assets, the OREDS may not maintain a complete and accurate statewide inventory of all real property held by the State. As a result, errors and discrepancies could occur and remain undetected. We found the following:

- For fiscal year ended June 30, 1992, the Department of Parks and Recreation reported in its Statement of Changes in General Fixed Assets approximately \$25 million in costs for improvements. However, the statewide real property inventory contained no additions to improvements for the Department of Parks and Recreation for the past three fiscal years.
- For fiscal year ended June 30, 1994, the California State Prison—Sacramento County (CSP) reported in its Statement of Changes in General Fixed Assets approximately \$151 million in net additions for buildings. Also, Folsom Prison reported a similar net amount as deletions

to its buildings. The prison construction was completed in fiscal year 1986-87 and was accounted for as an addition to Folsom Prison. Subsequently, the State decided to operate and account for the CSP separately from Folsom Prison. Therefore, it was necessary to transfer the costs of the prison from the records of Folsom Prison to the CSP. Beginning with fiscal year 1993-94, the two prisons have conducted their operations and accounting separately. However, neither prison notified the OREDS of the transfer.

- The statewide real property inventory does not contain cost data for the buildings at several prisons. For example, as of June 30, 1994, the ending balance for buildings at the R.J. Donovan Correctional Facility at Rock Mountain, as reported in the Statement of Changes in General Fixed Assets, was approximately \$321 million. According to the chief of the Accounting Management Branch of the Department of Corrections (DOC), this data was not provided to the OREDS because the DOC was not aware that this data was required by the OREDS. However, even if the DOC had known the requirement, it could not have provided the data for each building. The DOC does not accumulate the costs by individual building. Furthermore, the DOC currently does not have a methodology, nor has it been asked to develop a methodology, to allocate the total costs to individual buildings.

The Government Code, Section 11011.15(a), requires the DGS to maintain a complete and accurate inventory of real property held by the State. Section 11011.15(b) requires each agency to furnish the DGS a record of each parcel of real property that it possesses and to update its real property holdings, reflecting any changes, by July 1 each year.

In addition, the DGS's Statewide Real Property Inventory Instruction Manual requires state agencies to report all additions and improvements to real property that are funded from major capital outlay appropriations.

### **Salary Warrants Are Not Always Promptly Returned**

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State departments do not always return undelivered salary warrants to the State Controller's Office (SCO) within 90 calendar days of receipt. We performed tests at 44 locations and found that, at 14 locations, department staff did not return a total of 175 salary warrants to the SCO within 90 days of receipt. These warrants ranged in amount from \$0.67 to \$20,460.22. The oldest warrant found was written nearly six years ago. Although failure to return the undelivered warrants to the SCO does not cause any financial harm to the State, it increases the risk of the warrants' loss or misappropriation. The following table provides, by department, the number of undelivered salary warrants that were more than 90 days old.

**Table 3****Salary Warrants Not Returned  
Within 90 Days**

Agency	Number of Warrants More Than 90 Days Old	Amount of Warrants
California Highway Patrol	4	\$22,916.26
California State Lottery	19	5,645.11
California State University (two campuses)	6	1,052.17
Department of Corrections (five institutions)	16	4,834.31
Department of Developmental Services	1	313.18
Employment Development Department	5	397.27
Department of Food and Agriculture	1	3.81
Department of Justice	1	18,279.96
Department of Motor Vehicles	122	43,075.63
<b>Total</b>	<b>175</b>	<b>\$96,517.70</b>

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

**Errors Calculating the Cash  
Management Interest Liability**

The Cash Management Improvement Act (CMIA) of 1990 required the State and the Financial Management Service, U.S. Department of the Treasury (federal government) to enter into an agreement for fiscal year 1993-94 that established procedures for ensuring greater equity, efficiency, and effectiveness in the exchange of funds between the State and the federal government. The CMIA Agreement requires the State to track and calculate state and federal programs. However, the State made errors tracking and reporting the transfer of funds between the State and federal government and calculating the interest liabilities. The errors resulted in an understatement of the amount of interest the State owes the federal government for CMIA programs by approximately \$316,000.

The CMIA Agreement assigned the Department of Finance (DOF) the responsibility for implementing the procedures for tracking and calculating the state and federal interest liabilities for 17 of the 18 programs the CMIA affected. The federal government was assigned the responsibility for tracking and calculating the interest liability for the Supplemental Security Income program. Of the 17 programs, the California Department of Transportation calculated

the interest liability for the Highway Planning and Construction program, and because of the funding technique and the interest calculation method used for the Social Services Block Grant program, the California Department of Social Services was not required to report information to the DOF. Departments that administered the remaining 15 programs submitted information to the DOF on the transfer of funds between each department and the federal government.

We found errors in the information reported to the DOF and used in the interest calculations for 8 of the 15 programs. Specifically, departments did not correctly report the amount of funds transferred and the number of days federal funds were in the state treasury. In addition, we found errors in the DOF's calculation of the state interest liability. Specifically, for one program, the DOF did not use the correct amount of funds transferred in its calculation and did not correctly calculate the weighted number of interest days. For another program, the DOF did not correctly compile the daily interest liability. We found no errors in the DOF's calculation of the federal interest liability.

Further, as reported on page 63, the California Department of Transportation overstated the state interest liability it calculated and reported for the Highway Planning and Construction program by approximately \$46,000.

The State's interest liability reported by the DOF for the fiscal year was approximately \$5.7 million. The State incurred direct costs associated with implementing the CMIA Agreement of approximately \$300,000 and offset the state interest liability by this amount. As a result, the State paid approximately \$5.4 million for the CMIA interest liability for fiscal year 1993-94.

The overall effect of these errors is an underpayment of approximately \$316,000 for the State's interest liability for CMIA programs. The instructions to the CMIA Annual Report issued by the U.S. Department of the Treasury in October 1994 require the State to report liabilities resulting from subsequent audit findings in fiscal year 1994-95.

### **Lack of Centralized Records for Federal Receipts**

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The State does not have centralized records for recording the receipt of federal moneys, potentially resulting in an impairment of the State's ability to satisfy federal requirements for the continued receipt of federal moneys. The federal OMB Circular A-128 identifies these requirements. Specifically, it requires the State to annually prepare a schedule of federal assistance. In addition, the circular requires the State to identify all federal grants from which the State receives more than \$20 million in a single year and ensure that the grants are audited annually.

In 1978, the State took steps to establish a centralized record of federal receipts. In that year, the State created the Federal Trust Fund for the deposit of all moneys received by the State from the federal government where the expenditure was administered through or under the direction of any state agency. The purpose in creating the fund was to provide better accountability for

the State's receipts and expenditures of federal funds. If the State consistently required all federal receipts to be recorded in the Federal Trust Fund, the centralized records would help satisfy requirements under Circular A-128.

However, the State has allowed exceptions to the rule that all federal receipts are to be recorded in the Federal Trust Fund. For example, Section 89049.1 of the Education Code, which was established by statute in 1991, allows the Federal Trust Fund to be bypassed for receipts for student financial aid at the California State University. During fiscal year 1993-94, these receipts totaled more than \$137 million. In addition, the Department of Finance administratively created the State Legalization Impact Assistance Fund to account for receipts and expenditures from the federal State Legalization Impact Assistance Grants. These receipts totaled more than \$2.1 billion for fiscal years 1988-89 through 1993-94.

The absence of the centralized records results in additional work to prepare the schedule of federal assistance required by Circular A-128. For example, to determine fiscal year 1993-94 receipts, the State had to request that the California State University separately identify receipts for each of the student financial aid grants. In addition, the potential exists that the State will fail to identify all receipts. This lack of identification could result in material misstatements in the schedule of federal assistance or the failure to identify all grants requiring an audit under Circular A-128.

### **Inability To Account for Expenditures of Federal Money by Each Federal Program**

The State is not in compliance with a requirement of OMB Circular A-128 to present a schedule of federal assistance that shows total expenditures for each federal assistance program. The State cannot comply because it does not record its expenditures by federal program. The schedule of federal assistance that we present, beginning on page 197, shows total receipts by program, 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.

The Bureau of State Audits reported a similar weakness during audits for fiscal years 1991-92 and 1992-93, and the Office of the Auditor General reported a similar weakness during audits for fiscal years 1985-86 through 1990-91. The Department of Finance has reported that making the necessary modifications to the State's automated systems would require extensive effort.

## **Inadequate Monitoring of Advances to Subrecipients**

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The State does not always limit cash advances made to subrecipients to their immediate needs. We found that the State made cash advances that were in excess of the subrecipients' immediate needs for nine federal programs at five departments. These deficiencies occurred because the State did not adequately monitor the cash balances of the subrecipients. The table beginning on page 220 lists the federal programs for which we found such deficiencies. We found the following examples of inadequate monitoring of advances:

- The Department of Economic Opportunity made cash advances during the second quarter of fiscal year 1993-94 to 12 of the 16 subrecipients we reviewed for the Community Services Block Grant, even though these subrecipients maintained cash balances totaling more than \$247,000. During the third quarter, 9 of the 12 subrecipients we reviewed maintained excess cash balances totaling almost \$365,000. Finally, during the fourth quarter, 10 of the 11 subrecipients we reviewed maintained excess cash balances totaling more than \$420,000.
- The Department of Aging made advances that exceeded the immediate needs of the subrecipient for 5 of the 14 advances we reviewed for the Special Programs for the Aging—Title III grant. For example, one of the advances resulted in a cash balance that was approximately \$400,000 more than the immediate needs of the subrecipient.
- The California Postsecondary Education Commission did not always ensure that cash advances to subrecipients participating in the Eisenhower Mathematics and Science Education—State Grants program were limited to the subrecipients' immediate needs. We reviewed 18 payments the commission made to subrecipients and found that for five of the subrecipients, the commission issued additional funds without determining whether the federal funds were necessary to meet the immediate cash needs of its subrecipients.
- The Department of Alcohol and Drug Programs did not have adequate procedures to monitor the cash balances of subrecipients of the Substance Abuse Prevention and Treatment block grant and the Drug-Free Schools and Communities—State Grants. We reviewed quarterly federal cash transaction reports for 14 counties and found that 2 counties reported cash balances that would last more than 30 days. Further, we determined that the department did not withhold or adjust subsequent monthly advances for either of these counties.

Without adequate monitoring of subrecipient cash balances, the State cannot ensure that advances made to subrecipients are limited to their immediate needs.

## **Inadequate Monitoring of Recipients of State and Federal Moneys**

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The State is often deficient in its monitoring of recipients of state and federal moneys. We found the administration of more than 17 federal programs and 2 state programs in 12 departments deficient in a wide variety of required monitoring practices. Specifically, we determined that departments did not conduct audits or reviews of recipients' operations or records, or they did not ensure that subrecipients submitted audit reports completed by independent auditors. The table beginning on page 220 lists the federal programs for which we found such deficiencies. We found the following examples of deficient monitoring:

- The Department of Aging's Community Services Branch did not conduct complete program evaluations, assessments, or on-site visits of the supportive services for 31 of the 33 area agencies on aging for the Special Programs for the Aging—Title III, Part B grant. Additionally, the department did not conduct biennial on-site performance evaluations of the nutrition services for 20 of the 33 area agencies for the Special Programs for the Aging—Title III, Part C grant, and the Food Distribution Program. Failure to conduct evaluations of supportive services and nutrition services may prevent early detection and correction of irregularities or deficiencies in the services that the agencies provide.
- As of February 1995, the Office of Local Assistance (OLA) had not completed close-out audits on approximately 42 percent of the school construction projects that had been completed for at least two years. Without these audits, the OLA can neither determine the amount of the project's allowable expenditures nor whether the State owes school districts additional funds. Further, the OLA cannot determine whether any funds that may have been apportioned for these projects in excess of actual costs are to be returned to the State and made available for other projects.
- The Department of Health Services did not conduct required biennial site reviews for the Special Supplemental Food Program for Women, Infants, and Children at 46 of the 80 local agencies. Additionally, the department did not perform annual nutrition education evaluations at any of the 80 local agencies. Because the department did not perform all required site reviews and nutrition education evaluations, it lacks assurance that the local agencies are complying with program requirements.
- As of April 5, 1995, the Office of Criminal Justice Planning had identified 238 delinquent audit reports from local governments and nonprofit subrecipients receiving funds from the Drug-Free Schools and Communities—State Grants and the Drug Control and System Improvement—Formula Grant. Without these audit reports, the department cannot ensure that subrecipients are complying with all federal laws and regulations.
- The State Controller's Office (SCO) does not have an adequate system for identifying all special districts that are required to submit annual single audit reports to the SCO for review. As part of its responsibility for coordinating the single audit activities of local governments, the SCO reviews the special districts' single audit reports for adequacy and for compliance with federal regulations and standards. However, the SCO does not ensure that other state

departments notify it of all special districts to which they distribute federal funds. Although it has an adequate system for monitoring the audit reports that it is aware it should receive, without a complete list of reports, the SCO cannot be assured that all special districts receiving federal moneys are complying with federal requirements.



## **Recommendations**

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The State should revise its practices to improve the weaknesses in its accounting and administrative controls. Specifically, the Department of Finance should do the following:

- Ensure that the State's budget and accounting systems are able to efficiently record and report its financial operations in a manner that is as consistent with generally accepted accounting principles as possible;
- Provide leadership and direction to agencies to enable the State to produce audited financial statements that comply with applicable standards, within the time requirements established by the Government Finance Officers Association to receive the Certificate of Achievement for Excellence in Financial Reporting;
- Revise the State Administrative Manual to provide clearer guidance to agencies relating to their financial reporting, federal compliance, and contracting procedures;
- Ensure that agencies comply with existing State Administrative Manual requirements relating to fixed assets, undelivered salary warrants, and contracting procedures; and
- Ensure that agencies fully comply with federal requirements related to federal grant moneys received.

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# *Audit Information by Area of Government*

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## **Summary**

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The State of California continues to incur unnecessary costs and faces a reduced efficiency and effectiveness of its operations because of weaknesses in its internal controls. Although the State has corrected some of the problems the Bureau of State Audits reported for its audits of fiscal years 1991-92 and 1992-93 and the Office of the Auditor General reported for audits of prior years, the State can still significantly improve its accounting and administrative controls.

Table 4 below summarizes state expenditures and the financial and compliance audit activity of the Bureau of State Audits during fiscal year 1993-94. Other audits issued by the Bureau of State Audits are also summarized in the final column of the table and cover the period from July 1, 1993, through December 31, 1994. The table organizes this information according to the areas of government recognized in the Governor's Budget. The Bureau of State Audits conducted financial and compliance audit work in nine areas of government. Two areas of government, Health and Welfare and Education, have significant expenditures, totaling more than 77 percent of the State's expenditures, and receive moneys from 42 major federal grant programs. The Bureau of State Audits conducted extensive financial and compliance audit work in the departments in these two areas of government.

**Table 4****Summary of Audit Work by Area of Government**

Area of Government	Total Amount/ Percent of State Expenditures*	Number of Departments		With Reported Weaknesses	Amount/Number of Federal Grants Audited	Number of Special Topic Reports
		In Area of Government	Audited*			
Business, Transportation and Housing	\$6.8 billion 6.0%	17	\$6.5 billion 6	5	\$1.967 billion 4	7
Education	\$42.4 billion 37.5%	15	\$31.3 billion 5	4	\$2.608 billion 15	5
Environmental Protection	\$7 million .7%	6	\$4 billion 1	1	0	1
General Government	\$8.0 billion 7.1%	57	\$1 million 2	2	\$44 million 1	3
Health and Welfare	\$45 billion 39.7%	20	\$40.7 billion 9	9	\$19.780 billion 27	7
Legislative, Judicial and Executive	\$2.8 billion 2.5%	38	\$1.6 billion 6	5	\$821 million 3	10
Resources	\$2.3 billion 2.1%	23	\$1.2 billion 3	0	\$97 million 1	3
State and Consumer Services	\$1.2 billion 1.1%	11	\$8 million 2	2	0	6
Youth and Adult Correctional	\$3.7 billion 3.3%	6	\$3.7 billion 3	1	0	4

\* Amounts reported in these columns are total estimated expenditures for all state departments in the agency or for all departments audited during fiscal year 1993-94. Estimated amounts are from the Governor's Budget for fiscal year 1995-96. The estimates do not reflect actual amounts audited.

Table 5, which begins on page 30, summarizes the results of the financial and compliance audit work that the Bureau of State Audits conducted for fiscal year 1993-94. The Bureau of State Audits reports the results of these audits in management letters addressed to the administrators of each of the departments with audit issues to report. These management letters are included in this report, beginning on page 39.

Table 5 shows the distribution by state department of weaknesses in control over financial activities and weaknesses in compliance with state and federal regulations. The page number column in the table provides the location in this report of the beginning of the specific management letter for the indicated state department. The numbers in the other columns are

the item numbers for each weakness reported in the management letters for the departments. A more detailed table describing the type of weaknesses found in compliance with federal regulations begins on page 220.

TABLE 5

WEAKNESSES IN INTERNAL CONTROL SYSTEMS

		Weaknesses and Item Numbers <sup>a</sup>					
Agency	Page Number	Financial Reporting Activities	Revenue Activities/ Safeguarding of Assets	Expenditure and Electronic Data Processing Activities	Compliance With Federal Regulations <sup>b</sup>	Compliance With State Regulations	
<b>BUSINESS, TRANSPORTATION AND HOUSING</b>							
Housing and Community Development, Department of	47	6-8,10	1,5	3-4,10-13	1-2,5-8,10-13	1,3-6,9-10	
Motor Vehicles, Department of	58		1-2	3		1-3	
Stephen P. Teale Data Center	61	1				1-2	
Transportation, Department of	63	1,3	2-4	4	1-2,4	3-4	
<b>EDUCATION</b>							
California Community Colleges, Chancellor's Office	71	6,8	3	7	1-2,6	1,3-8	
California Postsecondary Education Commission	78		3		1-2	3-4	
California Student Aid Commission	82				1-4		
Education, California Department of	87	6		1,8	1-7	1,8	
<b>GENERAL GOVERNMENT</b>							
Criminal Justice Planning, Office of	97		1		2-5	1	
Economic Opportunity, Department of	104	4		4	1-4		

Footnotes are presented on page 32.

Weaknesses and Item Numbers <sup>a</sup>						
Agency	Page Number	Financial Reporting Activities	Revenue Activities/ Safeguarding of Assets	Expenditure and Electronic Data Processing Activities	Compliance With Federal Regulations <sup>b</sup>	Compliance With State Regulations
Finance, Department of	109				1	1-2
<b>HEALTH AND WELFARE</b>						
Aging, Department of	117	2-3			1-4	
Alcohol and Drug Programs, Department of	120	4,8		1-2,5	1-8	8
Employment Development Department	128	4		4	1-5	
Health and Welfare Agency Data Center	133	1	2			1-3
Health Services, Department of	135	1	2,11-12		2-10,12	1-2,11-12
Rehabilitation, Department of	146	1		1	1-2	
Social Services, Department of	148	1,3,7	4	7	1-7	1,5,7
<b>LEGISLATIVE, JUDICIAL, AND EXECUTIVE</b>						
Emergency Services, Office of	160				1-2	1,3
Insurance, Department of	162				1-2	1-2
Justice, Department of	164					1
State Controller's Office	157	1-2			1	1
State Treasurer's Office	166					1

Footnotes are presented on page 32.

**Weaknesses and Item Numbers<sup>a</sup>**

Agency	Page Number	Financial Reporting Activities	Revenue Activities/ Safeguarding of Assets	Expenditure and Electronic Data Processing Activities	Compliance With Federal Regulations <sup>b</sup>	Compliance With State Regulations
<b>STATE AND CONSUMER SERVICES</b>						
Franchise Tax Board	169		1			1-2
General Services, Department of	171	1,5-6	2-3,7,9-10			1-10
<b>YOUTH AND ADULT CORRECTIONAL</b>						
Corrections, Board of	185	1				1

<sup>a</sup> The item number is the number of each weakness as presented in the report on each state agency.

<sup>b</sup> The table on page 220 provides more detail regarding the weaknesses in compliance with federal regulations.

## **Report on the Internal Control Structure**





# CALIFORNIA STATE AUDITOR

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KURT R. SJOBERG  
STATE AUDITOR

MARIANNE P. EVASHENK  
CHIEF DEPUTY STATE AUDITOR

## Independent Auditors' Report on the Internal Control Structure

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, 1994, and have issued our report thereon dated December 15, 1994. We did not audit the financial statements of the pension trust funds, which reflect total assets constituting 77 percent of the fiduciary funds. We also did not audit the financial statements of certain enterprise funds, which reflect total assets and revenues, constituting 88 percent and 89 percent, respectively, of the enterprise funds. In addition, we did not audit the University of California funds. Finally, we did not audit the financial statements of certain component unit authorities, which reflect total assets and revenues, constituting 94 percent and 98 percent, respectively, of the component unit authorities. The financial statements of the pension trust funds, certain enterprise funds, the University of California funds, and certain component unit authorities 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, the University of California funds, and certain component unit authorities 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 April 17, 1995.

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 addition, we are required to review internal controls over nonmajor programs at least once during a three-year cycle.

In planning and performing our audits for the year ended June 30, 1994, we considered the internal control structure of the State of California in order to determine our auditing procedures for the purpose of expressing our opinion on the general purpose financial statements of the State of California, but not to provide assurance on the internal control structure, and on the State's 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.

The State's management is 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, the University of California funds, or certain component unit authority funds.

For all of the internal control structure categories listed in the paragraph 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. Because of the large number of nonmajor programs and the decentralized administration of these programs, we performed procedures to obtain an understanding of the internal control structure policies and procedures relevant to nonmajor programs on a cyclical basis. The nonmajor programs not covered during the current year are subject to such procedures at least once during the three-year cycle.

During the year ended June 30, 1994, 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 39 through 185 of our report. Management's comments regarding the recommendations appear on page 249 of this report. Additionally, beginning on page 235, 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 1992-93 that have not been corrected are included in the section beginning on page 39.

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 Bureau of State Audits performed other reviews related to federal programs. A schedule of the pertinent reports issued from July 1, 1993, to December 31, 1994, begins on page 225 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

April 17, 1995

## **Detailed Description of Weaknesses at State Agencies**

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## **Management Letters by Area of Government**

## **Business, Transportation and Housing**



# Department of Housing and Community Development

We reviewed the financial operations and related internal controls of the Department of Housing and Community Development (department), and the department's administration of the U.S. Department of Housing and Urban Development grants, Federal Catalog Nos. 14.228 and 14.857.

**Item 1.**  
**Poor Controls Over**  
**Housing Loans**  
**Cause**  
**\$25 million**  
**Discrepancy In**  
**Records**

**Finding**

The department is not adequately accounting for housing loans distributed from the California Disaster Housing Rehabilitation fund (fund 689), Housing Rehabilitation Loan fund (fund 929), and Rental Housing Construction fund (fund 938). We found the following specific deficiencies:

- The department is not maintaining adequate control over its records for the housing loans. Specifically, the department's accounting records as of June 30, 1994, included loans receivable for funds 689, 929, and 938 as approximately \$91.6 million, \$154.9 million, and \$260.7 million, respectively. In contrast, the department's program records indicate loans receivable for the same funds as approximately \$100.5 million, \$169.0 million, and \$263.1 million, respectively. The department is not able to reconcile the difference of approximately \$25.4 million between the accounting and program records for the three funds. In addition, the department is not able to provide information to support the different loans receivable balances included in the accounting and the program records. However, for fund 929, the department did determine that a portion of the difference between accounting and program records was the result of the department erroneously removing outstanding loans totaling at least \$9 million from the accounting records. Without proper recording of housing loans, the department cannot properly monitor loan repayments.
- The department is not adequately monitoring loans receivable. Specifically, of the 120 loan records we surveyed, we found that the department is not maintaining accurate information on 21 recipients of housing loans. Based on our limited review, the department has not properly identified correct names, addresses, and account numbers for borrowers of loans in funds 689, 929, and 938 totaling approximately \$56,000, \$9.5 million, and \$18.5 million, respectively. Without adequate procedures to keep accounts current, the department increases the risk that some receivables will become uncollectible.

As a result of these deficiencies, the department cannot provide effective accounting control over housing loans, which in turn protect the public's resources from abuse.

### **Criteria**

The California Government Code, Sections 13401 and 13403, requires agencies to maintain an effective system of internal control which includes recordkeeping procedures to provide effective accounting control over assets, liabilities, revenues, and expenditures. Moreover, the State Administrative Manual, Section 7900, discusses the importance of preparing regular reconciliations. Properly prepared 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.

### **Recommendation**

The department should review and strengthen its controls over its assets, liabilities, revenues, and expenditures. The department should also regularly reconcile its accounting records with its program data to ensure the completeness and accuracy of its financial data. Finally, the department should determine the actual value of its loans receivable.

## **Item 2. Commingling of Federal Grant Funds**

### **Finding**

According to the acting chief of the department's accounting office, the department has commingled approximately \$258 million in cash from nine federal programs in its Federal Trust Fund (fund) since at least fiscal year 1989-90 through 1993-94. Additionally, the acting chief stated that the fund has been used as a "melting pot" of federal dollars, in that expenditures for federal grants lacking available cash were paid for by federal grants having available cash. Consequently, the department cannot determine actual cash balances for specific federal grants during the time period of the commingling.

During our review, we found the following specific deficiencies:

- The commingling of federal funds hinders the department's ability to ensure that the timing and amount of federal cash advances is as close as administratively feasible to the actual disbursements. For example, we noted four instances totaling approximately \$743,500 for which the department had to reprocess claims because it did not have sufficient federal funds to make payments.
- The department used the Community Development Block Grant (CDBG) as a pool for reverting unused funds to the federal government. We found that the department reverted approximately \$249,000 through the CDBG. However, \$12,000 of the reversion was for another federal grant under another federal catalog number. The department could not determine what part of the remaining amount it reverted was actually for the CDBG grant or other grants.

### **Criteria**

The Code of Federal Regulations, Title 24, Section 85.20(b), states that grantees and subgrantees must maintain records that adequately identify the source and application of funds provided for financially-assisted activities. The Section also states that effective control and accountability must be maintained for all grant and subgrant cash, and that actual expenditures or outlays must be compared with budgeted amounts for each grant or subgrant.

### **Recommendation**

The department should maintain proper control and accountability of its grant cash and should ensure that funds are available when making disbursements.

### **Item 3. Weaknesses in Control Over the Revolving Fund**

#### **Finding**

The department has weaknesses in control over its revolving fund. We noted the following deficiencies:

- The department did not promptly request reimbursement for its revolving fund. As of June 30, 1994, the department had unreimbursed travel, expense, and salary advances totaling approximately \$444,000 that had been outstanding for more than 60 days. Approximately \$364,000 of the outstanding balance is the remaining portion of a \$1.3 million payment which was improperly made from the revolving fund in June 1990.
- In June 1990, the department improperly used the revolving fund to pay the Department of Transportation approximately \$1.3 million under an agreement to provide services which involved federal funds. The department cannot provide sufficient documentation to support the original payment of approximately \$1.3 million and consequently the remaining balance of approximately \$364,000. In addition, the department inappropriately applied an unrelated reimbursement of approximately \$170,000 to reduce the outstanding balance. Despite numerous reports of this finding by the State Controller's Office, the Department of Finance, and the Office of the Auditor General, the department has not taken action to write-off or produce a plan to reimburse its revolving fund.
- The department improperly used its revolving fund to pay for items that should be paid through the claims process. For 6 of the 28 revolving fund payments we reviewed, the department used its revolving fund rather than following the normal claims processing procedure through the State Controller's Office. The 6 payments totaled approximately \$105,000.

- The department paid 3 of the 28 payments without obtaining all of the necessary approvals. For example, the department paid one employee's travel expenses even though the travel expense claim was not approved. The 3 payments totaled approximately \$5,000.

These weaknesses in the control over revolving fund disbursements could result in the misuse of state funds. The Bureau of State Audits reported similar weaknesses during its audit for fiscal year 1991-92, and the Office of the Auditor General reported similar weaknesses during its audit for fiscal year 1989-90.

### **Criteria**

The State Administrative Manual, Section 8047, requires that state agencies schedule claims for reimbursement of office revolving funds promptly, and Section 8072.3 specifies the procedures for filing claims with the State Board of Control for cash deficiencies. In addition, Section 8110 describes permissible uses of revolving funds. Moreover, Section 8422.1 generally discusses the determination of the propriety of revolving fund disbursements before payment is made.

### **Recommendation**

As the Bureau of State Audits and the Office of the Auditor General recommended in previous years, 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 the 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. In addition, the department should restrict its use of the office revolving fund to the permissible uses described in the State Administrative Manual. Finally, the department should ensure that all the necessary approvals are obtained before making revolving fund payments.

#### **Item 4. Lack of Control Over Airline and Rental Car Expenditures**

### **Finding**

The department lacks control over its airline and rental car expenditures. Specifically, the department paid invoices for airline and rental car charges without verifying that the charges were valid. For fiscal year 1993-94, the department reported airline expenditures of approximately \$91,800 and rental car expenditures of approximately \$58,500. We reviewed approximately \$88,600 of airline expenditures and approximately \$22,200 of rental car expenditures and found that the payments had not been approved. The department's internal auditors reported a similar finding in March 1995.

### **Criteria**

The California Government Code, Sections 13401 and 13403, requires agencies to maintain an effective system of internal control, including authorization and recordkeeping procedures to provide accounting control over assets, liabilities, revenues, and expenditures. In addition, the State Administrative Manual, Sections 8422.114 and 8422.115, describes procedures for processing airline and rental car invoices.

### **Recommendation**

The department should ensure that it does not pay airline and rental car invoices without prior approval.

## **Item 5. Lack of Separation of Duties**

### **Finding**

The department does not have adequate separation of duties in its loan management and accounting units. Without the proper separation of duties, an employee could conceal errors or irregularities which may not be detected by management.

- The employee in the loan management unit who designed the system for monitoring the State's loans also originates billing information, authorizes adjustments, prepares invoices, maintains receivable ledgers, and controls blank invoice stock.
- In addition, the department does not have adequate separation of duties in its Rental Certificate Program (RCP) payment process. Specifically, the accounting technician who maintains the RCP database also originates payment information, prepares claim schedules for payment and updates the database for payments made.

### **Criteria**

The State Administrative Manual, Section 8080.1, requires agencies to establish and maintain an adequate system of internal controls. A key element in a system of internal controls is separation of duties. These duties include designing systems, inputting payment information, initiating payment documents, and controlling blank check stock. In addition, California Government Code, Sections 13401 and 13403, requires state agencies to maintain a system of accounting and administrative controls. Good internal controls require the separation of the following functions: designing systems, initiating the billing document, approving the billing document, controlling blank invoice stock, and recording receipts information.

## **Recommendation**

The department should ensure that its loan management duties are separated and performed by different individuals. In addition, the department should ensure that the RCP payment process duties are also separated and performed by different individuals.

### **Item 6. Federal Financial Reports Not Reconciled With or Supported By Accounting Records**

#### **Finding**

The department did not reconcile its federal financial reports prepared during fiscal year 1993-94 with the departmental accounting records. Moreover, according to an accounting administrator, the department has not performed reconciliations of its individual grant revenues and expenditures since at least fiscal year 1991-92. Failure to reconcile federal financial reports with the accounting records can result in mistated claims that are not supported by the department's accounting records and may go undetected. We noted the following instances when the department did not reconcile its federal financial reports:

- In its administration of the CDBG program, the department prepares the quarterly Report of Federal Cash Transactions (SF-272), which shows receipts and disbursements of federal funds during the period of the report. According to an accounting administrator, the report is not supported by or reconciled with any data from the CALSTARS system, and does not accurately disclose balances for receipts, disbursements, and cash on hand for the CDBG grant.
- We reviewed 55 federal financial reports for the RCP that were based on actual costs and found that none were supported by or reconciled with the department's accounting records. According to an accounting administrator, the cash of the Housing Assistance Program (HAP) grants, of which the RCP is a part, are commingled. In addition, the administrator stated that the department does not accurately record individual HAP grant expenditures in its accounting system.

The Bureau of State Audits reported a similar weakness during its audit for fiscal year 1992-93. In its response to the audit, the department stated that it would reconcile federal receipts with the expenditures posted to the CALSTARS system and to the receipts posted to the State Controller's Office records. However, during our review, we did not observe nor did department staff provide, reconciliations or CALSTARS adjustments for fiscal year 1993-94.

#### **Criteria**

The Code of Federal Regulations, Title 24, Section 85.20, requires the State to maintain accurate accounting records that permit preparation of reports and tracing of funds, as well as the accurate, current, and complete disclosure of its financial activities relating to the federal grant. In addition,

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 reconcile its federal financial reports to the accounting records at least every quarter. In addition, the department should ensure that its financial activities relating to federal grants are supported by its accounting records.

**Item 7.  
Annual Balance  
Sheet Report for the  
RCP Not Submitted**

**Finding**

As of March 21, 1995, the department had not submitted its Annual Balance Sheet Report for the RCP grant for fiscal year 1993-94. According to an accounting administrator, previous reports through fiscal year 1992-93 could not be supported by the department's official accounting records. Furthermore, the Office of the Auditor General reported during its audit for fiscal year 1991-92 that, although the department submitted a Balance Sheet Report, it could not produce support for or demonstrate the accuracy of the data in the report.

**Criteria**

The HUD requires the department to submit the Balance Sheet Report no later than September 15th of each year. The Code of Federal Regulations, Title 24, Section 85.20(b), states that grantees and subgrantees must maintain records which adequately identify the source and application of funds provided for financially-assisted activities. The Section also states that effective control and accountability must be maintained for all grant and subgrant cash, and that actual expenditures or outlays must be compared with budgeted amounts for each grant or subgrant.

**Recommendation**

The department should submit an accurate Balance Sheet Report for fiscal years 1993-94 and 1994-95 that is supported by its accounting records.

**Item 8.  
Federal Financial  
Reports Submitted  
Late**

**Finding**

The department did not submit its federal financial reports in a timely manner. We found the following specific deficiencies:

- The department did not always submit its financial and budget reports for the RCP in a timely manner. We reviewed 65 federal financial and budget reports the department submitted to HUD, and found that it submitted 27 reports from 4 to 17 days late. For example, we reviewed the financial and budget reports in which the department

estimates the annual costs of its housing programs and found that the department submitted 10 of the 11 reports late. Similarly, we reviewed 54 reports that the department submitted to HUD requesting advances for its housing programs and noted that it submitted 17 of these reports late.

When the department submits its estimates late, the department and HUD may not be able to assure that project costs do not exceed available funds. In addition, when the reports requesting advances are submitted late, the department increases the risk that it will not have funds to pay owners of contract housing on time.

- The department submitted the quarterly Report of Federal Cash Transactions (SF-272) eight working days late for the third quarter of fiscal year 1993-94. When the department fails to submit the report within the specified time, the department may not be able to draw funds for the continuation of ongoing CDBG projects.

#### **Criteria**

Section 7420.7 of the HUD Handbook requires the department to submit its financial and budget reports, for which it estimates annual costs of its housing programs, at least 90 days before the beginning of the subsequent fiscal year. The Section also requires the department to submit its reports, for which it requests advances, at least 45 days prior to the start of the next quarter. The Code of Federal Regulations, Title 24, Section 85.41(c)(ii)(4), requires grantees to submit the Report of Federal Cash Transactions no later than 15 working days following the end of each quarter.

#### **Recommendation**

The department should track federal financial report submittal requirements more closely and ensure that the reports are sent to HUD in a timely manner.

### **Item 9. CDBG Quarterly Grantee Reports Submitted Late**

#### **Finding**

In our testing of 20 quarterly activity reports, we found that grantees submitted 15 reports from 1 to 150 days late. Timely reports are essential to ensure that grantees use funds appropriately, do not exceed their budgets, and make appropriate progress with their projects. The Office of the Auditor General reported a similar weakness during its audits for fiscal years 1985-86 through 1987-88, and fiscal years 1989-90 and 1991-92.

#### **Criteria**

The California Code of Regulations, Title 25, Section 7108(e), requires grantees to submit quarterly reports to the grantor agency within 30 days



after the end of the reporting period. Further, the department's Grant Management Manual requires grantees to submit quarterly activity reports within 30 days after the close of each quarter.

**Recommendation**

The department should ensure that grantees submit their quarterly activity reports by the required due dates.

**Item 10.  
Annual Cost  
Allocation Plan Has  
Not Been Updated  
and Approved for  
Three Years**

**Finding**

The department's annual cost allocation plan has not been developed and submitted to the Department of Finance and to HUD for approval for fiscal year 1993-94. In addition, during the audit for fiscal year 1992-93, the Bureau of State Audits reported that the department had not developed or submitted its annual cost allocation plan to the Department of Finance and to HUD for approval for fiscal years 1991-92 and 1992-93. The lack of a cost allocation plan increases the risk that the department may use federal funds beyond the limits allowed for administering the department's federal grant programs.

**Criteria**

The federal Office of Management and Budget, Circular A-87 requires local governments to establish a cost allocation plan to support the distribution of any joint costs related to the grant program, that all costs included in the plan be supported by formal accounting records, and that this plan be retained at the local government level for audit by a designated federal agency except in those cases where the federal agency requests that the cost allocation plan be submitted to it for negotiation and approval. In addition, the State Administrative Manual, Section 8755.2, requires the department to submit its cost allocation plan to the Department of Finance for approval prior to submitting the plan to the cognizant federal agency for approval.

**Recommendation**

The department should finalize and submit its annual cost allocation plan for fiscal year 1993-94.

**Item 11.  
Payments to  
Landlords in the  
RCP Not Properly  
Approved**

**Finding**

The department made payments to landlords in the RCP without approved requests for payment from RCP program staff. As a result, the department cannot ensure that such payments are necessary and reasonable. We tested six RCP payments to landlords, totaling \$5,535. For each payment, RCP program staff did not review or approve the payment before the payment was made. We found that the computer printouts used to support the payments had not been reviewed or approved by supervisory

staff in either the RCP program or accounting units prior to payment. Consequently, the department made payments without verifying that the payments were valid or accurate. Although we did not detect any inappropriate or unallowed payments, without review or approval of payment information by RCP program staff, the department cannot ensure effective control over grant cash.

### **Criteria**

The federal Office of Management and Budget Circular A-87, Attachment A, Part C, requires that for costs to be allowable, they must be necessary and reasonable for proper and efficient administration of the grant programs. The Code of Federal Regulations, Title 24, Section 85.20 (b)(3), requires that effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. The Section also states that grantees and subgrantees must adequately safeguard such cash and property and must assure that it is used solely for authorized purposes.

### **Recommendation**

The department should ensure that RCP program staff determine the amount of payments to landlords and submit a claim to the accounting unit for payment. In addition, prior to making payments to landlords, the accounting unit should verify that the claims for payment have been properly approved by RCP program staff.

## **Item 12. Delays in Disbursing Federal Funds**

### **Finding**

The department does not always minimize the time between receipt and disbursement of federal funds. For example, for 6 of the 29 claims we reviewed for the CDBG program, the State was 3 to 6 days late in disbursing the funds, totaling more than \$656,000. In addition, for 2 of the 20 claims we reviewed in the RCP, the State was from 1 to 12 days late in disbursing the funds, totaling more than \$324,000. We consider a disbursement late if it is delayed more than 5 days after the receipt of federal funds. The Office of the Auditor General reported a similar weakness during its audit for fiscal year 1991-92.

We also found that the department mistakenly made a duplicate draw of federal funds of approximately \$725,000 in the Home Investment Partnerships Program (HOME) (Federal Catalog No. 14.239), with no immediate need for the funds. The department held the funds for approximately 5 months before returning approximately \$574,000 to the federal government. The remaining funds were used for the HOME program. The department may incur interest penalties by holding federal funds.

### **Criteria**

The Code of Federal Regulations, Title 31, Section 205.20 (a), requires that cash advances to a State be limited to the minimum amounts needed and are timed to be in accordance only with the actual immediate cash requirements of the State. The timing and amount of cash advances shall be as close as is administratively feasible to the actual cash outlay by the State.

### **Recommendation**

The department should minimize the time between receipt and disbursement of federal funds.

## **Item 13. Noncompliance With Other Federal Requirements**

### **Finding and Criteria**

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

- The department approved disbursement of federal funds to one CDBG recipient 6 days prior to the completion of the required 15-day waiting period for environmental compliance. When the department approves disbursement early, it may deprive the public of sufficient time to comment on the possible environmental effects of the proposed project. The Office of the Auditor General reported a similar weakness during its audit for fiscal year 1989-90. The Code of Federal Regulations, Title 24, Section 58.73, states that the State should not approve the release of funds for any project before 15 calendar days have elapsed from the time of receipt of the request for release of funds and the environmental certification, or from the time specified in the notice of intent to request release of funds, whichever is later.
- For 3 of 21 tenant contracts we tested in the RCP, the department did not accurately calculate the amount of tenant rents and housing assistance payments because it incorrectly determined the utility expenses allowed under the contracts. In one contract that we reviewed, the department owes the tenant \$46 for overpayments made by the tenant to the landlord. For the other two contracts that we reviewed, the department paid \$316 that it should not have paid to the landlord on the tenant's behalf. The Code of Federal Regulations, Title 24, Sections 882.116(g) and (h), requires the department to determine the tenant rent and the amount of the housing assistance payment.

### **Recommendation**

The department should improve its compliance with these federal requirements.

## Department of Motor Vehicles

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

**Item 1.**  
**Approximately**  
**\$9.2 million In Cash**  
**Collections Remains**  
**Unallocated to**  
**Programs**

### **Finding**

As of June 30, 1994, approximately \$9.2 million in cash collections remains unallocated to programs supported by department revenue. This amount represents the difference between the department's account balance for uncleared cash collections and the larger account balance for uncleared collections maintained by the State Controller's Office (SCO). According to its fiscal officer, the department cannot identify the exact cause of this discrepancy because its origin is prior to fiscal year 1985-86 and the supporting documentation is no longer available. However, it appears that the department deposited cash in the SCO's uncleared collections account but then did not request the SCO to transfer those deposits to the correct revenue accounts, or that the SCO did not process the department's request to transfer the deposits.

The department did not identify the discrepancy when it occurred because it has not established a separate general ledger account to record the uncleared collections transactions it reports to the SCO. If it had established this account and had reconciled it to the SCO's account balance, the department would have identified the discrepancy in the month it occurred. As a result, approximately \$9.2 million remains unallocated to the programs supported by revenue collected by the department.

### **Criteria**

The State Administrative Manual, Section 7900, requires that agencies reconcile their account balances to accounts maintained in the SCO within 30 days after the end of each month. In addition, the California Government Code, Section 13403, states that the elements of a satisfactory system of internal accounting and administrative controls should include, but are not limited to, a system of authorization and recordkeeping procedures that effectively controls assets, liabilities, revenues, and expenditures.

### **Recommendation**

The department should record uncleared collections transactions in a manner that allows it to reconcile its uncleared collections account balance to that account balance maintained by the SCO. In addition, it should pursue appropriate administrative remedies that will allow it to distribute the \$9.2 million in collections to programs supported by the department.

**Item 2.  
Inadequate Control  
Over Dishonored  
Checks**

**Finding**

The department does not have sufficient control over dishonored checks. As of June 30, 1994, the department had approximately 83,000 checks, totaling approximately \$23 million, that banks had not honored. The department has transferred the responsibility and authority for collection of delinquent vehicle registration fees, in excess of \$250, to the Franchise Tax Board (FTB).

However, according to the Revenue Sources Support Unit Manager, the department does not reconcile the checks transferred to the FTB to the checks collected or being pursued by the FTB. As a result, the department cannot ensure that all of the dishonored checks for vehicle registration are accounted for.

We reported a similar weakness during our audit for fiscal year 1992-93. The department responded that it was developing a system to transfer dishonored check information electronically between the department and the FTB and had a goal of implementing the system by March 1995. However, as of April 1995, the department had not implemented such a system. According to the Cash Management Unit Manager, the department has completed the first phase of the system, with the final phase scheduled for completion by February 1996.

**Criteria**

The California Government Code, Section 13403, 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 controls assets, liabilities, revenues, and expenditures.

**Recommendation**

The department should develop procedures to periodically confirm with the FTB the number and dollar amounts of the checks located at the FTB for collection and reconcile that information to the department's records.

**Item 3.  
Insufficient Control  
Over Access to EDP  
Data Files**

**Finding**

The department's electronic data processing (EDP) programming personnel have unrestricted read-only access to data files. For example, EDP personnel can access confidential and restricted data files even though such access is not necessary for these employees to fulfill their job duties.

We reported a similar weakness during our audit for fiscal years 1991-92 and 1992-93. In response, the department stated that it planned to begin a project to restrict programmer access to data, to be completed by March 1995. As of March 1995, the department has not completed implementation of any procedures to limit programmer access to data files.

According to the Data Processing Manager responsible for EDP operations and communications, the department has limited access to production data for about one-half of the programming staff. According to the information security officer, the project is not complete because of the difficulty of limiting the remaining groups of programmers due to their need to access a large number of data sets. 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 have access to EDP systems and that such access is necessary for 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. Inaccurate Financial Reports**

#### **Finding**

The data center did not accurately prepare its financial reports. Specifically, we noted the following conditions:

- The data center did not accurately analyze and report its accounts payable balance at June 30. Specifically, the data center accrued as accounts payable amounts related to goods and services received after June 30. In addition, the data center accrued a liability for a purchase that was paid before June 30. As a result, the data center overstated its accounts payable balance by approximately \$271,000. The Bureau of State Audits reported a similar weakness during its audit for fiscal year 1992-93.
- The data center did not record equipment acquired by installment contracts in the proper fiscal year. During fiscal year 1993-94, the data center acquired equipment totaling approximately \$950,000 by installment contracts, but did not record the equipment or the related installment contracts payable in the accounting records until fiscal year 1994-95. As a result, the data center understated its fixed assets, depreciation expense, and installment contracts payable accounts at June 30. The Office of the Auditor General reported a similar weakness during its financial audits for fiscal years 1988-89 through 1990-91. The Bureau of State Audits reported a similar weakness during its financial audit of fiscal year 1991-92.

Failure to accurately analyze and report 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 10544, requires state agencies to review their records to ensure that they have accurately recorded all amounts owed to others at June 30. Section 8632 requires state agencies to record fixed assets acquired by installment contracts in the accounting records as if the asset was purchased at the inception of the lease. In addition, Section 8660 requires agencies to report fixed assets and related depreciation in the year-end financial statements.

## **Recommendation**

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

## **Item 2. Noncompliance with State Requirements**

### **Finding and Criteria**

In the following instances, the data center did not always comply with administrative requirements of the State.

- The data center does not have adequate separation of duties in its accounting section. Specifically, the fiscal manager maintains the general ledger and prepares the bank reconciliation when the accounting analyst is unable to do so. Further, both of these individuals have access to and control over the blank check stock. Failure to adequately separate accounting duties can result in errors, irregularities, or illegal acts that may go undetected for extended periods. The State Administrative Manual, Section 8080, requires state agencies to separate functions so that the person who reconciles bank accounts and maintains the general ledger, or any subsidiary ledger affected by cash transactions, does not have access to the blank check stock.
- The data center did not prepare property survey reports for 4 of the 20 equipment dispositions we tested. The State Administrative Manual, Section 8640, requires state agencies to prepare property survey reports when disposing of equipment.
- The data center did not prepare stock received reports for 5 of the 13 purchases of goods we reviewed. The State Administrative Manual, Section 8422.20, requires state agencies to prepare stock received reports and forward them directly to the accounting unit on the day the goods are received.
- The data center did not cancel five checks totaling approximately \$4,500 that were outstanding for more than two years. The State Administrative Manual, Section 8042, requires state agencies to cancel checks that have been outstanding for two years and remit the amount of such checks to the Special Deposit Fund as unclaimed moneys.

### **Recommendation**

The data center should improve its compliance with state requirements.



## Department of Transportation

We reviewed the financial operations and related internal controls of the Department of Transportation (department) and the department's administration of U.S. Department of Transportation grant, Federal Catalog No. 20.205.

**Item 1.**  
**Overstatement of**  
**Liability to the**  
**Federal**  
**Government**

**Finding**

The department did not correctly calculate the annual interest liability to the federal government for the State's administration of the federal Highway Planning and Construction program (Federal Catalog No. 20.205) as required. Specifically, the Cash Management Improvement Act (CMIA) of 1990 required each state and the federal government to enter into an agreement for fiscal year 1993-94. The United States Treasury/State of California Agreement established procedures and requirements that are intended to ensure greater equity, efficiency, and effectiveness in the transfer of funds between the federal government and the State and the exchange of interest resulting from the timing of funds transferred. The Agreement and the Code of Federal Regulations, Title 31, Section 205.13, require the State to calculate the interest liability on funds transferred between the State and federal government for certain federal programs. For fiscal year 1993-94, the department made errors in its calculation of its interest liability.

The department used three incorrect redemption dates and included one item twice when incorporating data to determine average clearance patterns between disbursement of expenditures and receipt of funds for federal reimbursable construction contracts and subvention reimbursement contracts. In addition, the department erroneously included five nonconstruction contract billings in its average clearance pattern for its construction contracts. As a result, we estimate that the department overstated its interest liability to the federal government by approximately \$46,000.

According to the Accounting Administrator I in the department's Federal Program Accounting Unit, the department has a verbal understanding with the Department of Finance (DOF) to recalculate the average clearance pattern and its resulting liability calculation. However, the department and the DOF agreed that any necessary adjustment will be made by adjusting the fiscal year 1994-95 liability to the federal government.

### **Criteria**

Section 8.1 of a fiscal year 1993-94 Agreement between the State of California and the United States Department of Treasury, requires the State to develop a separate clearance pattern for the Highway Planning and Construction program using the average clearance funding technique. The Agreement and the Code of Federal Regulations, Title 31, Section 205.13, require the State to calculate the interest liability on funds transferred between the State and federal government. Further, Section 10.5 of the Agreement details the method to calculate and document the interest liability for construction contracts.

### **Recommendation**

The department should recalculate the average clearance pattern and adjust, as necessary, its calculation of the State's fiscal year 1993-94 liability to the federal government for the federal Highway Planning and Construction program.

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

### **Finding**

The department did not promptly submit several final claims to the Federal Highway Administration (FHWA) to close completed federal aid projects. For 7 of the 24 federal aid projects final vouchered during fiscal year 1993-94 that we reviewed, the department did not submit the final voucher to the FHWA within 24 months of project completion, as required. These 7 final vouchers for construction projects were submitted between 25 and 72 months after project completion. In addition to the 7 discussed above, we could not determine timeliness of one right of way final claim because the department does not have adequate procedures to ensure that districts notify headquarters upon completion of right of way projects. Since the department could not document the specific date of completion for the project, we could not determine if the department completed the final voucher within the required 24-month timeframe. Although the department generally receives reimbursement for eligible project costs before it submits the final voucher, any unpaid balance of the federal share will not be made until the FHWA approves a final voucher.

The Bureau of State Audits reported a similar weakness during the audit for fiscal years 1991-92 and 1992-93, and the Office of the Auditor General reported a similar weakness during its audit for fiscal year 1990-91.

### **Criteria**

The United States Code, Title 23, Section 121(b) and (c), states that after completion of a project and approval of the final voucher, a state will be entitled to payment of any unpaid balance of the federal share payable. Further, in August 1987, the department and the FHWA agreed that the department should submit the final voucher for projects within 24 months of project completion.

### **Recommendation**

The department should submit final vouchers for federal aid projects within 24 months of project completion.

### **Item 3. Inaccurate Accrual of Liabilities**

#### **Finding**

The department did not accurately analyze and accrue obligations in the State Highway Account at June 30, 1994. During fiscal year 1993-94, we reviewed accounts payable obligations totaling \$169 million. We found five obligations that were not properly accrued at year-end. For three of the five obligations, the department understated its obligations by approximately \$2.6 million. Part of the understatement occurred when the department did not follow its own procedures to properly apportion an obligation between fiscal years. The remaining portion of the understatement was because the department did not review its subsidiary ledgers to ensure that necessary manual adjustments were made to account for a June fixed asset purchase and June unemployment benefit charges. For the remaining two obligations, the department overstated its accounts payable balance by approximately \$3.9 million. Specifically, the department did not follow its own procedures to apportion certain expenditures between fiscal years. As a result of the five incorrect obligations, the department had a net overstatement of its accounts payable balance of approximately \$1.3 million.

#### **Criteria**

The State Administrative Manual, Section 10210, requires agencies to account for and accrue expenditures in the fiscal year in which the obligations to make the expenditure occur. In addition, the State Administrative Manual, Section 10544, requires agencies to record all valid obligations and expenditures at June 30 that had not been otherwise recorded by that date.

### **Recommendation**

The department should ensure that its accrued liabilities are complete and accurate.

### **Item 4. Noncompliance with State and Federal Requirements**

#### **Finding**

The department did not always comply with the administrative requirements of the state and federal governments. Specifically, we noted the following instances of noncompliance during our review:

- The department billed the FHWA for costs which were incurred prior to authorization and failed to bill the FHWA for costs which were incurred after receiving authorization under the federal Highway Planning and Construction program. For 6 of the 22 projects we

tested, the department overbilled one project and underbilled 5 projects, totaling a net underbilling of approximately \$29,000. The errors occurred because incorrect authorization dates were input in the system. Costs incurred before the date of authorization are not eligible for reimbursement. The department pro-rates the costs incurred in the month of authorization based on the percentage of the month that is prior to the date of authorization.

By using an incorrect authorization date, the department billed the FHWA for some ineligible costs and failed to bill the FHWA for other eligible costs. As of February 1995, the department has implemented procedures to ensure that the correct authorization date will now be entered into the system. In addition, as of April 1995, the department has corrected the billings for 5 of the 6 projects discussed above. The Code of Federal Regulations, Title 23, Section 1.9(a), states that federal funds shall not be paid on any cost incurred prior to authorization by the FHWA.

- The department did not bill the FHWA for eligible costs incurred under the federal Highway Planning and Construction program, totaling \$131,000, in a timely manner. Although the department received federal approval in June 1994, the department did not bill the federal government until November 1994 because the department incorrectly limited billable construction engineering costs. The State Administrative Manual, Section 911.4, requires state agencies to bill the federal government promptly.
- The department did not follow the required accounting procedures in determining its fiscal year 1993-94 overhead rate for its electronic data processing (EDP) service center. Through the application of the overhead rate, the department charges costs of the EDP service center to federal aid projects under the federal Highway Planning and Construction program. In determining its fiscal year 1993-94 overhead rate, the department used estimated future costs in its calculations to adjust its EDP overhead rate. However, the Code of Federal Regulations, Title 23, Section 140.715(b), states that the accounting procedures and methods of distribution used in cost accumulation centers must be representative of average actual costs.
- For 3 of the 15 federal Highway Planning and Construction program projects tested, the department advertised the projects in the State's Contract Register prior to receiving authorization from the FHWA. The Code of Federal Regulations, Title 23, Section 635.107(a), states that no work shall be undertaken on any federal project, nor shall any project be advertised for bids, prior to authorization by the FHWA division administrator.

- For 4 of the 44 utility relocation agreements tested under the federal Highway Planning and Construction program, the department did not incorporate the Code of Federal Regulations, Title 23, Section 645.113(a). This Section requires that when federal participation is requested, the agreement shall incorporate Section 645.113(a) by reference.
- The department did not perform its required monthly transfers of funds from the Motor Vehicle Fuel Account (MVFA) to the Off-Highway Vehicle Trust Fund (OHVF) and the Conservation and Enforcement Services Account (CSEA) in a timely manner. Specifically, the monthly transfers were between 2 and 59 days late for 11 of the 12 months tested. The Revenue and Taxation Code, Sections 8352.6 through 8352.8, requires the department to transfer funds from the MVFA to the OHVF and CSEA funds on the first day of each month.

### **Recommendation**

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

## **Education**

## California Community Colleges, Chancellor's Office

We reviewed the financial operations and related internal controls of the California Community Colleges, Chancellor's Office (Chancellor's Office), and the Chancellor's Office's Administration of the U.S. Department of Education grant, Federal Catalog No. 84.048.

### **Item 1. Vocational Education Funds Improperly Distributed**

#### **Finding**

The Chancellor's Office determined that it improperly distributed some vocational education funds to community college districts through the apportionment process. For example, the Chancellor's Office overpaid ten districts approximately \$749,000 during fiscal year 1993-94. The overpayments generally occurred because the Chancellor's Office had duplicate agreements for certain projects. To correct these overpayments, the Chancellor's Office either collected the funds from the districts or adjusted future apportionment payments.

In addition, the Chancellor's Office paid approximately \$391,000 to 14 districts prior to contract work being performed. The Chancellor's Office paid the districts prior to work being performed because it distributed the vocational education funds through the apportionment process. However, the Chancellor's Office later determined that some of the agreements were structured as contracts and therefore were not suited for payment through the apportionment process. To correct this condition, the Chancellor's Office subsequently removed these contracts from the apportionment process.

#### **Criteria**

The Code of Federal Regulations, Title 34, Section 74.61(c) requires the State to maintain effective control and accountability for all grant cash. In addition, the State Administrative Manual, Section 1258 indicates that contract payments must not be made in advance of service rendered.

#### **Recommendation**

The Chancellor's Office should maintain effective control and accountability over vocational education funds so that it properly distributes the funds to community college districts.

### **Item 2. Improvements Needed Over Cash Management**

#### **Finding**

The Chancellor's Office did not always properly manage its federal vocational education funds. The Chancellor's Office acts as an intermediary in the allocation of these funds between the California Department of Education (CDE) and subrecipients, including community

college districts. Each fiscal year, the Chancellor's Office enters into agreements with the CDE for its share of the federal vocational education funds. During our audit, we noted the following conditions:

- The Chancellor's Office both overbilled and underbilled the CDE for reimbursement of expenditures for various vocational education programs in fiscal year 1993-94. Specifically, during our review of billings through July 1994 and various adjustments, we found that the Chancellor's Office overbilled the CDE approximately \$759,000 and underbilled the CDE approximately \$645,000. The net effect of the errors was that the Chancellor's Office overbilled the CDE approximately \$114,000.
- The Chancellor's Office did not always minimize the amount of time between expending funds for the administration of the vocational education program and requesting reimbursement from the CDE. We tested five invoices to determine the amount of time between the monthly reports of expenditures and the invoices requesting reimbursement. We found that four of the five invoices covered nine months of expenditures for which the Chancellor's Office was from 1 to 128 days late in requesting reimbursement. We consider a reimbursement request late if it is delayed more than five days after the monthly expenditure information is available. As a result of the late invoices, the State's General Fund lost interest earnings of approximately \$12,000.

#### **Criteria**

The Code of Federal Regulations, Title 31, Section 205.20, requires that federal funds transferred to the State be limited to the actual immediate cash needed. This code Section also requires the State to minimize the time between the transfer of federal funds and the disbursement of those funds for program purposes.

#### **Recommendation**

The Chancellor's Office should request reimbursement for actual program expenditures and should minimize the time between the disbursement of funds and the reimbursement request.



**Item 3.  
Inadequate  
Accounting for  
Instructional  
Improvement  
Loans and Lack of  
Reconciliation  
With the State  
Controller's Office**

**Finding**

The Chancellor's Office has not maintained an adequate accounting system and repayment schedule for instructional improvement loans nor has it reconciled its records for these loans with those of the State Controller's Office (SCO). The Chancellor's Office issues these loans to community college districts, and the SCO reduces districts' future apportionments to repay the loans. During our review, we identified differences in repayment amounts for eight loans reflected on the loan repayment schedule prepared by the Chancellor's Office, and the SCO's records. In addition, we identified four loans on the repayment schedule that did not appear on the SCO's records. For example, the Chancellor's Office was unaware that the SCO had incorrectly recorded as a grant a \$44,000 loan that the Chancellor's Office issued in fiscal year 1990-91. Moreover, because the SCO recorded the loan as a grant, it has not reduced this district's apportionments to repay the loan, which should have been fully repaid by June 1994.

Without an adequate accounting system and repayment schedule for the loans, the Chancellor's Office cannot ensure that loans are properly recorded and repaid. Furthermore, failure to reconcile accounting records with the SCO can result in errors that may go undetected for extended periods of time.

**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, but not be limited to, recordkeeping procedures to provide effective accounting control over assets, liabilities, revenues, and expenditures. Moreover, the California Code of Regulations, Title 5, Section 56682, requires the Chancellor's Office to develop an accounting system and repayment schedule for instructional improvement loans, and Section 56684 requires the SCO to deduct loan repayments from districts' apportionments during each of the three fiscal years following the year in which the loan was made. Finally, the State Administrative Manual, Section 7900, discusses the importance of preparing regular reconciliations and states that regular reconciliations between agencies and the SCO may disclose errors both in the agency accounts and the SCO accounts as they occur.

**Recommendation**

The Chancellor's Office should maintain an adequate accounting system and repayment schedule for instructional improvement loans and should periodically reconcile its records with the SCO.

**Item 4.  
Incorrect  
Calculations of  
Apportionments**

**Finding**

The Chancellor's Office incorrectly calculated the apportionments for the Disabled Student Programs and Services (DSP&S) and the Extended Opportunity Programs and Services (EOPS) programs. During our audit, we noted the following conditions:

- The Chancellor's Office incorrectly calculated the allocations to college campuses for the DSP&S program. Specifically, the Chancellor's Office excluded one disability group for a campus in determining the weighted student count component of the allocation. The DSP&S allocations for all campuses were affected because this component of the allocation was based on each campus' weighted student count compared to the total weighted student count for all campuses. Furthermore, the campus with the incorrect weighted student count received approximately \$42,000 less than it should have for its DSP&S allocation. Finally, incorrect allocations in one year affect subsequent years' allocations because the allocations are based, in part, on the prior year's data.
- The Chancellor's Office did not calculate the EOPS allocation in accordance with the allocation formula. Specifically, the Chancellor's Office used allocation data from the wrong fiscal years to determine the college effort component of the allocation. In addition, the Chancellor's Office used budgeted expenditures rather than final expenditures for 15 of the campuses. The Chancellor's Office used budgeted information because it had not received final expenditure reports from those campuses. According to the EOPS coordinator, most of the 15 campuses had not provided final expenditure reports in time to run the allocations, because cutbacks in the Chancellor's Office caused delays in providing campuses with information necessary to complete the reports. Because the Chancellor's Office did not calculate the EOPS allocation in accordance with its formula, some campuses may not have received all of the funds they were entitled to receive. Furthermore, incorrect allocations in one year affect subsequent years' allocations because the allocations are based, in part, on the prior year's data.

**Criteria**

The California Education Code, Section 84850, requires the Board of Governors of the California Community Colleges to adopt rules and regulations for the administration and funding of educational programs and support services to be provided to disabled students by community college districts. As part of these rules and regulations, the Board of Governors adopted a formula for allocating DSP&S funds which specifies that a percentage of DSP&S funds be allocated on the basis of the numbers of students served, weighted by disability group.

The California Education Code, Section 69648, requires the Board of Governors of the California Community Colleges to adopt rules and regulations to implement EOPS programs that encourage enrollment of students with language, social, and economic disadvantages. To comply with these rules and regulations, the Board of Governors adopted a formula that allocates a portion of the EOPS funds based upon each college's level of effort. In its formula to determine the level of effort, the Board of Governors includes the most recent final expenditure information available and the allocation amounts that the campuses received for the previous three fiscal years.

### **Recommendation**

The Chancellor's Office should ensure that all applicable factors are included in the calculation of apportionments. In addition, the Chancellor's Office should calculate apportionments in accordance with its formulas.

**Item 5.  
Matriculation  
Apportionment Not  
Adequately  
Supported**

### **Finding**

The Chancellor's Office did not adequately support the determination of the matriculation apportionments. During our audit, we noted that the Chancellor's Office did not retain the supporting documentation needed to determine whether the matriculation allocation to individual college campuses was correctly calculated. Specifically, we could not determine whether adjustments made to student counts included in the allocation formula were appropriate. Although we determined that the amount in total distributed for matriculation was correct, we could not determine if the individual apportionments to campuses were correct.

### **Criteria**

The California Education Code, Section 78216, requires the Board of Governors of the California Community Colleges to develop a formula for funding student matriculation services at community colleges. This Section also states that the formula shall reflect several factors including: the number of students to receive matriculation services at each college, and the relative needs for matriculation services based on student populations such as low-income students, students with language differences, students with physical and learning disabilities, and students in need of remedial instruction. In addition, the California Government Code, Section 13401, requires agencies to maintain an effective system of internal control. Moreover, the Government Code, Section 13403, requires that the system of internal control include recordkeeping procedures to provide effective accounting control over assets, liabilities, revenues, and expenditures. Finally, the State Administrative Manual, Section 1667, requires agencies to consider audit requirements when making decisions for document retention periods.

### **Recommendation**

The Chancellor's Office should ensure that records supporting the calculation of apportionments are maintained at least until an audit is completed.

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

### **Finding**

The Chancellor's Office did not reconcile federal financial reports it prepared for the vocational education program during fiscal year 1993-94 with its accounting records. Failure to reconcile federal financial reports with the accounting records can result in misstatements of claims that may go undetected.

### **Criteria**

The Code of Federal Regulations, Title 34, Section 74.61(a), requires the grantees to provide accurate, current, and complete disclosure of the Vocational Education grant program. In addition, 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 Chancellor's Office should reconcile its federal financial reports with its official accounting records.

#### **Item 7. Travel Costs Not Adequately Monitored**

### **Finding**

The Chancellor's Office did not monitor all travel costs reimbursed to community college districts. During our review of agreements for administrative services for certain programs distributed through apportionments, we noted that the Chancellor's Office reimbursed three districts approximately \$7,200 for meals at various meetings. The average costs per person for these meals were \$12 for breakfast and \$20 for lunch. In total, the charges for the meals exceeded the State's reimbursement rates by approximately \$3,800.

### **Criteria**

The agreements between the Chancellor's Office and the community college districts specified that the district be reimbursed according to the State's reimbursement rates established by the Department of Personnel Administration rules. These rules are described in the California Code of Regulations, Title 2, Section 559.619, which states that the maximum reimbursement rates for employees traveling on business are \$5.50 for breakfast and \$9.50 for lunch.

### **Recommendation**

The Chancellor's Office should monitor travel costs to ensure that payments do not exceed the State's reimbursement rates.

### **Item 8. Noncompliance with Certain State Requirements**

#### **Finding**

We noted the following instances when the Chancellor's Office did not always comply with administrative requirements of the State:

- The Chancellor's Office submitted its financial reports for the General Fund to the State Controller's Office (SCO) in October 1994, more than two months after the deadline of July 29, 1994. In addition, the Chancellor's Office submitted its financial reports for other funds to the SCO more than one month after the deadline of August 22, 1994. Failure to submit financial statements to the SCO by the deadlines hinders the State's ability to promptly produce and issue its financial statements.
- The Chancellor's Office did not reconcile its physical inventory of property with its accounting records. Failure to reconcile the physical inventory with the accounting records can result in the failure to detect the loss or theft of state property. The Bureau of State Audits reported a similar weakness during the audit for fiscal year 1992-93, and the Office of the Auditor General reported a similar weakness during its audit for fiscal year 1990-91. The State Administrative Manual, Section 8652, requires that agencies reconcile the physical property counts with the accounting records at least once every three years.
- The Chancellor's Office has not taken steps to clear longstanding travel, expense, and salary advances made from the revolving fund. During our review, we noted that several items totaling approximately \$22,000 had been outstanding for more than one year. The Bureau of State Audits reported a similar weakness during the audit for fiscal year 1992-93, and the Office of the Auditor General reported a similar weakness during its audits for fiscal years 1988-89 through 1990-91. The State Administrative Manual, Section 8047, requires agencies to schedule claims for reimbursement of office revolving funds promptly.

Although individually these deviations may not appear to be significant, they do 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.

# California Postsecondary Education Commission

We reviewed the California Postsecondary Education Commission's (commission) administration of the U.S. Department of Education grant, Federal Catalog No. 84.164.

## **Item 1. Inadequate Procedures for Monitoring Cash Advances to Subgrantees**

### **Finding**

The commission does not always ensure that cash advanced to subgrantees participating in the Eisenhower Mathematics and Science Education—State Grants program (program) is limited to the subgrantees' immediate cash requirements. We reviewed 18 payments the commission made to subgrantees and found that for 5 of the subgrantees the commission issued additional funds without determining whether the federal funds were necessary to meet the immediate cash needs of its subgrantees, as required by the federal government.

For example, the commission initially advanced \$174,000 to one subgrantee. When the subgrantee submitted a request for additional funds, the commission paid the subgrantee \$22,290, the full amount requested, even though as part of its request, the subgrantee reported federal funds available of \$78,541. The commission did not ask the subgrantee whether it had obligated all or a portion of the \$78,541. Therefore, the commission did not determine if the additional funds requested by the subgrantee were necessary to meet the subgrantee's immediate cash needs. Because the commission does not determine the cash needs of its subgrantees, it cannot assure that it meets the standards of timing and amounts of advances required by the federal government.

We reported a similar finding during our audit for fiscal year 1992-93. The commission is in the process of implementing a new procedure.

### **Criteria**

The Code of Federal Regulations, Title 34, Section 80.20(b)(7), requires procedures for minimizing the time elapsing between the transfer of funds from the U.S. Treasury and disbursement by the commission be followed whenever advance payment procedures are used. Further, this Section requires the commission to monitor cash drawdowns by the subgrantees to assure that they conform substantially to the same standards of timing and amount as apply to advances to the commission.

### **Recommendation**

The commission should limit cash advances to the immediate needs of the subgrantees.

**Item 2.  
Inadequate  
Procedures for  
Monitoring  
Subgrantees**

**Finding**

The commission did not ensure that subgrantees receiving \$25,000 or more during its fiscal year had met the audit requirements of the program. Further, we noted that the commission's contract with subgrantees did not include provisions requiring the subgrantees to obtain the required audits and submit them to the commission.

Without these audits, the commission lacks assurance that subgrantees are complying with federal laws and regulations and that the federal grant moneys are being spent appropriately. For example, during our review we noted that a subgrantee hired an independent auditor to conduct an investigative audit of its grant's disbursements for its own purposes. A portion of the disbursements audited included grant funds provided by the commission. The subgrantee decided to inform the commission of the auditor's findings regarding unallowable expenditures. After receiving this information, the commission disallowed approximately \$26,000 in Eisenhower program costs to this subgrantee.

**Criteria**

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

Also, the Office of Management and Budget (OMB), Circular A-133, *Audits of Institutions of Higher Education and Other Nonprofit Institutions*, requires state or local governments that receive federal assistance and provide \$25,000 or more during its fiscal year to a subgrantee to:

- Ensure that the nonprofit institution subgrantees that receive \$25,000 or more have met the audit requirements of the circular;
- Ensure that appropriate corrective action is taken within six months after receipt of the audit report in instances of noncompliance with federal laws and regulations;
- Consider whether subgrantee audits necessitate adjustment of the grantee's own records; and
- Require each subgrantee to permit independent auditors to have access to the records and financial statements as necessary for the recipient to comply with this circular.

**Recommendation**

The commission should ensure that subgrantees receiving \$25,000 or more during a fiscal year have an independent audit in accordance with federal regulations and that the audits are submitted to the commission for review.

**Item 3.  
Weaknesses in  
Separating  
Accounting Duties**

**Finding**

The commission has weaknesses in its separation of duties over its accounting operations. Failure to maintain proper separation of duties can result in errors and irregularities that may go undetected. We found the following specific deficiencies:

- The employee responsible for recording cash receipts and disbursements also prepares the monthly bank reconciliation and performs the postings to the general ledger;
- Signed checks are returned to the requesters and/or the employee responsible for recording disbursements, rather than delivered directly to the payee; and
- Journal entries recorded into the general ledger are not reviewed and approved by the supervisor.

We reported a similar finding during our audit for fiscal year 1992-93. The commission has indicated that it will explore other possibilities to maintain proper separation of duties.

**Criteria**

The State Administrative Manual, Section 8080, prescribes the appropriate level of separation of duties for agencies with manual accounting systems. In addition, the Section requires that, when necessary, employees of units other than the accounting unit should be used to provide proper separation of duties. The California Government Code, Section 13401, requires state agencies to maintain a system of internal accounting and administrative controls. Furthermore, the California Government Code, Section 13403, states that the elements of a satisfactory system of internal accounting and administrative control should include, but are not limited to, a plan of organization that provides separation of duties for proper safeguarding of state agency assets.

**Recommendation**

The commission should separate its accounting duties to comply with the requirements in the California Government Code and the State Administrative Manual. Furthermore, the commission should use personnel from outside the accounting unit, if necessary, to achieve proper separation of duties.

**Item 4.  
Deficiency in  
Administering State  
Contracts**

**Finding**

The commission did not always obtain approval of its contracts before the contractors began work. Specifically, we reviewed 10 contracts that the commission entered into with consultants who participated as panelists on the Eisenhower Review Panel. These consultants reviewed and evaluated



proposals and interviewed potential grantees. The consultants participated as members of the review panel in February 1994; however, the commission did not obtain the proper approval for the contracts until March 1994.

**Criteria**

The State Administrative Manual, Section 1284, states that performance under a consulting services contract shall not be commenced prior to the approval by the Department of General Services or, if the department's approval is not required, by an authorized officer of the state agency entering into the contract.

**Recommendation**

The commission should ensure that it obtains approval for its contracts before the contractors begin work.

# California Student Aid Commission

We reviewed the California Student Aid Commission's (commission) administration of the U.S. Department of Education grant, Federal Catalog No. 84.032.

**Item 1.**  
**Student Loans**  
**Exceeded**  
**Allowable Limits**

**Finding**

The commission is not fully complying with the terms of one of its agreements with the federal government to participate in the Federal Family Education Loan programs. Under the terms of this agreement, the commission stated that it would ensure that its loan guarantee program meets certain maximum allowable loan requirements. We tested 60 student loans selected from the commission's database of students participating in the Stafford Loan program and the Supplemental Loans to Students program (SLS). Of these 60 loans, the commission guaranteed four SLS loans that exceeded the allowable loan amounts.

In one instance, the commission guaranteed a loan to an undergraduate student that exceeded the aggregate limit of \$23,000 by \$1,000. The commission's executive director indicated that this loan exceeded the aggregate loan limit because, after a change in the maximum aggregate loan limit, the commission mistakenly applied the later loan limit when the loan actually was subject to the earlier loan limit.

For the three other loans, the commission guaranteed loan amounts that exceeded the maximum annual amount by a total of \$4,277. In each of these three instances, the borrower was enrolled in a program that was less than a full academic year in length and the commission guaranteed loan amounts that exceeded the maximum prorated amount. The commission's executive director indicated that the commission's role is limited to ensuring that the amount requested on a single loan application does not exceed maximum allowable amounts for an applicable grade level. He also stated that because the federal loan application does not require information concerning the length of a school's academic year, nor the length of an applicant's academic program, the school is responsible for ensuring that applicants do not exceed annual loan limits based on these factors.

We believe that the commission shares responsibility with the schools to ensure that borrowers do not exceed maximum allowable loan limits. Noncompliance with federal loan limits could result in a loss of state funds if the borrower defaults. When a borrower defaults, the State will pay the lender for the defaulted loan. Following this, the federal government will reimburse the State the amount it paid the lender. However, the federal government may not reimburse the State for the portion of the loan that exceeded the amount authorized by regulations.

The Bureau of State Audits reported a similar weakness during the audits for fiscal years 1991-92 and 1992-93, and the Office of the Auditor General reported a similar weakness during its audits for fiscal years 1989-90 and 1990-91.

### **Criteria**

The Code of Federal Regulations, Title 34, Section 682.400, states that, in order for the commission to participate in the Federal Family Education Loan programs, it must enter into several agreements with the federal government. As part of one of these agreements, the commission agreed that it will ensure that its loan guarantee program meets the requirement that the total amount of student loans made to a borrower would not exceed specified limits. The commission also agreed that it would ensure that its program met the requirement that the maximum amount of an annual loan for a borrower would not exceed specified limits for an academic year.

The United States Code, Title 20, Sections 1078 and 1078-1, provide for specific loan limits for guaranteeing Stafford and Supplemental Loans to Students loans. These limits are based on the student's grade level, the length of the course in which the student is enrolled, and the student's total outstanding loan amounts for each loan program.

### **Recommendation**

The commission should develop adequate methods that enable it and the schools to meet their responsibility for ensuring that borrowers do not exceed maximum allowable loan limits.

## **Item 2. Incorrect Amounts Paid To Lenders**

### **Finding**

The commission did not always calculate the correct amount to pay lenders for defaulted student loans. For 7 of the 40 defaulted student loans that we reviewed, the commission incorrectly calculated the amounts to pay lenders. Specifically, the commission underpaid one lender \$2,154 on a loan with an outstanding balance of \$5,162 and overpaid lenders on six occasions in amounts ranging from \$2 to \$111. According to the commission's executive director, two of the seven errors were caused by the commission's computer system not using the correct dates to calculate interest payments.

For three of the seven errors, the commission's executive director disagreed with our conclusion that the commission did not correctly calculate the amounts to pay the lenders. He stated that the 1992 amendments to the federal regulations that we applied to the commission were not in effect during the period covered by our audit nor were they enforceable. The executive director believed this because of a letter from the secretary of the United States Department of Education (USDE) in

which the secretary stated that the USDE would not enforce the amendments to the regulations. We believe, however, that the amendments to the regulations were applicable to the commission because the secretary also indicated in his letter that he expected program participants "to take actions in good faith to begin implementation of the [amendments to the] regulations." The commission's executive director also stated that the commission could not determine the reasons why the remaining two errors occurred and attributed the incorrect calculations to human error.

If the commission does not properly calculate payments to lenders for defaulted student loans, the federal government may not reimburse the commission for these payments.

#### **Criteria**

The Code of Federal Regulation, Title 34, Section 682.406(a), authorizes the commission to pay a lender the unpaid principal and interest for a defaulted student loan.

#### **Recommendation**

The commission should ensure that it correctly calculates the amounts payable to lenders for defaulted student loans.

### **Item 3. Failure To Ensure That Defaulted Student Loans Meet Federal Requirements for Reimbursement**

#### **Finding**

The commission did not always ensure that it meets the federal 90-day guidelines for paying lenders for defaulted student loans. Of the 40 defaulted student loans that we reviewed, the commission did not pay the lenders of four student loans within the required 90 days from the date the lenders submitted their claims to the commission. The number of days late ranged from 18 to 294 days. The commission paid the four claims an average of 131 days late. Failure to ensure that loans meet federal requirements could jeopardize federal reimbursement. The Bureau of State Audits reported a similar weakness during the audits for fiscal years 1991-92 and 1992-93, and the Office of the Auditor General reported a similar weakness during its audits for fiscal years 1987-88 through 1990-91.

#### **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 the requirement that the commission pay a lender within 90 days of the date the lender filed a claim.

## **Recommendation**

The commission should ensure that all defaulted student loans it submits for reimbursement to the federal government meet the federal requirement for payment within 90 days.

### **Item 4. 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 \$22.4 million (30 percent) of the collections due to the federal government for fiscal year 1993-94 within the required time period. Although almost \$16 million of these collections were no more than one month late, over \$100,000 of the collections were more than one year late. The Code of Federal Regulations, Title 34, Section 682.404(g)(3), requires the commission to submit the federal share of borrower payments within 45 days of receipt. The Bureau of State Audits reported a similar weakness during the audits for fiscal years 1991-92 and 1992-93, and the Office of the Auditor General reported a similar weakness during its audit for fiscal year 1990-91.
- On six occasions during fiscal year 1993-94, the commission took longer than the 45-day maximum allowed by federal regulations to file claims for reimbursement from the federal government. The commission filed these claims from one to 15 days late. For example, for May 1994, \$12.2 million (60.1 percent) of the \$20.3 million in claims filed by the commission for that month was 15 days late. The Code of Federal Regulations, Title 34, Section 682.406(a)(9), requires the commission to submit requests for reimbursement on defaulted student loans within 45 days of payment to the lenders.
- The commission paid lenders for 2 of the 11 disability claims that we reviewed, even though the lenders did not include copies of the loan applications in the claim packages they submitted to the commission. The Code of Federal Regulations, Title 34, Section 682.402(e), requires that lenders provide specific documentation in their requests to the commission for payment of disability claims. A copy of the loan application is one of the required documents.
- For one of the 40 defaulted student loans that we tested, the commission did not promptly exercise the required due diligence in its collection efforts. Specifically, the commission did not send written notice to the borrower within 30 days from the date the commission purchased the loan. For this same loan, the commission did not attempt to contact the borrower during the period from the 31st to the 180th day after the commission purchased the loan. The commission,

however, did attempt to contact the borrower on the 183rd day after it purchased the loan. The Code of Federal Regulations, Title 34, Section 682.410(b)(7), requires the commission to exercise due diligence in its efforts to collect on loans that it purchased from lenders. The code specifies due diligence to include one written notice to the borrower within the first 30 days and one attempt to contact the borrower between the 31st and the 180th day from the date the commission purchased the loan from the lender.

**Recommendation**

The commission should improve its compliance with federal regulations.

# California Department of Education

We 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 Nos. 10.550, 10.553, 10.555, and 10.558, the U.S. Department of Labor grant, Federal Catalog No. 17.250, the U.S. Department of Education grants, Federal Catalog Nos. 84.002, 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 grants, Federal Catalog Nos. 93.565 and 93.575.

**Item 1.  
The State Did Not  
Maintain or  
Correctly Calculate  
Its Vocational  
Education Level  
of Effort**

**Finding**

The State did not maintain its level of effort in administering the Vocational Education—Basic Grants to States (program) for fiscal year 1992-93. We reviewed the State's fiscal year 1992-93 level of effort by comparing the fiscal years 1991-92 and 1992-93 expenditures for administration of the program from nonfederal sources. We found that the total expenditures for the department and the California Community Colleges, Chancellor's Office totaled \$3,121,673, which was less than the fiscal year 1991-92 expenditures of \$3,127,990. Therefore, the State's fiscal effort decreased by \$6,317 between the two periods. Federal regulations require that the State's expenditures for the administration of the program from nonfederal sources be equal to or surpass the expenditures from the preceding fiscal year.

In addition, the department may not be correctly calculating its level of effort because it includes contract amounts as obligations based on when the contract work is begun rather than when the contract becomes an obligation to the State. We reviewed the department's contracting procedures for this program for fiscal years 1991-92 and 1992-93. The purpose of our review was to determine whether contract amounts were obligated in the proper period. Contracts for personal services, or work other than personal services, are not binding upon the State until they are approved by the Department of General Services (DGS). Therefore, they are not obligations until the department receives such approval. For example, for the 1992-93 fiscal year level of effort, the department included a contract with the California Learning Assessment System (CLAS) to evaluate the effectiveness of a vocational program. The contract contains a provision for final approval which states that the agreement is of no force or effect until approved by the DGS. The contract was not approved by the DGS until August 1993. Therefore, the contract amount should not be included in expenditures for fiscal year 1992-93, because the written binding commitment was not made until August 1993.

Failure to maintain fiscal effort may result in fiscal sanction by the federal government.

### **Criteria**

The United States Code, Title 20, Section 2463, states that for each fiscal year for which a State receives assistance, the State shall provide from nonfederal sources for costs the State incurs for administration of programs, an amount that is not less than the amount provided by the State from nonfederal sources for such costs for the preceding fiscal year. Also, the Code of Federal Regulations, Title 34, Section 76.707, states that contracts for personal services or performance of work other than personal services, shall become an obligation to the State on the date that the State makes a binding written commitment to obtain the services. Furthermore, the California Public Contract Code, Section 10295, states that 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 DGS.

### **Recommendation**

The department should ensure that the State's fiscal effort is in accordance with federal requirements.

## **Item 2. Weaknesses in Monitoring Agencies Participating in the Food Distribution Program**

### **Finding**

The department does not always perform required program reviews or ensure the timely completion of program reviews of charitable institutions, nonprofit summer camps, and food processors for the Food Distribution program.

In our review of the department's listing of food processors, we found that the department conducted 18 reviews of the 37 food processors during fiscal year 1993-94 or 48.7 percent, which is below the 50 percent required by federal regulations. We also found that the department conducted 146 reviews of the 728 charitable institutions during 1993-94 or 20 percent, which is below the 25 percent required by federal regulations. Finally, we could verify that the department performed only 2 reviews of the 40 summer camps that were scheduled to be reviewed in fiscal year 1993-94. This is also below the 25 percent required by federal regulations.

We reported a similar weakness during our audit for fiscal year 1992-93. In its response to that finding, the department stated that it will designate a staff person to ensure that all program reviews are conducted when required. Because the department did not sufficiently perform its program reviews, it cannot ensure that the participating agencies are complying with federal regulations. Failure to conduct the required program reviews may result in fiscal sanction by the federal government.



### **Criteria**

The Code of Federal Regulations, Title 7, Section 250.19(b)(i) and (ii), requires the department to perform on-site reviews of charitable institutions and nonprofit summer camps once every four years with no fewer than twenty-five percent of their reviews completed per year. Additionally, the department must review food processors at least once every two years, with no fewer than fifty percent being reviewed each year.

### **Recommendation**

The department should ensure that it conducts reviews of all institutions as required by federal regulations.

### **Item 3. Inadequate Procedures To Resolve Deficiencies Identified in Audit Reports of Local Educational Agencies**

### **Finding**

The department's procedures do not ensure that instances of noncompliance with federal regulations identified in the audit reports of Local Educational Agencies (LEAs) are resolved within six months. We reviewed the audit reports of 11 LEAs and found that the 11 LEAs had resolved all the findings that required corrective action. However, only 2 of the 11 LEAs that we reviewed had resolved their findings within six months of the department's receipt of their audit reports. The audit findings for the 9 LEAs were resolved from one to four months after the end of the six months deadline.

We reported a similar weakness during our audit for fiscal years 1991-92 and 1992-93. In response to our fiscal year 1992-93 report, the department stated that it had developed an action plan with specific activities and dates for timely follow-up on identified audit exceptions. However, even with the action plan in place, the department still did not resolve the exceptions within the required time due to a departmental reorganization. Also, California Education Code, Section 41020, has recently been revised and now requires each county superintendent of schools to review audit exceptions contained in audits of school districts. The new Section is effective for fiscal year 1993-94 audit reports, which were due December 15, 1994. The participation of the county superintendent of schools in reviewing audit exceptions will reduce the department's workload.

### **Criteria**

The federal Office of Management and Budget, Circular A-128, Section 4(b), requires that states that allocate \$25,000 or more of federal financial assistance to LEAs must determine if the LEAs have met the audit requirements to ensure that the LEAs obtain an independent audit that determines whether federal financial assistance was spent in accordance with applicable laws and regulations. Also, for instances of

noncompliance with federal laws and regulations, Section 14 of the circular requires that states ensure that appropriate corrective action is taken within six months of receipt of the audit report.

**Recommendation**

The department should ensure that the findings identified in the LEA audit reports are resolved within six months of receipt of the audit report.

**Item 4.  
Inadequate Review  
of Audit Reports of  
Private Nonprofit  
Agencies**

**Finding**

The department does not ensure that audit reports that private nonprofit agencies submit to the department for the National School Lunch Program and School Breakfast Program and the Child and Adult Care Food Program include the value of food commodities. For example, in our review of 22 audit reports of private nonprofit agencies, we found 2 agencies that did not report the value of commodities received on the Schedule of Federal Awards in the audit report. When the department does not adequately review the audit reports of private nonprofit agencies, it cannot ensure that the value of commodities distributed by the Food Distribution Center is being reported by the nonprofit agencies and audited by an independent auditor.

**Criteria**

The federal Office of Management and Budget, Circular A-133, Paragraph 1574, requires that nonprofit institutions receiving at least \$25,000 of federal awards have an audit made in accordance with this circular or have an audit made of each federal award, in accordance with federal laws and regulations governing the programs in which they participate. The circular requires that the audit report include a Schedule of Federal Awards identifying major programs and showing total expenditures for each program. Additionally, the circular states that the value of non-cash assistance such as food commodities should be disclosed in the schedule.

**Recommendation**

The department should ensure that the value of commodities are properly reported in the audit reports of independent auditors.

**Item 5.  
The Department  
Should Continue  
To Implement Its  
Plan To Monitor  
Local Educational  
Agencies Program**

**Finding**

In June 1992, the United States Department of Education (USDOE) reported that the department did not systematically monitor the Local Educational Agencies (LEAs) participating in the Eisenhower Mathematics and Science Education—State Grants program (program). The USDOE recommended that the department develop a program to monitor the LEAs to ensure compliance with federal requirements such as equitable

participation of children and teachers from private, nonprofit schools in the program or that LEAs use funds to supplement and not supplant other federal, state, or local funds.

Similarly, we reported this weakness during our audit for fiscal years 1991-92 and 1992-93. In its response to our fiscal year 1992-93 audit report, the department stated that it was developing a plan to systematically monitor LEAs. During fiscal year 1993-94, the department continued to develop a monitoring plan. According to the department, beginning in fiscal year 1994-95, the department will include the program in its Coordinated Compliance Review (CCR) process. The department has also developed a CCR program which will test to ensure that LEAs comply with federal requirements in developing and implementing the program. As part of the CCR process, monitors will verify LEA procedures to ensure that children and teachers from private, nonprofit schools have equitable participation in the program, and that LEAs use program funds to supplement and not supplant other federal, state, or local programs.

### **Criteria**

The Code of Federal Regulations, Title 34, Section 80.40(a), requires grantees to monitor activities of LEAs to ensure that they comply with applicable federal requirements and achieve performance goals. The Code of Federal Regulations, Title 34, Subpart F, Sections 208.51(a) and (b), requires LEAs to make provisions for ensuring the equitable participation for children and teachers from private, nonprofit schools in the benefits of the Eisenhower Mathematics and Science Education—State Grants program. The Code of Federal Regulations, Title 34, Section 208.41(b), requires subgrantees not to use federal funds to supplant funds from nonfederal sources.

### **Recommendation**

The department should continue to implement its plan to monitor LEAs to ensure that LEAs comply with applicable federal regulations and achieve performance goals.

## **Item 6. Inaccurate Financial Status Report**

### **Finding**

The department did not accurately and completely report the financial status of the Vocational Education—Basic Grants to States (program) as of June 30, 1993, to the federal government. Specifically, the Financial Status Report for the fiscal year ended June 30, 1993, did not include approximately \$933,000 of expenditures from the California Community Colleges, Chancellor's Office which jointly administers the program. In addition, the department included approximately \$144,000 of expenditures for the period July 1 through September 30, 1993, even though the report was for the fiscal year ending June 30, 1993. As a result, the department reported approximately \$789,000 less than its actual

expenditures to the federal government for the program. Providing accurate fiscal reports to the federal government is important because the federal government relies on these reports to ensure that the State is meeting the requirements to maintain level of effort and to match federal funds with state funds. The department submitted a corrected Financial Status Report for fiscal year 1992-93 in April 1995.

### **Criteria**

The Code of Federal Regulations, Title 34, Section 74.61(a), requires the grantee's financial management system to provide accurate, current and complete disclosure of the financial results of each grant program.

### **Recommendation**

The department should ensure that its Financial Status Report contains accurate and reliable information.

## **Item 7. Inadequate Procedures for Reviewing Audit Reports for the Job Training Partnership Act State Education Coordination and Grants 8%**

### **Finding**

The department does not always ensure that it promptly reviews the audit reports submitted by Community Based Organizations (CBOs) for the Job Training Partnership Act State Education Coordination and Grants 8%. For fiscal years 1992-93 and 1993-94, 13 and 10 CBOs, respectively, should have sent audit reports to the department by November 15 of each fiscal year. However, as of March 1995, the department has received only 8 and 2 audit reports, respectively, from CBOs.

The department is supposed to monitor the CBO audit reports to ensure that CBOs are complying with federal regulations. The department's Management Planning and Development Unit (MPDU) receives the reports and is supposed to send the reports to the department's External Audits Unit for review. The External Audits Unit determines if there are financial or federal compliance deficiencies noted in the audit reports. However, as of March 1995 for fiscal years 1992-93 and 1993-94, the MPDU has not sent any of the 10 audit reports it has received to the External Audits Unit.

Within 30 days from the date the department receives the audit reports, the department is supposed to send an Initial Determination that describes each specific issue to those CBOs whose audit reports have identified deficiencies. However, as of March 1995, for both fiscal years, the department has not sent any Initial Determinations to the CBOs. If the department does not follow its own due dates for the issuance of Initial Determinations, the department cannot ensure that the CBOs will correct the deficiencies noted in the audit reports nor can it ensure that it will be able to recover any excess funds or take corrective actions in a timely manner.

We observed a similar weakness during our audit for fiscal year 1992-93. In its response to that finding, the department stated that it notified all CBOs that their fiscal years 1992-93 and 1993-94 audit reports were to be submitted to the department. However, as noted above, most of the CBOs did not comply with the department's request.

### **Criteria**

The Code of Federal Regulations, Title 34, Section 80.40(a), requires grantees to monitor grant activities to ensure that subrecipients comply with applicable federal regulations and that they achieve performance goals. Also, the federal Office of Management and Budget, Circular A-133, requires state governments that receive federal assistance and allocate \$25,000 or more of federal assistance to subrecipients to determine if the subrecipients have met the requirement that the nonprofit institutions obtain an independent audit that assesses whether federal financial assistance was spent in accordance with applicable laws and regulations. Furthermore, the department's contract with the subrecipients requires the submission of audit reports to the department by November 15. This same contract requires the department to send Initial Determinations to the subrecipients within 30 days of receipt of the audit reports.

### **Recommendation**

The department should closely monitor its subrecipients to ensure that the department and its subrecipients comply with applicable federal laws and regulations.

## **Item 8. Statewide Cost Allocation Plan Recoveries Are Not Transferred Promptly**

### **Finding**

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

- July through September 1993 on December 22, 1993—53 days late;
- October through December 1993 on October 31, 1994—274 days late; and
- January through March 1994 on October 31, 1994—184 days late.

The department, as of January 30, 1995, has not transferred the SWCAP recoveries for the period of April through June 1994.

We observed a similar weakness during our financial audit for fiscal years 1991-92 and 1992-93, and the Office of the Auditor General reported a similar weakness during its audits for fiscal years 1989-90 and 1990-91. In its response to this finding, the department stated that the 30-day requirement is impractical within the CALSTARS accounting system since monthly expenditure reports reflecting cost allocation transactions are not available until at least 30 days following the month of service. In addition, the department stated that supervisors and staff in the accounting office have been requested to expedite their SWCAP recovery activities to ensure that the transfer of SWCAP recoveries occurs as soon as possible. However, based on the analysis above, the number of days it took the department to do the transfers have increased during the year. The SWCAP transfers for the second, third, and fourth quarter for fiscal year 1993-94 were more than 6 months late.

### **Criteria**

The California Government Code, Section 13332.01, requires agencies to recover SWCAP costs from the federal government. Section 13332.02 of the Code requires agencies to transfer all funds recovered from the federal government to the State's General Fund in a manner prescribed by the Department of Finance. The State Administrative Manual, Section 8755.2, stipulates that a transfer of SWCAP recoveries to the State's General Fund be accomplished within 30 days of the end of the quarter.

### **Recommendation**

The department should transfer SWCAP recoveries in accordance with state requirements.

## **General Government**

# Office of Criminal Justice Planning

We reviewed the Office of Criminal Justice Planning's (OCJP) administration of the U.S. Department of Justice grant, Federal Catalog No. 16.579, for fiscal year 1993-94. In addition, we reviewed the OCJP's administration of the U.S. Department of Education grant, Federal Catalog No. 84.186 for fiscal years 1992-93 and 1993-94. Finally, we report for the first time the results of our review of these two grants for fiscal year 1991-92.

## **Item 1. Late Requests for Reimbursements of Federal Funds**

### **Finding**

The OCJP does not always promptly request federal reimbursements for costs it has incurred for federal programs. As a result, the State loses interest earnings on these late reimbursements. We identified the following specific conditions:

- The OCJP receives funding from the federal Drug-Free Schools and Communities—State Grants (DFSC) through an interagency agreement with the Department of Alcohol and Drug Programs (DADP). The agreement requires the OCJP to administer the grant program, to contract with eligible subrecipients to provide programs to combat drug use among youth, and to use grant moneys to reimburse these subrecipients for their costs. The OCJP initially uses state General Fund moneys to reimburse these subrecipients. The OCJP, in turn, is reimbursed by the DADP, which receives grant moneys directly from the federal government. However, for the 10 reimbursements we reviewed, the department took from 16 to 92 days to bill the DADP. These delays resulted in lost interest to the State.
- The State also lost interest earnings because the OCJP entered into agreements with certain subrecipients several months late, resulting in delayed reimbursements from the federal government's Drug Control and System Improvement—Formula Grant (DCSI). For example, the OCJP was late in entering into two direct interagency agreements with the Department of Justice. Although the Department of Justice began rendering services and incurring costs in July 1993, the interagency agreements were not approved until October and November 1993. As a result, the Department of Justice did not submit its first billings until December 1993.

In addition, in December 1993, the OCJP entered into a grant agreement with the City of Hawthorne for services provided through the Los Angeles County Police Chiefs' Association (LACPCA). The LACPCA then entered into a contract with the State's Department of Justice for that department to provide services under the DCSI. Although the Department of Justice provided services from July 1993



through December 1993, the city did not bill the OCJP, receive federal reimbursements, and transmit those reimbursements to the State's Department of Justice until after December 1993, when the grant agreement between the City of Hawthorne and OCJP was approved.

### **Criteria**

The State Administrative Manual, Section 0911.4, requires state agencies to bill the federal government promptly.

### **Recommendation**

The OCJP should promptly request reimbursements from the DADP. In addition, the OCJP should promptly enter into interagency agreements with subrecipients of federal grant funds so that the OCJP is then able to request reimbursements from the federal government promptly. Moreover, to facilitate prompt reimbursements for costs incurred, the OCJP should consider entering into an interagency agreement directly with the Department of Justice for services the Department of Justice currently renders under the contract with the LACPCA.

## **Item 2. Incomplete and Inaccurate Reports Submitted to the DADP**

### **Finding**

The OCJP does not consistently provide complete and accurate progress reports related to the Drug-Free Schools and Communities—State Grants to the DADP. The progress reports are required by the interagency agreements between the OCJP and the DADP. In our review of the progress reports, we noted the following instances in which the OCJP did not comply with reporting requirements:

- In fiscal years 1992-93 and 1993-94, the OCJP did not provide complete information to the DADP about guarantees that 90 percent of youths served in the program were categorized as high-risk youth. The problem existed because some subrecipients did not provide this information to the OCJP, as required. Specifically, in fiscal year 1992-93, 2 of the 12 subrecipients we reviewed did not provide the required information. In fiscal year 1993-94, 9 of the 11 subrecipients we reviewed did not submit the information. The OCJP uses the data from these forms to prepare its progress reports to the DADP. If the OCJP does not obtain this data from its subrecipients, it cannot provide complete information to the DADP. We noted a similar problem during our audit for fiscal year 1991-92, when the information submitted by 13 of 15 subrecipients we reviewed did not clearly identify the percentage of high-risk youth served.

In addition, the OCJP asserts in its fiscal year 1993-94 progress reports to the DADP that it performs yearly site visits of subrecipients in which it reviews documentation for the 90 percent participation of high-risk youth. However, the OCJP does not consistently complete these site

visits. For 3 of the 11 subrecipients that provided services to high-risk youth that we reviewed, the OCJP did not complete a site visit in fiscal year 1993-94. Moreover, seven of the eight site visit reports we reviewed for fiscal year 1993-94 did not contain evidence of such visits. As a result, the OCJP is providing inaccurate assurances in its reports to the DADP.

- In fiscal years 1991-92 through 1993-94, the OCJP did not ensure that its subrecipients provided notice to private schools in their areas of the availability of the federal grant moneys to these schools. Federal statutes require such notice, and the OCJP has established a procedure requiring written certifications from subrecipients that they have notified private schools in their area. However, the OCJP did not receive these certifications from 5 of the 22 subrecipients we reviewed for fiscal year 1991-92, from 3 of the 12 subrecipients we reviewed for fiscal year 1992-93, and from 13 of the 18 subrecipients we reviewed for fiscal year 1993-94. In addition, the OCJP asserts in its fiscal year 1993-94 progress reports to the DADP that it addresses and documents information relating to any private school participation in the site visit report. We did not find documentation of this review of private school participation in any of the 11 site visit reports we reviewed for fiscal year 1993-94. As a result, the OCJP may be providing inaccurate assurances in its reports to the DADP.
- In fiscal years 1992-93 and 1993-94, the OCJP did not ensure that it received all progress reports from each subrecipient of grant moneys. Specifically, the OCJP did not have all progress reports on file for 6 of the 20 subrecipients we reviewed for fiscal year 1992-93 and for one of the 20 subrecipients we reviewed for fiscal year 1993-94. The OCJP uses the data from these forms to prepare its progress reports to the DADP.

### **Criteria**

The United States Code, Title 20, Section 3192(b)(3), requires that not more than 10 percent of participants in innovative community-based high-risk programs may be individuals who are not high-risk youth. Moreover, the United States Code, Title 20, Section 3223(a), requires that the subrecipients of DFSC grant moneys shall, after consultation with appropriate private school representatives, make provision for including private school children and teachers and ensure equitable participation.

The fiscal year 1991-92 through 1993-94 interagency agreements between the OCJP and the DADP require that the OCJP include the following in its six-month written progress reports:

- A description of the OCJP's methodology for ensuring that all subrecipients provide documentation that 90 percent of students served with these funds shall be high-risk;
- Statistical information to ensure that 90 percent of students served under this agreement are high-risk; and
- A description of the OCJP's methodology for ensuring that those subrecipients that are using DFSC funds to implement school-based programs are notifying private schools of the availability of these funds.

In addition, in its fiscal year 1993-94 progress reports to the DADP, the OCJP states that it performs yearly site visits in which it reviews documentation of the percentage of high-risk youths served.

### **Recommendation**

The OCJP should ensure that all applicable subrecipients submit required progress reports and that the progress reports provide complete information to the DADP about guarantees that 90 percent of youths served in the DFSC program were high-risk youths. In addition, the OCJP should ensure that all applicable subrecipients submit an assurance that they will notify private schools of the availability of grant funds. Finally, the OCJP should note on its site visit reports that it specifically reviewed and verified documentation of the subrecipients' data on high-risk youth and notification to private schools.

### **Item 3. Audit Reports Not Submitted and Audit Findings Not Resolved Within Required Deadlines**

#### **Finding**

As of April 5, 1995, the OCJP had identified 238 delinquent audit reports from local government and nonprofit subrecipients. Also, from the audit reports that it had received, the OCJP identified approximately 220 audit reports with audit findings that remained unresolved after six months. The review and follow-up on these audit reports are part of the OCJP's system of monitoring subrecipients of federal funds under the DFSC and DCSI grants. Because of these backlogs, deficiencies in the subrecipients' administration of these programs will not be identified and resolved promptly, and the deficiencies may recur in subsequent grant periods. We reported a similar finding in our audit for fiscal year 1992-93.

These backlogs exist despite the progress the OCJP has made in reducing the number of delinquent audit reports and unresolved audit findings from prior years. OCJP records show that, of the 465 delinquent audit reports the OCJP identified as of December 31, 1992, only 63 had not been submitted to the OCJP by April 5, 1995. To help reduce the backlog of delinquencies, the OCJP has a policy of sending notices to remind subrecipients of the need to submit audit reports. Also, for certain reports

that are delinquent because the audit has not been performed, the OCJP contracts with an independent audit firm to perform the audits. Continued implementation of these procedures should result in additional reduction of delinquent audit reports.

#### **Criteria**

The federal Office of Management and Budget (OMB), Circular A-128, requires local governments receiving specified levels of federal moneys to have an annual audit completed within 12 months of the fiscal year end. For nonprofit organizations receiving specified levels of federal moneys, the OMB Circular A-133 requires completion of audits within 13 months of the end of the fiscal year being audited. The OCJP's grantee handbook requires the submission of the audit reports within 6 months of the subrecipient's fiscal year end.

OMB Circulars A-128 and A-133 require the grant recipient to monitor findings documented in subrecipient audit reports and to take corrective action within six months after receipt of the reports.

#### **Recommendation**

When subrecipients have not submitted audit reports within a specified time of the report due date, the OCJP should withhold payment on any subsequent requests for reimbursements. The OCJP should also refuse to fund in the future any subrecipient that fails to file audit reports. Finally, the OCJP should ensure prompt resolution of audit findings.

#### **Item 4. Lack of Monitoring of Grant Applicants' Equal Employment Opportunity Programs**

#### **Finding**

The OCJP could not document that it was fully complying with requirements for monitoring equal employment opportunity (EEO) programs for certain subrecipients of DCSI and DFSC grant moneys. We found the following specific conditions:

- For fiscal year 1991-92, the OCJP submitted for federal approval incomplete EEO program documents for 15 subrecipients awarded \$500,000 or more of DCSI moneys. The grant award required federal approval of these programs before the OCJP obligated or expended funds for these subrecipients. In April 1992, the OCJP announced new procedures to ensure compliance with this requirement for fiscal year 1992-93. We noted no noncompliance with the requirement for fiscal years 1992-93 and 1993-94.
- For fiscal years 1992-93 and 1993-94, the OCJP was unable to provide documentation that it had received and reviewed the EEO program documents for four of six subrecipients we reviewed that were awarded over \$25,000 in DFSC grant moneys. Applicants requesting \$25,000 or more in federal funds are required to submit

documentation related to their EEO programs for review by the OCJP. However, the OCJP does not always appropriately identify the level of federal funding on the grant award document for each subrecipient. As a result, the EEO unit, which is responsible for monitoring the subrecipients' submission of EEO documents, is not clearly informed about the source of funding and does not monitor the EEO programs for these subrecipients. Because of these problems with monitoring subrecipients' EEO programs, the OCJP lacks assurance that the subrecipients are in compliance with federal EEO requirements.

### **Criteria**

The 1991-92 federal grant award for the DCSI grant required the OCJP to submit to the federal government the EEO program documents for all subrecipients of \$500,000 or more in grant moneys. The grant award further required federal approval of these programs before the OCJP obligated or expended any of these funds.

The OCJP grantee handbook states that an applicant for federal grants with award amounts between \$25,000 and \$500,000 must submit a copy of its EEO program to the OCJP for review within 60 days of the date that the subrecipient's executive director signs the grant award face sheet.

### **Recommendation**

The OCJP should ensure that it identifies the correct funding source for grant applications for DFSC funds and review EEO program documents for appropriate applicants.

## **Item 5. Inadequate Documentation of Allocation of Direct and Indirect Support Costs**

### **Finding**

The OCJP was unable to provide sufficient documentation to support the amount of personal services costs it allocates to its federal grants. The OCJP allocates direct personal services support costs based on information provided by program branch managers. The managers' information consists of percentages that indicate the amount of time staff spend on the administration of various federal grants. However, the OCJP does not have a documented methodology for the managers to use for identifying these utilization percentages. Instead, it relies on the managers' estimates. In addition, the OCJP uses these same estimates to calculate the distribution percentages used for allocating indirect overhead costs to the federal program cost categories. Although these allocated costs appear reasonable and appropriate, the OCJP cannot ensure that it is charging direct and indirect support costs equitably among the federal programs it administers. We noted a similar problem in our audit for fiscal year 1992-93.

**Criteria**

The federal OMB Circular A-87 requires that costs charged to federal grants be allocated to grant programs in accordance with the benefits received.

**Recommendation**

The OCJP should develop and implement a documented methodology that would accurately and consistently identify the resources used to administer its federal grants. In addition, the OCJP should retain all supporting documentation used in preparing its cost allocation rates.

# Department of Economic Opportunity

We reviewed the Department of Economic Opportunity's (department) administration of the U.S. Department of Health and Human Services grants, Federal Catalog Nos. 93.568 and 93.569.

**Item 1.  
Excess Cash  
Balances  
Maintained By  
Subrecipients**

**Finding**

Contractors that received cash advances from the Community Services Block Grant (CSBG) program maintained excessive cash balances throughout fiscal year 1993-94. We examined the cash balances held by 20 contractors receiving funds from the CSBG program during fiscal year 1993-94. We defined as excessive those cash balances maintained by a contractor that exceeded 25 percent of the contractor's annual contract amount.

The table below summarizes the results of our review.

**Table Cash Balances Held by 20 Contractors**

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Number of contractors with excessive cash balances	0	12	9	10
Number of contractors with no excessive cash balances	16	4	3	1
Not applicable*	4	4	8	9
<b>Total Contractors Tested</b>	<b>20</b>	<b>20</b>	<b>20</b>	<b>20</b>

\* Contractors in this category include those that we did not determine whether they maintained excessive balances because of missing expenditure reports, expenditure reports that were not yet due, or expenditure reports that were not required.

As our table indicates, during the second quarter of their contracts, 12 of 16 contractors maintained excess cash balances. These cash balances totaled more than \$247,000. During the third quarter, 9 of 12 contractors maintained excess cash balances totaling almost \$365,000. During the fourth quarter, 10 of 11 contractors maintained excess cash balances

totaling more than \$420,000. Allowing contractors to maintain excess cash balances may cause the federal government to cease or limit the advancing of CSBG funds to the department.

According to the department's director, contractors maintained cash balances of CSBG funds that exceeded 25 percent because Section 12781 of the California Government Code requires the department to issue quarterly advances to contractors in an amount equal to 25 percent of the contractor's annual allocation for the contract period. The director further stated that state law does not allow the department to limit cash advances based on the contractor's immediate needs. Furthermore, although the department has a system in place to reduce the cash advances to subrecipients of the Low-Income Home Energy Assistance program grant who have excess cash balances, it does not have a similar system in place for subrecipients of the CSBG grant.

### **Criteria**

The Code of Federal Regulations, Title 31, Section 205.20, requires that cash advances to a state be limited to the minimum amounts required and be timed to be in accord only with the actual, immediate cash requirements of the State. Circular A-128, issued by the federal Office of Management and Budget, requires that cash advances made by the State to contractors, or other subrecipients, conform substantially to the same standards of timing and amount as apply to cash advances by federal agencies to primary recipients.

### **Recommendation**

The department should comply with federal regulations and guidance concerning limiting cash advances to contractors' immediate needs. To accomplish this, the department should seek to have state legislation passed that would amend existing law that requires it to issue cash advances of 25 percent each quarter. For example, the department could seek legislation that would allow it to issue cash advances of *up to* 25 percent each quarter depending on the immediate cash needs of the contractors.

## **Item 2. No Procedures To Assure That Energy Suppliers Do Not Discriminate**

### **Finding**

The department has not established procedures to assure that home energy suppliers it pays directly on behalf of eligible households agree to not discriminate against these households either in the costs of goods supplied or services provided. In a letter sent to energy suppliers participating in the direct payment program, the department provided information about crediting direct payments to households' accounts and confirming this information to the department. However, the department did not require the home energy suppliers to provide assurances that they will not discriminate against eligible households. According to the department's



director, aside from this letter, the department has no other agreement with home energy suppliers. Department information indicates that, through June 21, 1994, 12 utility companies received almost \$4.8 million from the department on behalf of more than 52,000 households. Failure to establish and implement procedures to assure that home energy suppliers do not discriminate against eligible households may jeopardize federal funding to the department.

### **Criteria**

The United States Code, Title 42, Section 8624(b)(7), requires that the department, if it pays home energy suppliers directly, establish procedures to assure that the home energy suppliers receiving direct payment agree not to discriminate, either in the cost of goods supplied or the services provided, against the eligible households on whose behalf the department makes payments.

### **Recommendation**

The department should establish procedures to assure that home energy suppliers receiving direct payment agree not to discriminate against eligible households on whose behalf the department makes payments.

### **Item 3. Failure To Comply With the Drug-Free Workplace Act**

### **Finding**

The department is not complying with the Drug-Free Workplace Act (act). The department does not have an ongoing drug-free awareness program. Specifically, the department does not provide follow-up information to employees regarding the hazards of drugs or information regarding the act. Also, the department did not provide a copy of the drug-free workplace policy statement to one of five employees we interviewed. Failure to comply with the act could jeopardize future receipt of federal funds.

### **Criteria**

The Drug-Free Workplace Act of 1988 requires grantees to publish a policy notifying employees that the unlawful manufacture, distribution, dispensing, possession, or use of a controlled substance is prohibited in the grantee's workplace, and specifying the actions that will be taken against the employees for violations of such prohibition. The act also requires that the department maintain an ongoing drug-free awareness program. In addition, the act requires grantees to give each employee engaged in the performance of the grant a copy of the policy.

### **Recommendation**

The department should comply with all requirements of the Drug-Free Workplace Act.

**Item 4.  
Noncompliance  
With Other  
Requirements**

**Findings and Criteria**

We noted the following instances when the department did not always comply with federal requirements or prudent business practices, or enforce contractual requirements:

- The department did not always limit cash advances to subrecipients that received funds from the Low-Income Home Energy Assistance program (LIHEAP). We examined the cash balances held by 15 subrecipients of LIHEAP funds. One of these 15 subrecipients maintained an excessive balance during two months of fiscal year 1993-94. We defined an excessive balance as one that exceeded 25 percent of the amount of the contract for a subrecipient. The Code of Federal Regulations, Title 31, Section 205.20, requires that cash advances to a state be limited to the minimum amounts required and be timed to be in accord with the actual, immediate cash requirements of the State. Circular A-128, issued by the federal Office of Management and Budget, requires that cash advances made by primary recipients to subrecipients conform substantially to the same standards of timing and amount as applied to cash advances by federal agencies to primary recipients.
- The department did not always correctly or completely report financial information regarding its use of federal funds to the State Department of Finance. Specifically, the department (1) incorrectly reported the date by one day that the State Controller's Office issued warrants for 2 of the 64 transactions that we reviewed, (2) incorrectly reported the date the State received federal funds for 2 of the 11 drawdown requests that we reviewed, (3) incorrectly included a transfer from another state department in one drawdown request, (4) did not include two claim schedules in a drawdown request, (5) incorrectly included a claim schedule in a drawdown request, and (6) did not report one drawdown request and three claim schedules to the State Department of Finance. Section 10.1 of the cash management agreement between the State of California and the Secretary of the U.S. Department of the Treasury requires that the department document on worksheets the amounts of funds requested from the federal government, the corresponding claim schedule amounts, the date the federal funds were deposited in the State's account, the date the warrants were issued, and the number of days of interest accrued on the federal funds.
- The department did not always approve contracts before contractors provided services. Of the 20 contracts that we reviewed, the department did not approve one contract until after the contractor provided services. In this one instance, the department did not

approve the 18-month contract until five days after it expired. Prudent business practices dictate that the department approve all contracts before the contractors begin work.

- The department did not fully enforce the terms of its contracts. To provide services under the CSBG program to California residents, the department contracts with service providers. These contracts require the service providers to periodically submit expenditure reports to the department. Of the 64 instances we reviewed, providers submitted only 11 (17.2 percent) expenditure reports within the required time. Providers submitted 40 expenditure reports (62.5 percent) late and, as of the conclusion of our audit, had not yet submitted 13 expenditure reports (20.3 percent). According to the terms of a contract to provide services to be paid with CSBG funds, a contractor is required to complete and submit an expenditure report to the department no later than the thirtieth day of the month following each calendar quarter.

### **Recommendation**

The department should improve its compliance with applicable federal requirements, follow prudent business practices, and ensure that its contractors comply with contractual requirements.

# Department of Finance

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

## **Item 1. Inaccurate Workload Data Used in the SWCAP and Prorata Allocations**

### **Finding**

The department's administrative services unit does not always submit correct Statewide Cost Allocation Plan workload data to its Fiscal Systems and Consulting Unit (FSCU). In our review of budgeting services provided to state agencies, we found that the 1991-92 actual data which is used to estimate the workload data for budget year 1993-94 were inaccurate and not fully supported. Specifically, we found the following deficiencies in the SWCAP workload data:

- In our test of 15 agencies for which the department prepares budgets, we found that the department's supporting documentation for 9 agencies did not agree with the workload data, resulting in a net understatement of 79 hours in the department's workload. In addition, for 4 of 9 agencies, the department was unable to provide employee timesheets to support 340 hours used in the plan.
- In our test of the 1991-92 summary of workload hours, we found that the total January 1992 summary was overstated by approximately 291 hours.
- We analyzed the employee timesheets for July 1991 and found that the department did not report 751 hours to the FSCU. In addition, we were not able to analyze the workload hours reported for the months of August 1991 through June 1992, because the employee timesheets and/or the monthly recaps were not available.

When the department does not include all pertinent data or makes errors in its workload calculations, the allocation of SWCAP and Prorata costs to state agencies may be over or understated. Consequently, SWCAP reimbursements charged to the federal government may be over or understated.

The Bureau of State Audits reported a similar weakness during the audit for fiscal year 1992-93 and the Office of the Auditor General reported a similar finding during its audits for fiscal years 1987-88 through 1990-91.

### Criteria

The federal Office of Management and Budget, Circular A-87, requires the State to charge the federal government only for allowable costs. In addition, the State Administrative Manual, Section 8752, requires state agencies to recover full costs for goods or services provided for other state agencies.

### Recommendation

The department should ensure that its workload data is accurate and fully supported.

## Item 2. Statewide Cost Allocation Plan Reimbursements Not Transferred Promptly

### Finding

In our review of fiscal year 1993-94 SWCAP reimbursements at nine departments, we found that six of these departments did not promptly request the State Controller's Office (SCO) to transfer reimbursements from the Federal Trust Fund to the State's General Fund. These reimbursements represent the federal government's share of service costs provided by the State's central service agencies. A state department that receives SWCAP reimbursements must request the SCO to transfer the reimbursement to the State's General Fund. The transfer request must also be approved by a budget analyst from the Department of Finance.

The following departments transferred SWCAP reimbursements more than 30 days after the end of a quarter. Eight of the ten transfers were more than two months late.

Department	Fiscal Year 1993-94 Quarter of Transfer	Number of Days Late
California Department of Education	First	35
Department of Fish and Game	First Second	186 94
Department of Health Services	Second	88
Department of Industrial Relations	First Second	137 45
Department of Toxic Substances Control	First Second	97 66
Office of Traffic Safety	First Second	171 79

**Criteria**

The California Government Code, Section 13332.01, requires departments to recover SWCAP costs from the federal government. Although no deadline is expressly mandated by the Government Code, the State Administrative Manual, Section 8755.2, stipulates that a transfer of SWCAP recoveries to the State's General Fund be accomplished within 30 days of the end of the quarter.

**Recommendation**

The department should monitor state departments to ensure that they transfer SWCAP recoveries in a timely manner.

**AGENCIES PERFORMING CENTRAL SERVICES  
FISCAL YEAR 1993-94**

Agency Name	Reviewed by the Bureau of State Audits
Department of Finance	X
Department of Justice	X
Department of Personnel Administration	
Health Benefits for Retired Annuitants (administered by the Public Employees' Retirement System)	X
Legislature	
Office of Administrative Law	
Bureau of State Audits	
Business, Transportation and Housing Agency	
Health and Welfare Agency	
Resources Agency	
State and Consumer Services	
Youth and Adult Correctional Agency	
State Board of Control	
State Controller's Office	X
State Library	
State Personnel Board	
State Treasurer's Office	
Environmental Protection Agency	

**ESTIMATED SWCAP AND PRORATA  
EXPENDITURES AND RECOVERIES  
FISCAL YEAR 1993-94  
(In millions)**

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Estimated SWCAP expenditures	\$445.0
Estimated SWCAP recoveries from the federal government	\$ 34.8
Percent of estimated recoveries	7.8%

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Estimated prorata expenditures	\$502.9
Estimated prorata recoveries from the State's special funds	\$187.2
Percent of estimated recoveries	37.2%

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Source: State of California, Department of Finance



## **Health and Welfare**

## Department of Aging

We reviewed the Department of Aging's (department) administration of the U.S. Department of Agriculture grant, Federal Catalog No. 10.550, and the U.S. Department of Health and Human Services grants, Federal Catalog Nos. 93.044 and 93.045.

### **Item 1. Failure To Monitor Area Agencies' Programs To Provide Supportive and Nutrition Services**

#### **Finding**

The department did not conduct performance evaluations of all the Area Agencies on Aging (agencies) as required. Specifically, the department's Community Services Branch did not conduct complete program evaluations, assessments, or on-site visits of the supportive services for 31 of the 33 agencies during fiscal year 1993-94. The department has agreed to perform site assessment visits of the agencies in order to determine the quality of the services being provided by the agencies. The department's Community Services Branch did not perform on-site visits for 31 of the 33 agencies. The department's Community Services Branch did perform desk reviews of all 33 agencies. However, while these reviews included some qualitative measures, they were primarily financial in nature and did not fully satisfy the qualitative compliance requirements of the programs being administered by the agencies. Also, the department's Audits Branch completed on-site reviews for 10 of the 33 agencies during fiscal year 1993-94. These audits included a review of whether the agencies were in compliance with applicable laws and regulations. In addition, the department did not conduct on-site performance evaluations of the nutrition services for 20 of the 33 agencies during the past two fiscal years. Failure to conduct evaluations of supportive services and nutrition services may prevent early detection and correction of irregularities or deficiencies in the services that the agencies provide.

The Bureau of State Audits reported a similar weakness during its audit for fiscal year 1992-93. In its response to that audit report, the department stated that its Community Services Branch had resumed supportive services performance monitoring and that the department's goal was to conduct on-site assessments of each agency and nutrition service provider at least once every two years.

#### **Criteria**

The United States Code, Title 42, Section 3027(a)(8), requires the department to conduct periodic evaluations of activities and projects carried out under Title III of the Older Americans Act. The Code of Federal Regulations, Title 45, Section 1321.3, defines periodic as, at a minimum, once each fiscal year. The department's Title III Program Manual, Part D, Paragraph 43.1(g), also requires the department to conduct periodic performance evaluations of the supportive services of the agencies. Furthermore, the department, in its 1993-1997 State Plan on

Aging, states that it will use contractor site assessment visits to ensure that quality service is provided to eligible persons. In addition, the department's goal is to conduct on-site evaluations of the nutrition services of the agencies at least every two years.

**Recommendation**

The department should conduct performance evaluations of the supportive services of all area agencies annually and on-site evaluations of the nutrition services of all area agencies at least every two years.

**Item 2.  
Improper Allocation  
of Indirect Costs**

**Finding**

The department charged approximately \$215,000 as direct costs to a federal program that should have been allocated as indirect costs to all the department's federal programs. Because the department did not allocate these costs as indirect costs, one of its federal programs was overcharged, and all the department's other federal programs that benefited from these services were undercharged.

**Criteria**

The Office of Management and Budget Circular A-87, Paragraph F(1), states that indirect costs should be distributed to benefiting cost objectives on bases that will produce an equitable result in consideration of relative benefits received.

**Recommendation**

The department should ensure that indirect costs are allocated to programs equitably in relation to the relative benefits received.

**Item 3.  
Inaccurate Federal  
Financial Reports**

**Finding**

The department's Federal Cash Transaction Reports for two of the four quarters we reviewed did not agree with the department's financial records. Specifically, for the quarters ending December 31, 1993, and March 31, 1994, the amount of federal cash on hand as indicated in the department's accounting records did not agree to the amount reported on its Federal Cash Transaction Reports by approximately \$11,000 and \$120,000, respectively. The department's Federal Cash Transaction Report for the quarter ended June 30, 1994, which included the cumulative effects of the previous quarters, did agree to the department's financial records.

**Criteria**

The Code of Federal Regulations, Title 45, Section 74.61(a), requires the department to submit accurate, current, and complete financial reports.

## **Recommendation**

The department should ensure that financial reports it submits to the federal government in the future contain accurate and reliable information.

### **Item 4. Inadequate Procedures To Ensure That Cash Advances Are Limited to Immediate Needs**

#### **Finding**

The department's procedures do not ensure that cash advances to agencies for its Title III programs are limited to the agencies' immediate needs. Although the department uses a forecasting worksheet to determine the advances, the department's current policies do not specify how its employees will determine whether an advance is appropriate or excessive. To determine if the advances the department made to agencies during fiscal year 1993-94 were limited to the agencies immediate needs, we selected 14 advances made by the department. We tested the advances against two different standards that we found were being used by the department's analysts to determine if a requested advance was appropriate. The first standard was 150 percent of the agency's average monthly expenditures compared to the requested advance plus any cash on hand. The second was one-twelfth of the agency's grant award compared to the requested advance plus any cash on hand. Additionally, we compared the amount of the advance to the amount that each agency actually expended. Five of the 14 advances we tested resulted in cash balances that were in excess of the agency's immediate needs. For example, one of the advances resulted in a cash balance that was approximately \$400,000 more than the immediate needs of the agency. As a result of the department's excessive cash advances, the federal government lost interest that it could have earned on the amounts that the department advanced too soon to agencies.

Additionally, we found that for at least one subrecipient, a similar condition exists in another program the department administers—the Senior Community Services Employment Program (Federal Catalog No. 17.235). We tested one advance and found that the subrecipient had an excess cash balance of approximately \$36,000.

#### **Criteria**

The Code of Federal Regulations, Title 31, Section 205.4(a), requires that advances to a recipient organization be limited to minimum amounts needed and shall be timed in accordance only with the actual, immediate cash requirements of the recipient organization in carrying out the purpose of the program.

#### **Recommendation**

The department should establish procedures to ensure that advances to subrecipients are limited to the immediate needs of the recipient.

## Department of Alcohol and Drug Programs

We reviewed the Department of Alcohol and Drug Programs' (department) administration of the U.S. Department of Education grant, Federal Catalog No. 84.186, and the U.S. Department of Health and Human Services grant, Federal Catalog No. 93.959.

**Item 1.  
Certain Costs  
Were Incorrectly  
Classified and  
May Not Be a  
Prudent Use of  
Federal Funds**

**Finding**

As part of the audit for fiscal year 1993-94, we reviewed the use of federal funds to pay for the National Association of State Alcohol and Drug Abuse Directors, Inc. (NASADAD) conference held in San Diego, California in June 1994. Specifically, we reviewed supporting documents and determined that the department spent at least \$195,900 in federal grant funds to plan, promote, manage, and attend the conference. This includes approximately \$7,700 that the department paid for employee travel and lodging related to planning the conference. While we believe the conference as a whole was beneficial to the State, we question the propriety of certain expenditures related to the conference.

Our review of conference expenditures indicated that the department paid a disproportionate share of the expenses. Not only did the department assign 6 of its own staff to attend periodic planning committee meetings, the department also paid approximately \$19,000 in travel and lodging expenses for 13 representatives of other states who attended planning committee meetings and 2 individuals who were presented special awards at the conference. These payments were in addition to approximately \$153,000 paid to two subcontractors for professional conference promotion and planning.

Furthermore, the conference did not attract as many participants as the planners envisioned, and the total number of hotel rooms used by conference attendees was less than anticipated. As a result, the department was required to pay a \$50,000 fee to compensate the Hotel del Coronado for last-minute cancellations by conference participants. While it appears to be standard practice for groups that sponsor conferences to agree to pay fees if hotel reservations are canceled at the last minute, we believe the department could have minimized the impact of such a costly penalty by reserving a smaller block of rooms.

The department also reduced conference revenues by waiving registration fees for certain federal officials, NASADAD staff members, and members of the press. It does not appear that the State always received a direct benefit in exchange for waiving these fees.

Conference-related expenditures were funded with a combination of registration fees paid by conference participants, miscellaneous conference income, and the federal Block Grant for Prevention and Treatment of Substance Abuse (SAPT). Registration fees and other miscellaneous conference income did not cover the total cost of the conference. As discussed above, \$195,900 of conference expenses were funded by the SAPT block grant. Therefore, the liability assumed by the department as a result of the penalty assessed by the hotel and each registration fee waived resulted in a direct increase in the amount paid by the SAPT block grant. We question the propriety of these transactions and the resulting increased expenditure of California's SAPT block grant funds.

### **Criteria**

The department is responsible for properly allocating expenses between state operations and local assistance. In addition, as a recipient of the SAPT block grant, the department is required to limit state administrative costs to 5 percent of the grant. We found that a majority of expenses for the conference were allocated to local assistance and were not reflected in the calculation of administrative costs as reported in subsequent SAPT block grant applications. Further, we believe the conference expenses are not properly allocated to local assistance since the Governor's Budget defines local assistance as expenditures made for the support of local government activities.

Apparently, the department agreed that conference expenses should be reported as administrative costs subject to the 5 percent cap because in his May 27, 1994, letter to the director of the U.S. Department of Health and Human Services' Center for Substance Abuse Treatment, the department's director stated that conference expenses were "one time federal administrative moneys from the Federal Fiscal Year (FFY) 1993 SAPT Block Grant." We noted similar inconsistencies in the accounting and reporting of certain nonconference expenditures. As a result, the department has not accurately calculated total administrative costs and cannot ensure that it has not exceeded the 5 percent administrative cap imposed by the SAPT block grant.

### **Recommendation**

The department should recompute the amount of state administrative costs that are to be charged to the 1993-94 SAPT block grant, including in its recomputation the expenses associated with the NASADAD conference.

## **Item 2. Improper Use of Federal Funds**

### **Finding**

The department improperly withheld \$9,080 from an advance payable to the County of Los Angeles under the federal Drug-Free Schools and Communities grant to pay fees that the county owed to the department.

### **Criteria**

The Code of Federal Regulations, Title 34, Subtitle A, Section 80.21(g)(1), prohibits awarding agencies from withholding payments to grantees or subgrantees unless the grantees or subgrantees have failed to comply with the terms of the grant or are indebted to the United States. In addition, the Code of Federal Regulations, Section 80.37(a)(4), requires states to conform any advances of grant funds to subgrantees substantially to the same standards of timing and amount that apply to cash advances by federal agencies.

### **Recommendation**

The department should ensure that it only withholds federal grant payments from subgrantees for purposes authorized by the federal government.

### **Item 3. Inadequate Monitoring of Subrecipient Cost Reports Resulted in Lost Federal Funds**

### **Finding**

The department did not adequately review and settle subrecipient cost reports timely to ensure that federal grant monies were appropriately spent within the period designated by the grant. As a result, approximately \$271,000 returned to the department by subrecipients was subsequently returned to the federal government because the funds were not expended during the allowable period. If the department had reviewed subrecipient cost reports timely, the funds could have been reallocated to other subrecipients and spent before the grant period expired. In addition, approximately \$831,000 returned to the department by subrecipients was transferred to subsequent grant years and expended. These funds should have been returned to the federal government since they were not obligated or expended during the period designated by the grant award. Failure to comply with the terms of the grant and relevant regulations may result in the future reduction of federal funding.

### **Criteria**

The United States Code, Section 300x-62, requires federal funds distributed to subrecipients to be expended prior to the end of the year following the grant award or within one year of the date the funds were paid to the state, whichever is later. Further, the Notice of Block Grant Award requires funds awarded under the SAPT block grant to be obligated by the end of the grant award year and expended by the end of the subsequent year.

### **Recommendation**

The department should adequately monitor subrecipient cost reports so that it appropriately spends federal funds within the period designated by the grant.

**Item 4.  
The Federal  
Financial Status  
Reports for Specific  
Grants Do Not  
Agree With the  
Department's  
Accounting Records**

**Finding**

The department's federal financial status reports for the Critical Populations and Criminal Justice (Non-Incarcerated) grants for the 1993 federal fiscal year contain indirect expense information that does not reconcile with the department's accounting records. Specifically, the department reported the federal share of indirect expense for the Critical Populations grant as \$54,052, while the accounting records indicated the federal share was only \$35,930. For the Criminal Justice (Non-Incarcerated) grant, the department reported the federal share of indirect expense as \$3,487, while the federal share was only \$1,860, according to the accounting records. Because the department charged the federal grants for expenses reported in their accounting records, instead of the amount reported on the federal financial status reports, the department did not overcharge the federal government. However, inaccurate federal financial reports impact the federal government's ability to properly monitor these federal grants.

**Criteria**

The Code of Federal Regulations, Title 45, Section 92.20(b)(1), requires accurate, current, and complete disclosure of the financial results of each project or program in accordance with the financial reporting requirements of the grant or subgrant.

**Recommendation**

The department should ensure that financial status reports submitted to the federal government are accurate.

**Item 5.  
Administrative  
Costs Charged to  
the Drug-Free  
Schools and  
Communities Grant  
Exceeded Allowable  
Costs**

**Finding**

For fiscal year 1993-94, the department spent approximately \$494,000 in federal funds to administer the Drug-Free Schools and Communities (DFSC) grant. These costs exceeded administrative costs allowed by the grant by approximately \$238,000. We noted that the department does not compare budgeted administrative costs to actual year-end administrative costs. The department budgets administrative costs using the 2.5 percent allowed by the United States Code, Title 20, Section 3191(a). However, because it does not have procedures in place to evaluate projected versus actual expenditures, the department cannot ensure that it has complied with administrative cost limitations.

**Criteria**

The United States Code, Title 20, Section 3191(a), limits state-level expenditures for administrative costs of the DFSC grant to 2.5 percent of the total grant amount paid to the State. Further, the Code of Federal Regulations, Title 34, Section 74.61(d), requires the State to compare the actual and budgeted administrative costs for each grant.



## **Recommendation**

The department should periodically compare actual to budgeted administrative costs and establish procedures to ensure that the cost of administering federal grants does not exceed limitations imposed by the federal government.

### **Item 6. Failure to Adequately Monitor Subrecipient Cash Balances**

#### **Finding**

The department does not have adequate procedures to monitor the cash balances of subrecipients of the Substance Abuse Prevention and Treatment (SAPT) block grant and the Drug-Free Schools and Communities—State Grants (DFSC). During our review of federal cash transaction quarterly reports for 14 counties, we found that 2 counties reported cash balances that would last more than 30 days. We determined that the department did not withhold or adjust subsequent monthly disbursements for either of these counties. Further, we determined that 6 counties reported cash receipts from the department that did not agree with the department's records and 4 of the 14 counties tested submitted their federal cash transaction quarterly reports between 8 days and 6 months late. Two counties had not yet submitted their reports as of the end of our fieldwork.

Without adequate procedures to monitor cash balances of subrecipients, the department cannot be sure that it limits monthly cash advances to the minimum and immediate 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 cash needs, it could jeopardize future advances of federal grant funds.

We reported similar weaknesses in our report for fiscal year 1992-93. Further, the Office of the Auditor General reported similar weaknesses during its audits for fiscal years 1989-90 through 1991-92. In its June 9, 1994, response to the fiscal year 1992-93 report, the department indicated that during fiscal year 1993-94, it would continue to implement procedures for monitoring subrecipients' cash balances and for advancing them money for federally funded programs.

#### **Criteria**

The Code of Federal Regulations, Title 31, Section 205.7(d), requires that cash advances to a primary recipient be limited to the minimum amounts required to meet the actual, immediate cash needs of the recipient. The timing and amount of cash advances must be as close as administratively feasible to the actual disbursements by the recipient for program costs.

### **Recommendation**

The department should reconcile quarterly cash reports submitted by subrecipients to department records so that the department is aware of the cash needs of each subrecipient. Further, the department should analyze quarterly cash reports to determine whether it needs to adjust cash advances so that it limits cash on hand to amounts required for immediate needs. Finally, the department should ensure that the subrecipients promptly submit quarterly cash reports to the department.

### **Item 7. The Department Was Late 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 found that for 8 of 10 Drug-Free Schools and Communities (DFSC) claims tested, the department was from one to 14 days late sending the claim schedules to the State Controllers Office (SCO) for payment processing. The total length of time between fund draw and disbursement for the 10 claims was from 4 to 21 days. For 2 of 21 Substance and Abuse Prevention and Treatment block grant claims tested, the department was one and 15 days late sending the claim schedules to the SCO. The total length of time between fund draw and disbursement for the 2 claims was 10 and 31 days.

#### **Criteria**

The Code of Federal Regulations, Title 31, Section 205.7(b), requires the State to minimize the time elapsing between the transfer of funds and the pay out of funds for program purposes. Further, Title 31, Section 205.7(c)(4), provides that a State shall request funds not more than 3 business days prior to the day on which it makes a disbursement .

#### **Recommendation**

The department should improve its compliance with federal regulations by minimizing the amount of time between the receipt of federal funds and the actual disbursement of funds for program purposes.

### **Item 8. Noncompliance With Certain State and Federal Requirements**

#### **Finding and Criteria**

We noted the following instances where the department did not always comply with administrative requirements of the State and federal government:

- The department did not adequately monitor its interagency agreement and contracts for the Drug-Free Schools and Communities (DFSC) grant. Specifically, reports submitted by the Office of Criminal Justice Planning (OCJP) did not always contain statistical information or a comprehensive description of overall program effectiveness as required

by the terms of the interagency agreement. Also, the department was unable to provide evidence that it consistently performed quarterly site reviews as required under the terms of the interagency agreement. For 4 of the 10 project files reviewed, the subrecipients did not always submit required reports in a timely manner. Because the department did not adequately monitor its interagency agreement and contracts, it cannot ensure that subrecipients of the DFSC grant have achieved their performance goals, accurately reported program results, or complied with relevant federal requirements. The Code of Federal Regulations, Title 34, Subtitle A, Part 80, Section 80.40(a), assigns responsibility for managing the day to day operations of grant and subgrant supported activities to the State. Further, the State must monitor grant and subgrant supported activities to ensure compliance with applicable federal requirements and that the State and its subgrantees meet performance goals.

- The department did not ensure the accuracy of the documents it prepared to request federal funds. Specifically, 8 of 12 federal fund requests tested for the Substance Abuse Prevention and Treatment (SAPT) block grant contained errors, corrections, or adjustments. To correct the errors, the department completed numerous federal funds transfer and offset letters. Excessive errors require additional staff time to correct and may result in inaccurate federal financial reports or cause the department to request federal funds before they are needed. As a result, the department may be subject to unnecessary interest charges. The California Government Code, Section 13401, requires agencies to ensure that a satisfactory system of internal controls is in place to provide effective accounting control over assets, liabilities, revenues, and expenditures.
- The department did not conduct independent peer reviews of alcohol and drug treatment providers receiving funds from the SAPT block grant during the 1993-94 fiscal year. The United States Code, Title 42, Section 300x-53(a)(1)(A), 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 SAPT block grant. Without independent peer reviews, the department cannot ensure that treatment providers have met performance goals or provided services consistent with the objectives of the SAPT block grant.
- The State did not maintain its level of effort in administering the SAPT block grant. The United States Code, Title 42, Section 300x-30, requires the State to maintain expenditures for authorized activities at a level equal to or greater than the average expenditures maintained by the State for the two-year period preceding the fiscal year of the block grant award year. However, during the 1993-94 state fiscal year, the

State expended approximately \$1.2 million less than the two-year average calculated by the department. Failure to maintain fiscal effort may result in the reduction of future federal grant monies.

**Recommendation**

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

# Employment Development Department

We 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 Nos. 17.207, 17.225, 17.245, 17.246, 17.250, and U.S. Federal Emergency Management Agency grant, Federal Catalog No. 83.516.

**Item 1.**  
**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 13 months after the end of the State's fiscal year. The department is responsible for monitoring the private nonprofit subrecipients of JTPA funds. We selected for review eight nonprofit subrecipients to determine when their audit reports were submitted. We found that two audit reports were submitted more than 13 months after the end of the State's fiscal year. If the audit division does not receive audit reports within 13 months after the end of the State's fiscal year, it may not be notified in a timely manner of major instances of noncompliance with federal laws and program regulations. Thus, the department may be delayed in implementing corrective action.

The Bureau of State Audits reported a similar weakness during the audit for fiscal years 1991-92 and 1992-93. In June 1994, the department responded that it would document procedures for follow up on delinquent Service Delivery Area reports in the Job Training Partnership Division's Standard Procedures and the Audit Division's Procedures Manual. We attempted to review the procedures; however, as of February 10, 1995, the department had not documented the procedures.

## **Criteria**

The Office of Management and Budget (OMB), Circular A-133, Section 15(i), requires that audits be completed and the report submitted no later than 13 months after the end of the State's fiscal year.

## **Recommendation**

The department should document the procedures for follow up of delinquent reports and inform the Service Delivery Area's of the procedures. Also, the department should ensure that subrecipients submit audit reports within the federally-required timeframe.

**Item 2.  
Late Resolution of  
Audit Reports**

**Finding**

In fiscal year 1993-94, the department did not always issue final determination letters regarding audit resolution within six months after the department's audit division received the final audit report. We reviewed 15 of 65 Job Training Partnership Act subrecipients' audit reports that had final determination due dates during fiscal year 1993-94. For 8 of the 15 reports, the department did not issue final determination letters within six months after receiving the reports. Furthermore, as of April 19, 1995, the department still had not issued final determination letters for 3 of the 8 reports, even though it received the audit reports in August 1993, April 1994, and June 1994. Failure to resolve questioned costs and administrative findings can result in additional questioned costs if the subgrantees do not correct deficiencies in their internal controls within a reasonable time.

The Bureau of State Audits reported a similar weakness during the audit for fiscal years 1991-92 and 1992-93, and the Office of the Auditor General reported a similar weakness during its audits for fiscal years 1984-85 through 1990-91. In fiscal years 1991-92 and 1992-93, we saw improvement in the number of audit reports resolved late. The department attributed this improvement to the increased emphasis on this function by its Job Training Partnership Division (JTPD) and the comprehensive logging of resolution activities. However, during our current audit we found that the JTPD had not updated its resolution activities database since November 1993. As a result, although the total number of audit reports decreased from 72 in fiscal year 1992-93 to 65 in fiscal year 1993-94, the number of reports with late resolutions increased from 5 to 8.

**Criteria**

OMB Circular A-128, Section 14, and Circular A-133, Section 16(b), require the department to make an audit resolution within six months after receipt of the audit report and to proceed with corrective action as soon as possible.

**Recommendation**

The department should attempt to reduce delays in the resolution of audits so that it can resolve questioned costs and administrative findings in all subgrantees' audit reports within the required timeframe. In addition, the department should update its resolution activities database in order to monitor the status of these resolutions.

**Item 3.  
Insufficient  
Monitoring of  
Subrecipients' Cash  
Balances**

**Finding**

The department did not consistently monitor the cash balances of its Job Training Partnership Act (JTPA) subrecipients. For fiscal year 1993-94, we noted the following activity:

- The Job Training Partnership Division (JTPD) was responsible for monitoring subrecipients' cash balances during the period from July 1993 through May 1994. During this period, the department required its subrecipients to submit monthly status of cash reports. In February 1994, the JTPD properly followed up with those subrecipients whose monthly status of cash reports indicated that they had excess cash from July 1993 through September 1993. However, the JTPD did not follow up with subrecipients that had excess cash during the period October 1993 through May 1994.
- In June 1994, the department transferred the monitoring responsibility from the JTPD to the Evaluation Division. As of December 1994, the Evaluation Division had not completed developing its procedures. Further, the department no longer requires its subrecipients to submit monthly status of cash reports. Accordingly, the department has no assurance that subrecipients' cash balances are reasonable to meet their needs.

The Bureau of State Audits reported a similar weakness during the audit for fiscal years 1991-92 and 1992-93. The department responded that it initiated a tracking system of the subrecipients' monthly status of cash reports and, in the future, would perform appropriate follow-up within 30 days. In addition, the department stated that the Evaluation Division would conduct on-site monitoring of subrecipients' cash management systems.

**Criteria**

The Code of Federal Regulations, Title 31, Section 205.7 (d), requires that the amount of funds transferred to a State shall be limited to the minimum required to meet the State's actual, immediate cash needs. Circular A-128, issued by the federal Office of Management and Budget, requires that cash advances made by primary recipients to subrecipients conform substantially to the same standards of timing and amount as apply to cash advances by federal agencies to primary recipients.

**Recommendation**

The department should improve its compliance with the federal requirements. Also, the Evaluation Division should develop procedures for on-site reviews and conduct on-site reviews of the subrecipients' cash management systems.

**Item 4.  
Relevant Sections of  
Federal Expenditure  
Report Do Not  
Reconcile**

**Finding**

Throughout fiscal year 1993-94, the department did not properly reconcile or explain two sections of its quarterly reports showing the expenditures of federal funds for unemployment compensation paid to federal employees and ex-service members. For example, for the quarter ending December 31, 1993, the difference between the two sections totaled more than \$1.4 million. Further, the department did not explain the difference in the report as required.

The quarterly report is a summary of expenditures charged to federal unemployment programs for unemployment compensation paid to federal employees and ex-service members. Section A of the report summarizes total expenditures charged to the 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. 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 cash solvency of the federal fund that reimburses the State for unemployment compensation benefits paid to federal employees and ex-service members.

In response to the audit for fiscal year 1992-93, the department stated that it was working on a report that will validate the accuracy of the benefit payment information. Further, it stated that the complete reconciliation of Sections A and B of the quarterly report will not be achieved until pending programming requirements are accomplished. The department anticipates that the reconciliation of Sections A and B of the quarterly report will occur in early 1996.

**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 proceed with its work group so that it can submit reports free of any differences between the two sections of the report. Until the report is reconciled, the department should identify the reason for any differences on the report.



**Item 5.  
Noncompliance  
With Prompt  
Payment Standards  
for Unemployment  
Benefits.**

**Finding**

For the 12 months ending March 31, 1994, the department did not comply with federal prompt payment standards for first-time payments of unemployment benefits for all interstate claims. On average, the department paid promptly only 58 percent of first-time unemployment benefit payments for all interstate claims. This is an improvement over the prior 12 months ending March 31, 1993, when the department paid only 47 percent of the first-time unemployment benefit requests for interstate claims. The federal prompt payment standard is 70 percent.

The Bureau of State Audits reported a similar weakness during the audit for fiscal years 1991-92 and 1992-93. The department responded that it has taken several corrective measures to improve the timeliness of the first-time unemployment payments and expects further improvements when its system automatically generates claim forms for new interstate claims.

**Criteria**

The Code of Federal Regulations, Title 20, Section 640.5, requires that on an annual basis, the State must pay at least 70 percent 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.

## 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. Weaknesses in Accounting for Assets**

#### **Finding**

The data center did not record in its accounting records all fixed assets acquired during the fiscal year. Specifically, the data center did not record equipment and software purchased on installment contract totaling approximately \$10.4 million and another software acquisition totaling approximately \$190,000 even though these items were received and accepted or placed in service before June 30. The omission of the installment contract purchase caused the data center's financial statements to be materially misstated. As a result, the data center had to revise its financial statements.

#### **Criteria**

The State Administrative Manual, Section 8632, requires state agencies to record assets acquired by installment contract in the accounting records as if the asset was purchased at the inception of the contract. In addition, Section 8621 provides the basic accounting rules for fixed assets, and Section 8660 requires state agencies to report fixed assets in the year-end financial statements.

#### **Recommendation**

The data center should record fixed assets in accordance with the State Administrative Manual.

### **Item 2. Weaknesses in Control Over Fixed Assets**

#### **Finding**

The data center has weaknesses in its control over fixed assets. Specifically, the data center has not taken a complete inventory of its fixed assets and reconciled the physical count with the accounting records within the last three fiscal years as required by the State Administrative Manual. The data center performed its last complete inventory in July 1990. In addition, the data center does not always promptly place property identification tags on its fixed assets. Three of the eight pieces of equipment we tested had no identification tags. The data center's failure to maintain sufficient accountability for its fixed assets prevents prompt detection of errors and exposes state property to increased risk of loss.

#### **Criteria**

The State Administrative Manual, Section 8652, requires a physical count of all property at least once every three years and requires a reconciliation

of the physical count with the accounting records. In addition, Section 8651 of the State Administrative Manual requires state agencies to place property identification tags on all state property when practical.

**Recommendation**

The data center should comply with the requirements contained in the State Administrative Manual to strengthen its control over state property.

**Item 3.  
Noncompliance  
With State  
Requirements**

**Finding and Criteria**

In the following instance, the data center did not comply with administrative requirements of the State.

- The data center did not prepare and forward to the accounting unit stock received reports for the 11 purchases of goods we tested. Stock received reports provide the accounting unit with information on the identity, condition, and quantity of goods received. The State Administrative Manual, Section 8422.20, requires that the original stock received report or a signed copy of the order used as a stock received report be forwarded directly to the accounting unit on the day the goods are received.

**Recommendation**

The data center should improve its compliance with state requirements.

## Department of Health Services

We 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 No. 10.557, and the U.S. Department of Health and Human Services grants, Federal Catalog Nos. 93.565, 93.566, 93.778, and 93.994.

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

#### **Finding**

The department did not accurately prepare its financial reports for fiscal year 1993-94 for its Health Care Deposit Fund, General Fund, and Cigarette and Tobacco Products Surtax Fund—Health Education Account. During our audit, we noted the following conditions:

- The department accrued an accounts receivable in the Health Care Deposit Fund and a related deferred receivable twice in its financial statements at June 30, 1994. Because it posted the accrual twice, the department overstated its accounts receivable and deferred accounts receivable balances by \$134 million. Additionally, the department did not analyze its accounts receivable balance to identify the amounts it expected to receive in the ensuing 12 months. Because it did not analyze its receivables, the department understated its accounts receivable balance by approximately \$72 million. Also, because the drug rebates the department receives reduce the amount it has to pay to drug manufacturers, the department's accounts payable balance was understated by \$72 million.
- The department did not accurately analyze and report its encumbrances at June 30, 1994, in two departmental funds for which we reviewed encumbrances. Encumbrances represent goods and services ordered but not received by June 30. Although the department implemented new procedures to address a similar weakness reported in our audit of fiscal year 1992-93, additional efforts are needed to ensure that encumbrances are analyzed and reported accurately. For its General Fund, the department understated encumbrances by approximately \$3.1 million. For its Cigarette and Tobacco Products Surtax Fund—Health Education Account, the department understated encumbrances by approximately \$13.2 million.

Failure to accurately analyze and report 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.

The Bureau of State Audits reported a similar weakness during its audits for fiscal years 1991-92 and 1992-93.

### **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 receivables that were not previously billed or accrued but which are expected to be collected within the ensuing year. The State Administrative Manual, Section 7952, requires the department to disclose in its Report of Accruals to Controller's Accounts the portions of its liability accruals that represent encumbrances. Finally, the State Administrative Manual, Section 10544, requires agencies to record as liabilities only those amounts relating to valid obligations as of June 30.

### **Recommendation**

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

## **Item 2. 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, 1994, these receivables totaled approximately \$421 million. We found the following specific deficiencies:

- The department did not maintain proper separation of duties. The employee who maintained the receivable ledger also received and deposited the invoiced remittances from the drug manufacturers. 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 risk that some receivables will become uncollectable.
- 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.

The Bureau of State Audits reported a similar weakness during its audits for fiscal years 1991-92 and 1992-93.

In November 1993, in response to an audit report submitted by federal auditors, the department agreed with similar findings and stated that it expected to have a system in place by December 1993 which would provide for the accurate reporting of drug rebates and timely collection of accounts receivable. Although the department has improved some of the internal control weaknesses previously reported, it has yet to implement a system that provides for accurate reporting of drug rebates and timely collection of accounts receivable.

#### **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. 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 the department to reconcile subsidiary ledgers 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 3. Unamended Indirect Charges**

#### **Finding**

For fiscal year 1992-93, the Bureau of State Audits reported that although the department's proposed Cost Allocation Plan had not been approved by the federal Department of Health and Human Services, the department allocated its indirect costs of federal programs based on the Cost Allocation Plan. Subsequently, the department submitted and received, in April 1994, approval of an Indirect Cost Rate Proposal (ICRP) for fiscal year 1992-93. The department informed us during our fiscal year 1992-93 audit that it planned to adjust the indirect costs charged for fiscal year 1992-93 at the closeout of each federal program to agree with rates in the approved ICRP. However, as of April 1995, the department had not made any adjustments to the accounting records or to its reports to the federal government for the differences between the allocated costs and the approved rates in the 1992-93 ICRP for the Medical Assistance program and Maternal and Child Health Services Block Grant to the States.

#### **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.

#### **Recommendation**

The department should ensure that it adjusts its indirect costs for each federal program to agree with the rates approved in the ICRP.

#### **Item 4. Food Vouchers Issued to Unauthorized Vendors**

#### **Finding**

The department cannot document that it adequately notifies local agencies who receive federal Special Supplemental Food Program for Women, Infants, and Children (WIC) moneys of unauthorized vendors and that local agencies return any unauthorized vendor cards. For 5 of the 18 unauthorized vendors tested, we found that the department could not provide us with evidence that it notified the appropriate local agencies that these vendors were no longer authorized to participate in the WIC program. As a result, the local agencies continued to issue food vouchers for these unauthorized vendors. For the remaining 13 vendors, the department did have evidence it notified the local agencies. If the department does not notify the local agencies that a vendor is no longer authorized to participate in the WIC program and ensure that the local agencies return unauthorized vendor cards, the local agencies may continue to issue food vouchers for unauthorized vendors.

The chief of the WIC Branch stated that the department is currently implementing a new on-line eligibility system that will allow local agencies to determine if a vendor is authorized to participate in the WIC program. This new system would make the vendor cards obsolete.

The Bureau of State Audits reported a similar weakness during its audit for fiscal year 1992-93.

#### **Criteria**

The Code of Federal Regulations, Title 7, Sections 246.12(e) and (f), requires that only vendors authorized by the state agency may redeem food instruments and the state agency shall ensure that all participating food vendors have written contracts or agreements with the state. In addition, the WIC state plan states that the department will notify local agencies of the vendors deleted from the WIC program.

#### **Recommendation**

The department should ensure that it notifies local agencies not yet on the new system of all unauthorized vendors and that local agencies return any unauthorized vendor cards.

**Item 5.  
Food Vouchers  
Not Reconciled  
Promptly**

**Finding**

For the first nine months of fiscal year 1993-94, the department reconciled less than 1 percent of the food vouchers it issued with the food vouchers participants redeemed through the WIC program by the required timelines. In addition, the department was late in reconciling 30 percent of the food vouchers for April 1994 and 36 percent of the food vouchers for the remaining two months of the fiscal year. The department is required to complete the reconciliation within 150 days of the first day of authorized use. Failure to promptly reconcile the vouchers may delay detection of irregularities such as redemption of fraudulent food vouchers.

The Bureau of State Audits reported a similar weakness during its audits for fiscal years 1991-92 and 1992-93, and the Office of the Auditor General reported a similar weakness during its audits for fiscal years 1987-88 through 1990-91.

**Criteria**

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

**Recommendation**

The department should continue its efforts to reconcile the food vouchers it issued with the food vouchers redeemed by participants within the required timelines.

**Item 6.  
Lack of Site Reviews  
and Nutrition  
Education  
Evaluations**

**Finding**

The department did not conduct all required biennial site reviews for the administration of its WIC program. Specifically, the department did not conduct biennial site reviews during the two years ending September 30, 1994, for 46 of the 80 local 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. Additionally, the department did not perform annual nutrition education evaluations of the 80 local agencies. Because the department did not perform nutrition education evaluations at the local agencies, it lacks assurance that the local agencies are providing adequate nutrition education services to the WIC participants.

The Bureau of State Audits reported a similar weakness relating to the lack of site reviews during its audits for fiscal years 1991-92 and 1992-93.



### **Criteria**

The Child Nutrition Act of 1966, Section 17(f)(21), requires the department to conduct monitoring reviews of each local agency at least biennially. Additionally, the California State Plan for the WIC program requires the department to conduct a biennial site review at each local agency. The Code of Federal Regulations, Title 7, Section 246.11(c)(5), requires the department to perform annual nutrition education evaluations of the local agencies.

### **Recommendation**

The department should complete biennial site reviews and annual nutrition education evaluations of the local agencies participating in the WIC program.

## **Item 7. Failure To Detect Instances of Dual Participation**

### **Finding**

The department did not implement procedures to prevent and detect instances of dual participation in the WIC program. In July 1987, the department suspended its existing procedures for detecting dual enrollment because the procedures did not operate as intended and produced inaccurate reports. In December 1993, the department decided to implement an interim system of dual participation detection until a new automated system being developed became operational. Under the interim system, the department would produce a dual enrollment report once a year that identifies possible instances of dual participation. This report would be forwarded to the local agencies, which would investigate the possible dual enrollment and report back to the department. Although this interim system had not been implemented as of July 1994, the department informed us that it sent a dual participation report to the local agencies for their review in December 1994.

The chief of the WIC Branch stated that the new automated system is currently being implemented which will allow the local agencies to immediately determine whether an applicant is already receiving benefits.

The Bureau of State Audits reported a similar weakness during its audits for fiscal years 1991-92 and 1992-93, and the Office of the Auditor General reported a similar weakness during its audits for fiscal years 1987-88 through 1990-91.

### **Criteria**

The Code of Federal Regulations, Title 7, Section 246.7(k), requires the department, in conjunction with the local agency, to prevent and detect instances of dual participation.

## **Recommendation**

The department should continue its efforts to establish and implement reliable procedures to prevent and detect instances of dual participation.

### **Item 8. Insufficient Monitoring of Audit Reports for Nonprofit Subrecipients**

#### **Finding**

The department did not sufficiently monitor the audit reports of nonprofit subrecipients participating in the Maternal and Child Health (MCH) Services Block Grant to the States program. We identified 40 audit reports that subrecipients should have submitted to the department and found the following:

- The department was unable to provide us with 16 of the 40 MCH nonprofit subrecipient audit reports that should have been submitted to the department. Eight of these 16 nonprofit subrecipients were not included on the department's database that it uses to monitor the receipt of required reports from subrecipients. For the remaining 8 subrecipients as of April 13, 1995, 5 were sent reminder notices and 3 were not sent reminder notices. Without the audit reports, and without a comprehensive database to track subrecipients, the department lacks assurance that the nonprofit subrecipients are complying with federal laws and regulations.
- Of the 24 audit reports that the department did receive, 20 audit reports were not received within the timeframe established in the contracts. Also, 1 of the 20 reports was not received within the longer timeframe established by federal regulations.
- Additionally, the department did not review within six months 9 of the 24 audit reports it did receive. Without prompt review of the reports, the department cannot ensure that it resolves audit findings within the required timeframe.

The Bureau of State Audits reported a similar weakness during the audits for fiscal years 1991-92 and 1992-93, and the Office of the Auditor General reported a similar weakness during its audits for fiscal years 1989-90 and 1990-91.

#### **Criteria**

The contracts between the State and nonprofit subrecipients establish a deadline of 5 months and 15 days after the end of the subrecipient's fiscal year for the submission of the required audit reports. Office of Management and Budget (OMB) 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 subrecipient's fiscal year. This circular also requires the state to resolve audit findings within 6 months after receiving the report.

#### **Recommendation**

The department should ensure that nonprofit subrecipients submit audit reports within the timeframes established in their contracts. Additionally, the department should ensure that it resolves the audit findings within six months after receiving the report.

### **Item 9. Unnecessary Administrative Costs Incurred**

#### **Finding**

The WIC program is a federal program that falls under the Cash Management Improvement Act of 1990 (CMIA). In an effort to readily identify claim schedules requiring expedited processing, the State Controller's Office and the Department of Finance developed a special form to be used to flag schedules containing payments for federal programs falling under the provisions of the CMIA. This form was sent out to the departments in January 1994 and the State Controller's Office did not charge the departments for using this form. It does charge departments when they use the regular expedite form. In our testing, we found that the department did not use this special form in all instances when it could have. The department used this special form on the claim schedules it submitted to the State Controller's Office to pay WIC vouchers, but it did not use the form on other claim schedules that paid WIC expenditures directly from the Federal Trust Fund. As a result of using the regular expedite form, the department incurred nearly \$2,000 in unnecessary administrative costs from February through June 1994.

#### **Criteria**

The Code of Federal Regulations, Title 7, Section 3015.61(f), requires agencies to have established procedures to determine the reasonableness, allowability, and allocability of costs.

#### **Recommendation**

The department should implement the use of the State Controller's Office special expedite form for all claim schedules for the WIC program that are paid directly out of the Federal Trust Fund.

### **Item 10. Nutrition Education Plans Not Received From Local Agencies**

#### **Finding**

The department did not require the 80 local agencies that participate in the WIC program to submit an annual Nutrition Education Plan. The department, in its fiscal year 1993-94 WIC State Plan submitted to the United States Department of Agriculture (USDA), included an objective of obtaining a waiver from the federal government allowing local agencies to

submit nutrition education plans on a biennial basis rather than an annual basis. However, the department never submitted a formal request to the USDA for the waiver, and did not require the local agencies to submit the annual nutrition education plans for fiscal year 1993-94.

#### **Criteria**

The Code of Federal Regulations, Title 7, Section 246.11(d)(2), requires the department to obtain annual nutrition education plans from the local agencies. Additionally, the WIC Program Manual, Section 410-10, requires local agencies to submit annual Nutrition Education Plans.

#### **Recommendation**

The department should ensure that all local agencies submit annual Nutrition Education Plans, or obtain a formal approval from the USDA to deviate from federal requirements.

### **Item 11. Failure To Obtain Federal Reimbursements Promptly**

#### **Finding**

During fiscal year 1993-94, the department did not promptly obtain reimbursement from the federal government for the Refugee and Entrant Assistance—State Administered Programs and the Maternal and Child Health Services Block Grant to the States. These delays in obtaining reimbursement of program expenditures resulted in a loss of potential interest earnings to the State of approximately \$116,000 and \$96,000, respectively.

#### **Criteria**

The State Administrative Manual, Section 911.4, requires agencies to secure prompt reimbursement from grant funds for goods and services provided.

#### **Recommendation**

The department should ensure that federal reimbursements are obtained promptly.

### **Item 12. Noncompliance With Certain Federal and State Requirements**

#### **Finding**

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

- For one of the eight on-site vendor monitoring visits we reviewed for the WIC program, the department was unable to provide documentation of the visit. Because the department could not provide documentation of the on-site monitoring visit, we were unable to determine if any exceptions were noted, whether the department took appropriate follow-up action, or whether the vendor was notified of

any exceptions that may have been discovered. The Code of Federal Regulations, Title 7, Section 246.12(i)(4), requires the department to document the results of on-site monitoring visits of WIC vendors.

- For one of the five WIC vendor audits we reviewed, the department had not made any attempt to collect \$1,695 in reimbursements that were questioned until we brought it to the department's attention. The department contracts with the State Controller's Office (SCO) to perform the WIC vendor audits. In February 1994, the SCO issued to the department an audit report that identified questioned amounts that had been reimbursed to a WIC vendor. However, the department did not attempt to recover the amount until August 22, 1994. After the department attempted to recover the amount, the vendor provided additional documentation that resulted in the questioned amount being reduced to \$1,262. The Code of Federal Regulations, Title 7, Section 246.12(i)(2), requires the department to take corrective action when abuse and errors are detected in a vendor audit.
- The department did not promptly destroy obsolete WIC vouchers. We found that the department had in its inventory certain vouchers with a maximum value of approximately \$27.8 million that became obsolete effective February 1994 because of a contractual change with a food producer. These obsolete vouchers remained in inventory as of March 21, 1995. Obsolete vouchers that are not promptly destroyed occupy inventory space and increase the possibility of theft or misuse.

The chief of the WIC Branch stated that the department has had a difficult time finding a contractor that could shred the vouchers in a secure manner. The department prepared a request for proposal, however, it received no responses. The department has recently been able to procure a one-time sole source contract to have these vouchers shredded. The Code of Federal Regulations, Title 7, Section 246.12(l), requires the department ensure secure storage of unissued supplemental foods and food instruments.

- The federal financial status report for the Refugee and Entrant Assistance—State Administered Programs grant for fiscal year 1993-94 did not reconcile with the department's official accounting records. Specifically, the department reported approximately \$110,000 less in expenditures on the federal financial status report than it recorded in its accounting records. In total, the department reported approximately \$37 million in expenditures for this federal program. The Bureau of State Audits reported a similar weakness in its audit for fiscal year 1992-93. The Code of Federal Regulations, Title 45, Sections 74.73(a) and (b), requires the department to prepare financial status reports that indicate the amount of grant funds received and

spent. Further, the State Administrative Manual, Section 20014, requires agencies receiving federal funds to reconcile federal financial reports with the official accounting records.

- The department is responsible for ensuring that providers of services furnished at nursing facilities are periodically surveyed and certified based on health and safety standards. These surveys and certifications are required by grant provisions of the Medical Assistance program. In our review of this requirement, we found that while the surveys were completed within the required time periods, the district offices did not promptly update the computer database to reflect the most recent survey completion dates. We compared survey information in 33 provider files to information on the database and found that information about two providers had not been promptly updated on the database. Specifically, we found that as of May 1994, the database information for two providers had not been updated although the surveys had been completed for five months in one instance and nine months in the other. Without updated information on the database, providers could receive Medi-Cal benefits when they were no longer eligible. The Code of Federal Regulations, Title 42, Section 442.12(a), states that an agency may not make Medicaid payments to a facility for nursing facility services unless the state has certified the facility to provide those services.

Although individually these deviations may appear to be insignificant, they do represent noncompliance with federal and state regulations, which are designed to protect the public's resources from abuse.

**Recommendation**

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

# Department of Rehabilitation

We reviewed the Department of Rehabilitation's (department) administration of the U.S. Department of Education grant, Federal Catalog No. 84.126.

## **Item 1. Inaccurate Federal Financial Reports**

### **Finding**

The department overstated the federal share of expenditures for indirect costs included in the financial status reports for September 30, 1993, December 31, 1993, and March 31, 1994. Specifically, the department erroneously included approximately \$17.3 million of state and local program costs in its federal programs' pool. In addition, these reports contained several minor clerical errors totaling approximately \$72,000. The cumulative effect of all of the errors resulted in a net overstatement of the federal share of indirect costs of approximately \$1.4 million at March 31, 1994. However, these errors did not result in an overcollection of federal funds. After we raised the issue, the department appropriately corrected these errors in the financial status report for June 30, 1994.

The Bureau of State Audits reported a similar weakness during the audit for fiscal year 1991-92, and the Office of the Auditor General reported a similar weakness during its audits for fiscal years 1987-88 through 1989-90.

### **Criteria**

The federal Office of Management and Budget, Circular A-102 revised, Subpart C, Paragraph 883A(b)(1), requires that financial reports contain accurate and reliable information. In addition, the federal Office of Management and Budget, Circular A-87, Attachment A, Paragraph F.1, states that indirect cost pools should be distributed to benefiting cost objectives on bases which will produce an equitable result in consideration of relative benefits derived.

### **Recommendation**

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

## **Item 2. Noncompliance With Other Federal Requirements**

### **Finding and Criteria**

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

- Two of the 25 open client files we reviewed were not reviewed within 90 days while the clients were in extended evaluation. Specifically, at the time of our review, one case had not been reviewed in over a year and the other had not been reviewed in almost two years. In addition,

the department provided rehabilitation services to one of these clients during the extended evaluation period. The Code of Federal Regulations, Title 34, Section 361.34, requires a thorough assessment of the individual's progress at least once every 90 days during the extended evaluation period. This Section also limits the scope of rehabilitation services during the extended evaluation period to a determination of rehabilitation potential.

- For 2 of the 25 open client files we reviewed, the individualized written rehabilitation programs were not reviewed annually while the clients were receiving rehabilitation services. Specifically, at the time of our review, neither client's program had been reviewed in approximately two years. The Code of Federal Regulations, Title 34, Section 361.40(c), requires the State to assure that the individualized written program will be reviewed at least on an annual basis.
- In one of the 25 open client files we reviewed, the department provided services to the client before determining whether the client was eligible for or received similar benefits under another program. Specifically, the department reimbursed this client for tuition, books, and transportation costs while the client attended college. The Code of Federal Regulations, Title 34, Section 361.47(b), requires the State to determine whether comparable services and benefits are available under any other program before services are provided at institutions of higher education.

Although individually these deviations may appear to be insignificant, 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.



## Department of Social Services

We reviewed the financial operations and related internal controls of the Department of Social Services (department) and the department's administration of the U.S. Department of Agriculture grants, Federal Catalog Nos. 10.551 and 10.561, the U.S. Federal Emergency Management Agency grant, Catalog No. 83.516, and the U.S. Department of Health and Human Services grants, Federal Catalog Nos. 93.560, 93.561, 93.563, 93.565, 93.566, 93.645, 93.658, 93.659, 93.667, and 93.802.

### **Item 1. Federal Financial Reports Not Reconciled With Accounting Records**

#### **Finding**

The department did not reconcile its federal financial reports prepared during fiscal year 1993-94 with the departmental accounting records. Failure to reconcile federal financial reports with the accounting records can result in misstatements of claims that may go undetected.

The Bureau of State Audits reported a similar weakness during its audits for fiscal years 1991-92 and 1992-93, and the Office of the Auditor General reported a similar weakness during its audits for fiscal years 1985-86 through 1990-91. In its response, the department stated that it has implemented a common data base for the reporting and payment of county assistance and administrative costs. Additionally, the department is developing automated federal ledgers to make transaction posting uniform. The department plans to use the automated ledgers to develop reconciliations that will ensure that data contained in federal reports are consistent with the accounting records maintained in the California State Accounting and Reporting System.

#### **Criteria**

The Code of Federal Regulations, Title 45, Sections 74.61(a) and 92.20(b)(1), require that grantees 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 continue its attempts to implement a reconciliation system that will reconcile its federal financial reports with departmental accounting records.

**Item 2.  
Insufficient  
Monitoring of  
Federal Programs**

**Finding**

The department did not adequately monitor counties participating in the Foster Care—Title IV-E program and the State Legalization Impact Assistance Grants program:

- The department conducted monitoring reviews of only four counties participating in the eligibility activities of the Foster Care—Title IV-E program. In addition, of the four counties that it reviewed, only one was among the ten counties with the largest caseloads. Furthermore, the department did not conduct three of the four reviews in accordance with the department's plan for monitoring the counties.

The department's goal is to perform an annual review of each county's eligibility procedures and practices; however, when staffing levels drop, the department's goal is to conduct reviews of the ten counties with the largest caseloads. According to the supervisor of the Foster Care unit, during fiscal year 1992-93 the number of staff conducting monitoring reviews was cut from eight to one, and had only increased to four by the end of fiscal year 1993-94.

- The department did not monitor counties participating in the State Legalization Impact Assistance Grants program during fiscal years 1992-93 and 1993-94. The Bureau of State Audits reported a similar weakness during its audit for fiscal year 1991-92.

Without monitoring, the State cannot ensure that the counties properly administer federal programs.

**Criteria**

The United States Code, Title 42, Section 671(a)(7), states that the Foster Care state plan will include a plan for the state agency to monitor and conduct periodic evaluations of the activities at the local level. To comply with this law, the department's Foster Care Policy Bureau has policies that outline the procedures for conducting reviews of eligibility activities at the county level. The Code of Federal Regulations, Title 45, Section 92.40, 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 adhere to its review procedures to improve its monitoring and evaluation of the Foster Care—Title IV-E eligibility activities and the department should conduct the required monitoring of the State Legalization\*Impact Assistance Grants program.

**Item 3.**  
**Inaccurate**  
**Reporting of Cash**  
**on Hand for Federal**  
**Programs**

**Finding**

The department overstated the cash on hand balance for various federal programs for the quarter ending June 30, 1994, by approximately \$612,000. The overstatement occurred because department staff were unable to reconcile cash on hand prior to submitting its report to the federal government. The Bureau of State Audits reported a similar weakness during its audit for fiscal year 1992-93.

**Criteria**

The Code of Federal Regulations, Title 45, Section 74.61(a), requires that accurate, current, and complete disclosure of the financial results of each project or program shall be made in accordance with the financial reporting requirements of the grant.

**Recommendation**

The department should ensure that it maintains accurate records of cash on hand for the federal programs that it reports to the federal government.

**Item 4.**  
**Deficiencies in Cash**  
**Management**

**Finding**

The department did not promptly request federal funds to reimburse the State for expenditures incurred and maintained balances of federal funds that exceeded its immediate cash needs. Federal funds 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 promptly request federal funds to reimburse the State for support expenditures incurred during fiscal year 1993-94. The department pays all support expenditures from its general fund and subsequently requests reimbursement for the federal portion of those expenditures. Allowing the department 12 working days to request and receive federal funds, the department was 3 to 11 days late in receiving reimbursement for three of the five transactions tested. As a result, the State lost approximately \$14,800 in interest income.
- The department did not properly analyze its cash on hand when requesting federal funds for the Job Opportunities and Basic Skills (JOBS) Training program and the Social Security—Disability Insurance (SSDI) program. As a result, for the JOBS Training program, the department maintained a balance ranging from approximately \$79,000 to \$108,700, between September 30, 1993, and October 31, 1993, and maintained a balance ranging from approximately \$5,800 to \$91,600 between December 31, 1993, and January 31, 1994. For the SSDI program, the department maintained a balance ranging from

approximately \$391,800 to \$2,036,600, between July 31, 1993, and September 30, 1993. The Bureau of State Audits reported a similar weakness during its audit for fiscal year 1992-93.

#### **Criteria**

The Code of Federal Regulations, Title 31, Section 205.7(b), requires that the time elapsing between the transfer of funds from the United States Treasury and the payment of funds for program purposes shall be minimized. Additionally, the Code of Federal Regulations, Title 31, Section 205.7(d), requires that the amount of funds transferred to a state be limited to the minimum required to meet the state's actual, immediate cash needs. Finally, the Code of Federal Regulations, Title 31, Section 205.20(a), stipulates that the timing and amount of federal cash advances be as close as administratively feasible to the actual cash outlay by the state.

#### **Recommendation**

The department should promptly request federal funds to reimburse its general fund for federally eligible expenditures and should ensure that its requests for federal funds are limited to its immediate cash needs.

### **Item 5. Inaccurate Reporting of Time Charges for the Social Security Disability Insurance Program**

#### **Finding**

The department did not accurately report to the federal government the time charged by department personnel for the Social Security Disability Insurance program. Specifically, during our review of the quarter ended March 31, 1994, we noted the following:

- The department understated the employee time charges for the program reported on the quarterly federal report by approximately 1,100 hours.
- For 1 of the 15 employee time reports that we reviewed, the department was unable to substantiate three hours of leave reported on the attendance report.

The Bureau of State Audits reported a similar weakness during its audit for fiscal year 1992-93.

#### **Criteria**

The Code of Federal Regulations, Title 20, Section 404.1625 and Section 416.1025, require the department to maintain the records and reports relating to the administration of the disability programs. In addition, the State Administrative Manual, Section 8539, requires that state agencies maintain complete records of attendance and absences for each employee during each pay period.

### **Recommendation**

The department should ensure that adequate support is maintained for reporting time charges and that time charges are accurately reported on the quarterly federal financial reports.

### **Item 6. System for Confirming Audit Adjustments is Flawed**

#### **Finding**

The department's system for ensuring that county welfare offices made all adjustments resulting from its audits of Aid to Families with Dependent Children (AFDC) administrative expense claims is flawed. Specifically, we reviewed AFDC administrative expense claims for four counties that had a total of 22 required audit adjustments. The counties completed 7 of the audit adjustments; however, we could not determine whether the counties made another 10 of the required adjustments and we could only partially confirm that the counties made the remaining 5 adjustments.

The department's instructions to counties for making audit adjustments do not require the counties to separately identify adjustments made as a result of the department's audits from other adjustments that counties make to the administrative expense claims. As a result, the department cannot ensure that all required audit adjustments have been made.

#### **Criteria**

The Code of Federal Regulations, Title 45, Section 205.120(a)(3), in part requires the department to conduct regularly planned examinations and evaluations of local county offices' operations, including developing methods for informing local county staff of state policies, standards, procedures, and instructions.

#### **Recommendation**

The department should amend its instructions to the counties to require the counties to separately identify adjustments made as a result of audits from other adjustments made to their administrative expense claims.

### **Item 7. Noncompliance with Additional Federal Requirements**

#### **Finding**

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

- The department incorrectly reported a portion of automated data plan development costs for the Food Stamps program for the quarter ending September 30, 1993. Specifically, the department reported the costs in the wrong funding category on the Financial Status Report (FSR) for the quarter ending September 1993. After we brought it to the department's attention, the department corrected the error in its FSR for the quarter ending June 30, 1994. The Code of Federal

Regulations, Title 7, Section 277.6(b)(1), requires that financial management systems for program funds shall provide accurate, current, and complete disclosure of the financial results of program activities in accordance with federal reporting requirements.

- The department does not always ensure that invoices are properly authorized for payment and maintained for disability expenditures. Specifically, 3 of the 20 invoices we selected did not contain a signature that authorized payment of the invoice. Additionally, the department could not locate 2 of the 20 invoices. The Code of Federal Regulations, Title 45, Section 92.20(b)(6), states that accounting records must be supported by source documentation. In addition, the department's Disability Evaluation Division Procedure Manual, Section 300, states that invoices must be authorized prior to issuing payments.
- The department completed only seven pages of the ten-page quarterly statement of expenditures for the Foster Care—Title IV-E program. Revised federal reporting instructions from the Administration for Children, Youth, and Families indicate the information to be included on the quarterly statements of expenditures. Since June 30, 1990, the department has been required to submit a ten-page quarterly statement of expenditures. Previously, the department was only required to submit a two-page report. The federal Department of Health and Human Services estimated that the revised statement could be completed in approximately 25 hours. However, in a letter submitted to the federal government on May 14, 1990, the department stated that the new report would require extensive system modifications and a significant increase in staff time. As a result, the department would not be able to provide all the information required for the new report. The Bureau of State Audits reported a similar weakness during its audit for fiscal year 1992-93.

Although individually these deviations may appear to be insignificant, 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.

## **Legislative, Judicial and Executive**

# State Controller's Office

We reviewed the financial operations and related internal controls of the State Controller's Office (SCO) and the SCO's administration of the U.S. Department of Agriculture grant, Federal Catalog No. 10.665, and the U.S. Department of the Interior grant, Federal Catalog No. 15.999.

## **Item 1. Inadequate System for Identifying All Special Districts Requiring Review**

### **Finding**

The SCO does not have an adequate system for identifying all special districts that are required to submit their annual single audit reports to the SCO for review. These special districts are local governments that receive federal grant moneys from various state departments administering the federal grants. As part of its responsibility for coordinating the single audit activities of local governments, the SCO reviews their single audit reports for adequacy and for compliance with federal regulations and standards. However, the SCO does not ensure that other state departments notify it of all special districts to which they distribute federal funds. Although it has a thorough system for monitoring the audit reports that it is aware it should receive, without a complete list of reports, the SCO cannot be assured that all special districts receiving federal moneys are complying with federal requirements.

### **Criteria**

The federal Office of Management and Budget, Circular A-128, establishes the audit requirements for state and local governments under the Single Audit Act of 1984. The circular requires states that receive federal financial assistance and that provide \$25,000 or more of this federal assistance to subrecipients, such as special districts, to determine whether the subrecipients have complied with all audit requirements of the circular. In addition, the states are required to determine whether the subrecipients spent these federal moneys in accordance with applicable laws and regulations and to ensure that appropriate corrective action is taken in instances of noncompliance with laws and regulations.

The State Administrative Manual, Section 20005, indicates that the SCO is the State's designated agency for coordinating the single audit activities in local governments.

### **Recommendation**

The SCO should work with the Department of Finance to ensure that state agencies notify the SCO of all special districts to which they disburse federal funds and how much each of these special districts receive. The SCO should then compile the list of all special districts receiving more than \$25,000 from the State and monitor their audit activities.



**Item 2.**  
**Contractual Audits**  
**Not Completed**  
**On Time**

**Finding**

The SCO does not always complete its audits of three building authorities within contractual deadlines. The building authorities are included as component units in the State's financial statements. These building authorities include the Los Angeles State Building Authority and the East Bay State Building Authority, for which the SCO performed the audits for fiscal year 1992-93. For fiscal year 1993-94, it plans to perform audits of these same two authorities and to add a third, the San Francisco State Building Authority.

The SCO did not meet contractual deadlines for audits for both fiscal years 1992-93 and 1993-94. Specifically, as of April 1995, the fiscal year 1992-93 audit for the East Bay State Building Authority had not been completed although it was due by September 30, 1993. In addition, the fiscal year 1993-94 audits for the East Bay State Building Authority and the San Francisco State Building Authority had not been completed as of April 1995, even though the audit deadlines were September 30, 1994, and December 31, 1994, respectively.

The joint power agreements that create the building authorities establish the audit deadlines. Although the SCO is not responsible for establishing these deadlines, it is responsible for preparing the State's financial statements. These statements have a recommended issue date of six months after the State's fiscal year end, or December 31. However, the deadlines for the audits of the Los Angeles State Building Authority and the San Francisco State Building Authority are too late for the audited information to be included in the State's financial statements. The deadline for the Los Angeles State Building Authority is 12 months after the State's fiscal year end, six months late. The deadline for the San Francisco State Building Authority coincides with the recommended issue date for the State's financial statements, a deadline too late to ensure the availability of the information for the State's reports.

**Criteria**

The joint power agreements that established the building authorities require the completion of audits within 3 months after the end of the fiscal year for the East Bay State Building Authority, 6 months for the San Francisco State Building Authority, and 12 months for the Los Angeles State Building Authority. Each of the building authorities has a fiscal year end of June 30.

For the State to be awarded a Certificate of Achievement for Excellence in Financial Reporting for its financial statements, the Government Finance Officers' Association requires the completion of the audit within six months of the end of the audited entity's fiscal year.

**Recommendation**

Although it is not one of the contracting parties for the joint power agreements, the SCO should recommend that the contracting parties for the Los Angeles State Building Authority and the San Francisco State Building Authority change the audit deadlines to November 1 following the fiscal year end. This completion date ensures the availability of the audited financial information for the State's general purpose financial statements. If the SCO continues to perform these audits, it should complete them by the November 1 following the fiscal year end. The SCO should also complete the audit of the East Bay State Building Authority by the current contractual deadline.

## Office of Emergency Services

We reviewed the Governor's Office of Emergency Services (office) administration of the U.S. Federal Emergency Management Agency grant, Federal Catalog No. 83.516.

### **Item 1. Delay in Appealing Denied Costs**

#### **Finding**

The office has not appealed all of the approximately \$7.7 million of claimed costs related to the Loma Prieta earthquake that was denied by the Federal Emergency Management Agency (FEMA). Since we reported this issue in last year's audit, the office has resolved approximately \$7.1 million of its claim, but as of April 1995, it has not appealed approximately \$564,000. According to the director, rather than appeal, the office sent a new claim to FEMA for approximately \$2 million that includes the previously denied costs. The new claim was submitted to FEMA 38 months after the denial of the original claim. The new claim, which the office submitted on April 27, 1994, has gone unpaid for 12 months. According to the director, the only follow-up actions the office has taken on this latest claim are telephone calls to FEMA. We reported the same issue during our audit for fiscal years 1991-92 and 1992-93 and the Office of the Auditor General reported the issue in its audit for fiscal year 1990-91.

#### **Criteria**

The State Administrative Manual, Section 0911.4, requires state agencies to secure prompt reimbursement from grant funds for goods and services provided. The Code of Federal Regulations, Title 44, Section 206.206, describes the process for appealing the denied costs. These procedures include appealing to higher FEMA authorities when appeals are denied at lower levels.

#### **Recommendation**

The office should pursue the pending claim until the claim is settled. In the future, if the office believes that FEMA's denial of claims is inappropriate, it should promptly appeal to higher FEMA authorities.

### **Item 2. The Office Failed To Collect Overpayments From Applicants**

#### **Finding**

During fiscal year 1993-94, the office failed to collect \$27,000 in overpayments made to two applicants (recipients of disaster assistance funds are referred to as "applicants") for disaster grants. Although the office has billed the applicants for the overpayments, the office has not collected the amounts owed because, according to the director, the office has not adopted procedures for following up on applicants that do not pay. We reported a similar weakness during our audit for fiscal year 1992-93.

**Criteria**

The Code of Federal Regulations, Title 44, Section 205.120(c), states that bills for collection are due upon receipt. We interpret this to mean that the office, barring appeals from the applicants, should collect the overpayments within 30 days of the bill for collection and should return the overpayment to the FEMA within 60 days of a bill for collection.

**Recommendation**

The office should promptly collect overpayments from applicants. Furthermore, the office should adopt procedures for promptly collecting overpayments from applicants.

**Item 3.  
The Office Did Not  
Promptly Transfer  
Statewide Cost  
Allocation Plan  
Recoveries****Finding**

The office did not promptly transfer to the State's General Fund reimbursements representing the federal government's share of service costs provided by central service agencies. Central service agencies provide services such as financial, personnel, and legal support. These costs are calculated under the Statewide Cost Allocation Plan (SWCAP), which is the plan that each state agency uses to pay for its share of the State's cost for central services. The office transferred the SWCAP recoveries for the periods July through September 1993 on January 4, 1994—66 days late; October through December 1993 on April 25, 1994—85 days late; January through March 1994 on July 25, 1994—86 days late. As of April 27, 1995, the office had not transferred the SWCAP recoveries for April through June 1994.

**Criteria**

The California Government Code, Section 1332.01, requires agencies to recover SWCAP costs from the federal government. Although no deadline is expressly mandated by the Government Code, the State Administrative Manual, Section 8755.2 implies that a transfer of SWCAP recoveries to the State's General Fund within 30 days of the end of each quarter would be appropriate.

**Recommendation**

The office should transfer SWCAP recoveries within 30 days.

# Department of Insurance

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

## **Item 1. Inadequate Documentation for Waivers Granted**

### **Finding**

We reviewed the tax payments of 31 insurance companies. Of those 31, 21 were required to pay by electronic funds transfer. We found that 16 of the 21 paid by electronic funds transfer. Any insurance company that is required but unable to file via electronic funds transfer due to a valid reason is required to request relief by submitting a statement stating the basis of the request. The department had evidence that some insurance companies had technical difficulties during the initial implementation of the electronic funds transfer program that started in January 1994. However, the department lacked evidence that the remaining insurance companies requested relief from paying by electronic funds transfer as required by the Insurance Code. Also, the department did not assess a penalty on any of the 5 insurance companies, as required.

### **Criteria**

The California Insurance Code, Section 1531(c), provides that any person required to remit taxes by electronic funds transfer who remits those taxes by means other than an appropriate electronic funds transfer, shall be assessed a penalty in an amount equal to 10 percent of the taxes due at the time of the payment. If the department finds that a person's failure to make a timely payment is due to reasonable cause, the person shall be relieved of the penalty. However, any person seeking to be relieved of the penalty must file a statement under penalty of perjury setting forth the facts upon which the person bases his or her claim for relief.

### **Recommendation**

The department should comply with the provisions of the Insurance Code and not relieve taxpayers of the 10 percent penalty without cause. Further, the department should require taxpayers seeking relief of the penalty for cause to do so by filing a statement under penalty of perjury setting forth the facts upon which the taxpayer bases his or her claim for relief.

## **Item 2. Lack of Evidence of Timely Payments of Gross Premium Taxes**

### **Finding**

The department did not have evidence of the timely receipt of checks received from insurance companies for their gross premium taxes. For example, while the department has documentation that it processed five checks after the due date of April 1, the department did not have adequate

documentation to establish date of receipt for these checks. Two of the payments were processed on April 5, two on April 7, and one on April 12. Furthermore, the department did not penalize any of these insurance companies for paying late or charge them interest on their late payments. If these payments were received by the due date, but not processed by the department until later dates, the department's delay in depositing the checks caused the State to lose interest earnings.

### **Criteria**

The Revenue and Taxation Code, Section 12631, provides that any insurer who fails to pay any gross premiums tax within the time required shall pay a penalty of 10 percent of the amount of the tax in addition to the tax, plus interest from the due date of the tax until the date of payment. The Revenue and Taxation Code, Section 12306, provides that the commissioner may, based on a request filed with the commissioner showing good cause, grant an extension of up to 30 days for the payment of tax. However, the Revenue and Taxation Code, Section 12307, requires insurers who receive extensions to pay interest from the due date until the date of payment.

### **Recommendation**

The department should assess the appropriate penalties and interest on late payments of the gross premiums tax. In addition, the department should establish procedures that will document the date that gross premiums taxes are received by the department. Finally, the department should timely process payments of gross premiums taxes to ensure that the State maximizes its interest earnings.

## Department of Justice

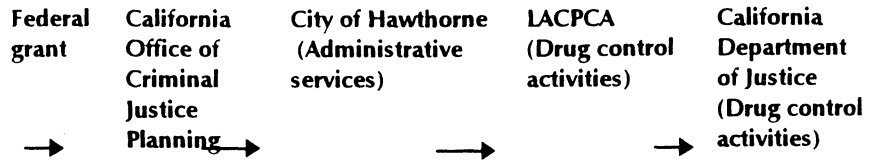
We reviewed the Department of Justice's (department) administration of the U.S. Department of Justice grant, Federal Catalog No. 16.579, and the U.S. Department of Health and Human Services grant, Federal Catalog No. 93.563.

### **Item 1. Reimbursements Not Promptly Received**

#### **Finding**

The State lost interest earnings because the department was not prompt in seeking reimbursement for its costs associated with the federal government's Child Support Enforcement program and the Drug Control and System Improvement—Formula Grant. For fiscal year 1993-94, we found the following specific conditions:

- The State lost interest earnings of approximately \$13,808 because of the department's late billings to the Department of Social Services, with which it entered into two contracts to provide services under the Child Support Enforcement program. For example, although the department began rendering services under this program in July 1993, it did not bill the Department of Social Services until January 1994. The Department of Social Services in turn billed the federal government for reimbursement of these costs. The billings to the Department of Social Services were late because the department did not have approved contracts with the Department of Social Services until late August 1993 for one of the contracts and November 1993 for the other contract. In addition, according to the manager of the department's reimbursement management unit, the billings were late because new billing instructions for fiscal year 1993-94 were being developed.
- The department also was not promptly reimbursed for services rendered under the Drug Control and System Improvement—Formula Grant. The department receives funds from this grant from two sources: a letter of agreement with the Los Angeles County Police Chiefs' Association (LACPCA) and interagency agreements with the Office of Criminal Justice Planning. The LACPCA receives its funds from the Office of Criminal Justice Planning, with the City of Hawthorne acting as an administrative intermediary. The following diagram depicts the flow of funds to the department from the contract with the LACPCA:



When the department bills for the services it renders under the contract with the LACPCA, each of these entities processes the invoice. The department received payments under this contract as much as five months after it billed for services rendered. To avoid delays that result from this cumbersome reimbursement process, the department could contract directly with the Office of Criminal Justice Planning.

The department also was late in billing for reimbursement under two direct interagency agreements with the Office of Criminal Justice Planning. Although the department began rendering services under these agreements in July 1993, it did not submit its first billing until December 1993. Late approval of the interagency agreements, in October and November 1993, contributed to the delayed billing.

**Criteria**

The State Administrative Manual, Section 0911.4, requires state agencies to bill the federal government promptly. In addition, the Government Code, Section 13401(b)(1), states that each state agency must maintain effective systems of internal accounting and administrative control as an integral part of its management practices.

**Recommendation**

The department should promptly bill the Department of Social Services and the Office of Criminal Justice Planning, thus ensuring that those agencies have the information needed to request prompt reimbursement from the federal government.

In addition, the department should consider contracting directly with the Office of Criminal Justice Planning for services it currently renders under the contract with the LACPCA. This arrangement should allow prompt reimbursement for costs incurred.



# State Treasurer's Office

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

**Item**  
**Insufficient**  
**Collateral for a**  
**Demand Deposit**

**Finding**

The State Treasurer's Office did not ensure that all state demand deposits were collateralized as required by the Government Code. The State Treasurer's Office is responsible for ensuring that the State's demand deposits with banks are adequately collateralized at all times. We reviewed the collateral on deposit for the State's demand deposits of \$551.3 million at June 30, 1994, and noted an instance in which collateral was less than required. Specifically, a bank with a deposit of \$523.2 million that required collateral of \$575.4 million had collateral on deposit of \$572.8 million, or \$2.6 million less collateral than required. While the collateral on deposit was sufficient to secure the demand account balance, the law requires more collateral on deposit to ensure the safety of the State's deposits.

**Criteria**

The Government Code, Sections 16521 and 16522, requires that banks deposit with the State Treasurer specified amounts of collateral as security for state demand deposits.

**Recommendation**

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

## **State and Consumer Services**

# Franchise Tax Board

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

## **Item 1. Incorrect Penalty and Interest Assessments**

### **Finding and Criteria**

The board did not always correctly calculate penalties and interest assessed taxpayers in fiscal year 1993-94. Of 40 penalty and interest transactions we reviewed, we found 4 cases where the board did not comply with the requirements of the Revenue and Taxation Code. As a result, the board overcharged or undercharged taxpayers for penalties and interest. Specifically, we found the following:

- In cases of fraud related to certain tax years, the Revenue and Taxation Code, Section 18684, requires the board to assess a taxpayer a penalty amounting to 75 percent of the underpayment of tax attributable to fraud. The board incorrectly charged a taxpayer the required penalty plus a penalty of 50 percent of the interest on the underpayment of tax. As a result, the board overassessed the taxpayer approximately \$164,400.
- The board undercalculated interest charged to two taxpayers for personal income tax underpayment by a total of approximately \$24,000. The board calculated the interest on the tax underpayment using incorrect effective dates for additional tax.
- The board incorrectly forgave a \$318,700 penalty originally charged a corporate taxpayer for the underpayment of tax year 1992 estimated tax. The board forgave the penalty after the taxpayer asserted that its overpayment from tax year 1991 should have been applied as 1992 estimated tax payments. However, the taxpayer was delinquent when it submitted its return for tax year 1991. Since the overpayment on a delinquent return is effective as of the date the return is received by the board, the board should not have forgiven the \$318,700 penalty for underpayment of the tax year 1992 estimated tax.

### **Recommendation**

The board should ensure it assesses penalties and interest to taxpayers in accordance with the Revenue and Taxation Code.

## **Item 2. Supporting Documentation Missing**

### **Finding**

The board could not locate documentation to support why it forgave a \$158,000 penalty assessed against a bank and corporation taxpayer for noncompliance with the State's requirement to remit tax payments using

electronic funds transfer. As a result, the board could not document that a penalty abatement was properly supported and in compliance with the Revenue and Taxation Code.

**Criteria**

The California Government Code, Section 13401, requires agencies to maintain an effective system of internal accounting and administrative control to reduce errors in state programs.

**Recommendation**

The board should improve its procedures to locate documents submitted by taxpayers.

## Department of General Services

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

### **Item 1. Inaccurate Financial Reports for the Office of Local Assistance**

#### **Finding**

The department's Office of Local Assistance (OLA) did not accurately prepare its financial reports for fiscal year 1993-94 for the School Building Lease-Purchase Fund (fund 344), the State School Building Lease-Purchase Fund, June 1992 (fund 745), and the School Facilities November 1988 Bond Account, State School Building Lease-Purchase Fund (fund 776). Specifically, during our audit we noted the following:

- The OLA prepares financial statements for various subfunds which it then uses to prepare the consolidated financial statements for the funds as a whole. These financial statements are ultimately submitted to the State Controller's Office (SCO). During our audit, we noted two instances where the OLA did not ensure that amounts included in the consolidated financial statements agreed with the sum of the individual subfunds. Specifically, the OLA's consolidated financial statement for fund 776 included a fund deficit of \$68.5 million. However, the total fund deficit included in the financial statements for the individual subfunds was only \$35.1 million. As a result, the fund deficit in the consolidated financial statement was understated by \$33.4 million. Also, the OLA's consolidated financial statement for fund 344 included \$34,000 as due to other funds; however, this amount was not included in financial statements for the individual subfunds. As a result, due to other funds in the consolidated financial statement was overstated by \$34,000.
- We also found instances where the OLA's financial statements did not agree with the SCO records. Specifically, the OLA did not report \$66.8 million in operating transfers in and transfers out for fund 745. However, these amounts were included in the SCO's records. The OLA also did not report \$10,700 of operating transfers out for fund 776.

Failure to accurately report financial information submitted to the SCO reduces the SCO's ability to prepare the State's financial statements accurately and in accordance with generally accepted accounting principles.

### **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 controls include recordkeeping procedures sufficient to provide effective accounting control over assets, liabilities, revenues, and expenditures. The State Administrative Manual, Section 7976, requires departments to include a reconciliation of their annual revenue and expenditure accounts with the transactions per the State Controller in its financial reporting. 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 ensure that its consolidated financial statements agree with the financial statements of the individual subfunds. Additionally, the OLA should reconcile its financial reports with the SCO's records.

## **Item 2. Inadequate Control Over Accounting Records**

### **Finding**

The department's OLA maintained inadequate controls over its accounting records for the State School Building Lease-Purchase Fund (fund 344) and the School Facilities November 1988 Bond Account, State School Building Lease-Purchase Fund (fund 776). We identified the following deficiencies:

- For 7 of the 37 projects we reviewed, the OLA did not ensure that its subsidiary project records, which document the detailed funding history of each project, agreed with the amounts reflected on the budget report. The budget report supports the general ledger. In five instances, the budget report was in error; in one instance, the project record was in error; and in one instance, both the budget report and the project record were incorrect. In addition, three of these differences had been previously identified in our fiscal year 1992-93 audit; however, as of November 1994, no action has been taken by the OLA to correct errors in the budget report or the project records. When project records are in error, the OLA does not have accurate information readily available about the remaining funds for projects before distributing funds to the school districts. When the budget reports are in error, the account balances that the department reports to the SCO are incorrect. For example, the account balances reported to the SCO as of June 30, 1994, for due to local governments in funds 344 and 776 were overstated by approximately \$799,000 and \$727,000, respectively.
- The OLA could not provide documentation to support the June 30, 1994, due to local governments account balance of \$91.2 million in fund 776. Based on our analysis, we determined that

the correct due to local governments account balance was \$89.9 million. As a result, due to local governments for fund 776 was overstated by approximately \$1.3 million.

- The OLA did not properly analyze the negative amounts included in the budget report for fund 344 to identify valid amounts due from school districts at June 30, 1994. The budget report shows the remaining amounts owed to school districts for approved projects. Because the OLA did not properly analyze these negative amounts, the department cannot be sure the amounts reported as expenditures and due from school districts in the financial statements for fund 344 are accurate. Specifically, for 9 of the 26 items we reviewed, the amount per the OLA's due from school districts listing (due from listing) differed from the amounts reflected on the budget report and the subsidiary project records. The due from listing supports the general ledger. In five instances, the due from listing was in error; in three instances, the due from listing and the budget report were in error; and in one instance, the due from listing and the subsidiary project records were incorrect. In addition, for eight of the nine projects identified above, we determined that the OLA had received payment from the school district during fiscal year 1993-94. However, the OLA did not reduce the amount due from the school district by the amount of the payment. As a result of these errors, the amount reported as due from school districts at June 30, 1994, was overstated by approximately \$321,000. Upon being notified of these errors, the OLA revised its financial statements.
- The OLA erroneously posted a transaction to an invalid project number. During our testing of negative amounts included in the budget report for fund 344, we found that one negative amount existed for an invalid project number. As a result, the amount reported as due to school districts at June 30, 1994, was understated by approximately \$352,000. Upon being notified of these discrepancies, the OLA revised its financial statements and the supporting budget report.
- The OLA did not always ensure that all amounts due from school districts had been reported in its financial statements. Specifically, during our testing of due to other governments for fund 776, we found that the June 30, 1994, budget report included due from school district project balances that had not been reported in the financial statements. Instead, these amounts had been netted against the due to local governments account balance. As a result, the OLA understated the due from school districts and due to local governments account balances at June 30, 1994, by approximately \$263,000.

The Bureau of State Audits reported similar weaknesses during the financial audit for fiscal years 1991-92 and 1992-93, and the Office of the Auditor General reported similar weaknesses during the financial audits for fiscal years 1987-88 through 1990-91.

### **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 records with its general ledger each month. In addition, the OLA should ensure that all amounts due from school districts are included in its financial statements. Finally, the OLA should maintain complete and accurate accounting records.

### **Item 3. Lack of Controls Over Interest Earned On School Districts' Deposits**

#### **Finding**

The OLA administers grants to school districts for construction projects under the lease-purchase program. Frequently, the OLA disburses grant funds to school districts before the school districts begin the construction projects. In these instances, the school districts deposit the funds into interest bearing accounts at their county treasuries. The county offices of education (counties) are required to report the interest earned on school district deposits to the OLA. The OLA subsequently reduces the amount of grant funds owed to the school districts by the amount of interest earned. During our testing, we found that the OLA lacked control over the recording of interest reported by the school districts. Specifically, we noted the following:

- The OLA did not properly record interest earned by the counties. For example, for 2 of the 42 items tested, the OLA incorrectly recorded the interest in the subsidiary project records. For one of the two items, the OLA recorded the interest for one reporting period three times. In the second instance, the OLA recorded the remaining project balance as the amount of interest earned rather than the amount of interest



reported by the county. As a result of these errors, the amount reported as due to local governments at June 30, 1994, is understated by approximately \$1.5 million.

- The OLA did not ensure that counties promptly reported interest earned by the school districts during fiscal year 1993-94. Specifically, as of August 1994, all 5 of the counties we tested were delinquent in reporting interest earned for at least one quarter of fiscal year 1993-94. We found that the OLA made no effort to notify these 5 counties regarding their failure to report interest earnings. Moreover, as of September 15, 1994, we noted that 15 of the 56 counties that participate in the lease-purchase program had not reported the amount of interest earned for at least one quarter of fiscal year 1993-94.

### **Criteria**

The California Code of Regulations, Title 2, Article 5, 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 ensure that the county offices of education promptly report the amount of interest earned on deposits of school districts and that these amounts are accurately posted in the accounting records.

#### **Item 4. Completed School Construction Projects Not Audited Promptly**

### **Finding**

The department's OLA did not complete close-out audits of completed school construction projects promptly. As of February 1995, approximately 42 percent of the projects that have been completed for at least two years have not received a close-out audit. Without these audits, the OLA can neither determine the amount of the project's allowable expenditures nor whether the State owes school districts additional funds. Further, the OLA cannot determine whether any funds that may have been apportioned for 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, as of February 1995, approximately 1,304 school construction projects were complete. Of those projects, 376 close-out audits were completed between January 1992 and February 1995. These audits determined that certain school

districts owed the State approximately \$11.4 million and the State owed other school districts approximately \$14.9 million of the districts' remaining apportioned amounts. Further, an additional 191 projects have had an audit report that the OLA submitted to the school districts for their review. This review is one of the final steps in the audit process, and provides assurance that the school district is in agreement with the OLA's final determination of project costs. However, there remains 737 completed projects for which close-out audits have not been prepared by the OLA.

The Bureau of State Audits reported a similar weakness during the audit for fiscal years 1991-92 and 1992-93. Also, the Office of the Auditor General reported this similar weakness in a January 1991 report titled "Some School Construction Funds Are Improperly Used and Not Maximized."

### **Criteria**

The California 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 allowable construction costs.

### **Recommendation**

The OLA should ensure the prompt close-out audits of completed construction projects.

### **Item 5. Inaccurate Analysis of Due Froms in the Service Revolving Fund**

#### **Finding**

The department did not adequately analyze its due from other funds balance at June 30 to identify any uncollectible amounts. Amounts identified as uncollectible should be included in an allowance account which is subtracted from the due from other funds account for financial statement purposes. Based on our testing, we determined that amounts due from other funds totaling approximately \$1.4 million were uncollectible and, therefore, should have been included in the allowance account. Further, although the department had identified \$412,000 of this amount, it did not include this amount in the allowance account at June 30, 1994. Because it did not properly analyze its due froms and include amounts considered uncollectible in an allowance account, the department overstated its due from other funds and revenues by approximately \$1.4 million.

### **Criteria**

The State Administrative Manual, Section 7620, provides for the use of an allowance account which shows the provision for those receivables which are estimated to be uncollectible. It further states that the allowance account is subtracted from receivables for financial statement purposes.

### **Recommendation**

The department should properly analyze its due from other funds account balance at year end and include amounts which it estimates to be uncollectible in the appropriate allowance account.

## **Item 6. Inappropriate Recognition of Sales Revenue**

### **Finding**

The department's Office of State Printing (OSP) inappropriately recorded sales revenue for goods which had not been shipped at year end. Specifically, we identified 17 instances in which the OSP recorded sales revenue even though the related goods had not been shipped as of June 30, 1994. Accounting standards stipulate that revenue should not be recognized until the earnings process is substantially complete. The shipment of goods culminates this process. Because it recorded sales before goods were shipped, the OSP overstated revenues by approximately \$79,000.

### **Criteria**

The State Administrative Manual, Section 10466, states that the year-end revenue balance includes earned revenue applicable to the current fiscal year.

### **Recommendation**

The OSP should implement procedures to ensure that only revenue earned during the current fiscal year is included in its financial statements.

## **Item 7. Inefficient Use of State Funds**

### **Finding**

The department's OSP does not always ensure that purchases of equipment are necessary. Specifically, in June 1992, the OSP purchased equipment costing approximately \$42,000. However, the new equipment was never placed in service because, before it was installed, the OSP modified existing equipment to operate more efficiently than the new equipment. According to the OSP's industrial engineer, the OSP is attempting to sell the new equipment; however, as of March 1995, the OSP had not been able to locate a buyer. As a result, although it has had the new equipment since June 1992, the OSP has not benefited from the purchase. Further, because the OSP's rates for services provided to other

state agencies are based on the amount of expenses incurred, any loss realized on the sale of the new equipment may ultimately be passed on to the other state agencies.

Finally, the OSP did not assign a property number or affix a state property tag to the new equipment until March 1995. Tagging equipment with a property number designates that the asset belongs to the State and protects the asset from theft or misuse.

### **Criteria**

The California Government Code, Sections 13401 and 13403, requires that internal accounting and administrative controls include methods that minimize waste of government funds, promote operational efficiency, assure that state assets are adequately safeguarded, and produce accurate and reliable financial data. The State Administrative Manual, Section 8651, requires that all state property be tagged upon acquisition.

### **Recommendation**

The OSP should ensure that all equipment purchases are appropriate and meet its needs before incurring any expenses. The OSP should also ensure that equipment is immediately assigned a property number and tagged upon acquisition.

## **Item 8. Noncompliance With State Requirements for Equipment**

### **Finding and Criteria**

The department's OSP has weaknesses in its accounting for equipment. We noted the following instances of noncompliance with administrative requirements of the State:

- The OSP incorrectly accounted for the disposition of equipment. Specifically, in February 1994, the OSP sold five pieces of equipment for approximately \$300. At the time of the sale, the equipment had a remaining book value of approximately \$10,400. Rather than record a loss of \$10,100 on the sale, as discussed below, the OSP allocated the remaining book value of the equipment to ten items that were donated from another state agency. The State Administrative Manual, Section 8641, requires that losses on the sale of equipment are to be recognized to the extent that sales proceeds are less than the adjusted basis of the asset.
- The OSP incorrectly assigned values to equipment acquired through a transfer from another state agency. Specifically, in April and November 1993, the OSP acquired equipment, free of charge, from another state agency. The State Administrative Manual, Section 8633, requires departments that acquire property free of charge from other state agencies to record the asset at the same cost as that recorded on the books of the transferor department. However, as discussed above, the

OSP assigned to these assets the remaining book value of five assets that it was selling, rather than the cost recorded on the books of the transferor department.

- The OSP did not immediately assign a property number and attach a property identification tag to equipment upon acquisition. In testing 11 equipment acquisitions, we found one item, costing approximately \$18,000, that was received in April 1994 but was not tagged until November 1994. Tagging equipment with a property number designates that the asset belongs to the State and protects the asset from theft or misuse. The Bureau of State Audits reported a similar weakness during the audit for fiscal year 1991-92. The State Administrative Manual, Section 8651, requires that all state property be identified as such with adhesive or metal property tags.
- The OSP did not contact the State Police immediately upon discovering the loss of one piece of computer equipment. Additionally, the OSP did not immediately prepare a property survey report to remove the property from the accounting records. This item, which the OSP purchased in fiscal year 1990-91 at a cost of \$650, was discovered missing in November 1993; however, the OSP did not notify the State Police of the loss until April 1994. Additionally, the OSP did not prepare until November 1994, a property survey report, which is needed to remove the item from the accounting records. Furthermore, the OSP had never assigned a property number or tagged the missing item, even though the Bureau of State Audits, in its fiscal year 1991-92 audit, had informed the OSP that this item was not tagged. The State Administrative Manual, Section 2625, requires that state agencies notify the State Police immediately when a crime or property damage on state-owned property occurs. Section 8643 requires that a Property Survey Report be prepared and that property accounting records be adjusted whenever property is lost or stolen. Finally, Section 8651 requires that all state property be tagged after acquisition.

### **Recommendation**

The department's OSP should improve its compliance with each of the state requirements indicated.

**Item 9.  
Noncompliance  
With State  
Requirements for  
the Architecture  
Revolving Fund**

**Finding**

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 return unencumbered funds to depositing agencies within three months after completion of the projects, as required by the California Government Code, Section 14959. Specifically, for six of nine projects we reviewed, the department took from approximately 4 to 33 months to return the unencumbered funds totaling approximately \$76,000. In two of the six instances, the department requested the return of the funds from the ARF within the required 3 months. However, the Department of Finance and the State Controller's Office took up to 4.5 months to process these requests totaling \$30,000.
- 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 California Government Code, Section 14959. Specifically, the department did not return approximately \$4,000 promptly for 3 of the 20 projects we reviewed for which funds were transferred to the ARF before June 30, 1991.
- The department did not always bill for services promptly. Specifically, in November 1994, we reviewed 10 construction projects that had a receivable balance at June 30, 1994. For 6 of the 10 construction projects, the department failed to bill promptly or had not yet billed for receivables totaling approximately \$431,000. The State Administrative Manual, Section 8776.3, requires that agencies prepare and send an invoice as soon as possible after recognition of a claim.

The Bureau of State Audits reported similar weaknesses during its audits for fiscal years 1991-92 and 1992-93.

**Recommendation**

The department should ensure that it returns unencumbered funds promptly. In addition, the department should promptly bill for amounts receivable.

**Item 10.  
The Department Is  
Not Verifying the  
Accuracy of the  
Statewide Real  
Property Inventory**

**Finding**

For the fiscal years ended June 30, 1993, and 1994, the department's Office of Real Estate and Design Services (OREDS) did not have state agencies verify the completeness and accuracy of the statewide real property inventory.

During the year, the OREDS continuously updates the statewide real property inventory based on information received from state agencies. At the end of each fiscal year, the OREDS' procedure is to send each state agency its detailed statewide real property inventory. The agencies are required to verify the completeness and accuracy of this information. However, the last time the OREDS sent a detailed statewide real property inventory to state agencies for verification was during the fiscal year ended June 30, 1992.

According to the OREDS' associate real estate officer, OREDS did not send a detailed statewide real property inventory to the state agencies for their verification for the fiscal years ended June 30, 1993, and 1994, due to a shortage of personnel and a computer conversion. State agencies verifying the information contained in the statewide real property inventory would help ensure that the inventory is complete and accurate.

In August 1990, the Office of the Auditor General issued a report (P-660) regarding the department's initial implementation of the statewide inventory of real property. In the department's response to this report, it acknowledged that state agencies' verification of the information contained in the statewide real property inventory is part of the ongoing process to maintain the statewide inventory.

### **Criteria**

The California Government Code, Section 11011.15, requires the department to maintain a complete and accurate statewide inventory of all real property held by the State and to categorize that inventory by agency and geographical location. The initial inventory was to be completed by January 1, 1989, and updated annually.

### **Recommendation**

At the end of each fiscal year, the department should send each state agency its detailed statewide real property inventory with instructions to verify the completeness and accuracy of the information. The department should update the statewide real property inventory based on the agencies' responses.

## **Youth and Adult Correctional**



## Board of Corrections

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

<b>Item</b>	<b>Finding</b>
<b>Inaccurate Estimate of Payables</b>	<p>The board did not accurately estimate its payables in its financial reports for fiscal year 1993-94 for two of its capital expenditure funds. Specifically, when the board analyzed its long-term agreements at June 30, 1994, it included in its estimate of payables amounts represented by invoices that had already been received and paid for or already included in the claims filed account by June 30. Because of these errors, the board overstated its payables in its 1986 County Correctional Facility Capital Expenditure Fund by approximately \$2 million and in its 1988 County Correctional Facility Capital Expenditure Fund and Youth Facility Bond Fund by approximately \$3 million. This condition was caused, in part, because of the extent of communication needed between the board who accumulates financial data and the Department of Youth Authority who prepares the board's financial statements.</p>

### **Criteria**

The State Administrative Manual, Section 10544, requires agencies to accrue the accounts payable that were not previously recorded on or before June 30.

### **Recommendation**

The board should ensure that it only accrues as payables amounts that have not been previously scheduled for payment with the State Controller's Office.

## **Report on Compliance With Federal Grant Requirements**



# CALIFORNIA STATE AUDITOR

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KURT R. SJOBERG  
STATE AUDITOR

MARIANNE P. EVASHENK  
CHIEF DEPUTY STATE AUDITOR

## Independent Auditors' Report on Compliance With Federal Grant Requirements

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, 1994, and have issued our report thereon dated December 15, 1994. The scope of our audit did not extend to financial aid programs administered by the University of California because the University of California contracts with other independent certified public accountants for Office of Management and Budget (OMB) Circular A-133 audits. The scope of our audit also did not extend to the financial aid programs administered by the California State University because the California State University contracts with independent certified public accountants for audits in accordance with the March 1990 Audit Guide, *Audits of Student Financial Assistance Programs*, and the Non-Federal Technical Bulletin 92-1, issued by the U.S. Department of Education, Office of Inspector General. 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 other independent auditors.

The following sections provide our opinion on major federal programs, our report on general requirements for major federal programs, and our report on nonmajor federal programs.

### Major Programs

We have also audited the State of California's compliance with the requirements governing types of services allowed or unallowed; eligibility; matching, level of effort, or earmarking of funds; 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. The major federal financial assistance programs for the year ended June 30, 1994, are identified in the schedule of federal assistance beginning on page 197. The State's management is responsible for the State's compliance with these requirements. Our responsibility is to express an opinion on compliance with these requirements based on our audit.

We conducted our audit of compliance with these requirements in accordance with generally accepted auditing standards, *Government Auditing Standards*, issued by the Comptroller of the United States, and 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.

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 of funds; 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 for the year ended June 30, 1994.

Further, we have applied procedures to test the State of California's compliance with the following general requirements applicable to each of its major federal financial assistance programs, which are identified in the schedule of federal financial assistance beginning on page 197, for the year ended June 30, 1994: 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 for testing compliance with these requirements 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 requirements listed in the preceding paragraph. Accordingly, we do not express such an opinion on the general requirements.

#### Nonmajor Programs

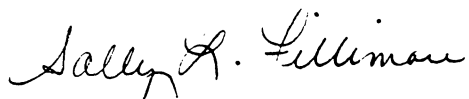
In connection with our audit of the State of California's general purpose financial statements and with our consideration of the State's control structure used to administer federal financial assistance programs, as required by OMB Circular A-128, we selected certain transactions applicable to certain nonmajor federal financial assistance programs for the year ended June 30, 1994. As required by OMB 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 on the nonmajor programs.

With respect to all the items tested, the results of the procedures described above disclosed no material instances of noncompliance with the 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 in the section of our report beginning on page 39. The instances of noncompliance identified in the State's single audit report for fiscal year 1992-93 that have not been corrected are also included in

that section. Additionally, beginning on page 235, we present a schedule listing instances of noncompliance that we consider to be minor. We considered these instances of noncompliance in forming our opinion on compliance with requirements for major federal programs, which is expressed above.

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

April 17, 1995

**Report on the  
Schedule of Federal Assistance**



# CALIFORNIA STATE AUDITOR

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KURT R. SJOBERG  
STATE AUDITOR

MARIANNE P. EVASHENK  
CHIEF DEPUTY STATE AUDITOR

## Independent Auditors' Report on the Schedule of Federal Assistance

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, 1994, and have issued our report thereon dated December 15, 1994. 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.

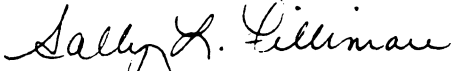
We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the general purpose financial statements 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 Office of Management and Budget, Circular A-128, *Audits of State and Local Governments*, and the Single Audit Act of 1984 require the schedule of federal assistance to present total expenditures for each federal assistance program. However, although the state accounting system separately identifies revenues for each federal assistance program, it does not separately identify expenditures for each program. As a result, the State prepares the schedule of federal assistance on a revenue basis. The schedule shows the amount of federal funds and the estimated value of food stamps and commodities received by the State for the year ended June 30, 1994. 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. The schedule does not include federal revenue received by the University of California or federal revenue for financial aid received by the California State University. The revenues of the University of California are audited by other independent auditors in accordance with the Office of Management and Budget, Circular A-133, *Audits of Institutions of Higher Education and Other Nonprofit Organizations*. The

revenues of the California State University are audited by other independent auditors in accordance with the March 1990 Audit Guide, *Audits of Student Financial Assistance Programs*, and the Non-Federal Technical Bulletin 92-1, issued by the U.S. Department of Education, Office of Inspector General.

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

April 17, 1995



**Schedule of Federal Assistance for  
Fiscal Year Ended June 30, 1994**

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>		
<b>Department of Agriculture:</b>				
Farm Labor Housing Loans and Grants	10.405	\$ 632,000		
Food Distribution	10.550	93,040,321	A	*
Food Stamps	10.551	2,459,128,688	A	*
School Breakfast Program	10.553	128,593,489	A	
National School Lunch Program	10.555	540,955,628	A	
Special Milk Program for Children	10.556	905,103		
Special Supplemental Food Program for Women, Infants, and Children	10.557	352,130,340	A	
Child and Adult Care Food Program	10.558	152,159,286	A	*
Summer Food Service Program for Children	10.559	71,398	**	
State Administrative Expenses for Child Nutrition	10.560	11,610,759		
State Administrative Matching Grants for Food Stamp Program	10.561	248,176,281	A	
Nutrition Education and Training Program	10.564	1,318,711		
Commodity Supplemental Food Program	10.565	3,401,033	**	
Emergency Food Assistance Program (Administrative Costs)	10.568	2,840,938		
Food Commodities for Soup Kitchens	10.571	4,703,210	**	
Forestry Research	10.652	81,534		
Cooperative Forestry Assistance	10.664	834,191		

Footnotes are presented on page 219.

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>	
Schools and Roads—Grants to States	10.665	47,060,153	A
Resource Conversion and Development	10.901	8,820	
Other—Department of Agriculture	10.999	4,640,837	
<b>Department of Commerce:</b>			
Trade Development	11.110	322,463	
Economic Development—Support for Planning Organizations	11.302	112,000	
Economic Development—Technical Assistance	11.303	5,346	
Anadromous Fish Conservation Act Program	11.405	343,217	
Interjurisdictional Fisheries Act of 1986	11.407	104,680	
Coastal Zone Management Program Administration Awards	11.419	2,833,543	
Coastal Zone Management Estuarine Research Reserves	11.420	120,495	
Financial Assistance for Ocean Resources Conservation and Assessment Program	11.426	190,115	
Marine Sanctuary Program	11.429	15,526	
Public Telecommunications Facilities—Planning and Construction	11.550	2,221	
Manufacturing Extension Partnership	11.611	599,556	
Other—Department of Commerce	11.999	217,508	
<b>Department of Defense:</b>			
Flood Control Projects	12.106	12,000	

Footnotes are presented on page 219.

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>	
Navigation Projects	12.107	99,287	
Planning Assistance to States	12.110	827,381	
State Memorandum of Agreement Program for the Reimbursement of Technical Services	12.113	9,283,831	
Selected Reserve Educational Assistance Program	12.609	21,181	
Language Grant Program	12.900	14,287	
Mathematical Sciences Grants Program	12.901	81,090	
Other—Department of Defense	12.999	11,639,003	
<b>Department of Housing and Urban Development:</b>			
Community Development Block Grants—State's Program	14.228	24,067,091	A
Rental Housing Rehabilitation	14.230	1,156	
Emergency Shelter Grants Program	14.231	2,277,738	
Supportive Housing Demonstration Program	14.235	1,234,947	
HOME Investment Partnerships Programs	14.239	14,358,198	
Housing Opportunities for Persons with AIDS	14.241	1,482,521	
Section 8 Rental Voucher Program	14.855	1,616,505	
Lower Income Housing Assistance Program—Section 8 Moderate Rehabilitation	14.856	360,342	
Section 8 Rental Certificate Program	14.857	22,086,161	A
Lead-Based Paint Hazard Control Program	14.900	145,067	

Footnotes are presented on page 219.

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
<b>Department of the Interior:</b>		
Endangered Honeycreeper on Maui	15.162	6,661
Small Reclamation Projects	15.503	295,589
Fishery Research—Information	15.604	1,169,581
Sport Fish Restoration	15.605	11,642,009
Wildlife Restoration	15.611	6,377,338
Endangered Species Conservation	15.612	593,084
Geological Survey—Research and Data Acquisition	15.808	145,389
Historic Preservation Fund Grants-In-Aid	15.904	813,990
Outdoor Recreation—Acquisition, Development and Planning	15.916	2,365,756
Shared Revenues—Potash/Sodium Lease	15.999	21,418,018 A
Other—Department of the Interior	15.999	5,987,009
<b>Department of Justice:</b>		
Juvenile Justice and Delinquency Prevention—Allocation to States	16.540	5,550,996
Criminal Justice Statistics Development	16.550	213,156
Justice Research, Development and Evaluation Project Grants	16.560	117,577
Criminal Justice Discretionary Grant Program	16.574	8,071,581
Crime Victim Assistance	16.575	6,544,601

Footnotes are presented on page 219.

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>	
Crime Victim Compensation	16.576	15,352,000	
Emergency Federal Law Enforcement Assistance	16.577	1,000,000	
Drug Control and System Improvement—Formula Grant	16.579	44,351,969	A
Other—Department of Justice	16.999	960,833	
<b>Department of Labor:</b>			
Labor Force Statistics	17.002	5,469,617	
Employment Service	17.207	104,089,677	A
Unemployment Insurance	17.225	2,055,681,077	A
Senior Community Service Employment Program	17.235	6,573,921	
Trade Adjustment Assistance—Workers	17.245	21,322,116	A O
Employment and Training Assistance—Dislocated Workers	17.246	80,328,332	A
Employment Services and Job Training—Pilot and Demonstration Programs	17.249	182,683	
Job Training Partnership Act	17.250	314,958,399	A
Occupational Safety and Health	17.500	19,579,627	
Mine Health and Safety Grants	17.600	260,272	
Disabled Veterans Outreach Program (DVOP)	17.801	11,112,693	
Veterans Employment Program	17.802	652,442	
Local Veterans Employment Representative Program	17.804	6,892,037	

Footnotes are presented on page 219.

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>	
<b>Department of Transportation:</b>			
Boating Safety Financial Assistance	20.005	1,820,160	
Airport Improvement Program	20.106	340,536	
Highway Planning and Construction	20.205	1,899,752,028	A
Motor Carrier Safety	20.217	2,947,225	
Motor Carrier Safety Assistance Program	20.218	60,386	
Federal Transit Capital Improvement Grants	20.500	12,841,412	
Federal Transit Technical Studies Grants	20.505	4,758,299	
Public Transportation for Nonurbanized Areas	20.509	11,101,347	
State and Community Highway Safety	20.600	20,654,231	A
Pipeline Safety	20.700	739,736	
State Marine Schools	20.806	200,000	
Other—Department of Transportation	20.999	34,038	
<b>Department of the Treasury:</b>			
Other—Department of the Treasury	21.999	114,455	
<b>Equal Employment Opportunity Commission:</b>			
Employment Discrimination—State and Local Fair Employment Practices Agency Contracts	30.002	2,655,640	

Footnotes are presented on page 219.

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
<b>General Services Administration</b>		
Donation of Federal Surplus Personal Property	39.003	8,897,610 **
<b>National Aeronautics and Space Administration:</b>		
Aerospace Education Services Program	43.001	418,810
<b>National Foundation on the Arts and the Humanities:</b>		
Promotion of the Arts—Design Arts	45.001	16,846
Promotion of the Arts—Arts in Education	45.003	98,800
Promotion of the Arts—Media Arts: Film/Radio/Television	45.006	25,730
Promotion of the Arts—State and Regional Program	45.007	1,019,300
Promotion of the Arts—Theater	45.008	57,924
Promotion of the Arts—Local Arts Agencies Program	45.023	240,000
Promotion of the Humanities—Summer Seminars for College Teachers	45.116	163,144
Promotion of the Humanities— NEH/ Teacher-Scholar Program	45.154	16,573
<b>National Science Foundation:</b>		
Engineering Grants	47.041	24,167
Mathematical and Physical Sciences	47.049	1,842,487

Footnotes are presented on page 219.

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Geosciences	47.050	273,029
Science and Technology Centers	47.073	262,087
Social, Behavioral, and Economic Sciences	47.075	180,653
Education and Human Resources	47.076	1,183,676
<b>Small Business Administration:</b>		
Business Development Assistance to Small Business	59.005	11,000
Procurement Assistance to Small Businesses	59.009	1,093,158
Small Business Development Center	59.037	3,708,407
<b>Department of Veterans Affairs:</b>		
Grants to States for Construction of State Home Facilities	64.005	5,671,510
Veterans State Domiciliary Care	64.014	2,766,628
Veterans State Nursing Home Care	64.015	4,701,382
Veterans State Hospital Care	64.016	100,193
All-Volunteer Force Educational Assistance	64.124	39,137
Other—Department of Veterans Affairs	64.999	843,367
<b>Environmental Protection Agency:</b>		
Air Pollution Control Program Support	66.001	4,581,024
Air Pollution Control—Technical Training	66.006	73,200

Footnotes are presented on page 219.



<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Air Pollution Control—National Ambient Air and Source Emission Data	66.007	122,113
State Indoor Radon Grants	66.032	93,643
Construction Grants for Wastewater Treatment Works	66.418	456,457
Water Pollution Control—State and Interstate Program Support	66.419	4,996,540
State Underground Water Source Protection	66.433	462,849
Water Pollution Control—Lake Restoration Cooperative Agreements	66.435	291,750
Construction Management Assistance	66.438	406,673
Water Quality Management Planning	66.454	1,334,622
National Estuary Program	66.456	1,346,314
Capitalization Grants for State Revolving Funds	66.458	97,210,072 A
Nonpoint Source Reservation	66.459	1,215
Nonpoint Source Implementation Grants	66.460	6,640,156
Wetlands Protection—State Development Grants	66.461	166,184
EPA New Coastal Waters Program	66.462	95,831
National Pollutant Discharge Elimination System Related State Program Grants	66.463	162,509
Near Coastal Waters	66.464	16,427
Air Pollution Control Research	66.501	8,625

Footnotes are presented on page 219.

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Safe Drinking Water Research and Demonstration	66.506	1,759,851
Toxic Substances Compliance Monitoring Program	66.701	277,062
Pollution Prevention Grants Program	66.708*** (66.900)	109,364
Hazardous Waste Management State Program Support	66.801	3,048,636
Hazardous Substance Response Trust Fund	66.802	5,446,577
State Underground Storage Tanks Program	66.804	676,321
Underground Storage Tank Trust Fund Program	66.805	6,544,071
State/EPA Data Management Financial Assistance Program	66.925	92,000
Other—U.S. Environmental Protection Agency	66.999	1,328,356
<b>Action:</b>		
Foster Grandparent Program	72.001	1,341,156
Senior Companion Program	72.008	15,295
<b>Department of Energy:</b>		
State Energy Conservation	81.041	1,159,369
Weatherization Assistance for Low-Income Persons	81.042	4,683,990
Basic Energy Sciences—University and Science Education	81.049	38,875

Footnotes are presented on page 219.

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Energy Extension Service	81.050	287,671
Energy Conservation for Institutional Buildings	81.052	677,954
Regional Biomass Energy Programs	81.079	25,000
Policy, Planning and Program Development	81.080	30,325
Conservation Research and Development	81.086	88,000
Environmental Restoration	81.092	1,656,780
Science and Engineering Research Semester	81.097	12,166
<b>Federal Emergency Management Agency:</b>		
Acquisition of Flood-Damaged Structures	83.502	231,335
Civil Defense—State and Local Emergency Management Assistance	83.503	6,302,567
State Disaster Preparedness Grants	83.505	10,011
Disaster Assistance	83.516	746,015,360 A
Earthquake Hazards Reduction Grants	83.521	1,531,124
National Urban Search and Rescue (US&R) Program	83.526	320,802
Emergency Management Institute—Field Training Program	83.528	416,049
State and Local Emergency Management Assistance—Other Assistance	83.531	924,074
Facilities and Equipment	83.532	14,703
Other—Federal Emergency Management Agency	83.999	30,000

Footnotes are presented on page 219.

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>	
<b>Department of Education:</b>			
Adult Education—State Administered Basic Grant Program	84.002	20,142,318	A
Bilingual Education	84.003	183,061	
Desegregation Assistance, Civil Rights Training, and Advisory Services	84.004	667,388	
Federal Supplemental Educational Opportunity Grants	84.007	87,723	
Education of Children With Disabilities in State Operated or Supported Schools	84.009	1,519,410	
Chapter 1 Programs—Local Educational Agencies	84.010	633,966,350	A
Migrant Education—Basic State Formula Grant Program	84.011	95,606,227	A
Educationally Deprived Children— State Administration	84.012	7,050,769	
Chapter 1 Program for Neglected and Delinquent Children	84.013	3,469,093	
Special Education—Innovation and Development	84.023	227,399	
Services for Children With Deaf— Blindness	84.025	1,122,946	
Special Education—State Grants	84.027	163,566,099	A
Special Education—Personnel Development and Parent Training	84.029	891,263	
Federal Family Education Loans	84.032	429,079,386	A
Federal Work-Study Program	84.033	22,293	
Public Library Services	84.034	9,816,732	

Footnotes are presented on page 219.

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>	
Interlibrary Cooperation and Resource Sharing	84.035	1,658,840	
Federal Perkins Loan Program— Federal Capital Contributions	84.038	27,270	
Vocational Education—Basic Grants to States	84.048	108,101,169	A
Vocational Education—Consumer and Homemaking Education	84.049	3,919,704	
Vocational Education—State Councils	84.053	393,195	
Higher Education—Cooperative Education	84.055	79,414	
Federal Pell Grant Program	84.063	215,595	
Higher Education—Veterans Education Outreach Program	84.064	1,775	
Grants to States for State Student Incentives	84.069	11,195,924	
Special Education—Severely Disabled Program	84.086	184,673	
Rehabilitation Services—Vocational Rehabilitation of State Grants	84.126	174,746,346	A
Rehabilitation Services—Service Projects	84.128	1,127,485	
Rehabilitation Long-Term Training	84.129	283,571	
Centers for Independent Living	84.132	253,277	
National Institute on Disability and Rehabilitation Research	84.133	65,712	
Migrant Education—Coordination Program	84.144	14,388	

Footnotes are presented on page 219.

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>	
Federal, State, and Local Partnerships for Educational Improvement	84.151	50,367,301	A
Public Library Construction and Technology Enhancement	84.154	837,010	
Secondary Education and Transitional Services for Youth With Disabilities	84.158	646,261	
Special Studies for Persons With Disabilities Program	84.159	3,320	
Emergency Immigrant Education	84.162	18,879,252	
Eisenhower Mathematics and Science Education—State Grants	84.164	25,095,901	A
Dwight D. Eisenhower National Program for Mathematics and Science Education	84.168	1,255	
Independent Living State Grants	84.169	774,334	
Special Education—Preschool Grants	84.173	26,850,735	A
Vocational Education—Community Based Organizations	84.174	1,651,522	
Douglas Teacher Scholarships	84.176	1,532,331	
Grants for Infants and Families With Disabilities	84.181	13,471,238	
Drug-Free Schools and Communities—National Programs	84.184	55,320	
Byrd Honors Scholarships	84.185	1,164,102	
Drug-Free Schools and Communities—State Grants	84.186	45,734,123	A O
Supported Employment Services for Individuals With Severe Disabilities	84.187	2,979,385	
Christa McAulliffe Fellowships	84.190	2,692	

Footnotes are presented on page 219.

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Adult Education for the Homeless	84.192	711,131
Bilingual Education Support Services	84.194	1,421,882
Education for Homeless Children and Youth—Grants for State and Local Activities	84.196	1,984,994
College Library Technology and Cooperation Grants	84.197	64,057
Jacob K. Javits Gifted and Talented Students Education Grant Program	84.206	91,935
Even Start—State Education Agencies	84.213	8,686,508
Even Start—Migrant Education	84.214	204,028
The Secretary's Fund for Innovation in Education	84.215	149,862
State Program Improvement Grants	84.218	1,089,599
Student Literacy Corps and Student Mentoring Corps	84.219	1,008,035
Tech-Prep Education	84.243	10,053,134
Rehabilitation Short-Term Training	84.246	46,766
Foreign Languages Assistance	84.249	741,954
Supplementary State Grants for Facilities, Equipment, and Other Program Improvement Activities	84.253	308,565
State Literacy Resource Centers	84.254	124,656
Rehabilitation Training—State Vocational Rehabilitation Unit In-Service Training	84.265	162,297
State Postsecondary Review	84.267	315,439

Footnotes are presented on page 219.

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
<b>Consumer Product Safety Commission:</b>		
Other—Consumer Product Safety Commission	87.999	32,830
<b>Department of Health and Human Services:</b>		
State Comprehensive Mental Health Service Planning Development Grants	13.158	1,782
Special Programs for the Aging—Title VII, Chapter 3—Programs for Prevention of Elder Abuse, Neglect and Exploitation	93.041	424,150
Special Programs for the Aging—Title VII, Chapter 2—Long-Term Care Ombudsman Services for Older Individuals	93.042	486,840
Special Programs for the Aging—Title III, Part F—Disease Prevention and Health Promotion Services	93.043	1,985,061
Special Programs for the Aging—Title III, Part B—Grants for Supportive Services and Senior Centers	93.044	29,347,356 A
Special Programs for the Aging—Title III, Part C—Nutrition Services	93.045	42,746,700 A
Special Programs for the Aging—Title III, Part D—In-Home Services for Frail Older Individuals	93.046	685,492
Special Programs for the Aging—Title IV— Training, Research and Discretionary Projects and Programs	93.048	105,044
Grants for Residential Treatment Programs for Pregnant and Postpartum Women	93.101	878,312
Demonstration Grants for Residential Treatment Women and Their Children	93.102	357,583

Footnotes are presented on page 219.



<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Food and Drug Administration— Research	93.103	298,643
Maternal and Child Health Federal Consolidated Programs	93.110	57,400
Biological Response to Environmental Health Hazards	93.113	44,351
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	93.116	1,515,908
Acquired Immunodeficiency Syndrome (AIDS) Activity	93.118	5,996,065
Mental Health Planning and Demonstration Projects	93.125	168,183
Emergency Medical Services for Children	93.127	154,252
Grants for Technical Assistance Activities Related to the Block Grant for Community Mental Health Services—Mental Health Statistics Improvement Program	93.128	4,258
Injury Prevention and Control Research and State Grants Projects	93.136	204,000
Minority Community Health Coalition Demonstration	93.137	141,010
Projects for Assistance in Transition from Homelessness (PATH)	93.150	3,760,941
Health Program for Toxic Substances and Disease Registry	93.161	518,015
Grants for State Loan Repayment	93.165	687,764
Community Youth Activity Program Demonstration Grants	93.170	306,396

Footnotes are presented on page 219.

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Community Youth Activity Program Block Grants	93.171	41,310
Conference Grant (Substance Abuse)	93.174	46,600
Drug Abuse Treatment Waiting List Reduction Grants	93.175	85,513
State Data Collection—Uniform Alcohol and Drug Abuse Data	93.179	323,225
Disabilities Prevention	93.184	126,319
Cooperative Agreements for Drug Abuse Treatment Improvement Projects in Target Cities	93.196	1,199,856
Health Services Research and Development Grant	93.226	50,152
Mental Health Research Grants	93.242	462,707
Childhood Immunization Grants	93.268	5,748,513
Centers for Disease Control and Prevention—Investigations and Technical Assistance	93.283	1,290,549
General Clinical Research Centers	93.333	35,414
Biomedical Research Support	93.337	262,707
Professional Nurse Traineeships	93.358	313,052
Cancer Detection and Diagnosis Research	93.394	44,349
Emergency Protection Grants—Substance Abuse	93.554	137,790
Family Support Payments to States—Assistance Payments	93.560	3,210,225,609 A

Footnotes are presented on page 219.

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>	
Job Opportunities and Basic Skills Training	93.561	102,175,275	A
Assistance Payments—Research	93.562	262	
Child Support Enforcement	93.563	218,127,893	A
State Legalization Impact Assistance Grants	93.565	688,683,839	A
Refugee and Entrant Assistance— State Administered Programs	93.566	92,715,867	A
Low-Income Home Energy Assistance	93.568	67,790,000	A
Community Services Block Grant	93.569	43,833,022	A
Community Services Block Grant Discretionary Awards—Community Food and Nutrition	93.571	493,875	
Emergency Community Services for the Homeless	93.572	1,155,953	
Child Care for Families At-Risk of Welfare Dependency	93.574	241,827	
Payments to States for Child Care Assistance	93.575	86,230,863	A
Refugee and Entrant Assistance— Discretionary Grants	93.576	889,545	
U.S. Repatriate Program	93.579	5,904	
Head Start	93.600	83,955	
Developmental Disabilities Basic Support and Advocacy Grants	93.630	6,325,558	
Child Welfare Services—State Grants	93.645	31,769,890	A
Social Services Research and Demonstration	93.647	166,435	

Footnotes are presented on page 219.

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>	
Adoption Opportunities	93.652	26,720	
Temporary Child Care and Crisis Nurseries	93.656	499,302	
Foster Care—Title IV-E	93.658	551,399,438	A
Adoption Assistance	93.659	43,123,991	A
Social Services Block Grant	93.667	296,442,007	A
Child Abuse and Neglect State Grants	93.669	461,645	
Child Abuse and Neglect Discretionary Activities	93.670	318,884	
Family Violence Prevention and Services	93.671	2,260,245	
Grants to States for Planning and Development of Dependent Care Programs	93.673	1,737,415	
Independent Living	93.674	9,831,146	
Medicare—Hospital Insurance	93.773	1,494,053	
Medicare—Supplementary Medical Insurance	93.774	11,876,525	
State Medicaid Fraud Control Units	93.775	7,204,338	
State Survey and Certification of Health Care Providers and Suppliers	93.777	19,476,966	
Medical Assistance Program	93.778	8,189,978,687	A O
Health Care Financing Research, Demonstration and Evaluations	93.779	619,785	
Social Security—Disability Insurance	93.802	139,386,338	A
Biophysics and Physiological Sciences	93.821	12,036	

Footnotes are presented on page 219.

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>	
Digestive Diseases and Nutrition Research	93.848	8,555	
Cellular and Molecular Basis of Disease Research	93.863	217,592	
Model Comprehensive Drug Abuse Treatment Programs for Critical Populations	93.902	7,898,056	
Model Criminal Justice Drug Abuse Treatment for Incarcerated Populations, Nonincarcerated Populations and Juvenile Justice Populations	93.903	1,811,832	
Grants to States for Operations of Offices of Rural Health	93.913	510,150	
HIV Care Formula Grants	93.917	15,877,193	
Cooperative Agreements for State-Based Comprehensive Breast and Cervical Cancer Early Detection Programs	93.919	4,096,045	
Demonstration Grants to States for Community Scholarships	93.931	47,962	
Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems	93.938	428,538	
HIV/AIDS and Related Diseases Among Substance Abusers: Community-Based Outreach and Intervention Demonstration Program	93.949	1,935,205	
Demonstration Grants to States With Respect to Alzheimer's Disease	93.951	316,120	
Block Grants for Community Mental Health Services	93.958	35,021,551	A
Block Grants for Prevention and Treatment of Substance Abuse	93.959	160,686,056	A O

Footnotes are presented on page 219.

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>	
Preventive Health Services—Sexually Transmitted Diseases Control Grants	93.977	2,051,783	
Mental Health Disaster Assistance and Emergency Mental Health	93.982	4,772,309	
Health Programs for Refugees	93.987	295,000	
Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation of Surveillance Systems	93.988	243,155	
National Health Promotion	93.990	62,928	
Preventive Health and Health Services Block Grant (PHHS Block Grants)	93.991	9,401,981	
Alcohol and Drug Abuse and Mental Health Services Block Grant	93.992	73,069	O
Maternal and Child Health Services Block Grant to the States	93.994	40,371,113	A
Other—Department of Health and Human Services	93.999	6,159,289	
<b>Commission on National and Community Service:</b>			
Service America/Higher Education	94.001	1,689,258	
<b>Miscellaneous Grants and Contracts:</b>			
Shared Revenue—Flood Control Lands	98.002	197,707	
Shared Revenue—Grazing Land	98.004	354,085	
College Housing Debt Service Grant	98.013	917,149	
U.S. Department of the Interior—Fire Prevention/Suppression Agreement	98.014	1,559	

Footnotes are presented on page 219.

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
U.S. Department of the Interior—Fire Prevention/Suppression Agreement	98.015	189,068
U.S. Department of Agriculture and Various Other U.S. Departments—Fire Prevention/Suppression Agreements	98.016	3,059,829
Miscellaneous Federal Receipts	98.099	51,468
Miscellaneous Federal Receipts	98.999	<u>1,354,696</u>
Total Grants Received		<u>\$25,917,232,874</u>
Total Major Grants Audited in Compliance With OMB, Circular A-128		<u>\$25,316,490,166</u>

Note: In addition, the State received \$3,895,211 in Petroleum Violation Escrow Funds that can be used to supplement five federal energy-related conservation and assistance programs. The funds were audited to the extent required by the OMB's Circular A-128.

A - The Bureau of State Audits reviewed these major grants for fiscal year 1993-94 in compliance with the OMB's Circular A-128.

O - The Bureau of State Audits reviewed this grant in conjunction with various reports issued from July 1, 1993, to December 31, 1994. See the Schedule of Audit Reports Involving Federal Grants from July 1, 1993, to December 31, 1994, beginning on page 225 for a description of these reports.

\* This amount includes cash and the value of commodities or cash and the value of food stamps.

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

\*\*\* The federal government changed the federal catalog number for fiscal year 1993-94. The number in parentheses represents the former federal catalog number.

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

Federal Catalog Number	Grantor Agency/Program Title	Administering State Agency	Page Number	Weaknesses and Item Numbers <sup>a</sup>				
				Inaccurate/ Inadequate/ Late Reports	Insufficient Support for Expenditures	Insufficient Monitoring/ Auditing	Inadequate Monitoring of Advances	Early Request/ Late Disbursement of Federal Funds Other
<b>Department of Agriculture</b>								
10.550	Food Distribution	California Department of Education	87		2			
		Department of Aging	117	3				2
10.551	Food Stamps	Department of Social Services	148	7				
10.553	School Breakfast Program	California Department of Education	87			4		
10.555	National School Lunch Program	California Department of Education	87			4		
10.557	Special Supplemental Food Program for Women, Infants, and Children	Department of Health Services	135			6-8,10,12		4-5,9,12
10.558	Child and Adult Care Food Program	California Department of Education	87			4		
<b>Department of Housing and Urban Development</b>								
14.228	Community Development Block Grants/State's Program	Department of Housing and Community Development	47	6,8	13			12 1-2
14.239	HOME Investment Partnership Program	Department of Housing and Community Development	47					12
14.857	Section 8 Rental Certificate Program	Department of Housing and Community Development	47	6-8	6,11,13			12 1,5

<sup>a</sup>The item number is the number of each weakness as presented in the report on each state agency.



**Weaknesses and Item Numbers<sup>a</sup>**

Federal Catalog Number	Grantor Agency/Program Title	Administering State Agency	Page Number	Inaccurate/ Inadequate/ Late Reports	Insufficient Support for Expenditures	Insufficient Monitoring/ Auditing	Inadequate Monitoring of Advances	Early Request/ Late Disbursement of Federal Funds	Other
<b>Department of Justice</b>									
16.579	Drug Control and System Improvement—Formula Grant	Office of Criminal Justice Planning	97		5	3-4			
<b>Department of Labor</b>									
17.225	Unemployment Insurance	Employment Development Department	128	4					5
17.235	Senior Community Service Employment Program	Department of Aging	117	3		1	4		
17.250	Job Training Partnership Act	California Department of Education	87			7			
		Employment Development Department	128			1-2	3		
<b>Department of Transportation</b>									
20.205	Highway Planning and Construction	Department of Transportation	63	1-2	4			4	4
<b>Federal Emergency Management Agency</b>									
83.516	Disaster Assistance	Office of Emergency Services	160						1-2

<sup>a</sup>The item number is the number of each weakness as presented in the report on each state agency.

Weaknesses and Item Numbers<sup>a</sup>

Federal Catalog Number	Grantor Agency/Program Title	Administering State Agency	Page Number	Inaccurate/ Inadequate/ Late Reports	Insufficient Support for Expenditures	Insufficient Monitoring/ Auditing	Inadequate Monitoring of Advances	Early Request/ Late Disbursement of Federal Funds	Other
<b>Department of Education</b>									
84.032	Guaranteed Student Loans	California Student Aid Commission	82	4		4			1-4
84.048	Vocational Education—Basic Grants to States	California Department of Education	87	1,6					
		California Community Colleges, Chancellor's Office	71	6					
84.126	Rehabilitation Services—Vocational Rehabilitation of State Grants	Department of Rehabilitation	146	1		2			2
84.164	Eisenhower Mathematics and Science Education—State Grants	California Department of Education	87			5			
		California Postsecondary Education Commission	78			2	1		
84.186	Drug-Free Schools and Communities—State Grants	Department of Alcohol and Drug Programs	120			3	6,8	7	2,5
		Office of Criminal Justice Planning	97		5	2-4			
<b>Department of Health and Human Services</b>									
93.044	Special Programs for the Aging—Title III, Part B—Grants for Supportive Services and Senior Centers	Department of Aging	117	3		1	4		2

<sup>a</sup>The item number is the number of each weakness as presented in the report on each state agency.

Weaknesses and Item Numbers<sup>a</sup>

Federal Catalog Number	Grantor Agency/Program Title	Administering State Agency	Page Number	Inaccurate/ Inadequate/ Late Reports	Insufficient Support for Expenditures	Insufficient Monitoring/ Auditing	Inadequate Monitoring of Advances	Early Request/ Late Disbursement of Federal Funds	
								Other	Other
93.045	Special Programs for the Aging— Title III, Part C—Nutrition Services	Department of Aging	117	3	1	4			2
93.560	Family Support Payments to States—Assistance Payments	Department of Social Services	148		6				
93.561	Job Opportunities and Basic Skills Training	Department of Social Services	148					4	
93.565	State Legalization Impact Assistance Grant	Department of Social Services	148		2				
93.566	Refugee and Entrant Assistance—State	Department of Health Services	135	12					
93.568	Low-Income Home Energy Assistance	Department of Economic Opportunity	104			4			2-4
93.569	Community Services Block Grant	Department of Economic Opportunity	104			1			2-4
93.658	Foster Care—Title IV-E	Department of Social Services	148	7	2				
93.778	Medical Assistance Program	Department of Health Services	135	3	12				
93.802	Social Security—Disability Insurance	Department of Social Services	148	5				4	
93.959	Block Grants for Prevention and Treatment of Substance	Department of Alcohol and Drug Programs	120	8	3,8	6		7	1,8

<sup>a</sup>The item number is the number of each weakness as presented in the report on each state agency.

Weaknesses and Item Numbers<sup>a</sup>

Federal Catalog Number	Grantor Agency/Program Title	Administering State Agency	Page Number	Inaccurate/ Inadequate/ Late Reports	Insufficient Support for Expenditures	Insufficient Monitoring/Auditing	Inadequate Monitoring of Advances	Early Request/ Late Disbursement of Federal Funds	Other
93,994	Maternal and Child Health Services Block Grant to the States	Department of Health Services	135	3		8			
<b>Various Federal Departments</b>									
	Numerous Federal Programs	Department of Finance	109	1					
	Numerous Federal Programs	Department of Health Services	135			2			12
	Numerous Federal Programs	California Department of Education	87			3			
	Numerous Federal Programs	Department of Social Services	148	1,3	7				3,7
	Numerous Federal Programs	California Community Colleges, Chancellor's Office	71						1-2
	Numerous Federal Programs	State Controller's Office	157			1			
	Numerous Federal Programs	Department of Housing and Community Development	47						2,10
	Numerous Federal Programs	Department of Alcohol and Drug Programs	120	4		3			

<sup>a</sup> The 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, 1993 to December 31, 1994**

From July 1, 1993, to December 31, 1994, the Bureau of State Audits issued reports on audits involving federal grants. The following schedule lists the reports issued and presents a summary of the report findings. The agencies' response to these findings are included in each of the separate audit reports.

<u>Agency Receiving Federal Funds</u>	<u>Federal Grant and Federal Catalog Number</u>	<u>Report Title and Description</u>
Alcohol and Drug Programs, Department of	Drug-Free Schools and Communities—State Grants 84.186	A Review of the Accomplishment of Goals Designed To Reduce Drug and Alcohol Abuse in California (93017, 9-23-93)
	Block Grants for Prevention and Treatment of Substance Abuse 93.959	(1) Provisions have been added to the California Health and Safety Code designed to reduce drug and alcohol abuse in California, improve the coordination of efforts to reduce drug and alcohol abuse, and provide direction for public policy decisions affecting drug and alcohol services.
	Alcohol and Drug Abuse and Mental Health Services Block Grant 93.992	2) Division 10.6 of the Health and Safety Code, Section 11998.1, sets forth 79 long-term five-year goals that focus on the elimination of drug and alcohol abuse in California. State agencies and counties share responsibility for 13 of these goals, with state departments solely responsible for 27 goals and counties solely responsible for 39 of the 79 goals.
		(3) State agencies have fully achieved 13 of the 40 goals they could address. Additionally, state agencies have made partial progress in meeting 22 of the goals. However, they have made no progress on 5 of the 40 goals they could address.
		(4) The Department of Alcohol and Drug Programs (department) provides guidance and funding to the counties for the development of county master plans. In our review of a sample of ten county master plans, we found that all ten master plans contain a description of the county's master plan advisory body as required by the State's guidance.

Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Report Title and Description
Employment Development Department	Trade Adjustment Assistance—Workers 17.245	<p>(5) All 58 counties in the State are in some stage of developing a master plan for reducing drug and alcohol abuse. However, with few exceptions, information on the counties' progress in meeting the goals they could address is not available at the department because the department does not believe it has the statutory power to require such information.</p>
		<p>Investigative Activity Report and Public Reports of Investigations Completed by the Bureau of State Audits from January 1 Through July 31, 1994 (194-2, 9-14-94)</p>
		<p>(1) A program manager at a branch office of the Employment Development Department (EDD) violated federal, state, and departmental conflict-of-interest laws, regulations, and standards during the awarding of more than \$770,000 in state contracts to a company in which she had a financial interest. Although the program manager told her supervisor about her relationship with the company, her disclosure was delinquent. Her supervisor inappropriately failed to remove her from this position after she disclosed her financial interest in the company.</p>
Health Services, Department of	Medical Assistance Program 93.778	<p>The Department of Health Services' Information on Drug Treatment Authorization Requests (93012, 10-5-93)</p>
		<p>(1) From June 1992 through May 1993, the Department of Health Services (department) processed approximately 33 percent more drug treatment authorization requests (TARs) than it did in the first year of our review. In addition, the department's monthly backlog of drug TARs received by mail increased to approximately 5,000 in May 1993. In comparison, at the end of May 1991, the department's backlog of drug TARs received through the mail was approximately 2,900.</p>

- (2) During the 12-month period from June 1992 through May 1993, the department reported that its average time for processing mailed drug TARs exceeded the 5 days state law requires. In May 1993, it took an average of 16 days to process mailed drug TARs.
- (3) In April 1993, the department contracted with nine pharmacist consultants to enable the drug units to process drug TARs more effectively and promptly. The department also hired two full-time pharmacist consultants to staff a new drug unit in San Bernardino. Their role is to process drug TARs by either approving, denying, modifying, or returning the TARs to providers (to request additional information).
- (4) From June through November 1992, the department was not processing drug TARs received by telephone facsimile machine within 24 hours, as federal law requires. However, for drug TARs received during May 1993, after the department contracted with nine pharmacist consultants, we found the department met the 24-hour requirement.

Medical Assistance Program  
93.778

Department of Health Services' Licensing and Certification  
Program Performance Audit (93020, 1-4-94)

- (1) There are significant weaknesses in the Department of Health Services' (department) Licensing and Certification Program (L&C) control procedures surrounding the preparation of the fee schedule required by Section 1266 of the California Code.
- (2) The L&C is not completing all of the Priority 1 federal mandates for conducting surveys of the Health Care Financing Administration (HCFA) within the timeframe required. In fiscal year 1992-93, the L&C had a compliance failure rate of 3.5 percent and 42.9 percent for long-term care and home health care facilities, respectively. Although, as recently reported by HCFA, the L&C has made significant improvement, it still is currently unable to complete the required Priority 1 mandates within the required timeframe.

(3) Antiquated proprietary computer systems are used to support the L&C survey reporting process. The systems lack functionality and are not integrated. The result of having nonintegrated systems is a time-consuming error-prone, and manually-driven survey reporting process.

Medical Assistance Program  
93.778

The Department of Health Services' Information on Drug Treatment Authorization Requests (93029, 2-1-94)

(1) From June through November 1993, the Department of Health Services (department) processed approximately 87 percent more drug treatment authorization requests (TARs) since the first six months of our review. In addition, the department reduced its total backlog of drug TARs from a high of 33,800 for the six-month period of December 1992 through May 1993, to a total of 7,194 for the six-month period of June through November 1993.

(2) In November 1993, the department generally met the state requirements to process mailed drug TARs within five days. In five of the six months, from June through November 1993, both the Stockton and Los Angeles drug units met the state requirement to process mailed drug TARs within five days. This is an improvement from the OAG's first report in December 1990, when the OAG reported that it took an average of 15 days to process mailed drug TARs.

(3) From June through November 1993, the Stockton drug unit processed TARs received by telephone facsimile machines (FAX) within 24 hours of receipt, as federal law requires. The Los Angeles drug unit processed 99 percent of the drug TARs received by FAX within 24 hours of receipt, and processed 98 percent of the drug TARs received by the department's audio response telephone system—Voice Drug TARs System—within 24 hours of receipt.



**Agency Receiving Federal Funds**

**Federal Grant and Federal Catalog Number**

**Report Title and Description**

Medical Assistance Program  
93.778

The Department of Health Services' Information on Drug Treatment Authorization Requests (94012, 8-1-94)

- (1) From December 1993 through May 1994, the Department of Health Services (department) processed approximately 97 percent more drug treatment authorization requests (TARs) since the first six months of our review. However, the department also increased its total backlog of TARs from 1,452 at the end of November 1993 to 5,970 TARs at the end of May 1994.
- (2) During the six-month period December 1993 through May 1994, the department generally did not meet the state requirements to process mailed drug TARs within five days. The Stockton drug unit met the requirement in four of the six months, while the Los Angeles drug unit met the five-day requirement in only two of the six months. The extended processing time in the Los Angeles drug unit was primarily caused by the effects of the Northridge earthquake on January 17, 1994.
- (3) From December 1993 through May 1994, the Stockton drug unit processed 80 percent of the TARs received by telephone facsimile machines (FAX) within 24 hours of receipt, as federal law requires. The Stockton drug unit processed the remaining 20 percent of the TARs in no more than 2 hours beyond the 24-hour requirement. The Los Angeles drug unit processed 81 percent of the Drug TARs received by FAX within 24 hours of receipt and processed 74 percent of the drug TARs received by the department's audio response telephone system—Voice Drug TAR System—within 24 hours of receipt.

Public Employees' Retirement System  
State Teachers' Retirement System  
through various departments

Various federal grants

The State's Contribution to the Public Employees' Retirement System and the State Teachers' Retirement System (93028, 4/12/94)

We contracted with a consulting firm that provides actuarial services to assist us in reviewing each system's most recent actuarial valuation.

- (1) The most recent actuarial valuations conducted by the State Teachers' Retirement System (STRS) and the Public Employees' Retirement System (PERS) provided reasonable estimates of the costs and funding needed for the systems. The assumptions and methods that the systems used were reasonable and in accordance with generally accepted actuarial practice. However, the PERS' implementation of a 40-year funding period and the use of a special 5-year period to recognize the actuarial gains for one year were not in accordance with generally accepted actuarial practice. Nevertheless, these actions reflect policy decisions made by the State that were put into statute. The system's estimates regarding unfunded liabilities were reasonable and in accordance with generally accepted actuarial practice. Additionally, the systems' computations of the annual contribution needed to fund the normal costs and the unfunded liabilities were accurate following statutory policies.
- (2) The State's contributions to the STRS have increased in recent years and will continue to increase as the salaries and number of teachers increase. In addition to changes caused by increases in payroll, the State's contribution has changed because of legislative action taken by the State.
- (3) The PERS made an error in implementing one of the contribution reduction measures. Correction of this error will provide an additional \$1.4 million to be used to offset the State's General Fund contribution.

(4) The administrative costs of both the PERS and STRS have increased in recent years. An increase in the systems' administrative costs has a dollar-for-dollar effect on the systems' unfunded liabilities or, in the case of certain PERS state groups, on the surpluses. Increases to unfunded liabilities and reductions to surpluses at the PERS both directly affect the State's contribution. The State's contribution to the STRS would not be directly affected by an increase in administrative costs because the contribution rate is mandated by statute. However, if administrative costs were to increase significantly, it could affect whether the statutory rate was considered sufficient to provide an adequate level of funding for the system.

Additionally, because the PERS serves employers other than the State, the PERS, in effect, allocates to each employer a portion of the total administrative costs. However, the PERS does not have a specific cost allocation system that distributes administrative costs to the various employers based on the cost incurred on behalf of that employer. Instead, it allocates administrative costs based on each employer's relative share of assets. We could not determine whether the current methodology resulted in an equitable distribution of costs to the State because of the manner in which the PERS conducts its operations.

Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Report Title and Description
Public Employees' Retirement System through various departments	Various federal grants	<p>A Review of Service-Related Disability Retirements at Three Retirement Systems (93105, 10-6-94)</p> <p>(1) According to Section 21300 of the California Government Code, the Public Employees' Retirement System (PERS) may reduce or eliminate a member's ordinary disability retirement (ODR) monthly pension if that member earns income after retirement from a job that is not in state service, but the PERS cannot do so for any member who receives industrial disability retirement (IDR) benefits. If Section 21300 was amended to allow the PERS to apply earnings limitations as allowed for ODR to members with earned income who receive IDR benefits, the PERS would save approximately \$1.8 million a year by reducing members' pension for the 214 members included in our sample, and a total of \$7.2 million by the time those members reach the age of 50.</p>
Transportation, Department of	Various federal grants	<p>A Review of Caltrans' Management of the Contract With Morrison Knudsen Corporation for the Design and Construction of Railcars (93114, 3-8-94)</p> <p>(1) In June 1990, the voters of California approved Propositions 108 and 116 authorizing the sale of nearly \$3 billion in general obligation bonds. The purpose of these propositions was to provide funds for the acquisition of rights-of-way, capital expenditures and improvements, and the acquisition of passenger railcars and locomotives for intercity rail, commuter rail, and urban rail transit systems.</p> <p>According to Proposition 116, the Department of Transportation (Caltrans) will be allocated \$100 million to fund a competitive proposal program for the acquisition of standardized state-of-the-art intercity and commuter railcars. As of January 1, 1994, Caltrans had committed approximately \$215 million of the funds raised from bond sales authorized by both propositions to fund a contract for the purchase of 113 railcars.</p>

Originally, the funding for the design and construction of the railcars was to be exclusively from state funds. However, Caltrans now projects that \$5 million of federal funds will also be part of the funding for the railcars.

(2) Unlike state law, federal law makes no distinction between minorities' and women's businesses, including both under the category of disadvantaged business enterprises. In addition, federal law does not set any participation goals for the businesses of disabled veterans. Although Caltrans had originally established state goals for the participation of disadvantaged businesses in the railcars contract, by the time the contract was awarded Caltrans had substituted federal goals for obtaining the participation of disadvantaged businesses.

(3) By using the federal requirements, Morrison Knudsen Corporation was allowed to establish a participation goal of 10 percent for disadvantaged businesses with both minority and women's businesses falling under the same designation of disadvantaged businesses.

Various federal grants

Veterans Affairs, Department of

The Veterans Home of California Has Not Maximized Revenue From Residents and Reimbursements for the Federal Government (93027, 4-19-94)

(1) By not implementing adequate procedures and adopting policies to recover all possible fees, the Veterans Home of California (home) has not maximized revenue from residents.

(2) The home does not have the authority to collect the state-funded cost of care provided to residents who leave the home to live somewhere else.

(3) By not implementing adequate procedures to recover all possible reimbursements, the home has not maximized reimbursements from the federal government.

Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Report Title and Description
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(4) The home could have received up to approximately \$446,000 annually in aid and attendance allowances if the federal Department of Veterans Affairs determined that 95 residents had been eligible to receive the allowances and if the home had obtained the statutory authority to receive the allowance for all veterans, including those with dependents.

**Schedule of Minor Federal Issues for  
Year Ended June 30, 1994**

Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Description of Issue
Aging, Department of	Special Programs for the Aging—Title III, Part B—Grants for Supportive Services and Senior Centers 93.044	(1) The department posted erroneous cost statistics to its cost allocation system resulting in \$52.96 in indirect cost being charged to an inappropriate program.
Alcohol and Drug Programs, Department of	Block Grants for Prevention and Treatment of Substance Abuse and Drug-Free Schools and Communities—State Grants 93.959 84.186	(1) The department failed to disburse federal grant money to the 58 counties during July and August 1993 and April 1994. According to the Block Grant Application, the department was to disburse 1/12th of each county's federal grant money at the end of each month. However, the department made lump sum payments for July, August, and September on September 30, 1993, and made lump sum payments for April and May on June 7, 1994.
California Community Colleges, Chancellor's Office	Vocational Education—Basic Grants to States 84.048	(1) The Chancellor's Office took more than five days to disburse funds to subrecipients for one of 17 claims that we reviewed.
California Postsecondary Education Commission	Eisenhower Mathematics and Science Education—State Grants 84.164	(1) The commission needs to strengthen its control to prevent duplicate payments. We noted an instance where a vendor was paid twice, resulting in an overstatement of grant expenditures of \$297.39.

Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Description of Issue
Criminal Justice Planning, Office of	Drug Control and System Improvement— Formula Grant 16.579	<p>(1) The office did not ensure that the contract that a subrecipient, the Los Angeles County Regional Criminal Information Clearinghouse, entered into with the Department of Justice met federal requirements. The contract specifies that the Clearinghouse had the right to use, authorize others to use, duplicate, and disclose copyrighted material, a provision that conflicts with federal regulations regarding copyrights. The federal regulations reserve these rights exclusively for the federal government. The contract similarly gave title to the Clearinghouse for patents created with grant moneys, and this provision may also violate the same federal regulation.</p>
		<p>(2) The office coded federal funds of \$58,593 received under this grant to an incorrect federal catalog number. The office corrected this error in April 1995.</p>
		<p>(3) The office did not have all progress reports for 2 of 12 subrecipients.</p>
	Drug-Free Schools and Communities— State Grants 84.186	<p>(4) In its fiscal year 1992-93 final progress report to the Department of Alcohol and Drug Programs, the office did not provide a description of the problems encountered by program components as required by the interagency agreement.</p>
		<p>(5) The office did not have drug free workplace or equal employment opportunity certifications for one of 20 subrecipients we reviewed for fiscal year 1992-93.</p>



Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Description of Issue
Education, California Department of	Payments to States for Child Care Assistance 93.575	(1) The department has not received the required approval from the Department of General Services (DGS) and the Department of Finance (DOF) for the funding terms and conditions in contracts the department enters into with providers of services under the Payments to States for Child Care Assistance program. To obtain greater efficiency in the execution of these contracts, the state laws require that the funding terms and conditions included in the contracts be approved by the DGS and the DOF.
Emergency Medical Services Authority	Emergency Medical Services for Children and Preventive Health and Health Services Block Grant (PHHS Block Grants) 93.127 93.991	(1) The authority does not have an ongoing policy for ensuring that its employees are aware of the requirements of the Drug-Free Workplace Act.
Emergency Services, Office of	Disaster Assistance 83.516	(1) The files for two recipients of disaster assistance funds did not contain all the required forms.
Employment Development Department	Various	(1) The department's drug-free workplace policies do not meet all the requirements of the Drug-Free Workplace Act.
	Disaster Assistance 83.516	(2) The department incorrectly calculated the weekly assistance amount for a Disaster Unemployment Assistance claim resulting in an overpayment of \$161. Subsequently, the department recomputed the claim and collected the overpayment from the claimant.

Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Description of Issue
	Employment Service 17.207	<p>(3) For one of the 25 expenditures that we reviewed, we determined that an employee has been using an incorrect project code. As a result, for fiscal years 1992-93 and 1993-94, the department overcharged the program approximately \$2,800.</p> <p>(4) For 2 of the 25 expenditures that we reviewed, the claimants did not include the project or activity code on the claim and the clerical staff filled in an incorrect code. As a result, the program was overcharged a total of \$874.</p>
Health Services, Department of	Special Supplemental Food Program for Women, Infants, and Children 10.557	<p>(1) One of 36 food vouchers we tested had not been stamped by the authorized vendor. The redemption of vouchers that are not stamped by the redeeming vendor could result in the redemption of vouchers by unauthorized vendors.</p> <p>(2) In our test of the department's labor distribution process, we found that the department had charged an incorrect amount of time for one of its employees. Specifically, an intermittent employee's timesheet reflected 86 hours worked in September 1993. However, due to an apparent keypunch error, the employee was paid for 89 hours. As a result, the employee was overpaid by \$20.64.</p>
Justice, Department of	Drug Control and System Improvement— Formula Grant 16.579	<p>(1) The department does not always ensure that new employees receive a Drug-Free Workplace Act policy statement.</p>

Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Description of Issue
Social Services, Department of	Food Stamps 10.551	(1) The department overpaid the federal government by approximately \$62 for the quarter ending September 30, 1993, and overpaid the federal government by approximately \$10 for the quarter ending December 31, 1993. The department corrected the errors on the federal report for the quarter ending June 30, 1994.
	Disaster Assistance 83.516	(2) For 2 of 15 files that we reviewed, the department did not ensure that they obtained copies of Federal Emergency Management Agency inspection reports before awarding requests for payment.
	Job Opportunities and Basic Skills Training 93.561	(3) The department understated the federal and state shares of expenditures by approximately \$80 for the quarter ending March 31, 1994. These expenditures exceeded the allowable limit for the 90 percent federal funding rate and should have been reported at either a 50 percent or 60 percent federal funding rate.
		(4) The department understated the federal and state share of statewide cost allocation expenditures by \$21,000 for the quarter ending March 31, 1994. The department corrected the error on the federal report for the quarter ending June 30, 1994.
	Refugee and Entrant Assistance—State Administered Programs 93.566	(5) For five of six cases that we reviewed, the department did not receive timely required progress reports from counties for unaccompanied minors served in the program. For one of the six cases, the department did not receive the required progress report from the county for an unaccompanied minor served in the program.
	Social Services Block Grant 93.667	(6) The department undercharged the federal government by approximately \$75 for its share of operating expenses of the In-Home Supportive Services program.

Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Description of Issue
State Controller's Office	Various	<p>(1) In its monitoring of subrecipients' audit reports, the controller inappropriately accepted two audit reports for local educational agencies. The audit reports did not include a report on the Schedule of Federal Assistance.</p> <p>(2) In its monitoring of subrecipients, the controller did not complete one of the subrecipients' audits for fiscal year 1992-93 by the required due date of June 30, 1994.</p>
Traffic Safety, Office of	State and Community Highway Safety 20 600	<p>(1) For one of the 45 expenditures tested, the office charged the federal government for an unallowable entertainment and donation expenditure.</p> <p>(2) For 7 of the 45 expenditures tested, the office did not minimize the time between the receipt and disbursement of federal funds. Specifically, the office held federal funds between 6 and 30 days before disbursing payment for the expenditures.</p>
Transportation, Department of	Highway Planning and Construction 20 205	<p>(1) For one of the 44 construction projects tested for compliance with provisions of the Davis-Bacon Act, the certified payroll document was not completed with the information necessary to verify compliance.</p> <p>(2) For one of the 44 construction projects tested, the department could not locate a material inspection report that should be reconciled with the material release documents before payment is made in order to ensure that payment is not made for unacceptable items.</p>

Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Description of Issue
Water Resources Control Board	Capitalization Grants for State Revolving Funds 66.458	(1) For one of 61 claims we reviewed, the board held the related federal funds for 11 working days before disbursement.

## **Report on Compliance With State Laws and Regulations**



# CALIFORNIA STATE AUDITOR

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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, 1994, and have issued our report thereon dated December 15, 1994. We did not audit the financial statements of the pension trust funds, which reflect total assets constituting 77 percent of the fiduciary funds. We also did not audit the financial statements of certain enterprise funds, which reflect total assets and revenues constituting 88 percent and 89 percent, respectively, of the enterprise funds. In addition, we did not audit the University of California funds. Finally, we did not audit the financial statements of certain component unit authorities, which reflect total assets and revenues, constituting 94 percent and 98 percent, respectively, of the component unit authorities. The financial statements of the pension trust funds, certain enterprise funds, the University of California funds, and certain component unit authorities 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, the University of California funds, and certain component unit authorities is based solely upon the reports of other independent auditors.

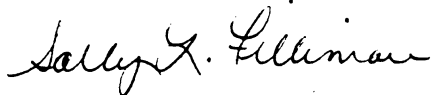
We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the general purpose financial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

The State's management 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 39 through 185 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 cursive script that reads "Sally L. Filliman".

SALLY L. FILLIMAN, CPA  
Deputy State Auditor

April 17, 1995



**Appendix**

**Reports Issued by the Bureau of State Audits  
From July 1, 1993, to December 31, 1994**

<u>Date of Issue</u>	<u>Report Title</u>	<u>Report No.</u>
<b><u>1993</u></b>		
Sep 23	A Review of the Accomplishment of Goals Designed To Reduce Drug and Alcohol Abuse in California	93017
Oct 5	The Department of Health Services' Information on Drug Treatment Authorization Requests (Contract audit by The Thornton Group)	93012
Oct 7	State of California, Statement of Securities Accountability of the State Treasurer's Office, June 30, 1992	92008
Dec 1	Review of the Department of Toxic Substances Control's Implementation of the Hazardous Waste Source Reduction and Management Review Act of 1989 (Contract audit by Ernst & Young)	93018
Dec 28	State of California Financial Report Year Ended June 30, 1992	92001
Dec 30	A Review of the Department of Motor Vehicles' Administration of the Collegiate License Plate Program	93022
Dec 31	A Review of the State's Controls Over Its Financial Operations	92002
Dec 31	State of California, Comprehensive Financial and Compliance Audit Report, Year Ended June 30, 1992	92003
<b><u>1994</u></b>		
Jan 4	Department of Health Services' Licensing and Certification Program Performance Audit (Contract audit by Deloitte & Touche)	93020
Jan 11	A Review of the Reports Submitted by the Department of Corrections and the Department of the Youth Authority on the Early Intervention Program	93011

<u>Date of Issue</u>	<u>Report Title</u>	<u>Report No.</u>
Jan 11	Employees of the University of California, San Diego, Misappropriated Public Funds for Personal Profit and Falsified Documents To Make Other Improper Payments	1930108
Jan 21	A Review of the State's Bond Sales for 1991 and 1992	93016
Feb 1	The Department of Health Services' Information on Drug Treatment Authorization Requests	93029
Feb 2	Investigative Activity Report and Public Reports of Investigations Completed by the Bureau of State Audits From May 7 Through December 31, 1993	194-1
Mar 1	A Review of the State's Allocations and Expenditures of the Additional Transportation Funds Made Available by the 1989 Transportation Blueprint Legislation (Contract audit by R & G Associates)	93014
Mar 8	A Review of Caltrans' Management of the Contract With Morrison Knudson Corporation for the Design and Construction of Railcars	93114
Mar 17	The Franchise Tax Board's Tax Settlement Program Has Achieved the Legislature's Intent	93025
Mar 17	The Board of Equalization's Tax Settlement Program Has Achieved the Legislature's Intent	93026
Mar 22	State of California, Statement of Securities Accountability of the State Treasurer's Office, June 30, 1993	93008
Apr 5	Review of the Implementation, Administration, and Plans for Termination of the California Residential Earthquake Recovery Program	93013
Apr 6	The Department of Insurance Cannot Completely Identify Its Costs for Implementing Proposition 103 and Performing Examinations	93030
Apr 12	The State's Contributions to the Public Employees' Retirement System and the State Teachers' Retirement System	93028

<u>Date of Issue</u>	<u>Report Title</u>	<u>Report No.</u>
Apr 14	An Analysis of the State's Compliance With Requirements for Consultant Contracts	93015
Apr 19	The Veterans' Home of California Has Not Maximized Revenue From Residents and Reimbursements From the Federal Government	93027
May 5	Poor Management Practices at the Department of Insurance's Conservation and Liquidation Division Warrant the Department's Corrective Action	93113
Jun 30	State of California, Financial Report Year Ended June 30, 1993	93001
Jun 30	Continued Improvement Needed in the State's Controls Over Its Operations	93002
Jun 30	State of California, Comprehensive Financial and Compliance Audit Report, Year Ended June 30, 1993	93003
Jul 18	Restrictive Implementation Schedules Effectively Limited Competition for the California State Lottery's New On-Line Gaming System	93119
Jul 26	The Adelanto Redevelopment Agency Needs To Improve Its Procedures To Comply With the Community Redevelopment Law	93112
Aug 1	The Department of Health Services' Information on Drug Treatment Authorization Requests	94012
Aug 17	The Department of Motor Vehicles and the Office of Information Technology Did Not Minimize the State's Financial Risk in the Database Redevelopment Project	94107
Aug 22	A Review of the Department of Education's Cost and Development of the California Learning Assessment System	94109
Sep 14	Investigative Activity Report and Public Reports of Investigations Completed by the Bureau of State Audits From January 1 Through July 31, 1994	I-94-2
Oct 6	A Review of Service-Related Disability Retirements at Three Retirement Systems	93105

<u>Date of Issue</u>	<u>Report Title</u>	<u>Report No.</u>
Nov 22	Employees of the University of California, San Francisco Improperly and Illegally Managed the Center for Prehospital Research and Training	1930279
Dec 7	The State Needs To Reengineer Its Management of Information Technology	94022

**DEPARTMENT OF FINANCE**

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



June 9, 1995

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

Dear Mr. Sjoberg:

### CONTINUED IMPROVEMENT NEEDED IN THE STATE'S CONTROLS OVER ITS OPERATIONS

Thank you for the opportunity to respond to the statewide issues which you've identified. We also appreciate your comment about the State's significant improvements in certain areas.

This report was the result of your examination of the State's general purpose financial statements for the Fiscal Year-ended June 30, 1994. The report will be part of the Single Audit Report covering Fiscal Year 1993-94. Although our systems can always be improved, the fact that the cumulative findings do not adversely affect the State's general purpose financial statements is evidence that the State's operations are materially under control.

California is an entity with numerous programs and activities being carried out for its citizens, and is much more complex and vast than most economic entities in the world. Such complexity, along with budget constraints, challenge us to not only meet the requirements of those programs and activities, but to do so in a manner that is effective and efficient. Moreover, such operations must exist within a system of internal control that safeguards assets and resources, and produces reliable financial information. Attaining these objectives and overseeing the financial and business practices of the State continues to be an important aspect of the Department of Finance's leadership for the State.

In further meeting our responsibility of financial leadership and oversight, we have updated our five-year plan so that we can increase our audits of internal controls of departments. Our plan may include audits of cross-cutting issues; that is areas of potential weaknesses common to many state departments. In addition, we have increased our oversight of internal audit units at individual departments. We provide to them audit guidelines and conduct quality assurance reviews of their work. Further, last year we started a process of issuing Audit Memos to departments to establish policy, or provide technical advice on various audit

related issues. One of the Audit Memos was issued to highlight the statewide issues that you have identified, to remind departments of their responsibilities to resolve such issues, and to provide some guidance for them to resolve such issues.

The Department of Finance provides leadership, assistance and oversight of financial and business practices. However, the head of each agency is responsible for establishing and maintaining a system of internal controls within their agency. This responsibility includes documenting the system, communicating system requirements to employees, and assuring that the system is functioning as prescribed and is modified for changes in conditions. Moreover, all levels of management of state agencies must be involved in assessing and strengthening the systems of internal controls to minimize fraud, errors, abuse, and waste of government funds.

Each department for which you have identified internal control weaknesses is responsible and is held accountable for developing corrective action. Based on their responses to your findings, we will monitor their corrective actions to ensure the resolution of such findings.

Our response to each of the statewide concerns that you have identified in your draft report follows.

#### PROBLEMS WITH THE STATE'S CONVERSION TO GAAP

We are continuing to address some of the Generally Accepted Accounting Principles (GAAP) issues. A committee has been formed including representatives of the Department of Finance, the State Controller's Office and your office. This committee recommends analysis of accounting issues for possible conversion to GAAP. We agree that certain changes to comply with GAAP are desirable and items that are determined to be in the best interests of the State will be converted to GAAP. As you're aware, and have pointed out in your report, the State has already made several significant changes. However, there are some areas where GAAP treatment may not be practical, or where the cost of establishing the necessary systems exceeds the benefits.

The State's legal or budgetary basis of accounting is converted each year by the State Controller's Office to a GAAP basis for reporting purposes. In general, we are not aware of specific problems occurring with material impacts to the financial statement presentations during this process. We look forward to hearing from you regarding specific areas that we should consider for change.

We believe that although perhaps desirable, it is not required or necessary that the Governor's Budget be prepared on a basis consistent with GAAP. The Government Finance Officers' Association recognizes and allows for differences between the basis for budgeting and the basis for accounting. We do not anticipate presenting GAAP basis revenues and expenditures in the Governor's Budget.

### INADEQUATE REPORTING OF LEASING INFORMATION

As indicated in your report, there are some state agencies for which the Department of General Services (DGS) does not have oversight responsibility. In order to include the information for these entities in the DGS records, it will probably be necessary to make the submission of this information a legal requirement. The information currently included in DGS records does not include some of the information needed for the notes to the State's financial statements. Since the information currently maintained by DGS is primarily for internal management purposes, acquiring and maintaining additional information would be an increased cost to DGS.

It may not be cost effective to require the gathering and maintaining of this information for all departments. The DGS is currently addressing the issue of expanding their database on leasing information to include additional information.

### IMPROPER OMISSIONS FROM THE STATE REPORTING PROCESS

A Statement of Operations and a Budget Report are submitted annually by District Agricultural Associations to the Division of Fairs and Expositions within the Department of Food and Agriculture. However, Section 4005 of the Food and Agricultural Code states that the fiscal year for these entities is January 1 to December 31. Section 4505 of the Food and Agriculture Code requires a Statement of Operations to be filed on a calendar year basis. In order to include statements in the State Controller's annual report for these entities, the statute will have to be changed, or statements will have to be prepared twice a year at an additional cost.

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### AGENCIES ARE NOT REQUIRED TO PREPARE RECONCILIATIONS OR REPORTS OF ACCRUALS

As we reported to you before, efforts are underway to make financial reporting more accurate and prompt. As part of this effort a determination will be made, as other priorities and resources allow, as to which year-end financial statements are necessary. Specifically, Report 15 contains summary information that is included on a number of other required reports.

②

### DEFICIENCIES IN ACCOUNTING FOR AND CONTROL OVER STATE EQUIPMENT

As you reported, the State Administrative Manual provides guidelines on accounting for state equipment. Moreover, as table 1 of your report shows, most of the departments have recorded additions and deletions to inventory. However, this is an area where our own auditors continue to find deficiencies. We will issue an Audit

Memo identifying this and other statewide issues, and direct the departments to comply with applicable requirements.

### INELIGIBILITY FOR CERTIFICATE OF ACHIEVEMENT

We recognize that the Certificate of Achievement may be desirable, however, we do not believe that it is a necessary requirement. Moreover, the criteria used for the certificate is different than the criteria used for the Single Audit Report, such as the time requirement for submitting audited financial statements and the format of the report. We feel that we have met the Single Audit requirements.

Regarding your comments about late audited financial statements, efforts are underway to reduce the time required by state agencies to prepare and submit the year-end statements to the State Controller's Office. The State Controller was working towards having statements electronically submitted, and was conducting a review to reduce the number of different statements. Moreover, in a response to a recent audit report, the Controller indicated that their accounting system would be included in their technology upgrade.

In response to comparing the State to major corporations for the timeliness of financial statements, we feel that such a comparison may not be necessarily valid. The comparison overlooks the complexity and the number of funds, programs and related requirements that the State must develop, implement, maintain, account and report upon. We feel that a more appropriate measure would be other comparable governmental entities with a similar size, structure and function.

Finally, your issue relating to the lack of combining statements by fund type is also something that may be desirable. However, we do not believe that it's practical due to the number of funds that the State uses to account for its operations. The Legislature continues to establish more funds, forcing us to change the State's system of numbering funds in order to accommodate the increasing number of funds. As of June 1995, the State has approximately 900 separate funds.

### CONFUSION OVER REQUIREMENTS FOR APPROVAL FOR SOME CONTRACTS

As indicated in your report, approval of contracts is the responsibility of the Department of General Services (DGS). If there are agencies that are not complying with the Public Contract Codes, DGS should initiate corrective action. However, we aren't aware that there have been material losses or misuse of grant funds disbursed. We will notify the Department of General Services of your recommendation to obtain a current opinion from the Attorney General to clearly identify the factors distinguishing grants from contracts.



### DEFICIENCIES IN ADMINISTERING STATE NONCONSULTANT CONTRACTS

Your report identifies 59 contracts, out of 231 tested at 21 agencies, that lacked approval before the start of work. In addition, you identified 147 contracts, out of the same 231 tested that were not competitively bid.

Of the 59 contracts, 37 contracts were found in agencies that have internal audit units. Also, of the 147 contracts, 98 were found in agencies that have internal audit units. The audit program for internal control audits provides guidelines on reviewing contracting procedures. The audit program is provided to the internal auditors for them to use when conducting reviews of their department's internal controls. Our next quality assurance reviews of these internal audit units will focus on the work of the internal auditors in these areas.

The issue of contracts was included in our Audit Memo 94-6, issued on December 1994. We directed departments to comply with the California Public Contract Code. Moreover, in regards to sole source contracts, the Governor's Office in August 1994 issued Executive Order W103-94 prohibiting sole source contracts except for state emergency or public health and safety. Finally, the Department of General Services on September 1994 issued a Management Memo to provide guidelines to comply with the Governor's Executive Order.

### STATE AGENCIES DID NOT PROPERLY ACCOUNT FOR CONSTRUCTION IN PROGRESS

As defined by Section 8600 et. seq. of the State Administrative Manual, state policy does require the identification of the completion of all construction projects and the transfer to the fixed asset-buildings account. In our efforts to make the State more accountable for fixed assets, all agencies will be reminded of their requirements for notification of completion of construction projects through the issuance of a forthcoming Audit Memo of their responsibilities for closing out construction projects in a timely manner. In addition, a subsequent revision of the audit program for the review and evaluation of internal control will emphasize the need for monitoring of construction and fixed assets accounting practices used by the agencies. We are pleased to note that the identified omissions account for less than one-tenth of one percent of the State's total fixed assets as of June 30, 1994, and, while misclassified, all costs have been identified and accounted for.

### INCOMPLETE STATEWIDE REAL PROPERTY INVENTORY

In July 1995, the DGS, Office of Real Estate and Design Services (OREDS) will send a detailed statewide real property inventory to all state agencies for verification. At the completion of the verification process, OREDS should have a valid property

listing. In addition, the agencies will be reminded of their responsibilities for notifying OREDS of all real property transactions in a forthcoming Audit Memo.

#### SALARY WARRANTS ARE NOT ALWAYS PROMPTLY RETURNED

State policy as detailed in Section 8580.5 of the State Administrative Manual requires undelivered salary warrants to be returned to the State Controller's Office within 90 days of receipt. In order to increase compliance with this policy, agencies were reminded of this requirements through Audit Memo 94-6 issued on December 1994. We directed departments to return undelivered salary warrants to the State Controller within 90 calendar days of receipt. In addition, the next update to the audit program for internal control audits will place more emphasis on this issue.

#### ERRORS CALCULATING THE CASH MANAGEMENT INTEREST LIABILITY

The Department of Finance continues to work with the state agencies to ensure accurate cash flow tracking and reporting of federal fund transfers between the State and federal government. Also, as a result of a recent change to a more superior spreadsheet software, errors in the calculation of the State and federal interest liability will be reduced.

The \$316,000 identified as underpaid to the federal government was determined partially by a manual calculation by the Bureau of State Audits. However, when the same calculation was made by the Department of Finance in the computer spreadsheet for interest calculation, the underpaid amount totaled \$310,000. The \$6,000 difference was due to a minor variance in the number of weighted interest days. The total interest liability amount that will be adjusted in the Fiscal Year 1994-95 Annual Report will be \$310,000.

#### LACK OF CENTRALIZED RECORDS FOR FEDERAL RECEIPTS

As indicated in your report, the State adapted a general policy of establishing the Federal Trust Fund in 1978 for the deposit of moneys received by the State from the federal government when the expenditure was administered through or under the direction of a state agency. Unfortunately, exemptions were also allowed. The necessary changes to statutes to achieve the objectives of the Federal Trust Fund will be analyzed as priorities and resources allow.

The issue of lack of centralized records was included in our Audit Memo 94-6 issued on December 1994. We directed departments to notify the State Controller of receipts of federal funds that were not being recorded in the Federal Trust Fund.

INABILITY TO ACCOUNT FOR EXPENDITURES OF FEDERAL MONEY BY EACH FEDERAL PROGRAM

The accounting system currently used to record federal receipts and expenditures will need extensive modification to meet all federal and state requirements. The system does not currently allow a cross-over between receipts and subsequent expenditures by federal program. Required changes will be addressed in relation to other priorities and existing resources.

INADEQUATE MONITORING OF ADVANCES TO SUBRECIPIENTS AND  
INADEQUATE MONITORING OF RECIPIENTS OF STATE AND FEDERAL  
MONEYS

The monitoring of all funds to subrecipients, including cash advances, is the responsibility of individual state agencies and specific requirements are found in Section 20050 of the State Administrative Manual.

The issue of inadequate advances was included in our Audit Memo 94-6 issued on December 1994. We directed departments to comply with federal program requirements to monitor and audit funds provided to local governments. In addition, Audit Memo 94-7 was also issued on December 1994 to provide further information on requirements and methodologies regarding monitoring and auditing.

In regards to your specific recommendations, we will continue to:

- record and report on state operations that is as consistent as possible with generally accepted accounting principles, but will continue to develop the State's budget on a legal basis.
- provide the leadership and direction to enable the departments to produce timely and correct reports that meet the needs of the State.
- provide clear guidance to departments relating to their financial reporting and contracting procedures, through the State Administrative Manual and through our Audit Memos.
- direct departments to comply with applicable State Administrative Manual requirements.
- direct departments to comply with applicable federal requirements related to federal grant moneys received.

In addition, we will continue to:

- increase the number and the scope of internal control audits necessary to ensure the financial and business practices of the state, and safeguarding and effective use of the State's assets and resources. This includes intensifying our review of the department's monitoring of recipients of federal and state moneys.
- update our audit guides for internal auditing, and issue audit memos to internal auditors and others to provide technical assistance in audit and accounting related areas.
- monitor the implementation of corrective action taken by departments.

Again, we appreciate the issues that you have identified to help us improve the State's operations. Our own efforts, as well as those of departmental internal auditors, have identified similar areas in need of improvement. We are aware of efforts underway by various departments in a number of areas to correct these weaknesses.

We will continue to provide the leadership to ensure the proper financial operations and business practices of the State, and to ensure that internal control structures continue to exist for the safeguarding and effective use of assets and resources.

If you have any questions concerning this letter, please contact Enrique Farias, Chief, Office of State Audits and Evaluations at 322-2917.

Sincerely,



RUSSELL S. GOULD  
Director

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# Comments

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## *Comments of the California State Auditor on the Response from the Department of Finance*

To provide clarity and perspective, we are commenting on the Department of Finance's response to our audit report. The numbers correspond to the numbers we have placed in the response.

- ① The Department of Finance (department) has not correctly addressed the issue of *Improper Omissions from The State Reporting Process*. Specifically, the department addressed the omission of financial information for District Agricultural Associations in the State Controller's (SCO) annual report rather than the omission of this information from the State's general purpose financial statements. In addition, the department asserts that because Section 4005 of the Food and Agricultural Code specifies the fiscal year for the District Agricultural Associations as January 1 through December 31, to include financial information for the District Agricultural Associations would require either a change in the statute or the preparation of statements twice per year. The department is incorrect, because the SCO can include financial information for these entities in the State's general purpose financial statements with a note disclosing the reporting period. Moreover, the SCO currently uses this method to include the State Compensation Insurance Fund that also reports its financial information on a calendar year basis.
- ② As we stated last year, the funds that are exempt from providing a Report 15 to the SCO are also exempt from providing other required reports that contain the same information. Therefore, the SCO does not have evidence that agencies have reconciled financial information that appears in the State's general purpose financial statements with records of the SCO.

cc: Members of the Legislature  
Office of the Lieutenant Governor  
Attorney General  
State Controller  
Legislative Analyst  
Assembly Office of Research  
Senate Office of Research  
Assembly Majority/Minority Consultants  
Senate Majority/Minority Consultants  
Capitol Press Corps