

State of California:

**Internal Control and State and
Federal Compliance Audit Report
for the Year Ended June 30, 1996**

June 1997
96002

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June 26, 1997

96002

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

Dear Governor and Legislative Leaders:

As required by California Government Code, Section 8542 et seq., the Bureau of State Audits presents its audit report concerning our review of the State of California's internal controls and compliance with state and federal laws and regulations for the year ended June 30, 1996. This report concludes that the State continues to experience problems in accounting and administrative practices that affect the State's internal control system and that result in noncompliance with some state and federal regulations. Although these weaknesses are not individually significant, they have a cumulative effect on the accuracy of reported financial information and on the efficiency, effectiveness, and propriety of the State's operations.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Kurt Sjoberg".

KURT R. SJOBERG
State Auditor

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Summary

The State continues to experience problems in accounting and administrative practices that affect the State's internal control system and that result in noncompliance with some state and federal regulations. Internal control problems include overlooked opportunities to increase revenue, failure to cut costs, inappropriate use of public funds, failure to address operational inefficiencies, and inaccurate reporting of financial information. Other weaknesses result in noncompliance with federal program requirements. Although these weaknesses are not individually significant, they have a cumulative effect on the accuracy of reported financial information and on the efficiency, effectiveness, and propriety of the State's operations.

Internal Control Issues

Inadequacies in various state departments' internal controls resulted in lost revenues, unnecessary expenditures, inappropriate use of public funds, operational inefficiency, inaccurate financial information, and other miscellaneous problems. Following are issues of special concern:

Overlooked Opportunities To Increase Revenue

Several state departments overlooked opportunities to increase revenue. The Department of Education submitted late reports required for federal reimbursement resulting in \$190,000 in potential lost interest earnings. Two departments failed to collect reimbursements and fees in a timely manner and deposit them in interest-bearing accounts. One of these departments, the Department of Consumer Affairs (DCA), did not promptly deposit fees collected by its Board of Pharmacy. If the DCA similarly fails to promptly deposit fees for all of its numerous boards and bureaus, it could potentially lose interest earnings of up to \$200,000. In addition, another department, the Council for Private Postsecondary and Vocational Education, incorrectly computed client fees, resulting in an estimated \$132,000 in underpayments.

Cost Savings To Be Achieved

The Department of Health Services took from 12 to 31 months before it began procedures to recover \$2.5 million in overpayments to drug providers for the Medical Assistance Program.

Inappropriate Use of Public Funds

The California Department of Transportation paid its own employees \$4,800 to provide training on behalf of the department. The department contracted with the Regents of the

University of California who, in turn, hired the department's own employees to provide part of that training. The department paid these employees \$2,014 more than they would have received for their normal work and paid the university an additional administrative fee, totaling \$480.

Failure To Address Operational Inefficiencies

The Department of Real Estate incurs administrative expenses on collection activities that are unlikely to result in the collection of amounts owed for court judgments against real estate licensees. The department's accounting staff prepare and mail collection letters as required by state administrative practices and as is reasonable in most circumstances. While other collection efforts have yielded less than a 1 percent collection rate, the department has received no benefit from the collection letters.

Inaccurate Reporting of Financial Information

For fiscal year 1995-96, due to inaccurate accounting methods, the Department of Health Services overstated its receivable and liability accounts for the Health Care Deposit Fund and Federal Trust Fund by \$1.3 billion and its revenues and expenditures for the Federal Trust Fund by the same amount.

Additional Control Weaknesses

The Department of Housing and Community Development did not ensure that participants in the Mobilehome Park Resident Ownership Program met program eligibility requirements. Specifically, it approved loans exceeding specific program limitations, inappropriately allowed extended grace periods before payments began, and failed to maintain adequate documentation in a loan file to demonstrate that the borrower met eligibility requirements.

Issues of General Concern Related to Compliance With Federal Requirements

Weaknesses exist in the State's system of controls over cash management, cost allocation, financial reporting, and subrecipient monitoring related to federal grant programs administered by many departments. We noted the following specific conditions:

Cash Management

The State did not always comply with federal regulations for the Cash Management Improvement Act. As a result, for certain federal programs governed by default procedures, the State overstated the interest it owed to the federal government by approximately \$148,200. In addition, for other programs, the State did not consistently limit its requests for cash advances from the federal government. For example, the Department of Health Services maintained excess cash balances between \$1,300 and \$6.3 million for periods ranging from 9 to 18 months.

Cost Allocation

The State improperly allocated personal service costs for some of the federal programs it administers. For example, the Department of Community Services and Development charged three employees' time, totaling 3,071 hours, to the Low-Income Home Energy Assistance Program (LIHEAP) even though the employees worked on a different project to determine eligibility for a state energy assistance program.

The State does not always comply with the requirement to certify or document personal service costs charged to federal programs. Specifically, three departments failed to prepare required periodic certifications when employees worked on a single federal program. In addition, another department failed to maintain certified time sheets for employees working on multiple federal programs to support costs charged to each program.

Financial Reporting

The State does not always ensure that its federal financial reports are accurate and reconcile to the appropriate accounting records. Four departments did not reconcile federal financial reports with appropriate accounting records. Differences ranged from \$104,000 in the Vocational Education Program at the California Community Colleges, Chancellor's Office, to \$23 million for the Refugee and Entrant Assistance—State Administered Program grant at the Department of Health Services. In addition, the Department of Social Services did not have a system of reconciliation in place for reports for several federal grants.

Subrecipient Monitoring

The State does not adequately review audit reports submitted by subrecipients of federal grant moneys. These subrecipients include cities, counties, school districts, and nonprofit organizations. The State also does not ensure that subrecipients promptly correct instances of noncompliance with federal regulations identified in these reports.

Issues Related to Specific Grants

We also found weaknesses in several state departments relating to the administration of individual federal programs under the following federal departments:

U.S. Department of Housing and Urban Development

The State's Department of Housing and Community Development has weak controls over Home Investment Partnerships Program funds. Specifically, the department exceeded administrative and planning costs for this program by \$580,000, did not properly allocate program income at year-end, and incorrectly recorded \$57,000 in administrative charges as program costs. In addition, it reported erroneous and incomplete statistical and fiscal information for two grants to the federal government.

U.S. Department of Education

The State's Department of Education may have inappropriately used federal funds for the Grants to States for the Education of Children With Disabilities program. Specifically, it used these funds to pay \$734,000 in plaintiff attorney fees. Although the Department of Education contends that its use of federal funds for this purpose is allowable, we believe the law does not provide authority for the State to use federal funds to pay these costs. In addition, the Department of Education did not allocate \$76,000 in excess funds for the Emergency Immigrant Education grant among all local educational agencies, as required by federal regulations. Further, it used approximately \$73,000 to fund supplemental programs at five educational agencies.

Federal Emergency Management Agency

The State's Office of Emergency Services used federal funds from the Disaster Assistance Program to fund a project that did not meet the basic eligibility requirements. Specifically, it reimbursed the Los Angeles County Fire Department \$386,000 for costs inconsistent with the State Hazard Mitigation Plan.

U.S. Department of Health and Human Services

The State's Department of Community Services and Development exceeded the amount allowed for planning and administrative costs for the Low-Income Home Energy Assistance Program by approximately \$626,000. In addition, the State's Department of Health Services could not demonstrate that it used 15 percent of HIV Care Formula Grants funds to provide health and support services to specified populations, as required. Finally, during its administration of the Medical Assistance Program, the Department of Health Services had not fully implemented procedures to track and promptly bill drug companies for rebates due the State and the federal government.

Introduction

As part of our examination of the general purpose financial statements of the State of California for the fiscal year ended June 30, 1996, we evaluated the State's internal controls. This evaluation was 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 that affect the general purpose financial statements; and
- To determine compliance with state laws and regulations that affect the general purpose financial statements.

During our audit, we reviewed fiscal controls at various state agencies included in the general purpose financial statements. We also selected items from numerous departments for centralized testing of important transaction cycles. For example, we selected and tested a sample of payroll warrants the State processed through its payroll system and a sample of other warrants the State processed through its claims payments system.

We reviewed the compliance of these agencies with state laws and regulations that materially affect the State's financial statements. These laws and regulations help to ensure that the State maintains sufficient control over the budgeting, investing, collecting, and disbursing of state money and accurately reports the results of its financial activities.

Finally, we reviewed the State's compliance with federal regulations for all federal grants exceeding \$20 million. Of the 337 federal grants the State administers, we reviewed 55, which represent approximately 97 percent of the federal funds the State received in fiscal year 1995-96. We excluded federal grants administered by the California State University and the University of California because other independent auditors review them.

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 to prepare the general purpose financial statements and to administer federal assistance programs (begins on page 3);
- The reports on weaknesses and instances of noncompliance with state and federal laws and regulations (begin on pages 9 and 53);

- The report on compliance with federal requirements, including required reports on compliance with laws and regulations related to major and nonmajor federal programs, and reports on the resolution of prior-year findings related to federal programs (begins on page 47);
- The report on the accuracy of the supplementary schedule of federal assistance (begins on page 169); and
- The report on compliance with state laws and regulations (begins on page 203).

Between July 1, 1995 and December 31, 1996, the Bureau of State Audits issued 60 individual audit reports, many of which discussed needed improvements in the State's operations. These reports are listed in Appendix A and are available to the public through the Bureau of State Audits.

**Independent Auditors' Report on the
Internal Control Structure**

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, 1996, and have issued our report thereon dated November 27, 1996. We did not audit the financial statements of the pension trust funds, which reflect total assets constituting 82 percent of the fiduciary funds. We also did not audit the financial statements of certain enterprise funds, which reflect total assets and revenues constituting 86 percent and 90 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 97 percent and 95 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 these funds and entities, 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 May 16, 1997.

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, 1996, 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 perform 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, 1996, the State of California received 97 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, present recommendations to correct them, and present management's comments regarding the recommendations on pages 9 through 46 and pages 53 through 150 of our report. Additionally, beginning on page 163, we present a schedule listing instances of noncompliance that we consider to be minor. The reportable conditions identified in the State's single audit report for fiscal year 1994-95 that have not been corrected are included in the sections beginning on pages 9 and 53.

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, 1995 to December 31, 1996, begins on page 151 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



PHILIP J. JELICICH, CPA
Deputy State Auditor

May 16, 1997

Internal Control Issues

Opportunities To Increase Revenue

Several departments that we reviewed failed to maximize revenues from various sources. For example, the cash management practices of three departments resulted in lost interest revenue to the State. Loss of legitimate revenues to the State ultimately increases the costs of state programs, which must be funded by other state resources.

Department of Consumer Affairs

Reference Number: 96-1-1

Condition

The Department of Consumer Affairs (department) did not always promptly deposit cash receipts collected by both the Board of Pharmacy (board) and the department on behalf of the board. Specifically, 17 of the 20 cash receipts we reviewed were not deposited within one day of receipt. Twelve of the late deposits were for application and license fees and manually processed renewals that the board collected and remitted to the department for deposit. The remaining five late deposits were for automated renewal fees that the department collected and deposited on behalf of the board. The department deposits cash receipts for numerous boards and bureaus and the majority of the cash receipts are for license fees that are processed by its automated renewal system. The annual amount deposited during fiscal year 1995-96 was \$291 million. If the department experienced delays between two and six days for all of its deposits associated with the centralized cashiering process for renewal fees, which represents approximately 75 percent of its cash receipts, the delays could potentially result in lost interest ranging from \$70,000 to \$200,000. The board and the department recognize that there are delays in the deposit process.

Criteria

The State Administrative Manual, Section 8030.1 (3), requires that daily collections exceeding \$500 in cash or \$5,000 in cash, checks, money orders, and warrants be deposited on the day of receipt. In addition, the State Administrative Manual, Section 8030.1 (4), requires that agencies consider any procedure to expedite depositing to be practical if the additional interest earned will exceed the additional costs of such a procedure.

Recommendation

The board and the department should evaluate their cashiering and deposit procedures to determine the cause of the late deposits and identify ways to ensure that cash receipts are deposited promptly, thus maximizing the State's interest earnings.

View of Department

Both the board and the department agree with this finding. The department states that it is in the process of developing procedures to track the actual date the report of collections is

received in the cashiering unit and the promptness of the deposits. In addition, the department states that it will continue to pursue automation efforts to expedite cashiering and remittance processes.

California Department of Education

Reference Number: 96-1-2

Condition

The California Department of Education (CDE) administers the Special Education—Grants for Infants and Families with Disabilities grant under an interagency agreement with the Department of Developmental Services (DDS). The DDS requires the CDE to submit expenditure reports that provide it with information that it needs to draw funds from the federal government to reimburse the State's General Fund. During fiscal year 1995-96, the CDE failed to promptly submit two of the five reports we reviewed. Specifically, the CDE submitted the two expenditure reports 124 and 93 days late, respectively. Similarly, in fiscal year 1994-95, the CDE submitted one expenditure report 208 days late.

Moreover, the CDE submitted two of the three late reports from 84 and 133 days after the State Controller's Office had paid the expenditures from the General Fund. As a result, the DDS was not able to promptly draw down federal funds to reimburse the State's General Fund, thus causing the State to lose potential interest earnings totaling nearly \$190,000.

Criteria

The interagency agreement between the CDE and the DDS requires the CDE to submit expenditure reports to the DDS within certain time frames. The State Administrative Manual, Section 0911.4, requires the CDE to secure prompt reimbursement from grant funds when goods and services are provided.

Recommendation

The CDE should ensure that it promptly submits expenditure reports to the DDS to enable the DDS to minimize the amount of time between payment of state funds and reimbursement of federal funds.

View of Department

The CDE staff administering the early intervention service program (Individuals With Disabilities Education Act, Part H) are working together to ensure that federal funds are drawn down, to the extent possible, at the same time as apportionment payments are made to Special Education Local Planning Areas (SELPA's). The CDE staff are coordinating the submittal of reports to the DDS and claim schedules to the State Controller's Office.

In addition, the CDE is recommending revisions to the 1997-98 interagency agreement with the DDS which will extend the due dates for submission of the first and second invoices to the DDS. The additional time will enable the CDE staff to prepare the invoices on time and allocate funds to SELPA's when federal funds are available for expenditure.

Council for Private Postsecondary and Vocational Education

Reference Number:

96-1-3

Condition

The Council for Private Postsecondary and Vocational Education (council) used incorrect billing information which reduced the approval fees that it was entitled to receive from certain private postsecondary educational institutions (institutions). In two of ten cases we tested for internal controls over cash receipts, the council received underpayments from schools for its fiscal year 1995-96 approval fees. The schools made these underpayments in response to council invoices that were based on incorrect gross revenue data. Due to the errors identified in our testing of internal controls, we expanded our procedures, recalculating all of the annual fee billings for fiscal year 1995-96 and comparing them to the actual fees received. We tested 54 of 325 identified underpayments and determined that annual fees had been underpaid in 31 of the 54 cases for a total of approximately \$73,000. Based on our procedures, we estimate that total underpayments for fiscal year 1995-96 amounted to approximately \$132,000.

The council underbilled some clients because it failed to base annual fee computations on the latest gross revenue data of its client schools. The council used fiscal year 1992-93 gross revenue data to compute billings sent between July and December 1995 and fiscal year 1993-94 gross revenue data to compute billings sent between January and June 1996. In fact, fiscal year 1994-95 gross revenue data was never input to the billing system and was therefore unavailable for use in creating invoices. The council stated that problems related to staffing and the computer system hindered it from obtaining and inputting the most current gross revenue data.

When the council fails to adhere to its adopted fee schedule, it risks underbilling schools for annual fees, thus reducing revenues that could be used to further its programs.

Criteria

The Education Code, Section 94331, requires the council to adopt a fee schedule for all institutions approved under the statute. The fee schedule adopted by the council states that annual fees are to be based on the annual gross revenues derived during the school's last fiscal year ending before the due date of an annual fee payment.

Recommendation

To ensure that it collects all revenue owed, the council should bill schools in accordance with its adopted fee schedule.

View of Department

The following is an abbreviated version of the council's response:

The council agrees with the finding and states that due to several problems with the 1993 and 1994 gross revenues submitted by the schools, in addition to its computer system

deficiencies, a conscious decision was made to bill schools based on old gross revenue data. However, to eliminate billing problems in the future, the council will:

- Design its prospective database so that gross revenues can be entered without a designation for reporting year, when received and tracked by reporting year, rather than entered only after data from all schools has been received; and
- Change its procedures for the current database to focus initial data cleanup efforts on gross revenue data submitted by schools, immediately entering this data once it has been checked.

In addition, the council states that it has emphasized to the schools the correct way to report gross revenues during its annual report training sessions.

Department of Justice

Reference Number: 96-1-4

Condition

The State lost interest earnings of approximately \$7,800 because the Department of Justice (department) billed the Department of Social Services (DSS) late for services provided under the Child Support Enforcement grant. The DSS does not request federal funds for the Child Support Enforcement grant until it receives the department's billings. Thus, when the department's billings are late, the State loses interest. Specifically, the department contracted with the DSS to provide legal and support services for this program starting in July 1995 but did not begin billing the DSS for some of the services until December 1995. The contracts between the department and the DSS were approved in September 1995. However, according to the department's reimbursement management manager, the billings to the DSS were late because the department's accounting office did not receive copies of the approved contracts until December 1995. The Bureau of State Audits reported the same issue in fiscal years 1993-94 and 1994-95. In both instances, we reported that the contracts were approved late.

Criteria

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

Recommendation

The department should promptly bill the DSS for the costs of services chargeable to federal grants.

View of Department

The department agrees with our findings. According to the department, in response to the fiscal year 1994-95 audit, it took corrective action to provide timely contracts beginning

in fiscal year 1996-97. In addition, the department has taken some steps to promptly bill the DSS, including signing agreements that cover several years to minimize delays between contract approval, receipt, and billing.

Department of Justice

Reference Number: 96-1-5

Condition

The Department of Justice (department) was not promptly reimbursed for services that it provided to the Los Angeles County Police Chief's Association (LACPCA) under the Drug Control and System Improvement (DCSI) grant. The department invoices the LACPCA monthly for services already provided under the DCSI grant. The invoices are reviewed by the LACPCA and forwarded to the City of Hawthorne for payment. For the 11 fiscal year 1995-96 invoices we reviewed, the length of time between the issuance of an invoice and the receipt of payment averaged 52 days. For example, the department submitted one invoice for approximately \$83,000 to the LACPCA in September 1995 that was not paid until January 1996. Because of the delays in payment for the 11 invoices, the State lost total interest earnings of approximately \$5,500. The Bureau of State Audits reported the same issue in fiscal year 1994-95 and years previous to that.

Criteria

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

Recommendation

The department should ensure that it receives prompt reimbursement for its costs of services.

View of Department

The department agrees with our finding. According to the department, it has taken several steps to decrease the time lag between invoicing and reimbursement. According to the chief of the accounting office, for fiscal year 1996-97, the department is billing the LACPCA separately for personnel and operating expenses because the LACPCA does not question the salaries portion of the billings as much as the operating expenses, and salaries make up the largest share of the billings. In addition, the department has eliminated most of the operating expenses from its agreement with the LACPCA, allowing the LACPCA to charge those expenses directly to the grant. Finally, for fiscal year 1997-98, the department has drafted a new memorandum of understanding with the LACPCA requiring payment within 30 days of receipt if the department submits invoices by the agreed cutoff dates.

Cost Savings To Be Achieved

One department we reviewed did not avoid unnecessary costs associated with its programs or administration. The department did not attempt to recover overpayments to providers of supplies for an extended period of time. When unnecessary costs are incurred, the State's limited resources may be diverted from providing essential program goals.

Department of Health Services

Reference Number: 96-2-1

Condition

The Department of Health Services (department) does not have adequate controls to ensure that it promptly corrects overpayments to providers for pharmacy claims, determines the accuracy of certain reimbursement amounts for provider claims, or oversees that provider claim documents are appropriately certified. Because it lacks these controls, the department does not have prompt access to the moneys it is entitled to, cannot prevent overpayments for inaccurate claim amounts, and cannot be assured that it is paying providers for authentic claims.

Recovery of Overpayments to Providers Is Slow

The department did not promptly recover from providers approximately \$2.5 million in overpayments for pharmacy dispensing services the providers rendered between March 1, 1994 and October 23, 1995. Specifically, during our review of payment calculations, we identified one pharmacy claim that was overpaid by \$9.06 because of a coding error in the drug pricing file. After our discovery, the department initiated its process for erroneous payment corrections to determine the total number of claims that were similar to the overpayment that we found. The department identified an additional 357,665 claims representing a net overpayment of approximately \$2.5 million to providers.

In October 1995, the department corrected the coding errors in its automated claims payment system to prevent future overpayments. However, it did not begin taking steps to recover any previous overpayments until October 1996. According to the acting chief of the department's Performance and Change Management Branch, the department delayed the processing of these payment corrections because of increased workload and because it wanted to resolve other coding errors in the automated claims payment system.

The Automated Claims Payment System Cannot Identify Incorrect Co-Payments

The department does not have preventive controls in its automated claims payment system for determining whether a long-term care beneficiary's share of cost, or required co-payment, reported on a claim form agrees with the amount recorded in this system. Although the automated claims payment system contains 16 months of a beneficiary's historical information, including the share of cost, the department does not have an edit in this system to compare the share of cost with the amount reported by the provider. As a result, the department cannot detect in advance those claims that the department should not pay because

they contain incorrect amounts. For one of the two long-term care claims we reviewed, the department overpaid the provider by \$7 because the department did not detect that the provider submitted a claim with an incorrect share of cost.

To make a preliminary determination of the impact of the lack of an edit, the department reviewed a sample of 300 long-term care claims with dates of services in July 1996. Based on its review, the department estimates that between 94 percent and 98 percent of these claims were correctly paid. However, we did not audit the results of this review.

Provider Claim Forms Need the Proper Certification

Finally, for 5 of the 23 provider claims we reviewed, the claim documentation did not contain evidence of the provider's statement and signature certifying the authenticity of the claim information. All 5 providers had claim agreements on file for a different method of claim submission; therefore, these claims should have included a signed provider certification statement with the billing document submitted. We reported a similar weakness during our fiscal year 1994-95 audit.

Criteria

- The California Code of Regulations, Title 22, Section 51458.1(a)(1), states that the department shall recover overpayments to providers including, but not limited to, payments determined to be in excess of program payment ceilings or allowable costs.
- The California Government Code, Section 13401(b)(1), requires that each state agency maintain effective systems of internal accounting and administrative control as an integral part of its management practices. An adequate system of internal controls should include preventive measures, such as automated edits of transactions, to verify the accuracy and reliability of amounts submitted for payment.
- The California Code of Regulations, Title 22, Section 51502.1(f)(5), requires provider certification of all claim document information.

Recommendations

- The department should implement procedures to ensure that it recovers overpayments promptly.
- The department should develop and use computer edits to detect whether the beneficiary's share of cost reported on the provider's claim is accurate.
- The department should ensure that provider agreements on file are current and that the method of claim submission used by providers is appropriate.

View of Department

The acting chief of the department's Performance and Change Management Branch agreed that a significant delay occurred between the identification and correction of the pharmacy claims in the automated claims payment system and the reprocessing of claims paid before the

correction. The department increased the staff hours of its fiscal intermediary contractor to resolve errors in the claims payment system and to correct erroneous claim payments to providers.

The acting branch chief also agreed that long-term care claims could contain incorrect share of cost amounts that the automated claims payment system would not detect. He indicated that the department is currently reviewing its automated payment process for long-term care claims. The department believes that the preliminary results of this review, which includes the sample discussed above, indicate that the problem is minimal. The acting branch chief believes, based on the preliminary results, that preventing the potential for payment error would cost the State a significant amount and disrupt the claim filing process of long-term care providers. The acting branch chief also indicated that the department continues to conduct post-payment audits of long-term care claims. Therefore, the department is not considering any immediate corrective action. However, if the final results of the review indicate that the problem is widespread, the department will consider potential changes to the automated claims payment system for long-term care claims. In either case, the department will issue a reminder notice to long-term care providers describing the process for submitting claims that include share of cost amounts.

The chief of the department's Provider Master File Unit agreed that the department did not have the correct provider agreements for all providers and indicated that, as of November 1996, the department completed and issued to providers a new comprehensive provider agreement that covers multiple methods of claim submission.

Inappropriate Use of Public Funds

During our review, we noted two departments that did not use public funds in accordance with established standards. Because such standards exist to protect the State's resources and assets, failure to follow them may result in their loss.

Department of Transportation

Reference Number: 96-3-1

Condition

The Department of Transportation (department) contracted with the University of California Regents (university) to provide training on behalf of the department. The university has in turn contracted with individual department employees to provide part of that training. Seven department employees we investigated violated the State's Public Contract Code because they were employed by the university under a contract that was ultimately funded by the department. In addition to the wages normally paid, the department paid six of the seven department employees \$3,200 through the department's contract with the university. A seventh employee took leave without pay on the days he worked on the contract, but was compensated \$1,600 through the department's contract with the university. In total, through its contract with the university, the department paid \$4,800 to its own employees. Further, the department paid an additional 10 percent administrative fee (\$480) related to these employees to the university for administering the contract. Consequently, the department paid a total of \$5,280 to the university for its own employees.

According to the State's Legislative Counsel, a civil service employee of the department who, outside of his or her regular employment with the department, contracts with the university to provide training services that are sponsored by the department through its contract with the university is in violation of the Public Contract Code unless those services are required as a condition of the employee's regular state employment. These seven employees were not required to provide the contractual services.

Moreover, the department paid its employees, through its contract with the university, rates greater than it ordinarily paid them. For example, during the period the employees provided the instruction, the seven employees' time was valued at \$2,786, based on their wages as department employees. However, because the department paid \$4,800 to the employees through its contract with the university, the employees received \$2,014 more to teach the classes than they ordinarily earned.

Criteria

The California Public Contract Code, Section 10410, provides that no state employee shall engage in any employment or activity from which the employee receives compensation and which is funded by any state agency or department through a contract unless the employment or activity is required as a condition of the employee's regular state employment.

Recommendation

The department should ensure that its employees are not paid by the contractor for any employment or activity that is funded through a contract with the department.

View of Department

The department agrees with the finding. The department's State and Local Project Development office plans to review the entire arrangement between the university and department employees to make sure it is conforming to applicable codes and sound business practice. At the time the department entered into the contract with the university it believed that department employees were constrained by the fact that participation was to be done on their own time and at their own expense and should not detract from their assigned duties. Six of seven department employees met these conditions. The department will review the case of the employee who did not meet these conditions.

California Highway Patrol

Reference Number: 96-3-2

Condition

The Department of the California Highway Patrol (department) inappropriately paid for contracted services for which it had no authority and continued to receive services under an expired contract. In July 1993, the department entered into a \$124,000 multiyear contract with a vendor for photography services. This contract, and the first amendment to this contract, were properly approved by the Department of General Services (DGS) and required the vendor to provide these services from July 1, 1993 through December 31, 1995.

However, by October 1995, the allocated amount for this contract was exhausted and the department prepared and submitted a second amendment to the DGS for \$20,000. Prior to obtaining the DGS approval for this amendment, the department continued to approve and pay invoices submitted by the vendor. According to the department, the DGS subsequently denied approval of the second amendment, stating that the contract appeared to be a sole-source agreement. As a result, the department paid \$20,000 for services for which it had no authority. In addition, the department continued to receive and was billed for services through January 1996 totaling \$10,800, although the contract had expired December 31, 1995.

The contract manager did not ensure that the department had the necessary authority to pay for and receive the services outlined in the contract prior to allowing the services to be rendered. In addition, the contract manager did not inform the vendor that the department could not further receive the vendor's services until the appropriate approvals from the DGS had been granted.

Criteria

The State Administrative Manual (SAM), Section 8422.1, requires that the department determine whether invoices comply with the provisions of purchase orders, sub-purchase orders, contracts, leases, service agreements, and similar documents. The SAM also requires the department to determine whether authority existed to obtain the goods or services received.

Recommendations

To comply with the State's contracting process, the department should:

- Ensure that its contract managers are fully aware of their responsibilities for managing contracts; and
- Ensure that it has the authority to pay invoices for goods and services received.

View of Department

The department agrees with the finding and states that it is currently revising its policies to include detailed responsibilities for contract managers, particularly in monitoring contract spending levels against the provisions of the contract. Furthermore, the department states that while it considers this contract issue to be an isolated incident, it will reinforce its existing practices of reviewing contracts prior to payment.

Areas in Which Operational Efficiency Is Limited

Although our review was not specifically designed to identify inefficient practices, we noted operational inefficiencies at two departments. Included in these inefficiencies was one department that incurs administrative expenses on collection activities that are unlikely to result in the collection of amounts owed.

California Highway Patrol

Reference Number: 96-4-1

Condition

The Department of the California Highway Patrol (department) inappropriately used its Office Revolving Fund (ORF) to pay vendors during the 1995-96 fiscal year in order to compensate for inefficiencies in its invoice-processing system. Specifically, of the 39 ORF disbursements we reviewed, 14 did not meet the "permissible uses" criteria for the ORF. In addition, the department failed to take advantage of \$4,851 in vendor discounts for 3 of these 14 items.

For 9 of the 14 disbursements, the department used the ORF to either prevent penalties from accruing or to prevent additional penalties from accruing on past-due invoices. For the remaining 5 exceptions, the department could not substantiate the use of the ORF as opposed to the normal claim-processing procedure which requires departments to remit claim schedules to the State Controller's Office for payment. In addition, the department failed to take advantage of discounts offered by vendors because it did not expedite the payments for discounted invoices. The department may continue to incur penalties from past-due invoices unless the department's statewide area offices and its accounting office improve claim-processing procedures to allow for the issuance of payments to its vendors in a timely manner.

Criteria

The State Administrative Manual, Section 8110, states that revolving funds drawn may be used only for payment of compensation earned, traveling expenses, traveling expense advances, or where immediate payment is otherwise necessary. In determining whether immediate payment is necessary, the determining factor is whether payment could be made through the normal claim-processing procedure and with a State Controller's Office warrant issued.

In addition, Section 8113 states that invoices will be paid by revolving-fund checks only when a discount of at least \$5 can be taken and where the discount percentage is at least one-half of one percent, and when the discount period is too short to permit taking advantage of the discount if payment is made by warrant.

Recommendations

To comply with the ORF policies outlined in the State Administrative Manual, Section 8100, the department should:

- Improve its claims-processing procedures by ensuring that its area offices approve and submit invoices for payment to the accounting office in a timely manner and that its accounting office processes such invoices in a manner which allows for payment prior to the due date; and
- Take advantage of discounts offered by vendors.

View of Department

The department agrees with the finding and, as a result, has instituted tighter controls over the use of the ORF. Specifically, the department states that it will restrict ORF payments to discounted invoices, salary advances, travel advances, and travel expenses, as well as require accounting section managers to approve these payments prior to issuance.

The department also states that it will release statewide corrective advisories requiring area offices to submit invoices to its accounting section within three business days after receipt to ensure prompt processing. Furthermore, the department states that its policy is to take advantage of discounts offered by vendors. However, in those instances in which discounts are not taken, it generally considers them to be oversights rather than the result of a lack of procedures.

Department of Real Estate

Reference Number: 96-4-2

Condition

The Department of Real Estate (department) incurs administrative expense on collection activities that are unlikely to result in the collection of amounts owed. The department reported over \$14 million in uncollectible accounts receivable as of June 30, 1996, that were related to payments from the Real Estate Recovery Account. The account, an account within the Real Estate Fund, is used as a last resort for people who have been defrauded by real estate licensees in connection with acts requiring a real estate license.

The account is funded by 12 percent of all license fees collected. Prior to applying for a claims payment from the account, a claimant is required to obtain final court judgment based on the licensee fraud and the licensee's inability to pay the judgment, which is determined through an asset search. The claimant may file a claim against the account up to \$20,000 for any one transaction and \$100,000 for any one licensee, the maximum amount allowed by law.

When claims are paid out of the account, the license of the licensee is automatically suspended, and his or her name is flagged in the department's license database until the account has been repaid with interest. In addition to these automated records of amounts owed, the department establishes an accounts receivable in its accounting records equivalent to each of the amounts owed. For example, we noted that there were 415 entries in the department's accounts receivable subsidiary. While these receivables may be valid, and the department assumes the judgment creditor's rights, they are not considered collectible as established by the final court judgments.

The department's accounting staff prepare and mail collection letters as required by state administrative practices, and as is reasonable in most circumstances. While other collection efforts have yielded less than a 1 percent collection rate, the department has received no benefit from the collection letters. Specifically, it estimates that its collection efforts using the services of the Franchise Tax Board and flagging the debtor's name in its licensing database have yielded less than a 1 percent collection rate. In addition, according to the department, during the fiscal year it received approval from the Board of Control to write off approximately \$7 million in uncollectible receivables. This assisted the department in reducing the uncollectible accounts receivable balance to the \$14 million existing as of June 30. The department's establishment of receivables for payments that are remotely collectible in addition to records already maintained in its license database causes increased workload for its accounting staff.

Criteria

State Administrative Manual, Section 8776.6, provides guidelines for the collection of nonemployee accounts receivable. It requires departments to send three collection letters to the last known address of the debtor. If the collection letters are unsuccessful, the process moves to the next phase, which requires departments to prepare an analysis to determine what additional collection efforts should be made. The analysis should include a cost/benefit analysis of the collection actions such as: offset procedures, court settlements, collection agencies, and sales accounts receivable.

Recommendation

Because of the extremely low recovery rate on its efforts to collect on judgments against licensees who are identified in its licensing database, the department should seek a permanent exemption from the Department of Finance to discontinue establishing a receivable in its accounting records when it pays a claim. The exemption should also be sought to minimize the department's collection efforts to the existing offset procedures allowed by the State.

View of Department

According to the department it will continue seeking approval to obtain relief of accountability on the balance of outstanding recovery accounts receivable.

Inaccurate Financial Information

We found five problems at three departments that resulted in actual or potentially inaccurate financial information being submitted to state policy makers. For example, the Department of Health Services overstated Federal Trust Fund assets and liabilities by \$1.3 billion, and the Council for Private and Postsecondary and Vocational Education does not account for revenues and expenditures of \$152,000 as required by statute.

Department of Health Services

Reference Number: 96-5-1

Condition

The Department of Health Services (department) did not accurately prepare its fiscal year 1995-96 financial reports for the Health Care Deposit Fund and the Federal Trust Fund. As a result, at June 30, 1996, the department overstated by approximately \$1.3 billion the receivable and liability accounts for both funds and also overstated the revenues and expenditures for the Federal Trust Fund.

The department incorrectly prepared its accrual because it failed to estimate costs associated with certain appropriations for the Medical Assistance Program for fiscal years 1992-93 through 1994-95. Instead, the department based its accrual on the remaining balance in these appropriations at June 30, 1996. For example, the department recorded the entire remaining balance of \$708 million for the accruals related to the 1992-93 and 1993-94 appropriations for county administration costs for the Medical Assistance Program. However, representatives from the department's legal counsel and federal liaison units estimated that the department would pay only \$54 million of its reported year-end accrual, specific to fiscal year 1992-93 and 1993-94 appropriations. Similarly, because it failed to estimate costs correctly, the department overstated by \$686 million the accruals for county administration costs related to the Medical Assistance Program for the fiscal year 1994-95 appropriation.

Failure to analyze and provide accurate financial information to the State Controller's Office reduces the State's ability to prepare financial statements that are in conformity with generally accepted accounting principles. Many groups, including the State Legislature and the general public, rely on accurate financial statements. Such errors by the department could significantly distort the State's financial statements. The department should have recognized these errors because its accrual was nearly twice the amount reported the previous year. Also, in our prior-year audit, we reported a similar weakness in the department's financial statements.

Criteria

The State Administrative Manual, Section 10608, requires state agencies to record as liabilities only those amounts relating to valid obligations as of June 30. In addition, the State Administrative Manual, Section 8776.2, requires state agencies to record as valid receivables all amounts that are due and payable to the agencies and, at June 30, to accrue those receivables that the agencies expect to collect within the next fiscal year.

Recommendation

To ensure that it submits accurate financial information to the State Controller's Office, the department should base its accruals on reasonable estimates and on valid obligations and receivables.

View of Department

The acting chief of the department's Financial Management Branch agreed with the finding and notified the State Controller's Office to adjust the State's financial statements for the Health Care Deposit Fund and the Federal Trust Fund. The acting chief stated that the department will analyze the accrual more closely during the year-end closing process by comparing prior-year accruals to current-year accruals. In addition, the accounting section will use the estimates for the current-year and prior-year accrual prepared by the department's Fiscal Forecasting and Data Management Branch.

Department of Housing and Community Development

Reference Number: 96-5-2

Condition

Although the Department of Housing and Community Development (department) has improved its control over loans distributed from the California Disaster Housing Rehabilitation Fund (fund 689), the Housing Rehabilitation Loan Fund (fund 929), and the Rental Housing Construction Fund (fund 938), some deficiencies remain. During our review of fiscal year 1995-96, we found the department did not reconcile all differences in its accounting and program records, and could not provide all of the supporting documents for reconciliations of loans receivable. In addition, the department cannot assure that necessary adjustments have been posted to the accounting records. Furthermore, the department lacks a central filing system for its reconciliation documents and a tracking system to ensure that adjustments that result from reconciliations are posted to its accounting records. As a result, the department cannot ensure that its housing loan records are complete and accurate and that public resources invested in housing loans are adequately safeguarded.

In prior years, we reported the department did not reconcile loans receivable balances in its accounting and program records for the three funds. To address the issue, the department hired an independent CPA firm to resolve differences in the balances and prepare procedures for monthly reconciliations of the records. The department began reconciling loans receivable balances for its accounting and program records in the quarter ending March 31, 1996. However, during our fiscal year 1995-96 audit, we found the department failed to identify all of the differences between the records. In addition, the department could not provide some supporting documents for the required reconciliations and adjustments. Further, we noted that the department performed the reconciliations on a quarterly, rather than a monthly, basis as described in the procedures prepared by the CPA firm.

We reviewed the department's reconciliations of loans receivable balances in its accounting and program records for the quarters ending March 31, 1996, and June 30, 1996. We found the department had not identified all of the differences between the records. For example, in

the March 31, 1996 reconciliation, the department had not identified differences ranging from \$249 to \$78,460 for 4 of the 19 loan accounts we reviewed from fund 689. In addition, the department could not provide all of the documentation to support its resolution of the differences in some of its loan account balances. Specifically, the department could not provide documentation for 4 of 19 loan accounts for fund 689, 19 of 93 loan accounts for fund 929, and 1 of 14 loan accounts for fund 938. Similarly, for the June 30, 1996 reconciliations, the department could not provide documentation for 1 of 65 loan accounts from fund 929, and 5 of the 13 loan accounts from fund 938.

After program staff members perform the reconciliations of loans receivable balances for the accounting and program records, they forward the identified adjustments to the accounting unit where the adjustments are posted to the department's accounting records. Accounting staff members are required to sign the reconciliation documents as evidence they posted the adjustments and return the reconciliation documents to the program unit. However, we found that the accounting staff members did not always sign the reconciliation documents. For the quarter ending March 31, 1996, 8 of 71 reconciliation documents we reviewed for fund 929, and 5 of 13 we reviewed for fund 938, lacked signatures confirming that adjusting entries had been posted to the department's records. In addition, for the quarter ending June 30, 1996, 26 of 62 reconciliation documents we reviewed for fund 929, and 1 of 8 we reviewed for fund 938, lacked confirming signatures. When accounting staff fail to sign reconciliation documents, program staff members who prepare the reconciliations cannot determine whether the adjustments have been posted.

Criteria

The California Government Code, Sections 13401 and 13403, require agencies to maintain an effective system of internal control, which includes accurate record-keeping procedures for assets, liabilities, revenues, and expenditures. In addition, the State Administrative Manual, Section 7900, prescribes preparing monthly reconciliations to ensure that transactions have been processed properly and that financial records are complete.

Recommendation

To improve its controls over loans receivable balances, the department should take the following steps:

- Perform reconciliations of the loans receivable account balances in its accounting and program records on a monthly basis rather than a quarterly basis;
- Create a central filing system for documentation used to prepare the reconciliations; and
- Establish a tracking system to ensure that staff post adjustments to the department's records and store supporting documentation in a retrievable manner.

View of Department

The department agrees with the findings and provided the following comments. The department has implemented most of the CPA firm's reconciliation guidelines and procedures provided in January 1996. Since it completed its first reconciliations in March 1996, the department has made significant progress in identifying and resolving differences in the loans receivable account balances reported in its program and accounting records. As a result of its

new procedures, the department corrected 99 of 126 outstanding items identified in the reconciliation prepared for the quarter ending December 31, 1996. In addition, the department will develop a tracking system to ensure that its records are adjusted for all identified items from the reconciliations. It will also establish a consistent filing system to provide easier access to the reconciliation spreadsheets and back up information. These improvements should be in place during fiscal year 1997-98. Finally, the department plans to seek an exemption from the Department of Finance to allow for quarterly reconciliations because it believes monthly reconciliations slow the reconciliation process and do not provide any measurable safeguards or other advantages.

Department of Housing and Community Development

Reference Number: 96-5-3

Condition

The Department of Housing and Community Development (department) needs to improve its accounting of the transactions of the Mobilehome Park Resident Ownership Program (MPROP). As a result of deficiencies noted in the department's accounting for MPROP loans, we found that the actual revenues generated and the actual costs of operating the MPROP are unknown to policy makers. Specifically we found the following:

- The department does not maintain loan amortization schedules for loans with deferred payment status and, as a result, it is unable to determine the interest earned on these loans. Specifically, according to the department, the majority of the loans funded by the MPROP are originated with note terms allowing the payment of principal and interest to be deferred for the full term of the loans. The department calculates the interest for those loans that are in deferred payment status only when the loan matures. The department neither accrues interest nor does it disclose the number of these loans outstanding and the related interest income that would have been earned if they were not deferred to state policy makers prior to maturity.
- According to the department, it does not periodically evaluate its loan portfolio nor has it established an allowance for loan losses account. The allowance for loan losses is an estimated amount of losses in a loan portfolio that the department considers to be adequate to cover the estimated losses inherent in its loan portfolio which is charged to operating expenses. As a result of not recording the allowance in the financial statements, the department has understated the expenses of the MPROP.
- The department failed to promptly write off loans that it deemed uncollectible. Specifically, we noted 11 loans with a principal loss totaling \$124,672 that the department deemed uncollectible during the period from February 1994 to June 1996. Although the department had prepared the applications for discharge from accountability for these loans, it had not submitted the applications to the Board of Control for write-off approval. As a result, the department has understated these expenses of the MPROP as well.
- Finally, we noted that the department failed to reclassify as accounts receivable five loans totaling \$118,942 that, according to the department, became due and payable prior to 1993, because the borrowers have either died or are no longer residing on the property. Without proper identification of the loans that have become due and payable,

the department can not effectively follow up on the repayment of its loans. Further, the department's delays in the following up on the loans increases the risk of uncollectible loans.

Criteria

The California Government Code, sections 13401 and 13403, requires state agencies to maintain an effective system of internal control which include record-keeping procedures to provide effective accounting controls over assets, liabilities, revenues, and expenditures.

Recommendation

To ensure that loans receivable are properly accounted for, the department should:

- Maintain loan amortization schedules for mobile home park purchase ownership loans with deferred payment terms and disclose the number of these loans outstanding and the related interest income that would have been earned if they were not deferred to state policy-makers;
- Maintain an allowance for loan losses through periodic charges to operating expenses. The allowance should be adequate to cover specifically identified loans as well as loans for which losses are probable but not specifically identifiable. The department should evaluate the amount of estimated losses and adjust its allowance annually. Factors to be considered when analyzing its portfolio for uncollectible loans include, but are not limited to, the department's previous collection experience with its loans, changes in real estate market trends, and the fair market value of the collateral for its loan portfolio in relation to the loan amounts;
- Obtain the Board of Control's approval to write off the amount of loans that are deemed uncollectible; and
- Reclassify as accounts receivable the portion of loans that have become due and payable.

View of Department

The department generally concurs with all the recommendations. The department states that beginning with its 1996-97 year-end financial statements, it will reclassify those loans that have become due and payable from long-term to short-term status, estimate losses on its loan portfolio, and establish an allowance for loan losses which will be reviewed annually. Moreover, the department will begin developing amortization schedules for all of its loans starting with MPROP and anticipates that amortization schedules for MPROP loans will be developed by the end of fiscal year 1997-98.

Council for Private Postsecondary and Vocational Education

Reference Number: 96-5-4

Condition

The Council for Private Postsecondary and Vocational Education (council) does not record billed receivables that remain outstanding at year-end as revenue, nor does it record revenues unearned at year-end as advance collections. As a result, the council did not always record revenues for the period in which they were earned, as required by generally accepted accounting principles and state administrative procedures.

The council understated the 1995-96 fund balance by approximately \$152,000 because it did not accrue accounts receivable and revenues at year-end, and it did not classify unearned revenues as advance collections rather than revenues.

Criteria

The State Administrative Manual (SAM), Section 8290, requires that income, as represented by billed accounts receivable earned but not received, be accrued in the same year if the accounts receivable are estimated to be collectible by the end of the next fiscal year. Such amounts are considered earned as of June 30 of the year just ended. In addition, SAM Section 8210 requires that revenue collected in advance, received on or before June 30 but not earned as of that date, be reported as revenue collected in advance, a liability account.

Recommendation

We recommend the council establish procedures for accruing accounts receivable and revenues at year-end, and for recording unearned revenues as advance collections. Such procedures may include analysis of billings outstanding at year-end, analysis of fee payments subsequent to year-end, and analysis of the service year associated with fees received during the year.

View of Department

The following represents an abbreviated version of the council's response:

The council agrees with the finding. However, it states that since its current computer system was not designed to associate payments received with a given due date, it would be very labor intensive to develop a breakout of revenues by fiscal year. Further, due to the governor's veto of legislation extending its life and the resulting departure of its staff, the council's accounting functions have been returned to the contracted fiscal services (CFS) unit of the Department of General Services. Neither the council nor the CFS is currently tracking accounts receivable, nor does the council have the resources to do so manually.

Council for Private Postsecondary and Vocational Education

Reference Number: 96-5-5

Condition

The Council for Private Postsecondary and Vocational Education (council) did not allocate fees and expenditures between a subaccount for degree-granting institutions and a subaccount for vocational education institutions within the Private Postsecondary and Vocational Education Administration Fund (Fund 305), as required by statutes. Without deposit of fees and allocation of expenditures to required subaccounts, the council is unable to determine if approval fees and federal funding are adequate to cover expenditures attributable either to degree-granting or to vocational education institutions.

Council staff stated that data system and staffing constraints had not allowed the use of special subaccounts on a cost-effective basis. The council did not begin developing procedures for depositing fees and allocating expenditures on a special subaccount basis until fiscal year 1996-97.

Criteria

The Education Code, Section 94304(g), requires that all fees derived from postsecondary degree-granting institutions and related veterans' education benefits be deposited to a special degree-granting institution subaccount within Fund 305. Similarly, all fees derived from vocational education institutions and related veterans' education benefits are to be deposited to a special vocational education subaccount within Fund 305. This section also requires that staff time used to approve degree granting and vocational education institutions be charged to the appropriate subaccount. In addition, general administrative expenses are to be allocated to the appropriate subaccounts on a pro rata basis.

Recommendation

We recommend that the council implement procedures for depositing fees and allocating expenditures to special accounts in the Private Postsecondary and Vocational Education Administration Fund.

View of Department

The following represents an abbreviated version of the council's response:

The council agrees with the finding and states that in the past expenditure data was not captured in a way that allowed for the association of expenditures with revenues by subaccount. The council states that it has now established processes for reporting revenues and expenditures by subaccount. However, due to the governor's veto of legislation extending its life and the resulting departure of its staff, the council does not have the resources to implement the new procedures.

**State Controller's Office
Department of Finance**

Reference Number:

96-5-6

Condition

The State Controller's Office (SCO) and the Department of Finance (DOF) report on the State's budgetary basis financial condition using different accounting practices that may result in different fund balances for many of the State's funds; however, neither the SCO nor the DOF consistently reconciles these discrepancies. We compared the SCO and DOF fiscal year 1995-96 fund balances for five funds and noted discrepancies in all five instances, ranging from approximately \$44,000 to \$388.6 million. For example, the SCO reported a General Fund balance of \$1.074 billion and the Governor's Budget, prepared by the DOF, reported a General Fund balance of \$685.4 million, a difference of \$388.6 million for the same reporting period. In addition, the SCO reported a fund balance in the Air Pollution Control Fund of \$11 million, while the DOF reported a fund balance of \$2.2 million, a difference of \$8.8 million. While the SCO and DOF reconciled the fiscal year 1995-96 General Fund discrepancies, they did not complete the reconciliation until April 10, 1997. Moreover, neither the SCO nor the DOF reconciled the differences in fund balances for the remaining four funds we reviewed.

Inconsistent accounting practices and the resulting differences in fund balances provide the financial decision makers and the investment community with conflicting information about the State's true financial condition. For example, because the DOF's records are used in the State's budgeting process, the inability to account for the differences adequately may impair the integrity of the State's budget. In addition, the State Treasurer's Office discloses in its prospectus for the sale of state bonds that the SCO and the DOF use different accounting practices. The disclosure is important because the schedules prepared by the two entities, which are included in the prospectus, do not agree.

Criteria

The California Government Code, Section 13403, discusses the importance of a satisfactory system of internal accounting and administrative controls. These controls help provide reasonable assurances regarding the accuracy of accounting data. In addition, the State Administrative Manual, Section 7900, discusses the importance of preparing regular reconciliations.

Recommendation

Because of the need for accurate and consistent financial information, the DOF and the SCO should reconcile differences that exist in reports of the budgetary basis fund balances.

View of Department

We reported this issue previously, and the DOF responded that it works closely with the SCO to reconcile major differences between its own budget documents and the SCO's preliminary reports. However, parent departments for special funds have the primary responsibility for preparation of the Fund Condition Statements to be included in the Governor's Budget.

Various State Departments

Reference Number: 96-5-7

Condition

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 state agency accounting records. Specifically, state agencies are not required to reconcile the amount they reported for the Statewide Real Property Inventory to the amount they report in their Statement of Changes in General Fixed Assets. Unless the agencies reconcile the cost information in the two documents, the State may not maintain a complete and accurate inventory of all its real property and the amounts reported in the State's financial statements may not agree with the Statewide Real Property Inventory.

Criteria

The California Government Code, Section 11011.15, requires the DGS to maintain a complete and accurate inventory of all real property held by the State. It also requires each agency to furnish the DGS with a record of each parcel of real property that it possesses and to update its real property holdings by July 1 each year. Further, the State Administrative Manual, Sections 7977 and 8660, requires agencies to report all additions and improvements to real property funded by government resources.

Recommendation

Because of the need for accurate financial information, the State should require agencies to reconcile their real property inventory to their annual Statement of General Fixed Assets.

View of Department

We have previously reported this issue and the Department of Finance stated that during the review of required year-end reports, it would consider requiring departments to reconcile the amounts reported in the Statewide Real Property Inventory with their Statement of General Fixed Assets. In addition, in January 1997, the Department of Finance requested state agencies to develop and submit corrective action plans and related costs to remedy statewide internal control weaknesses, including this weakness in real property inventory.

Miscellaneous Control Weaknesses

We found seven control problems at three departments that resulted in assets not being protected, employees not receiving leave credit to which they were entitled, or programs not operating as required by statute. For example, payments for airline tickets and postage were not reconciled to airline tickets and postage purchased, and housing loans were not made according to statutory requirements.

Department of Housing and Community Development

Reference Number: 96-6-1

Condition

The Department of Housing and Community Development's (department) administration of the Mobilehome Park Resident Ownership Program (MPROP) requires improvement. The department has been administering the MPROP since 1984. The purpose of the program is to provide supplemental financing to make it possible for mobile home park residents to acquire the mobile home parks in which they reside and convert them to resident ownership.

We reviewed 9 of the 21 loans disbursed in fiscal year 1995-96 for the MPROP and noted the following deficiencies:

- For four of the nine borrowers, the department approved loans which exceeded the provisions of the program. Specifically, the statutes allow loans for up to 50 percent of the acquisition costs; however, under certain conditions, loans can be granted for up to 95 percent of the acquisition costs. We found that three of the loans exceeded 95 percent of the acquisition costs by 3 to 5 percent and the other loan exceeded 50 percent of the acquisition costs by less than 1 percent. Misinterpretation of the statutes, less than prompt review of the eligibility files, and failure to obtain sufficient documentation to waive the 50 percent financing limitation have contributed to the department's noncompliance. In addition, the loan origination and underwriting guidelines provided to the loan originators, which contain a loan summary form, do not specify the conditions necessary to allow loans up to 50 percent and 95 percent of the acquisition costs.
- For one of the nine borrowers, the department required a monthly payment that caused the borrower's post-conversion housing costs to exceed both 40 percent of her monthly income and pre-conversion housing costs. Post-conversion housing costs are the borrower's monthly housing expenses prior to purchasing the residence that have been adjusted for expenses related to the purchase, such as mortgage payments to other lenders and the department. The regulations require that the post conversion housing costs are not to exceed the greater of 40 percent of the resident's gross monthly income or the resident's housing costs prior to the conversion. The department failed to change its calculations when a co-borrower, who was no longer residing on the property, was removed from the application, in accordance with the Health and Safety Code, Division 31, Section 50780, which requires the borrowers to reside on the property.
- For two of the nine loans, the department failed to secure pertinent documents to support the disbursement of MPROP funds. For example, the department was unable to locate security and pledge agreements and closing escrow statements. Further, in one

instance, it did not have sufficient documents in the loan files to verify that the borrower's loan amount did not exceed 50 percent of the conversion costs attributable to low income spaces. The department's untimely review of loan files and its deficiencies in communication with loan originators contributed to the lack of properly documented loan files.

- Our review indicates that in six of the nine, or 67 percent, of the files reviewed, the contracted loan originators either did not compute the loan amount correctly or failed to provide the department with the proper loan documents after the close of escrow. In our opinion, due to the high percentage of errors noted, it would be beneficial to the department to invest the financial resources to substantially reduce these errors. The department receives an annual registration fee of \$5, for each transportable section of a manufactured home or mobile home, which is to be used solely for the disbursement of loans and its administrative costs. In addition, it receives interest income from loans and investments. For fiscal year 1995-96, although the department collected \$1,781,730 in fees and spent \$981,838 and \$724,555 on the disbursement of loans and administrative costs, respectively, the MPROP had a cash balance of approximately \$9.5 million at year end. In our opinion, since the eligibility criteria established by the statutes for the MPROP are complex and the number of loans disbursed is relatively low, the department should use MPROP funds to reduce the administrative errors identified in the loan origination process.

Further, we noted the following deficiencies in the overall administration of the MPROP:

The department inappropriately allowed a five-month grace period which reduced the borrower's monthly housing costs below the 30 percent allowed by statutes. Specifically, the statutes prohibit the use of MPROP funds to reduce monthly housing costs for low-income residents to less than 30 percent of their monthly incomes. Further, the statutes make no provision for a grace period. The department generally allows a 60-day grace period before requiring a borrower to start the payment of principal and interest if the borrower's housing costs are to be reduced below 30 percent of his monthly income because he pays off another lender's loan on the mobile home.

In addition, the department does not have procedures in place to ensure that an individual borrower's monthly housing costs are at least 30 percent of his monthly income throughout the life of the loan. Specifically, the department approves individual loans with deferred loan payments based upon income information obtained when the loan is originated and does not require or perform periodic income verification to ensure that the borrower's existing housing costs are at least 30 percent of the borrower's income and warrant the continued deferral of loan payments. The department states that it interprets the statutes to require the borrower's monthly housing costs to be at least 30 percent of the monthly income only at the time of loan closing. Although the statutes allow the department to establish flexible repayment terms, they clearly prohibit the use of these funds to reduce monthly housing costs to less than 30 percent of the borrower's monthly income.

Also, the department failed to obtain the Department of General Services' (DGS) approval for all its loan origination service contracts entered into with mortgage lenders to provide services such as processing loan applications, verifying income and housing costs, and preparing loan documents. The department obtained an exemption from DGS for its standard agreements with local public entities and resident organizations. However, it misinterpreted the exemption and considered the mobile home loan origination service contracts to be exempt from DGS approval as well.

Finally, the department provided inaccurate information to its loan originators. Specifically, in its loan origination and underwriting guidelines, which contain a loan summary form, the department states on the loan summary form that “to be eligible for MPROP assistance, the household’s annual gross income cannot exceed 80 percent of the lower income limit, by household size, for the county of residence.” However, the statutes allow the use of MPROP funds to assist low-income residents whose annual gross incomes are at 80 percent of the median income limit. We are unable to determine the number, if any, of the applicants who may have been denied MPROP funds as a result of this error.

Without adequate administrative control, the department cannot ensure that all loans are provided only to eligible borrowers at correct amounts, and that it has adequately secured all the related loan documents from its loan originators.

Criteria

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

The California Health and Safety Code contains specific program requirements as follows:

Section 50784(d) dictates that loan amounts for individual loans, to the extent possible, shall not exceed 50 percent of the acquisition costs. The department may approve loans with loan amounts up to 95 percent of the acquisition costs only when the borrower has demonstrated that he has unsuccessfully sought additional funding from other sources and would be unable to purchase the individual interest in the mobile home park without a waiver of the 50 percent financing limitation. In addition, Section 50784(e) dictates, with limited exceptions, that loan amounts for loans provided to resident organizations shall not exceed 50 percent of the conversion costs attributable to the low-income spaces.

Section 50786(b) directs the department to obtain the best available security for a loan such as a note, deed of trust, assignment of lease, or other form of security on real or personal property that the department determines is adequate to protect the interest of the state.

Section 50784(f) dictates that mobile home park purchase funds shall not be used to reduce monthly housing costs for low-income residents to less than 30 percent of their monthly incomes.

The California Code of Regulations, Section 8002, requires that post-conversion housing costs shall not exceed the greater of 40 percent of the borrowers’ gross monthly incomes or their housing costs prior to conversion.

The California Public Contract Code, Section 10295, states that, unless otherwise exempt, contracts entered into by any state agency for the purchase of equipment, supplies, materials, services, or construction are void unless or until approved by DGS.

The California Health and Safety Code, Section 50079.5, establishes income limits for lower income households at 80 percent of the median family income of a particular geographic area.

Recommendation

To ensure that loans are provided only to eligible borrowers at correct amounts for their intended purposes and that they are adequately secured, the department should:

- Require contracted loan originators to submit all eligibility files to the department for final approval before the close of escrow and review the files to ensure that income and housing costs have been properly verified and that loan amounts and monthly payments have been correctly determined in accordance with the laws and regulations. We recommend that the department perform this procedure until the administrative errors in the loan origination process are substantially reduced. Subsequently, it can implement alternative methods such as random spot checks on selected loans and the simplification of its loan origination forms to ensure that the errors remain at a relatively low level;
- Review the loan files immediately after the close of escrow to ensure that all loan and security documents have been received and to verify that the actual loan amount does not exceed the amount approved by the department;
- Revise its loan origination and underwriting guidelines to eliminate the allowance of a 60-day grace period;
- Seek a legal opinion to determine whether the statutes require the borrower's monthly housing costs to be at least 30 percent of his monthly income only at the time the loan closes;
- Ensure that it obtains DGS approval for its loan origination service contracts; and
- Revise the loan summary form contained in its loan origination and underwriting guidelines to correct the eligibility requirements for lower income households to 80 percent of the median income limit and to include the 50 percent and 95 percent acquisition cost requirement.

View of Department

The department generally concurs with the recommendations. Specifically, the department states that it has made a concentrated effort during the past 18 months to eliminate the backlog of unreviewed loan files and will continue its efforts to review loan files promptly. In addition, it will revise the MPROP loan summary forms immediately to correct the eligibility requirements and to include the 50 percent and 95 percent acquisition cost requirement. Further, it will eliminate the allowance of a 60-day grace period and develop a procedure to require the borrowers to notify the department if there is a need to delay starting their MPROP payments. Finally, it will seek an exemption from DGS for loan origination contracts and will forward the contracts to DGS for approval until the exemption is granted.

However, the department believes that requiring it to review and approve all loan transactions prepared by its loan originators prior to the close of escrow defeats the purpose of using contract loan origination services and states it will investigate alternative methods to reduce the frequency of errors noted. Alternative methods include, if feasible to administer, random spot checks on selected loans prior to funding; review of and revision to, as appropriate, the loan origination forms used by contract loan originators to simplify the required calculations;

and the development of criteria to be used in circumstances under which the department would withhold loan origination fee payments until the errors made by contract loan originators are corrected.

The department states that it interprets Section 50784(f) to require the borrower's monthly housing costs to be at least 30 percent of his monthly income to be in effect only when the loan closes and will seek a legal opinion to determine whether this statute requires ensuring that the borrower's housing costs are least 30 percent of his monthly income over the term of the loan.

Department of Housing and Community Development

Reference Number: 96-6-2

Condition

The Department of Housing and Community Development (department) has been administering the state's Mobilehome Park Resident Ownership Program (MPROP) since 1984; however, according to the department, prior to November 1996, it did not have procedures in place to monitor periodically the loans made to individual borrowers. Specifically, according to the department, its owner loan management unit first started to monitor loans in November 1996 by conducting a survey of the 329 outstanding loans and found that 18 of these borrowers no longer resided on the property. The department's efforts entailed contacting the 20 homeowner associations for the mobile home parks of its borrowers and requesting copies of their occupancy rolls. The department compared its records against the associations' lists and identified the 18 items mentioned above. Our review of the department's monitoring revealed that as a result of its inaction prior to November 1996, the department has jeopardized its security interest in 18 loans totaling approximately \$323,000, plus accrued interest. Specifically we found the following:

- For 6 of the 18 loans, totaling approximately \$106,000, the borrowers had died and the department had not proceeded with contacting the borrowers' heirs for total payment of its loans plus accrued interest;
- For 5 of the 18 loans, totaling approximately \$110,000, the borrowers had either sold or had made plans to sell their properties without the department's knowledge, and as a result, for those that had been sold, the department had not received its portion of the proceeds;
- For 4 of the 18 loans, totaling approximately \$45,000, other lenders to the borrowers foreclosed on the property without the department's knowledge. Further, in one instance, we noted that the other lender had a security interest in the property that was subordinate to the department's; and
- For the remaining 3 of the 18 loans, totaling approximately \$62,000, the borrowers had rented their properties without the department's knowledge. This is in violation of Health and Safety Code, Division 31, Section 50780, which requires the borrower to reside on the property.

According to the department, it is negotiating the repayment of the loans with estate administrators or heirs of deceased borrowers, with borrowers who have rented out their mobile homes and with the homeowner associations where units have been sold, to recover all or a portion of the \$323,000, plus accrued interest. It is the department's intent to continue its annual monitoring. However, in our opinion, the benefit to the department of monthly or quarterly monitoring to ensure that its security interest in its loans is not jeopardized outweighs the cost of its current monitoring procedures. The cost to the department of contacting 20 homeowner associations and comparing the lists of residents is small compared to the risk of loss that increases as time passes between borrowers' deaths, foreclosure proceedings, etc. and notification to the department.

In addition to the 18 items discussed above, we identified another instance where one borrower had passed away in January 1996 with an outstanding principal amount of \$41,144. Although the MPROP loans are not assumable, the department's financial management branch continued to bill the deceased borrower and received monthly payments from the deceased borrower's daughter. The department has in effect allowed the daughter to assume her mother's loan and this action by the department violates its current regulations. The department has proposed an amendment to its current regulations to allow the assumptions of MPROP loans in circumstances where there will be periodic payments on the assumed loan, and where the assumption is necessary to prevent a financial loss to the department.

Without adequate monitoring, the department cannot ensure that all borrowers comply with the program requirements and the terms of the notes. It also cannot ensure that long-term loans receivable that have become due and payable because of the borrowers' deaths or noncompliance with the MPROP agreement are identified and collected.

Criteria

The California Code of Regulations, Section 8030, requires the department to monitor the borrowers to protect its security interest in the program loans and to ensure that the borrowers comply with its program requirements.

The California Code of Regulations, Section 8004, states that loans made under the Mobilehome Park Purchase Ownership Program are not to be assumable by another borrower.

Recommendation

The department should monitor individual borrowers monthly or at least quarterly instead of annually to ensure that they comply with its program requirements and that it protects its security interest in the program loans. The department should also promptly follow up on loans that have become due and payable.

The department should comply with its current regulatory requirements, which prohibit the assumption of loans, until the proposed amendment is approved.

View of Department

The department does not generally concur with the recommendation stating that it has currently developed an annual program for monitoring its borrowers' compliance with program requirements and for ensuring that it protects its security interest in program loans.

Based upon its first review of the history of the MPROP portfolio for borrowers' activities, only 3.6 percent of the loans were found in noncompliance. The extremely low number of unreported infractions suggests that in a majority of instances, the surviving spouses or heirs notify it of deaths or that concerned borrowers attempt to work out a solution with it for problem loans.

The existing program for annually monitoring occupancy through the records of homeowner associations is the most efficient and cost-effective monitoring mechanism available within the current program financial resources. Should continued annual monitoring uncover a greater percentage of noncompliant loans, the department states that it will reconsider increasing the frequency of its monitoring.

Department of Housing and Community Development

Reference Number: 96-6-3

Condition

The Department of Housing and Community Development (department) needs to improve internal control over the payment of airline and car rental invoices. Specifically, the department does not verify airline and car rental charges with employee travel receipts before it pays invoices, as required by the State Administrative Manual. When travel expenses are not properly verified, the department cannot ensure that it is paying only for actual costs incurred for state service.

For fiscal year 1995-96, the department reported total airline expenditures of approximately \$53,000 and total car rental expenditures of approximately \$22,000. We reviewed approximately \$52,000 of airline expenditures and \$14,600 of car rental expenditures and found the department did not verify the total amount of airline charges and \$13,600 of the car rental charges before it paid the expenses.

We reported a similar finding in our prior years' audits. In response, the department's accounting officer stated that during fiscal year 1995-96, the department revised procedures to compare airline and rental car invoices with approved travel itineraries prior to paying invoices. However, its procedures do not meet the requirements of the State Administrative Manual and do not provide assurance that the department is paying only for actual costs incurred for state service. Moreover, we found the department does not always compare charges to approved travel itineraries. For 7 of the 28 airline charges we reviewed, it could not provide approved travel itineraries to support charges totaling \$974. In another instance, the department paid an airline charge of \$84 before it received an approved travel itinerary.

Criteria

The State Administrative Manual, Section 8422.114, requires that employees submit the passenger copy of an airline ticket with travel expense claims. The departments should then compare the airline invoice to the passenger copy to verify the charges.

The State Administrative Manual, Section 8422.115, requires that employees submit the customer copy of the car rental contract with the travel expense claim. In addition, the department should compare the customer copy with the car rental invoice to determine the propriety of the charges.

Recommendation

To ensure that it pays only for actual travel costs incurred for state service, the department should follow the requirements of the State Administrative Manual for verifying airline and car rental charges prior to paying the invoices.

View of Department

The department agrees with this recommendation. The department will review its existing procedures and either request Department of Finance exemption from the requirements of the State Administrative Manual, Sections 8422.114 and 8422.115, or incorporate the requirements into its procedures during fiscal year 1997-98.

Department of Housing and Community Development

Reference Number: 96-6-4

Condition

The Department of Housing and Community Development (department) continues to lack adequate control over its revolving fund. During our review of fiscal year 1995-96 expenditure transactions, we found that the department improperly used this fund to pay withholding taxes on behalf of one of its employees and to pay a vendor invoice that could have been scheduled for payment through the State Controller's Office (SCO). In addition, the department did not always promptly request reimbursement for its revolving fund. Weaknesses in control over revolving fund disbursements can result in the misuse of state funds.

During our review of fiscal year 1995-96 revolving fund disbursements and unreimbursed disbursements from prior years, we found the department improperly used the revolving fund for two of the eight disbursements we examined. In the first case, the department improperly paid withholding taxes totaling \$5,049 to the SCO in June 1995 on behalf of one of its employees. The department had failed to withhold a sufficient amount of income taxes from relocation expenses paid to the employee during January and February 1995, so it paid the withholding taxes for the employee. Although the department has sought reimbursement from the employee, as of June 30, 1996, approximately \$2,600 of the \$5,049 remains unreimbursed. In September 1996, the department arranged for the employee to repay the balance with a \$100 per month payroll deduction. In the second instance, the department used the revolving fund to pay airline charges totaling approximately \$3,800, that could have been paid using a warrant from the SCO. While state administrative requirements allow the department to use its revolving fund to pay vendor invoices that require immediate payment, the department made the payment 41 days after it received the invoice.

We also noted that the department does not always promptly request reimbursement for revolving fund disbursements from the SCO. Specifically, in three of the eight instances we reviewed, the department requested reimbursement for employee travel and office expenses 118 to 145 days after it issued checks. As of June 30, 1996, the department had unreimbursed revolving fund disbursements, totaling approximately \$25,000, outstanding for more than 60 days. We reported a similar finding in our fiscal year 1994-95. In response, the department stated that it could not always request the SCO to reimburse revolving fund disbursements promptly because the reimbursements are provided through an account in the State's general fund, for which the department has a limited appropriation. However, the State Administrative Manual, Section 8110, requires that the department should make revolving fund disbursements only when a sufficient appropriation exists for the expenditures.

Criteria

The State Administrative Manual, Section 8110, describes the permissible uses of the revolving fund as payment for earned compensation, traveling expenses, and advances, or where immediate payment is necessary.

Additionally, the State Administrative Manual, Section 8047, requires state agencies to promptly schedule claims for reimbursement of office revolving funds.

Recommendation

To improve controls over its revolving fund, the department should ensure that it uses the revolving fund only for purposes described in the State Administrative Manual. In addition, the department should implement the necessary corrective action to ensure prompt reimbursement to the revolving fund.

View of Department

The department agrees with the recommendations and provides the following comments. During the past year, the department's accounting administrators have written comprehensive procedures and trained staff to improve controls over the revolving fund. In addition, the department has cleared long-outstanding items from the revolving fund and implemented an improved revolving fund reconciliation process. The department will review its procedures for disputed invoices in order to prevent a recurrence of the information found during the audit.

However, according to the department's chief deputy director, the department will continue to experience cash flow problems due to its small general fund appropriation and its multi-funded structure. The department uses the general fund to pay expenditures. Then, monthly, through a plan of financial adjustment, the department uses special funds to reimburse the general fund. In the past year, the department has attempted to alleviate cash flow problems by gaining Department of Finance approval to consolidate four special funds into other existing funds.

Department of Consumer Affairs

Reference Number: 96-6-5

Condition

Neither the Board of Pharmacy (board) nor the Department of Consumer Affairs (department) maintains adequate accounting records supporting advance payments made to the U.S. Postal Service for the board's bulk mail postage. Specifically, we noted that the board made an advance payment of \$8,500 to the U.S. Postal Service for the bulk mail postage of 38,000 newsletters. However, the Postmaster mailed only 36,600 newsletters at a total cost of \$8,254. Thus, the actual cost of the mailing was \$246 less than the board estimated and yet the board did not request reimbursement for this overpayment.

The advance payments made to the U.S. Postal Service are deposited into postal account #685, which the department established for its boards and bureaus. According to the department, each board and bureau is responsible for accounting for its advance payment. However, the U.S. Postal Service does not send the boards and bureaus an invoice detailing the actual number of items mailed and the actual cost of the postage for them. In some cases, the U.S. Postal Service will send a "Statement of Mailing with Permit Imprints" (invoice) to the department; however, the department does not forward the invoice to its boards and bureaus. Furthermore, the department has neither a procedure in place to reconcile advance payments to the actual costs incurred nor a procedure to request reimbursements for overpayments.

When neither the department nor the board reconciles the advance payments made to the account to the actual postage costs, then neither is aware of whether it should request reimbursement for overpayments. Further, since there are no subaccounts, a board or bureau requesting bulk mailings can potentially use funds deposited by another board or bureau, without reimbursement, if its mailing is processed before that of the board or bureau that has made the deposit.

Criteria

The California Government Code, Section 13401, requires agencies to maintain an effective system of internal control. Furthermore, the California Government Code, Section 13403, requires that the system of internal control include, but not be limited to, record-keeping procedures to provide effective accounting control over assets, liabilities, revenues, and expenditures.

Recommendation

The department should establish procedures to account properly for the advance payments made to the U.S. Postal Service. Specifically, the procedures should require the department to identify the following:

- The party responsible for requesting the "Statement of Mailing with Permit Imprints" upon completion of the mailing. This statement provides the name of the board or bureau, mailing date, total number of pieces mailed, and postage cost.

- The party responsible for requesting the reimbursements for overpayments made to the U.S. Postal Service.

Further, the procedures should be communicated to all boards and bureaus.

View of Department

The department agrees with this finding and states that it is developing procedures to track the prepayments for postage issued for each board's and bureau's bulk mailings and to reconcile actual costs to these prepayments upon receipt of the invoice from the U.S. Postal Service. The department states that it will be responsible for requesting refunds of unused prepayments and such moneys will be returned to the appropriate department fund.

Department of Consumer Affairs

Reference Number: 96-6-6

Condition

The Department of Consumer Affairs (department) does not track accumulated leave balances and, as a result, cannot determine such balances for approximately 6,104 of the 6,159 examination proctors on record as of March 1997 that are used by its boards and bureaus. To assist in administering exams for licensure, the department's boards and bureaus use proctors. The proctors are intermittent employees who accrue leave credits after they accumulate 960 hours or 120 days of paid employment. However, the department does not provide the approximately 6,104 proctors with annual statements of leave.

As a result of the department's failure to track the accumulated leave balances, proctors who have either separated from state service or obtained permanent positions in state service may not receive full compensation or credit for their leave balances. The department anticipates that approximately 82,500 proctor hours will be needed annually to complete licensing examinations. This represents the equivalent of approximately 42 full-time employees. If each of the examination proctors had previously worked over 120 days, they would collectively accumulate credit for over 400 hours of vacation annually. However, the department states that it maintains leave cards for only the 55 proctors whose work history shows regular or continuous work for the department. As an example of the magnitude of the problem, the department did not maintain a leave card for a proctor who worked for approximately 15 boards over a number of years. When the proctor left the department to work full-time for one of the boards, she requested an accounting of her accrued leave credits. The department calculated that she had accrued 576 hours of sick leave and 612 hours of vacation.

The department cites the difficulty in tracking the hours the proctors have worked over the years for the various boards, bureaus, and other state agencies and its limited staff resources as reasons for not maintaining leave cards or providing annual leave statements to its proctors. Further, the department states that it is currently in the process of implementing a plan to correct the problem. Specifically, the department's plan includes hiring a contractor to provide some of its proctors as well as establishing a central unit to monitor the leave balances of the remaining proctors it chooses to retain.

Criteria

The State Administrative Manual, Section 8534, states that agencies will maintain sick leave and vacation records for *each* employee using STD. Form 642(A) (intermittent employee leave record). In addition, the section requires that agencies provide *each* employee an annual leave statement.

The California Government Code, Section 19839(a), states that a person is entitled to a lump-sum payment, as of the time of separation from state service, for any unused or accumulated vacation or annual leave.

The California Code of Regulations, Title 2, Section 599.740(a), states that intermittent employees shall accrue vacation credits following the completion of 960 hours or 120 days of paid employment.

Recommendation

The department should implement its plan for examination proctor services which includes hiring a contractor to provide some of its proctors as well as establishing a central unit to monitor the leave balances of the remaining proctors it chooses to retain.

View of Department

The department recognizes its responsibility to maintain leave cards for and provide annual leave statements to all of its employees. According to the department, it is in the process of establishing a central appointment unit to track better the total hours which each proctor works and therefore facilitate maintaining leave records. Also, the department is in the process of implementing a plan to contract out some of the proctor services.

Department of Transportation

Reference Number: 96-6-7

Condition

The Department of Transportation's (department) controls over contracts are not sufficient to ensure that total payments do not exceed agreed upon amounts. Specifically, the department approved a vendor's claim for payment that exceeded the balance on the contract by \$146,476. Because the department's accounts payable section did not record an initial payment and the district office contract administrator did not consider previous payments when approving the invoice the vendor submitted for payment, the department attempted to pay an amount in excess of the contract.

State regulations require that agencies keep records to provide effective accounting control over liabilities and expenditures. When records are not properly maintained, the State assumes a risk that it may overpay on its contracts. In this instance, however, the State Controller stopped payment.

Criteria

The California Government Code, sections 13401 and 13403, requires agencies to maintain an effective system of internal accounting and administrative controls that includes record-keeping procedures to provide effective accounting control over assets, liabilities, revenues, and expenditures.

Recommendation

The department's accounting office should ensure that it posts to contract files all payments made and calculates remaining balances in contracts so that it does not overpay any contracts. Each district office should ensure that its contract administrators do not approve invoices for payment when the dollar amount of the contract is exceeded.

View of Department

The director of the department's Accounting Service Center and the chief of the department's Office of Accounts Payable concur with this finding. The procedures outlined in the recommendation existed in the payment process when the incident occurred. The chief of the Office of Accounts Payable will advise staff of the finding and its potential impact to the State and remind staff of the importance of adhering to procedures.

Since consolidation of the accounting function, contract managers are able to view payment history records within the department's accounting system to confirm the accuracy of their payment records. The chief of the Office of Accounts Payable will remind all contract managers that this capability is available to them to assist in carrying out their responsibility to monitor contract expenditures.

**Independent Auditors' Report on Compliance With
Federal Grant Requirements**

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, 1996, and have issued our report thereon dated November 27, 1996. The California State University's compliance with federal requirements was audited by another independent auditor whose report has been furnished to us, and our opinion, insofar as it relates to the California State University, is based solely upon the report of the other independent auditor. The scope of our audit did not extend to financial aid programs administered by the University of California because it contracts with other independent certified public accountants for Office of Management and Budget (OMB) Circular A-133 audits. 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 not allowed; 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, 1996, are identified in the schedule of federal assistance beginning on page 173. 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 that are applicable; federal financial reports and claims for advances and reimbursements; and amounts claimed or used for matching that are applicable to each of its major federal financial assistance programs for the year ended June 30, 1996.

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 173, for the year ended June 30, 1996: political activity, Davis Bacon Act, civil rights, cash management, relocation assistance and real property acquisition, federal financial reports, allowable costs/cost principles, 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 this 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, 1996. 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 53. The instances of noncompliance identified in the State's single audit report for fiscal year 1994-95 that have not been corrected are also included in those sections. Additionally, beginning on page 163, 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

A handwritten signature in cursive script that reads "Philip Jelicich".

PHILIP J. JELICICH, CPA
Deputy State Auditor

May 16, 1997

**Issues of General Concern Related
to Federal Grant Requirements**

Cash Management

The federal government enacted the Cash Management Improvement Act (CMIA) in 1990 to ensure greater efficiency, effectiveness, and equity in the exchange of funds between the federal government and the states. The CMIA requires the calculation of a liability to the federal government for interest charges when states request and receive federal funds in advance of disbursement to vendors, subrecipients, or program participants. Similarly, in instances in which the states incur costs for federal programs before receiving federal reimbursements, the CMIA allows the states to calculate interest charges against the federal government. To implement the CMIA, the federal government prescribed regulations for the transfer of funds for federal programs between the federal government and the states. The regulations differentiate between the requirements for most major federal programs, for which the State receives over \$20 million, and for other federal programs.

The CMIA requires the State to enter into an agreement with the federal government that covers applicable major federal programs and establishes the procedures and requirements for the transfer of funds. The procedures include calculating federal and state interest liabilities for each applicable program and annually reporting these interest liabilities to the federal government. However, since fiscal year 1994-95, the State and the federal government have been unable to agree on all of the procedures to implement the requirements of the CMIA. Therefore, in lieu of an agreement, in 1994 the federal government issued the CMIA Default Procedures (default procedures), which it amended in 1995, for the State to follow to implement the CMIA. The default procedures assigned the Department of Finance (DOF) the responsibility for implementing the procedures for tracking and calculating the state and federal interest liabilities for the major federal programs affected by the CMIA. In addition, the DOF is responsible for reporting the interest liability to the federal government in the CMIA Annual Report.

For federal programs that are not subject to an agreement or default procedures, the regulations require only that the State ensures the timing of a request for a cash advance and the amount requested come as close as administratively feasible to the actual cash disbursements.

We have identified the following issues related to the CMIA.

Excessive Federal Cash on Hand

Reference Number:	96-7-1-Variou
Federal Catalog Number:	
Federal Program Title:	See listing of the specific federal program details following the discussion of the issues below.
Federal Award Number and Period:	
State Administering Department:	

Criteria

In our review of federal programs, we determined that the following were among the compliance requirements related to cash management:

The Code of Federal Regulations, Title 31, Section 205.20(a), requires that the timing and amount of cash advances be as close as administratively possible to the actual cash outlay.

The Code of Federal Regulations, Title 34, Section 74.22(b)(2) and Title 45, Section 74.22(b)(2), requires that cash advances be limited to the minimum amounts needed and be timed to be in accordance with actual, immediate cash requirements.

Condition

The State does not always ensure that departments limit the timing and amount of cash advances to the actual immediate cash requirements. Failure to ensure that the timing and amount of cash advances are as close as administratively feasible to the actual cash outlay may cause the State to incur an interest liability to the federal government. Specifically, we found that:

- The Department of Health Services (department) maintained excess cash balances for the HIV Care Formula Grants Program. The department's accounting section records cash advances and expenditures for the program by fiscal year and project work phase. For five of the eight work phases we reviewed that had activity during fiscal year 1995-96, the department maintained cash balances that did not meet its actual immediate needs. Specifically, for one work phase, the department maintained cash on hand from between \$26,700 and \$6.3 million for approximately nine months. For another work phase, the department held cash balances between \$54,400 and \$375,400 for ten months. For a third work phase, the department maintained balances between \$39,000 and \$104,100 for 52 days. For the remaining two work phases, the department had cash balances of approximately \$1,300 and \$3,200, respectively, for 1 to 1 1/2 years. We reported a similar issue during our audit for fiscal year 1994-95.
- In paying for support expenditures for the Special Education—Grants for Infants and Families With Disabilities Program, the Department of Developmental Services (department) did not match its receipt of funds with its disbursement of those funds. As a result, the department maintained cash balances for approximately six months that exceeded its immediate needs. The cash balances ranged from approximately \$200 to \$93,300. We reported a similar finding during our audit for fiscal year 1994-95.
- For one of seven cash requests we reviewed that were used to pay for local assistance expenditures for the Vocational Education—Basic Grants to States Program, the Department of Education (department) did not minimize the time between the receipt and disbursement of those funds. As a result, the department maintained a cash balance of \$653,800 for at least 38 days.

Recommendation

To ensure that the State complies with federal requirements, the State should ensure that departments limit the cash advances to the minimum amounts needed and time the advances according to their actual, immediate cash requirements.

View of Departments

According to a Department of Health Services accounting administrator, prior to November 1995, the employee responsible for cash requests for the HIV Care Formula Grants Program maintained cash balances for several different work phases. After the employee was replaced, the department decided in March 1996 that it should request cash only for actual expenditures. The accounting administrator also stated that the \$6.3 million cash balance for one work phase resulted from clerical errors that occurred in December 1995 and January 1996. The department discovered the errors in March 1996 and used the excess balance for expenditures in May 1996. For the other work phases, the department either reduced the cash balances by actual expenditures by March 1996 or moved the cash balances to the current work phase in January 1997.

The Department of Developmental Services accounting section chief stated that the \$93,000 excess cash balance occurred because expenditure information was incorrectly keyed into the State's accounting system. As a result, a claim schedule was not generated and forwarded for payment after the department requested the federal funds. The accounting section chief stated that the department has since changed its procedures to request federal funds only when a claim schedule is generated. Smaller excess cash balances occurred because the department estimated the amounts of its requests for federal funds to cover Interagency Coordinating Council member travel expenses. Therefore, when the travel expenses were less than the estimates, the department held excess cash. According to the accounting section chief, beginning in fiscal year 1996-97, the department will process these travel claims for payment through the department's clearing account before the federal funds are requested.

The California Department of Education (CDE) concurs with this finding. The CDE's Federal Funds Unit processed approximately 125 requests for federal funds during fiscal year 1995-96. The CDE inadvertently maintained a cash balance for the one federal cash request identified.

As a result of the delay in disbursement of the federal funds, the State accrued interest on the funds and the CDE properly reported the cash balance on its quarterly Cash Management report submitted to the Department of Finance (DOF). Following Cash Management Improvement Act (CMIA) procedures, the DOF subtracted the interest earned on the federal funds from the amount due from the federal government for all State programs. CMIA procedures work to equalize the benefit of holding cash balances according to the use and source of the funds in question.

The CDE has implemented a more stringent review and documentation process to minimize the time between the receipt and disbursement of federal funds. The Federal Funds Unit manager will review monthly reports to immediately identify cash balances of federal funds. All delays in disbursement of federal funds will be documented, clearly describing the reasons for the delays.

Department of Education

Federal Catalog Number: 84.048
Federal Program Title: Vocational Education—Basic Grants to States
Federal Award Number and Period: V048A50005; FFY 1995-96
State Administering Department: Department of Education
Federal Catalog Number: 84.181
Federal Program Title: Special Education—Grants for Infants and Families With Disabilities
Federal Award Number and Period: H181A50071; FFY 1994-95
State Administering Department: Department of Developmental Services

Department of Health and Human Services

Federal Catalog Number: 93.917
Federal Program Title: HIV Care Formula Grant
Federal Award Number and Period: BRX/070041-93; FFY 1993-94
BRX/070041-94-0; FFY 1994-95
BRX/070041-95-0; FFY 1995-96
State Administering Department: Department of Health Services

Noncompliance With Federal Regulations or Default Procedures

Department of the Treasury

Reference Number: 96-7-2-Variou
Federal Catalog Number: Refer to Table 1
Federal Program Title: Refer to Table 1
Federal Award Number and Period: Various
State Administering Department: Department of Finance (DOF)

Criteria

The Code of Federal Regulations, Title 31, Section 205.14(b)(1), does not allow the State to be reimbursed for the direct costs of implementing the Cash Management Improvement Act (CMIA) when the State is using default procedures.

The Code of Federal Regulations, Title 31, Section 205.15(a)(2), requires that the annual report submitted by the State include the state interest liability for each program subject to the regulations. The CMIA Default Procedures, Section 7.2.1 and 7.6.1, established requirements for calculating federal and state interest liabilities, respectively. Further, CMIA Default Procedures, Section 7.2.2(c) and Section 7.6.2(c), provide the methods for calculating these liabilities.

These default procedures require that the time period between when the State issues warrants to recipients and when the warrants are cleared by the bank be determined by the clearance patterns specified in the default procedures. Exhibit A of the default procedures lists by program the average days to clearance that are to be used for calculating state and federal interest liabilities.

Condition

The State could not or did not always comply with federal regulations or the default procedures required by the federal government when implementing CMIA for fiscal year 1995-96. As a result, the interest liability the State calculated and reported to the federal government for the fiscal year did not always comply with the regulations or default procedures. The State reported a net state interest liability of \$11.6 million related to the fiscal year 1995-96 CMIA. The net effect of the State's noncompliance is an overstatement totaling approximately \$148,200 in interest liabilities for applicable programs.

As shown in Table 1, we identified the following instances in which the State's noncompliance with the federal regulations or default procedures had an effect on the interest liability calculated and reported to the federal government.

- The Department of Finance (DOF) understated the State's interest liability due to the federal government because it did not include in the Annual Report approximately \$432,100 of state interest liability it calculated for federal funds advanced to the State for payroll expenditures. The DOF required departments to track and report the advance payroll expenditure information, and the DOF calculated the resulting state interest liability as required by the default procedures. However, the DOF did not include this information in the Annual Report because it believes it would not be equitable to include such information since the State cannot efficiently and effectively calculate the federal interest liability to the State when the State uses its own funds to cover payroll and operating costs for applicable federal programs. Specifically, the payroll and operating expenditures initially paid by the State and later reimbursed by the federal government are not tracked by the departments and therefore, not included in the interest liability calculation. If the State could track and calculate the interest liability resulting from these payroll and operating expenditures, the federal government would owe the State for interest liabilities.

- The DOF overstated the State's interest liability to the federal government for local assistance expenditures by approximately \$787,400, and it understated the interest liability for payroll expenditures by \$11,700 because the State used clearance patterns in the calculations that did not comply with the default procedures. The clearance patterns represent the average number of days from warrant issuance to redemption. For local assistance expenditures, the State used clearance patterns that were generally more days than those specified in the default procedures. In contrast, for payroll expenditures the State used a clearance pattern that was fewer days than the pattern specified in the default procedures.
- The DOF understated the State's interest liability due to the federal government by \$15,900 for other errors that we identified. For the Disaster Assistance program, the DOF did not use the correct amount of transferred funds in its calculation. In addition, for 2 of the 21 programs we audited, we found errors in the information departments reported to the DOF. Specifically, we found that one department omitted a transfer of funds for the Disaster Assistance program, and another department did not correctly report for the Community Development Block Grant—States Program the number of days the federal funds were in the state treasury before a warrant was issued.

In addition, the State understated its interest liability by \$179,500 because it offset the liability by the direct cost of implementing CMIA even though the offset is not allowed when the State is using default procedures.

Recommendation

The State should correct errors that affect the interest liability reported in the Annual Report. In addition, the State should continue to discuss with the federal government the areas of disagreement in the transfer of funds between the State and the federal government.

View of the Department

The supervising administrative analyst of the DOF's Fiscal Systems and Consulting Unit stated during fiscal year 1995-96, the DOF continued to negotiate with the federal government about various outstanding issues. The negotiations resolved some minor issues; major issues, such as state administrative costs, funding techniques for specific programs, and allowable direct costs, remain unresolved. In addition, the supervising administrative analyst stated the amended default procedures contained some errors and omissions.

The DOF identified the following specific issues:

- The payment of state interest liability for payroll funds requested in advance and federal interest liability for payroll and operating expenses requested in arrears is one of the outstanding issues still being negotiated with the federal government. Based on a DOF study that was reviewed and reported on in April 1995 by the Bureau of State Audits (BSA), the federal interest liability would exceed the state interest liability by a small amount. Thus, in DOF's opinion, the administrative difficulties for state agencies to track the cash flow and calculate the federal interest liability cannot be solved effectively. In April 1996, the U.S. General Accounting Office (GAO) reviewed the BSA report. Although the DOF has received no information on the results of the GAO's review, the DOF believes the

GAO will confirm the BSA's findings. If the U.S. Treasury accepts the BSA's findings and agrees to no exchange of interest for the state administrative costs, the State will not owe the federal government any interest for advance funding of payroll expenditures.

- The DOF believes two programs should be excluded from the incorrect clearance patterns calculation in Table 1. The federal government added the programs to the default procedures in fiscal year 1995-96 but, according to the DOF, did not amend the default procedures (Exhibit A) to include clearance patterns for these programs. In addition, the DOF contends that it neither overstated nor understated the interest liability related to the use of different clearance patterns because the clearance patterns it used reflect more accurately the actual warrant redemption activities. The DOF revises the clearance patterns each year based on warrant redemption activities of the prior calendar year. As required by the Code of Federal Regulations, Title 31, Section 205.8(c), the DOF notified the federal government in June 1995 of the changes to the patterns. However, when the federal government amended the default procedures for fiscal year 1995-96, it omitted the most current clearance patterns the DOF provided. Thus, the DOF believes that, if the federal government had included the revised clearance patterns when it amended the default procedures, the findings would not have been made.
- The \$15,900 understated interest liability that resulted from two departmental reporting errors and one DOF calculating error represent a 0.1 percent error rate of the \$11.6 million net state interest liability reported in the 1995-96 Annual Report. The DOF will continue its ongoing effort to reduce reporting errors by analyzing the information reported by state agencies, providing ongoing consultation and training, and annually reminding state agencies of their responsibilities.
- The DOF argues that the State is entitled to direct cost reimbursement even if the State does not have a signed agreement. The state agencies and the DOF incur costs to track federal funds and to calculate the interest liability. Therefore, all costs associated with CMIA activities should be eligible for reimbursement as an offset against the State's interest liability.

Table 1

Interest Liability Effect of Noncompliance with
Cash Management Regulations and Procedures

Federal Catalog Number	Program Name	Overstated (Understated)			
		Omission of Advance Payroll Liability	Incorrect Clearance Patterns		
			Advance Payroll	Local Assistance	Other
10.553	School Breakfast Program			\$ 5,593.42	
10.555	National School Lunch Program			152,991.26	
10.557	Special Supplemental Food Program for Women, Infants, and Children			3,913.51	
10.558	Child and Adult Care Food Program			(40,046.79)	
10.561	State Administrative Matching Grants for Food Stamp Program	\$ (3,639.95)	\$ (85.17)	(3,110.26)	
14.228	Community Development Block Grants—State's Program	(103.43)	(1.29)	9,059.47	\$ (6.80)
16.579	Drug Control and System Improvement—Formula Grant			5,156.34	
17.207	Employment Service	(46,086.03)	(1,269.22)		
17.225	Unemployment Insurance	(263,488.41)	(7,030.25)		
17.245	Trade Adjustment Assistance—Workers	(1,215.87)	(33.55)		
17.246	Employment and Training Assistance—Dislocated Workers	(11,893.64)	(284.61)		
17.250	Job Training Partnership Act	(7,430.42)	(174.51)		
20.600	State and Community Highway Safety			2,595.11	
83.516	Disaster Assistance			115,345.94	\$(15,910.79)
84.002	Adult Education—State Administered Basic Grant Program			78.78	
84.010	Title 1 Grants to Local Educational Agencies			(117,511.81)	
84.011	Migrant Education—Basic State Grant Program			16,132.37	
84.027	Special Education—Grants to States			(56,403.58)	
84.048	Vocational Education—Basic Grants to States			124,596.43	
84.126	Rehabilitation Services—Vocational Rehabilitation Grants to States	(8,046.52)	(691.78)	(2,217.87)	
84.151	Chapter 2—State Block Grants			275.69	
84.164	Eisenhower Mathematics and Science Education—State Grants			576.87	
84.173	Special Education—Preschool Grants			150.60	
84.186	Safe and Drug-Free Schools—State Grants			8,647.80	
93.044	Special Programs for the Aging—Title III, Part B—Grants for Supportive Services and Senior Centers			(5,970.16)	
93.045	Special Programs for the Aging—Title III, Part C—Nutrition Services			(8,776.43)	
93.560	Family Support Payments to States—Assistance Payments	(6,532.76)	(147.77)	111,484.47	
93.561	Job Opportunity and Basic Skills Training	(325.92)	(7.54)	(53,599.83)	
93.563	Child Support Enforcement	(3,531.25)	(90.18)	4,579.89	
93.566	Refugee and Entrant Assistance—State Administered Programs	(423.36)	(9.88)	4,468.77	
93.568	Low-Income Home Energy Assistance	\$ (4,577.89)	\$ (108.99)	\$ (4,509.96)	

Federal Catalog Number	Program Name	Overstated (Understated)			
		Omission of Advance Payroll Liability	Incorrect Clearance Patterns		
			Advance Payroll	Local Assistance	Other
93.569	Community Services Block Grant	\$ (1,590.63)	\$ (37.18)	\$ 4,938.24	
93.574	Child Care for Families At-Risk of Welfare Dependency			(5,110.16)	
93.575	Child Care and Development Block Grant			41,722.85	
93.645	Child Welfare Services—State Grants	(246.76)	(5.73)	7,804.67	
93.658	Foster Care—Title IV-E	(5,708.89)	(135.41)	9,349.04	
93.659	Adoption Assistance	(780.01)	(18.25)	5,787.72	
93.778	Medical Assistance Program			445,515.00	
93.958	Block Grants for Community Mental Health Services			(5,782.93)	
93.959	Block Grants for Prevention and Treatment of Substance Abuse	(5,714.89)	(156.69)	9,668.83	
96.001	Social Security—Disability Insurance	(60,730.26)	(1,386.87)		
	Total	\$(432,066.89)	\$(11,674.87)	\$787,393.29	\$(15,917.59)

Miscellaneous Federal Cash Management Issues

Department of the Treasury

Reference Number:	96-7-3-Variou
Federal Catalog Number:	See listing of the specific federal program details following the discussion of the issues below.
Federal Program Title:	
Federal Award Number and Period:	
State Administering Department:	Department of Finance (DOF)

Criteria

The Cash Management Improvement Act (CMIA) Default Procedures, Section 5.2.2, describe the “pre-issuance funding techniques.” When state agencies use this technique, they must make every effort to request funds so that the funds are deposited in a state account not more than two business days before disbursement.

The CMIA Default Procedures, sections 5.3.17, 5.3.18, 5.3.20, 5.3.22, 5.3.23, and 5.3.25, require that the “in advance of issuance” funding technique be used for payroll expenditures of the Migrant Education—Basic State Grant Program, Special Education—Grants to States Program, Vocational Education—Basic Grants to States Program, Chapter 2—State Block Grants Program, Eisenhower Mathematics and Science Education—State Grants Program, and the Safe and Drug-Free Schools—States Grants Program.

The CMIA Default Procedures, Section 5.3.44, require funds to be drawn weekly for Maternal and Child Health Services Block Grant Program expenditures and require that the requests be based on weekly estimates of expenditures.

Condition

The State did not always comply with default procedures. In addition, one department did not comply with the required time limits for the pre-issuance funding technique. Specifically, we identified the following instances of noncompliance with the default procedures:

- According to the Department of Finance (DOF), the Department of Health Services was unable to make the required weekly estimate of federal expenditures and the required request for the funds from the federal government in advance of the expenditures for the Maternal and Child Health Services Block Grant because it was unable to obtain timely information from the State’s accounting system to accommodate the requirements of the default procedures. Therefore, the State advanced its own funds to pay federal program expenditures for this program, and the federal government reimbursed the State. However, the State could not calculate an interest liability for the program even though it would have been fair for it to do so since it advanced its own funds. We reported a similar issue during our audit for fiscal year 1994-95.

- The Department of Education used funding techniques different from the techniques required by the default procedures for payroll expenditures in six federal programs. The DOF proposed for fiscal year 1995-96 to use the same funding technique for these programs administered by the Department of Education that it uses for other programs. However, the federal government did not make the proposed revisions when it amended the default procedures. As a result, the Department of Education used an after-cost allocation rather than the required advance funding for the Migrant Education—Basic State Grant Program, Special Education—Grants to States Program, Vocational Education—Basic Grants to States Program, Chapter 2—State Block Grants Program, Eisenhower Mathematics and Science Education—State Grants Program, and the Safe and Drug-Free Schools—States Grants Program.
- Using the required pre-issuance funding technique, the Office of Criminal Justice Planning (office) disbursed within two business days only 8 of 188 requests for federal funds (4.3 percent) for the Drug Control and System Improvement—Formula Grant Program. The office disbursed \$36.5 million during fiscal year 1995-96. These disbursements were made, on average, seven business days from the request.

Recommendation

The State should continue to discuss with the federal government the instances in which it cannot comply with the default procedures because the State's systems do not accommodate the requirements of the default procedures. In addition, the State should propose again to amend the default procedures for certain programs the Department of Education uses to reflect the same funding technique it uses for other programs. Finally, the State should ensure the Office of Criminal Justice Planning makes every effort to disburse its federal funds within two business days of the advance.

View of the Department

The supervising administrative analyst of the DOF's Fiscal Systems and Consulting Unit provided the DOF's perspectives on the findings:

- The funding technique for the Maternal and Child Health Services Block Grant Program is one of the outstanding issues still being negotiated with the federal government. The primary area of disagreement is the State's use of a reimbursement funding technique. The DOF argues that the CMIA does not prohibit the use of a reimbursement funding technique. It indicates that, if a State disburses its own funds for federal program purposes, the State is entitled to interest from the federal government. However, the CMIA regulations contain a specific prohibition against the use of a reimbursement funding technique. The DOF believes that this prohibition is not equitable to the states. In addition, the State should have the option to not calculate the federal interest liability due to lack of available information and the cost of calculating the liability.
- The State's proposed agreement with the federal government for fiscal year 1995-96 revised the funding technique for the payroll component of the six federal programs administered by the Department of Education. However, the federal government

did not amend the default procedures for these funding technique changes. The DOF believes that the after-cost allocation is the correct technique for the six programs. Between 1994-95 and 1995-96, the Department of Education's method for requesting federal funds for payroll did not change. The revision to the proposed agreement was to correct the funding technique description.

- The DOF is aware that the Office of Criminal Justice Planning (office) did not meet the time limit for the pre-issuance funding technique for a significant number of disbursements for the Drug Control and System Improvement—Formula Grant program. The default procedures allow a state agency to exceed the two-day requirement for a small number of disbursements because of variances in processing time. However, the office exceeded the time limit for the majority of its disbursements. The DOF will continue to work with the office to improve its fund request and claim schedule processes to reduce the number of days from the deposit to the disbursement of federal funds.

Department of Justice

Federal Catalog Number:	16.579
Federal Program Title:	Drug Control and System Improvement—Formula Grant
Federal Award Number and Period:	94DBCX0006; FFY 1993-94 95DBCX0006; FFY 1994-95

Department of Education

Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education—Basic State Grant Program
Federal Award Number and Period:	S011A50005-95A; FFY 1995-96
Federal Catalog Number:	84.027
Federal Program Title:	Special Education—Grants to States
Federal Award Number and Period:	H027A50115-96; FFY 1995-96
Federal Catalog Number:	84.048
Federal Program Title:	Vocational Education—Basic Grants to States
Federal Award Number and Period:	V048A50005; FFY 1995-96

Federal Catalog Number: 84.151
Federal Program Title: Chapter 2—State Block Grants
Federal Award Number and Period: S151Z40057; FFY 1994-95

Federal Catalog Number: 84.164
Federal Program Title: Eisenhower Mathematics and Science
Education—State Grants
Federal Award Number and Period: S164A40005; FFY 1994-95

Federal Catalog Number: 84.186
Federal Program Title: Safe and Drug-Free Schools—States Grants
Federal Award Number and Period: S186A50005; FFY 1995-96

Department of Health and Human Services

Federal Catalog Number: 93.994
Federal Program Title: Maternal and Child Health Services Block Grant
to the States
Federal Award Number and Period: 95B1CAMCHS-04; FFY 1994-95

Cost Allocation

Recipients of grant moneys, including state departments, must ensure that the costs they incur for federal grants meet grant objectives. The federal Office of Management and Budget, Circular A-87 Revised, guides grant recipients on the types of costs they can charge to federal grants and on the acceptable methods for demonstrating the propriety of those costs. Circular A-87 provides specific guidance on the cost of providing services funded by grants, and guidance on allocating costs that indirectly benefit grant recipients. In the following two sections, we discuss instances of noncompliance with Circular A-87 found during our audit.

Noncompliance With Requirements To Certify or Document Personal Service Costs

Department of Agriculture

Department of Education

Department of Health and Human Services

Reference Number: 96-8-1-Variou

Federal Catalog Number: See listing of the specific federal program details following the discussion of the issues below.

Federal Program Title:

Federal Award Number and Period:

State Administering Department: Various

Criteria

In our review of federal programs, we determined that the following were among the compliance requirements related to cost allocation:

The federal Office of Management and Budget (OMB), Circular A-87 Revised, Section 839A, 11.h(4), requires salaries and wages charged to a federal grant for employees working on multiple cost objectives or programs to be supported by personnel activity reports. Additionally, Section 839A, 11.h.(5), states personnel activity reports must reflect an after-the-fact distribution of the actual activity of each employee, must account for the total activity of each employee, and must be signed by the employee. Section 839A, h.(5), states when employees are expected to work solely on one federal grant or cost objective, charges for salaries will be supported by periodic certifications that the employees worked solely on that program for the period covered by the certifications. The certifications will be prepared at

least semiannually and will be signed by the employee or supervisor. Finally, Section 839A, 11.h.5(e), states that budget estimates or other distribution percentages determined before the services are performed do not qualify as support for charges to the federal grant.

Condition

Many departments do not fully comply with new federal requirements to certify or document personal service costs such as salaries and benefits charged to the federal grant programs they administer. In our reviews of the cost allocation systems at 18 departments, we found instances in which the departments failed to keep personnel activity reports certifying the amount of time spent on each program when employees worked on more than one program.

For employees who work exclusively on one program, several departments also failed to have these employees certify semiannually how they spent their time, as required. These requirements became effective for all grants awarded after September 1, 1995. When such records do not exist, there is an increased likelihood of under- or over-charges to federal grants, and the related over- and under-reimbursement to the State can be significant. We have the following specific concerns:

- Twelve of the 18 departments had employees who worked on a single program or award and were charging the related personal service costs to grants awarded after September 1, 1995. Therefore, the departments should have prepared periodic certifications for these employees to support the personal service costs charged to federal grants. However, three departments, the Department of Aging, the Department of Health Services (DHS), and the Department of Rehabilitation, did not prepare the certifications.
- Eight of the 18 departments had employees charging multiple grants awarded after September 1, 1995. One of the eight departments failed to require or use personnel activity reports, such as certified time sheets, for employees who worked on certain grants. Specifically, the California Community Colleges, Chancellor's Office (Chancellor's Office) allocated personal service costs based on budget estimates rather than actual time worked. We reviewed time sheets for five employees who worked on the Vocational Education program. Although these employees prepared time sheets, the Chancellor's Office allocated the related personal service costs based on preliminary budget estimates. As a result, personal service costs for four of the five employees were incorrectly allocated to various state and federal programs, including the Vocational Education—Basic Grants to States program. The amounts inappropriately allocated ranged from 1.1 percent to 15 percent of the employees' monthly salaries. This resulted in a \$2,000 under-allocation of personal service costs to the vocational education program for the one month we reviewed.

In a similar instance of noncompliance, the DHS used Childhood Immigration Grants funds to pay \$87,000 in salaries for two Local Assistance Branch employees from February 1, 1996, through December 31, 1996, without supporting personnel activity reports. The Immunization Branch agreed to budget two Local Assistance Branch employees using federal funds to assist in a study of prenatal screening practices in California hospitals. However, according to the assistant chief of the Division of Communicable Disease Control, the two employees did not perform the study alone; rather, a total of 14 employees completed the study. The assistant chief said that if only the two employees who were funded had performed the study, the department would have incurred higher costs for travel-related expenses throughout the State. Although the DHS

charged salaries to the grant for the two employees, neither the Immunization Branch nor the Local Assistance Branch could provide monthly activity reports to indicate the amount of time the employees worked on the survey.

The Immunization Branch also used Childhood Immunization Grants funds to pay \$211,000 in salaries for three employees of the Data Systems Branch from July 1, 1995, through December 31, 1996, even though the employees did not work on activities related to the grant program. The Immunization Branch agreed to have the Data Systems Branch design a data processing system to track statewide immunization information with costs reimbursed from federal grant funds. The Immunization Branch then included in its budget the costs for three new Data Systems Branch employees who were to develop the statewide immunization information system. According to the assistant chief of the Immunization Branch, the branch agreed to have the work performed by other, more experienced, senior Data Systems Branch staff as opposed to the less experienced staff funded by the federal grant program. However, this method did not allocate cost accurately to the federal grant program.

Recommendation

Each grant recipient should establish an adequate time reporting system that uses activity reports or certifications to document and account for the total activity of each employee.

Views of Departments

California Community Colleges, Chancellor's Office:

During fiscal year 1996-97, staff that were funded wholly or in part with federal dollars were required to submit a monthly employee time report. This report shows actual hours worked in specific funding categories.

These time sheets have recently been analyzed and adjustments are being made which include reducing or increasing funding sources for certain individuals to more accurately reflect their actual work and to keep within funding limits. In fiscal year 1997-98, the Chancellor's Office plans to review and analyze these time reports on a quarterly basis and make adjustments, if needed.

Department of Aging:

The department concurs with our finding. Semiannual certification of time spent by employees working on a single federal award has been instituted.

Department of Health Services:

The department agrees with the audit finding that staff working on a single federal award or cost objective did not complete semiannual certifications. Beginning in 1997, staff working 100 percent of their time on a single project will complete certification for the period ending June 30 and December 31 of each year. When staff work on multiple activities, the department will work with the federal agency to review the current time reporting system. The department will implement changes as needed.

Department of Rehabilitation:

The department agrees with the issue as described. However, it disagrees with the recommendation. It argues that over 99 percent of the department's employees work on a single federal grant, and 98 percent of those employees work on the same grant. The department has not established a cost accounting system to allocate employee time among various cost objectives because essentially all employees are funded from only one federal grant. Therefore, it seems burdensome to require this staff to complete certifications. In these days of federal and state directives to streamline processes and reduce paperwork, the department questions whether the intent of the Circular A-87 is served by the creation of a certification system within this department.

Specific Federal Program Details

Department of Agriculture

Federal Catalog Number:	10.557
Federal Program Title:	Special Supplemental Food Program for Women, Infants, and Children
Federal Award Number and Period:	7F6003; October 1, 1995 through September 30, 1996
State Administering Department:	Department of Health Services

Department of Education

Federal Catalog Number:	84.048
Federal Program Title:	Vocational Education—Basic Grants to States
Federal Award Number and Period:	V048A40005; July 7, 1994 through September 30, 1995
State Administering Department:	California Community Colleges, Chancellor's Office
Federal Catalog Number:	84.126
Federal Program Title:	Rehabilitation Services—Vocational Rehabilitation Grants to States
Federal Award Number and Period:	H126A60005; October 1, 1995 through September 30, 1997
State Administering Department:	Department of Rehabilitation

Department of Health and Human Services

Federal Catalog Number:	93.044
Federal Program Title:	Special Programs for the Aging—Title III, Part B— Grants for Supportive Services and Senior Citizens
Federal Award Number and Period:	Various
State Administering Department:	Department of Aging
Federal Catalog Number:	93.045
Federal Program Title:	Special Programs for the Aging—Title III, Part C—Nutrition Services
Federal Award Number and Period:	Various
State Administering Department:	Department of Aging
Federal Catalog Number:	93.268
Federal Program Title:	Childhood Immunization Grants
Federal Award Number and Period:	H23/CCH904423-07; January 1, 1996 through December 31, 1996
State Administering Department:	Department of Health Services
Federal Catalog Number:	93.566
Federal Program Title:	Refugee and Entrance Assistance—State Administered Programs
Federal Award Number and Period:	G-96-AA-CA-9115; October 1, 1995 through September 30, 1996
State Administering Department:	Department of Health Services
Federal Catalog Number:	93.778
Federal Program Title:	Medical Assistance Program
Federal Award Number and Period:	MAP 05-9605CA5-28; October 1, 1995 through June 30, 1996 ADM 05-9605CA5048; October 1, 1995 through June 30, 1996

State Administering Department:	Department of Health Services
Federal Catalog Number:	93.777
Federal Program Title:	State Survey and Certification of Health Care Providers and Supplies
Federal Award Number and Period:	05-9605CA5000; October 1, 1995 through September 30, 1996 05-9605CA5001; October 1, 1995 through September 30, 1996
State Administering Department:	Department of Health Services
Federal Catalog Number:	93.917
Federal Program Title:	HIV Care Formula Grants
Federal Award Number and Period:	BRX-0/0041-96-3; April 1, 1996 through March 31, 1997
State Administering Department:	Department of Health Services

Continuing Cost Allocation Problems at Two Departments

Department of Health and Human Services

Department of Justice

Reference Number:	96-8-2-Variou
Federal Catalog Number:	See listing of the specific federal program details following the discussion of the issues below.
Federal Program Title:	
Federal Award Number and Period:	
State Administering Departments:	Department of Community Services and Development Office of Criminal Justice Planning

Criteria

In our review of federal programs, we determined that the following were among the compliance requirements related to costs allocation:

The Office of Management and Budget, Circular A-87, establishes the principles and standards for determining costs under federal awards. The guidelines of the Circular A-87 require that costs charged to federal programs must be necessary and reasonable for the proper and efficient performance and administration of the federal award. In addition, when employees work on multiple activities, a distribution of their salaries must be supported by monthly personnel activity reports that reflect an after-the-fact distribution of the actual activity of each employee. Further, Circular A-87 distinguishes between direct and indirect costs charged to federal grants. Section 836 E.2.a of the circular states that direct costs chargeable to federal grants include compensation of employees for the time devoted specifically to meeting the objectives of those grants. Section 834 C.3.a states a cost may be allocated to a particular cost objective or program if the goods or services involved are chargeable and assignable to such cost objectives in accordance with the relative benefits received.

Condition

The following two departments have continuing problems with the allocation of costs to federal grant programs: the Department of Community Services and Development and the Office of Criminal Justice Planning.

Department of Community Services and Development

The Department of Community Services and Development (department) continues administrative practices that result in improper charges of its operating costs to the programs it administers. The department operates the Community Services Block Grant program (CSBG), the Low-Income Home Energy Assistance Program (LIHEAP), and other federal and nonfederal programs designed to provide assistance to low-income Californians. However, we found that the department does not ensure that the costs of its employees' salaries are correctly charged to the programs it operates based on the actual time the employees worked on the programs. As a result, the department does not charge each program a fair share of its labor costs and other costs that are allocated based on the amount of labor costs directly charged to each program. Because the department does not ensure that it correctly charges its administrative costs, it cannot be certain it spends federal funds on the programs the funds were awarded to support or that the department complies with the spending restrictions of the federal programs it operates.

We reviewed employees' time sheets for fiscal year 1995-96 and found that, although time sheets are reviewed by program managers, the department does not ensure that employees correctly charge their time to the programs they work on each month. For example, in July 1995, we found that four employees ultimately charged all of their time (514 hours) to the Home Energy Assistance Program (HEAP) component of the LIHEAP when the original entries to their time sheets showed they had also worked on three other programs. Two additional employees charged all of their time (233 hours) to the LIHEAP with comments on their time sheets that management had directed them to charge their time to the LIHEAP program. In total, five of the above time sheets carried comments that the employees were directed to charge their time to the LIHEAP. For August and September 1995, we found that five

employees charged time, totaling 597 hours, to the LIHEAP when their time sheets described they had worked on the CSBG program. On a sample basis, we examined documents from the department's contract files that demonstrated the employees had worked on CSBG activities. We identified six additional employees who charged all of their time in August and September 1995 (731 hours) to the LIHEAP when their time sheets described that they had worked on more than one program during those months.

In an attempt to correct the improper time charges, the chief of fiscal operations summarized the hours for the employees who had charged time to the HEAP component of the LIHEAP during July, August, and September 1995 and reassigned the cost for their time to an account used to accumulate program administrative costs. Program administrative costs are those costs that the department cannot directly identify to a specific program. The department then used percentages to allocate the costs to programs that historically would have benefited from program administrative activities. As a result, the department allocated personal services costs, totaling approximately \$110,960, to federal and nonfederal programs in proportions that did not represent their fair share when the costs should have been directly charged to the federal program that benefited from the services of the employees. According to the chief of fiscal operations, he allocated the costs because it would not have been cost-effective to make all of the adjustments to the accounting records to reflect the correct costs for each program.

To determine the extent of improper charges to the LIHEAP, we also reviewed employees' time sheets for the period October 1995 through June 1996. The time sheets showed two employees charged time (totaling 1,050 hours) to the LIHEAP when their time sheets indicated they worked on the CSBG program or both the LIHEAP and CSBG program. In addition, for the same time period three employees charged time (totaling 3,071 hours) to the LIHEAP when their time sheets indicated they worked on a project to determine eligibility for a state energy assistance program that is administered by local energy utility companies. Because the department's employees charged their time to the LIHEAP, the department is using federal funds to pay for some of the costs to determine eligibility for state energy assistance programs. When we brought the incorrect time charges to the attention of the chief of fiscal operations, he credited the LIHEAP for the costs related to the 1,050 hours (totaling approximately \$14,800) and correctly charged the costs to the programs that benefited from the employees' time. In addition, the chief of fiscal operations credited the LIHEAP for the costs related to the 3,071 hours (totaling approximately \$58,700) and reassigned the costs to the state energy assistance program.

In our fiscal year 1994-95 audit, we similarly reported that the department had directed its employees to change their time sheets so that an estimated \$114,000 in employee time was charged to the Earthquake Disaster Assistance program even though the employees had not actually worked on that federal program. According to the department, it directed its employees to change their time sheets because the department had undercharged the Earthquake Disaster Assistance program in fiscal year 1993-94. In July 1995, when we discussed this issue with the department, it agreed to take steps to correct the errors that had been made by properly documenting the charges made to the Earthquake Disaster Assistance program. The department provided us with a schedule of the employees who had worked on the Earthquake Disaster Assistance program. The schedule summarized the program initially charged, hours worked, salary and benefits, and travel costs. However, the department documented only \$65,000 of the \$114,000, and the schedule that was provided to us was incomplete and inaccurate.

In response to our fiscal year 1994-95 audit, the department stated that after it had identified all of the program costs and draws of federal funds, it would make any correcting entries to its accounting records. However, for fiscal year 1995-96, the department has changed its position. The department has not identified adequate support for all of the costs it charged to the federal Earthquake Disaster Assistance program in fiscal 1994-95, nor has it corrected its accounting records to adjust for the unsupported administrative costs. According to the chief of fiscal operations, it would not be cost-effective to identify the entries and correct the accounting records because the amount is immaterial.

In summary, federal guidelines for determining allowable costs under federal grants require that costs charged to federal programs be necessary, reasonable, and adequately documented. Throughout fiscal year 1995-96, the department's employees continued to improperly charge their time to federal programs when they had not actually worked on the programs. In addition, the department's attempt to correct improper charges of the department's administrative costs to the LIHEAP (totaling approximately \$110,960) resulted in charges to federal and nonfederal programs in proportions that did not represent their fair share, when the costs should have been directly charged to the federal programs that benefited from the services of the employees. Finally, the department has not provided complete and accurate support for nor made corrections to its accounting records to adjust for unsupported charges (totaling approximately \$114,000) to the Earthquake Disaster Assistance program that we identified in our fiscal year 1994-95 audit. Until the department takes the necessary steps to correct the above conditions, it cannot comply with federal guidelines.

Office of Criminal Justice Planning

The Office of Criminal Justice Planning (OCJP) incorrectly allocated the personal service costs for three employees working on the Drug Control and System Improvement—Formula Grant (DCSI). Specifically, personal service costs for two of the three employees were charged as indirect costs and allocated to all programs administered by the OCJP; however, the employees worked directly on the DCSI grant. The remaining employee's personal service costs were not allocated to the DCSI grant for March 1996 although the employee worked on the grant for half the month. As a result of the incorrect allocation, personal service costs charged to the DCSI grant were understated by at least \$63,000. Consequently, personal service costs allocated to the OCJP's other federal and state programs were overstated by the same amount. The OCJP uses budget estimates by branch to allocate personal service costs; however, they do not always update the labor distribution table when employees change branch assignments.

In addition, in fiscal year 1994-95, we reported that the OCJP inappropriately charged the DCSI grant more than \$50,000 in personal service costs for three employees in fiscal year 1994-95 and more than \$11,000 for one of the three employees during fiscal year 1993-94. The errors occurred because the accounting office did not update the labor distribution table when the OCJP employees changed assignments. In our fiscal year 1994-95 management letter, we recommended the OCJP ensure employment changes be properly reflected in the accounting system's labor distribution tables for accurate payroll cost allocation. In addition to continuing to misallocate personal service costs, the OCJP has not corrected amounts identified in fiscal year 1994-95.

Recommendations

The Department of Community Services and Development should develop and implement the procedures necessary to ensure federal programs are charged only their fair share of the department's administrative costs. The procedures should include those steps necessary to ensure that costs charged to federal programs are necessary, reasonable, and adequately documented.

The OCJP should correct all personal service costs identified as incorrectly allocated. Additionally, it should implement a review process to ensure that personal service costs are allocated to the appropriate federal or state programs.

Views of Departments

Department of Community Services and Development:

Although the department does not disagree with our findings, the department's response does not address all of the issues we present in our findings, nor does it fully address our recommendations. In its response, the department stated it has corrected the specific problem we identified in our prior year's audit: the practice of employees to inappropriately change their time sheets to charge their time to programs when they had not actually worked on the programs. However, according to the department, the problem, as noted in the fiscal year 1994-95 audit, carried over to the 1995-96 fiscal year.

On the issues of continuing errors on time sheets that we found in fiscal year 1995-96 and the department's failure to correct for these errors, the department had the following comments. The fiscal year 1995-96 audit found that when the department made adjustments to its accounting records for incorrect time charges, it used an accounting code that charged some of the costs for employees' time to programs other than those on which the employees worked. However, the amount charged to the nonfederal program is insignificant and would cost more to correct than any value received. Additionally, the department's managers are reviewing time sheets much more closely. No changes are being made, except for legitimate errors.

Office of Criminal Justice Planning:

The OCJP does not dispute the audit finding. According to its executive director, when an employee transfers to a new branch, the personnel branch sends an employee status form to the accounting branch. However, as a result of a clerical error, this step was missed. The executive director stated the accounting branch will now review announcements of staff movement to ensure that all employee status forms are received.

Specific Federal Program Details

Department of Health and Human Services

Federal Catalog Number: 93.568
Federal Program Title: Low-Income Home Energy Assistance Program
Federal Award Number and Period: 5G992201; FFY 1994-1995
State Administering Department: Department of Community Services
and Development

Department of Justice

Federal Catalog Number: 16.579
Federal Program Title: Drug Control and System Improvement—
Formula Grant
Federal Award Number and Period: Various
State Administering Department: Office of Criminal Justice Planning

Federal Financial Reporting

Reference Number: 96-9-1-Variou

Federal Catalog Number:

Federal Program Title: See listing of specific federal program details following the discussion of the issues below.

Federal Award Number and Period:

State Administering Department:

Criteria

In our review of federal programs, we determined that the following were among the compliance requirements related to financial reporting:

The Code of Federal Regulations, Title 7, sections 3016.20(b)(1) and (2), Title 34, sections 74.21(a) and (b)(1) and (2), and Title 45, sections 92.20(a)(1) and (2) and (b)(1) and (2), requires the State to maintain accurate accounting records to properly track and report the financial activities related to federal grants. The State Administrative Manual, Section 20014, requires agencies receiving federal funds to reconcile federal financial reports with the official accounting records.

Condition

The State does not always ensure that its federal financial reports are accurate and reconcile to the accounting records. Failure to reconcile reports with the accounting records can result in misstated amounts in federal reports that are not supported by the accounting records. More specifically, we found the following:

- During fiscal year 1995-96, the Department of Social Services (social services) did not reconcile all of its quarterly federal cash transaction reports for June 30, 1996, or its final federal financial status reports to accounting records. As a result, we could not determine if receipts, disbursements, and cash balances, as reported on the federal cash transactions report for June 30, 1996, and total grant expenditures, as reported on financial status reports, agreed with the accounting records.
- The Department of Health Services (health services) did not reconcile its quarterly report of federal cash transactions for June 30, 1996, with its official accounting records. Specifically, health services reported disbursements totaling approximately \$4 million more for the Childhood Immunization Grant and \$23 million more for the Refugee and Entrant Assistance—State Administered Programs than it recorded in its accounting records.

Conversely, health services reported approximately \$18 million less in disbursements than it recorded in its accounting records for the HIV Care Formula Grant. As a result, health services overstated disbursements on the federal cash transactions report by approximately \$9 million.

- Health services also did not reconcile two of the final federal financial status reports submitted during fiscal year 1995-96. More specifically, for the period ending September 30, 1994, health services reported approximately \$3 million more in expenditures on the final financial status report for the Refugee and Entrant Assistance—State Administered Program than it recorded in the accounting records. In addition, for the period ending December 31, 1994, health services reported approximately \$187,000 more in expenditures than it recorded in its accounting records for the Childhood Immunization Grant.
- The Department of Aging's federal cash transaction report for the quarter ending June 30, 1996 did not agree with its accounting records. Specifically, it overstated disbursements for the Special Programs for the Aging—Title III, Part C-Nutrition Services Grant by approximately \$137,000 and also understated cash on hand by an equal amount.
- The California Community Colleges, Chancellor's Office (Chancellor's Office) did not reconcile its accounting records with the final federal financial status report for the Vocational Education Program during fiscal year 1995-96. Specifically, the Chancellor's Office reported approximately \$104,000 less in expenditures on the federal financial status report for the fiscal year 1994-95 allocation of vocational education funds than it recorded in its own records. The Chancellor's Office submits federal financial status reports to the California Department of Education, which then combines this information with its own data for submission to the federal government.

Recommendation

To ensure compliance with federal reporting requirements, the State should ensure that its departments prepare accurate federal financial reports and reconcile them to accounting records.

View of Departments

Social services agreed with the finding. Social services has been making continuous progress to improve its procedures. It has already automated and standardized grant ledgers used to reconcile data to the quarterly federal Payment Management System reports and to a variety of smaller federal grants. In addition, social services is developing a workplan to reconcile large entitlement programs. The use of multiple-platform accounting systems and the number and diversity of federal grants and disbursements have contributed to a complex reconciliation process; however, based on the current workplan, social services anticipates having procedures developed to implement new procedures for report reconciliations by July 1, 1997.

The acting chief of the Financial Management Branch of health services agreed that the information presented in the quarterly report of federal cash transactions should reconcile with its accounting records. Therefore, health services is currently implementing procedures to perform these reconciliations.

Furthermore, the acting chief indicated that an error on the final financial status report for the Childhood Immunization Grant occurred because health services inadvertently included encumbrances in the total expenditures. Health services plans to prepare a revised report.

Finally, the acting chief agreed that the final financial status report for the Refugee and Entrant Assistance—State Administered Program did not reconcile with the accounting records. However, health services will reconcile subsequent years' reports with its accounting records and will document any differences for our review.

The chief of the Fiscal Operations Branch for the Department of Aging concurred with the audit finding and indicated that the Department of Aging has reviewed the report and made the necessary corrections.

The dean of Operations and Program Accountability at the Chancellor's Office explained that the discrepancy between the federal financial report and the accounting records occurred because the Chancellor's Office prepared the federal reports before all expenditure information was available. In the future, the Chancellor's Office will ensure that all expenditures are included in the federal financial status report.

U.S. Department of Agriculture

Federal Catalog Number: 10.551
Federal Program Title: Food Stamps
Federal Award Number and Period: 7F6156; FY 1995-96
State Administering Department: Department of Social Services

Federal Catalog Number: 10.561
Federal Program Title: State Administrative Matching Grants for Food Stamp Program
Federal Award Number and Period: 7F6156; FY 1995-96
State Administering Department: Department of Social Services

U.S. Department of Education

Federal Catalog Number: 84.048
Federal Program Title: Vocational Educational—Basic Grants to the State
Federal Award Number and Period: V048A40005; FY 1994-95

State Administering Department: California Community Colleges,
Chancellor's Office

U. S. Department of Health and Human Services

Federal Catalog Number: 93.560
Federal Program Title: Family Support Payments to States—
Assistance Payments
Federal Award Number and Period: G-9604CA4007; FY 1995-96
State Administering Department: Department of Social Services

Federal Catalog Number: 93.561
Federal Program Title: Job Opportunities and Basic Skills Training
Federal Award Number and Period: G-9603CAJOBS; FY 1995-96
State Administering Department: Department of Social Services

Federal Catalog Number: 93.563
Federal Program Title: Child Support Enforcement
Federal Award Number and Period: G-9604CA4004; FY 1995-96
State Administering Department: Department of Social Services

Federal Catalog Number: 93.566
Federal Program Title: Refugee and Entrant Assistance—State
Administered Programs
Federal Award Number and Period: G-96AACA9110; FY 1995-96
State Administering Department: Department of Social Services
Department of Health Services

Federal Catalog Number: 93.574
Federal Program Title: Child Care for Families at Risk of Welfare Dependency
Federal Award Number and Period: G-9604CA4012; FY 1995-96
State Administering Department: Department of Social Services

Federal Catalog Number: 93.645
Federal Program Title: Child Welfare Services—State Grants
Federal Award Number and Period: 1-9601CA1400; FY 1995-96
State Administering Department: Department of Social Services

Federal Catalog Number: 93.658
Federal Program Title: Foster Care—Title IV-E
Federal Award Number and Period: G-9601CA1401; FY 1995-96
State Administering Department: Department of Social Services

Federal Catalog Number: 93.659
Federal Program Title: Adoption Assistance
Federal Award Number and Period: 9601CA1401,9601CA1404/7; FY 1995-96
State Administering Department: Department of Social Services

Federal Catalog Number: 93.667
Federal Program Title: Social Services Block Grant
Federal Award Number and Period: 9601CASOSR; FY 1995-96
State Administering Department: Department of Social Services

Federal Catalog Number: 93.268
Federal Program Title: Childhood Immunization Grants
Federal Award Number and Period: H23/CCH904423-07; FY 1993-94
OCCH904423; FY 1995-96
State Administering Department: Department of Health Services

Federal Catalog Number: 93.917
Federal Program Title: HIV Care Formula Grants
Federal Award Number and Period: BRX/070041-95-0; FY 1995-96
State Administering Department: Department of Health Services

Federal Catalog Number: 93.045
Federal Program Title: Special Programs for the Aging—Title III,
Part C-Nutrition Services
Federal Award Number and Period: 95AACA1712; FY 1994-95
State Administering Department: Department of Aging

Identifying Grant Expenditures

Reference Number: 96-9-2-All Grants
Category of Finding: Reporting Requirements

Criteria

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

The Office of Management and Budget, Circular A-128, requires that the State prepare a schedule of federal assistance showing total expenditures for each federal program. Further, Circular A-128 requires that the State identify and audit all federal grants from which it expends more than \$20 million in a single year.

The California Government Code, Section 13300, assigns the Department of Finance the responsibility for maintaining a complete accounting system to ensure that all revenues, expenditures, receipts, disbursements, resources, obligations, and property of the State are properly tracked and reported. Further, the California Government Code, Section 16360, requires that all federal money received by the State be deposited in the Federal Trust Fund.

Condition

The State has not complied with a provision of the Office of Management and Budget (OMB), Circular A-128 (Circular A-128), requiring the preparation of a schedule showing total expenditures for each federal assistance program. The State has not complied because of limitations in its automated accounting systems. As a result, the schedule of federal assistance (beginning on page 173) shows total receipts, rather than expenditures, by program. Expenditure information is necessary to identify which grants the State is required to audit; OMB Circular A-128 requires the State to audit all grants, called major programs, for which it expends \$20 million or more. To ensure that we identified all major grants for audit, we reviewed accrual basis expenditure data, which are discretely identified in nonautomated records, for all programs with cash receipts within 10 percent of \$20 million to ensure that these programs should not have been classified as major programs. We identified one program with cash receipts that were within 10 percent of the major program threshold; however, our review of its expenditures verified that it did not exceed the \$20 million major program threshold.

The State also lacks complete, centralized records of the receipt of federal moneys, again contributing to difficulties in satisfying these federal requirements for reporting financial information. In 1978, the State took steps to establish a centralized record of federal receipts by creating the Federal Trust Fund for the deposit of all federal moneys administered through any state agency. This fund was created to provide better accountability for the State's receipts and expenditures of federal moneys. If the State consistently required that all federal receipts be recorded in the Federal Trust Fund, the centralized records would help satisfy requirements under OMB Circular A-128; however, the State has instead allowed some

federal receipts to be recorded in other funds. For example, during fiscal year 1994-95, the Department of Corrections (Corrections) received a \$33 million award of federal funds under the State Criminal Alien Assistance Program (SCAAP). These funds were deposited in the State's General Fund. Corrections also received a SCAAP award during fiscal year 1995-96 in the amount of \$31 million, which was also deposited in the State's General Fund. The Department of Finance (DOF) and the State Controller's Office (SCO) advised Corrections to deposit these funds in the General Fund.

Recommendations

As priorities and resources permit, the DOF should modify the State's accounting system to discretely identify expenditures for all federal programs. In addition, the DOF and SCO should ensure that state agencies deposit all federal moneys in the Federal Trust Fund.

View of Department

We have previously reported on the inadequacies of the State's financial reporting. The DOF has responded that the State's accounting system will require substantial modification to meet all federal and state requirements, and changes will be addressed in relation to other priorities and costs.

Corrections acknowledges that the federal moneys awarded under the SCAAP should have been deposited in the Federal Trust Fund and, beginning with fiscal year 1996-97, it has deposited SCAAP awards in the Federal Trust Fund.

Monitoring of Subrecipients

For many federal programs, the State acts as a pass-through entity to provide federal funds to various subrecipients. These subrecipients include cities, counties, special districts, school and community college districts, and nonprofit entities. In this capacity, the State is required to ensure that subrecipients of more than \$25,000 in federal assistance have an annual audit. If necessary, the State must also take steps to ensure that subrecipients correct any lack of compliance with federal laws and regulations identified during the annual audit. The State Controller's Office monitors the annual audit reports of cities, counties, special districts, and school districts. The California Community Colleges Chancellor's Office monitors the annual audit reports of the community college districts. The state agencies that provide the nonprofit subrecipients' federal assistance monitor those annual audit reports. We have identified issues related to the monitoring of the annual audit reports in each of these areas.

Monitoring of Nonprofit Subrecipients

Reference Number: 96-10-1-Variou

Federal Catalog Number:

Federal Program Title: See listing of the specific federal program details following the discussion of the issues below.

Federal Award Number and Period:

State Administering Departments:

Criteria

In our review of federal programs, we found that the following were among the compliance requirements related to subrecipient monitoring:

The federal Office of Management and Budget (OMB), Circular A-133, requires nonprofit subrecipients of federal assistance totaling more than \$25,000 during a fiscal year to submit copies of the audit reports to the State within 30 days after the audit is completed and no later than 13 months after the end of the fiscal year audited. Also, for instances when subrecipients have failed to comply with federal laws and regulations, OMB Circular A-133 requires the State to make a management decision regarding audit resolution within six months of receipt of the audit report. Corrective action should then proceed as rapidly as possible.

Condition

The State did not always sufficiently monitor the audit reports of nonprofit subrecipients, nor did the State always take steps to ensure that audit findings were resolved within six months of receipt of the audit report. More specifically, we found the following conditions:

- The Office of Emergency Services did not have a system to identify the nonprofit subrecipients receiving more than \$25,000 in federal Disaster Assistance Program funds that should have submitted an annual audit report during fiscal year 1995-96.
- The Department of Health Services did not receive the audit reports from at least 14 of its nonprofit subrecipients receiving federal funds for the HIV Care Formula Grants that should have submitted audit reports during fiscal year 1995-96.
- The Department of Community Services and Development (department) did not always ensure that it had resolved reported audit findings associated with its nonprofit subrecipients within the six-month deadline. We reviewed four audit reports nonprofit subrecipients submitted to the department that contained audit findings related to the Low-Income Home Energy Assistance and the Community Services Block Grant programs. We found that the department had resolved audit issues related to only one of the four nonprofit subrecipients within six months after the department had received the audit report.

Without a system to identify the subrecipients who must submit specific audit reports to the appropriate state agency and ensure prompt resolution of audit findings, the State cannot ensure that all nonprofit subrecipients have submitted audit reports and that the nonprofit subrecipients are complying with federal laws and regulations.

Recommendation

The State should identify all nonprofit subrecipients required to submit an audit report prepared by an independent auditor. Further, the State should ensure audits are submitted on time and all reported audit findings are appropriately resolved within six months.

Views of Department

Agency officials agreed with the findings reported above and offered the following reasons for the reported conditions and planned resolution actions.

A fiscal unit program manager with the Office of Emergency Services said limited staffing had prevented the office from implementing a system to track single audits of nonprofit subrecipients. The Disaster Assistance Division currently has only one associate management auditor assigned. Two additional positions have been established to assist with this workload.

The chief of the CARE Section of the Office of AIDS at the Department of Health Services indicated that, effective April 15, 1997, all nonprofit HIV Care Formula Grants subrecipients must submit their required OMB Circular A-133 audit reports to the Audits and Investigation Unit of the department. Nonprofit subrecipients will also be reminded of the specific grant language requiring the audit and of their responsibility to comply.

The manager of the Audit Services Unit (ASU) within the Department of Community Services and Development (department) stated during fiscal year 1995-96 the department implemented budget reductions that reduced staffing levels of various units within the department. The staff of the ASU, the unit responsible for reviewing the audit reports submitted by the nonprofit subrecipients, was reduced from four to two auditors. Additionally, one of the two remaining auditors was absent during six months of the year, and the remaining auditor was also performing reviews of agencies not funded by the department under a contractual agreement.

However, the manager indicated that, subsequent to fiscal year 1995-96, the ASU filled one of the vacant positions with a full-time auditor.

Department of Health and Human Services

Federal Catalog Number: 93.917
Federal Program Title: HIV Care Formula Grants
Federal Award Number and Period: BRX 070041-94-0; FY 1994-95
State Administering Department: Department of Health Services

Federal Catalog Number: 93.568
Federal Program Title: Low-Income Home Energy Assistance
Federal Award Number and Period: 5G992201; FY 1994-95
State Administering Department: Department of Community Services and Development

Federal Catalog Number: 93.569
Federal Program Title: Community Services Block Grant
Federal Award Number and Period: 5G994002; FY 1994-95
State Administering Department: Department of Community Services and Development

Federal Emergency Management Agency

Federal Catalog Number: 83.516
Federal Program Title: Disaster Assistance
Federal Award Number and Period: N/A
State Administering Department: Office of Emergency Services

Monitoring of Community College Districts

Reference Number: 96-10-2-84.048
Federal Catalog Number: 84.048
Federal Program Title: Vocational Education—Basic Grants to States
Federal Award Number and Period: V048A40005; FFY 1994-95
State Administering Department: California Community Colleges, Chancellor's Office

Criteria

In our review of federal programs, we determined that the following were among the compliance requirements related to the monitoring of subrecipients:

The federal Office of Management and Budget (OMB), Circular A-128, Sections 4(b) and 13(f), requires college districts receiving more than \$25,000 in federal assistance to have an annual audit completed within 12 months of the fiscal year-end. Also, in instances when college districts have failed to comply with federal laws and regulations, OMB Circular A-128, Section 9(c), requires the Chancellor's Office to ensure that community college districts take appropriate corrective action within six months of receipt of the audit reports.

Condition

The Chancellor's Office did not sufficiently monitor the fiscal year 1995-96 audit reports of the State's 71 community college districts, even though the office received and reviewed all these reports. Our review of audit reports of five community college districts disclosed that the Chancellor's Office had not ensured that the community college districts resolved the issues noted in these audit reports within six months of receiving the reports. These five reports identified insufficient internal controls, such as lack of procedures to monitor accounts receivable and failure to stamp invoices as paid; failure to comply with state requirements, such as insufficient or inaccurate attendance accounting and miscalculations in the Gann Limit; and failure to comply with federal regulations, such as incorrect calculations of Pell Grant awards and lack of satisfactory progress toward monitoring financial aid eligibility. Because the Chancellor's Office does not have a system to identify and ensure prompt resolution of all audit issues, it cannot be sure that community college districts are resolving failures to comply with regulations specific to the vocational education program. Additionally, without prompt resolution of audit issues, the Chancellor's Office cannot ensure that it will be able to recover any questioned costs or take corrective actions quickly.

Recommendation

The Chancellor's Office should implement a system to ensure that when failure to comply with federal regulations is identified in community college district audits, appropriate corrective action is taken quickly.

View of Department

The fiscal and business services administrator of the Chancellor's Office stated that for its review of audit reports received in fiscal year 1996-97, the Chancellor's Office implemented a process to summarize and forward audit issues involving federal programs identified in the audit reports to the appropriate program unit for resolution.

Monitoring of City, County, and Special District Subrecipients

Reference Number: 96-10-3-Various

Federal Catalog Number:

Federal Program Title: See listing of the specific federal program details following the discussion of the issues below.

Federal Award Number and Period:

State Administering Department:

Criteria

In our review of federal programs, we determined that the following were among the compliance requirements related to the monitoring of subrecipients:

The federal Office of Management and Budget (OMB), Circular A-128, Sections 4(b) and 13(f), requires local governments receiving more than \$25,000 in federal assistance to have an annual audit completed within 12 months of the fiscal year-end. Also, for instances when these audit reports indicate local governments have failed to comply with federal laws and regulations, OMB Circular A-128, Section 9(c), requires the State to ensure local governments comply within six months of receipt of the audit report.

Condition

The State does not always take steps to ensure that audit findings are resolved within six months of receipt of audit reports. The State Controller's Office (SCO) is responsible for monitoring the annual audit reports of the cities, counties, and special districts that receive federal assistance through the State. As part of this responsibility, the SCO identifies audit findings included in the audit reports and, depending on the nature of the finding, either takes steps to ensure that the local government resolves the issue or notifies the appropriate state agency. Once notified by the SCO, the state agency must ensure resolution.

During our review of the audit reports from five local governments that contained audit findings, we found that the SCO did not complete its review, nor did it inform the appropriate three state agencies of noncompliance contained in two of the audit reports until approximately six months after it received the reports. As a result, these state agencies were unable to meet the deadline that requires the State to ensure resolution of the federal issues within six months of receiving the audit reports. These two audit reports contained instances of a failure to comply with regulations that related to six federal programs.

Because the SCO did not quickly notify other state agencies, the agencies cannot ensure that the local governments will comply promptly with federal regulations noted in the audit reports, nor can it ensure that it will recover any questioned costs or take corrective actions quickly.

Recommendation

The SCO should complete its review of the audit reports from local governments in time to notify the appropriate state agencies to take action on issues identified in the audit reports within six months.

View of Department

The SCO agrees with the importance of the timely review of audit reports but questions the practicality of the present requirement. It has the following specific comments on this issue.

In accordance with the State Administrative Manual, the SCO provides the State of California centralized administration designed to ensure subrecipient units of local government comply with the Single Audit Act (SAA). Centralization of the single audit oversight function ensures consistency in terms of report review and the tracking of audit resolution by other state agencies.

The SAA requires state or local governments ensure that appropriate corrective action occurs within six months after the receipt of the audit report in instances of noncompliance with federal laws and regulations. The SAA does not address the situation where a state has centralized administration for report collection, review, and distribution. According to an assistant director of the U.S. General Accounting Office, there is no written guidance in regard to when the audit resolution period begins when the report is received by a central clearinghouse. The Bureau of State Audits is interpreting the six-month requirement as applying to the State as a whole. The SCO questions the feasibility of imposing the six-month requirement under the existing process when the audit reports are first reviewed and processed through a central clearinghouse.

The SCO agrees that single audit reports should be reviewed in a more timely manner to allow other state agencies the time to resolve instances of noncompliance. The SCO is developing a plan to emphasize a complete review earlier in the process so that SCO and the other state agencies can have a larger portion of the six month period to resolve audit findings.

Department of Housing and Urban Development

Federal Catalog Number:	14.228
Federal Program Title:	Community Development Block Grants—State Program
Federal Award Number and Period:	B-91-DC-06-0001; FY 1991 B-92-DC-06-0001; FY 1992
State Administering Department:	Department of Housing and Community Development

Department of Agriculture

Federal Catalog Number: 10.561
Federal Program Title: Food Stamp Program
Federal Award Number and Period: 7S2512; FY 1995
State Administering Department: Department of Social Services

Department of Health and Human Services

Federal Catalog Number: 93.959
Federal Program Title: Substance Abuse Prevention and Treatment Block Grant
Federal Award Number and Period: 94 B1 CA SAPT-04; FY 1994
State Administering Department: Alcohol and Drug Programs

Federal Catalog Number: 93.560
Federal Program Title: Aid to Families with Dependent Children Program
Federal Award Number and Period: G9504CA4007; FY 1995
State Administering Department: Department of Social Services

Federal Catalog Number: 93.563
Federal Program Title: Child Support Enforcement Program
Federal Award Number and Period: G-95-04-CA-4004; FY 1995
State Administering Department: Department of Social Services

Federal Catalog Number: 93.658
Federal Program Title: Foster Care Program
Federal Award Number and Period: 9501CA1404; FY 1995
9501CA1401; FY 1995
State Administering Department: Department of Social Services

**Issues Related to Grants Administered
by Individual Federal Departments**

U.S. Department of Agriculture

Reference Number: 96-16-1-10.550
Federal Catalog Number: 10.550
Federal Program Title: Food Distribution
Federal Award Period: Fiscal Year 1995-96
Category of Finding: Special Reporting Requirements
State Administering Department: California Department of Education (CDE)

Criteria

In our review of the Food Distribution program, we found the following requirements for special reporting. The Code of Federal Regulations, Title 7, Section 250.16(a), requires the California Department of Education (CDE) to maintain accurate and complete records with respect to the receipt, distribution, use, and inventory of donated foods. Further, Section 250.16(b) requires the CDE to maintain pertinent records for at least three years.

Condition

The CDE was unable to provide records to support data it reported on the FNS-155 Inventory Management Register reports from its Pomona warehouse during fiscal year 1995-96. The purpose of the FNS-155 is to report the estimated amount of inventory in the State's warehouses that exceed a six-month supply and to describe how the CDE will dispose of the excess inventory. Additionally, the CDE was unable to provide supporting records for one of five FNS-155 reports we reviewed at its Sacramento warehouse.

Recommendation

The CDE should ensure that it maintains accurate and complete records supporting its FNS-155 Inventory Management Register reports for at least three years.

View of Department

The FNS-155 report, which is sent to the U.S. Department of Agriculture (USDA), is merely an estimate of the donated foods which might be in excess of six months' inventory at the warehouse. The report is not a critical management tool for the CDE or the USDA. The report is not related to the management and control of the warehouse inventory. The Bureau of State Audits found the warehouse inventory to be accurate and complete as required by the Code of Federal Regulations, Title 7, Section 250.16.

The FNS-155 report describes the CDE action plan for reducing an estimated excess and is currently prepared once a month for the USDA from calculator tapes and scratch notes. However, because the report does not contain significant operating information, the USDA is planning to change the reporting period to once every six months.

The CDE is developing a standard form and procedure to be used in both warehouses to calculate estimated excess donated foods for the FNS-155 report. The information gathered to calculate the estimates will be retained in CDE files with a copy of each FNS-155 report.

Reference Number:	96-18-1-10.558
Federal Catalog Number:	10.558
Federal Program Title:	Child and Adult Care Food Program
Federal Award Period:	Fiscal Year 1995-96
Category of Finding:	Monitoring
State Administering Department:	California Department of Education (CDE)

Criteria

In our review of the Child and Adult Care Food Program, we found the following requirement for monitoring of subrecipients. The Code of Federal Regulations, Title 7, Section 226.6(l), requires the California Department of Education (CDE) to review at least 33.3 percent of the participants in its Child and Adult Care Food Program each fiscal year.

Condition

Federal regulations require the department to review 33.3 percent of the participants in the Child and Adult Care Food Program each fiscal year to assess compliance with program provisions. During fiscal year 1995-96, the department completed reviews for only 224 of the 739 participants (30 percent) in its Child and Adult Care Food Program. Without adequate monitoring, the department cannot assure that participants in the program are performing services properly.

Recommendation

The department should ensure that it reviews at least 33.3 percent of the participants in its Child and Adult Care Food Program each year.

View of Department

In addition to requiring the annual review of 33.3 percent of all institutions, the Code of Federal Regulations, Title 7, Section 226.6(l), requires the CDE to ensure that independent centers, sponsoring organizations of centers, and sponsoring organizations of day care homes, with 1 to 200 homes, are reviewed at least once every four years. Even though the CDE slightly missed the 33.3 percent review requirement in 1995-96, the CDE met the requirement for reviewing centers and organizations at least once every four years.

The CDE was not able to review 33.3 percent of all institutions in 1995-96 because there were three staff vacancies in several large counties (San Bernardino, San Mateo, San Diego, Imperial, and Los Angeles) during the entire year. Those vacancies are now filled. A new staff member was hired for San Mateo County in April 1996 and two new staff were hired for San Bernardino, San Diego, Imperial, and Los Angeles counties in June 1996.

Under normal conditions, when there are staff vacancies for an extended period of time, the CDE's standard operating procedure is to have existing staff increase their workload and cover the assignments of the vacant positions. However, in 1995-96 existing staff became responsible for administering two new federal programs in addition to their existing workload and were unable to cover the assignments of the vacant positions. The CDE has prepared budget change proposals requesting additional staff to cover the two new federal programs.

All institutions which were not reviewed in 1995-96 have since been reviewed or are scheduled to be reviewed by June 30, 1997. In addition, all 1996-97 scheduled reviews will also be completed by June 30, 1997.

U. S. Department of Housing and Urban Development

Reference Number: 96-15-1-14.239

Federal Catalog Number: 14.239

Federal Program Title: Home Investment Partnerships Program

Federal Award Number and Period: M 92-SG 060100; FFY 1992-93
M 93-SG 060100; FFY 1993-94
M 94-SG 060100; FFY 1994-95
M 95-SG 060100; FFY 1995-96

Category of Finding: Earmarking

State Administering Department: Department of Housing and Community
Development (department)

Criteria

In our review of the Home Investment Partnerships Program (HOME), we determined the following compliance requirements relate to the administration of the program. The Code of Federal Regulations, Title 24, Section 92.207, requires that a participating jurisdiction may not spend more than 10 percent of HOME funds for administrative and planning costs. In addition, this section allows a participating jurisdiction to use for administrative and planning costs up to 10 percent of any return on HOME investments it receives. Further, the Code of Federal Regulations, Title 24, Section 85.20, requires that a state maintain fiscal control and accounting procedures adequate to assure that grant funds have not been used in violation of the prohibitions and restrictions of program requirements.

Condition

To ensure that it complies with HOME's spending restrictions for administrative and planning costs, the Department of Housing and Community Development (department) needs to continue improving its internal controls. In our 1994-95 audit report, we noted weaknesses in the department's controls over the spending of HOME funds for administrative costs. In response, the department stated that it had revised its procedures for using program income, and that it had established program cost accounts and index codes to identify project costs properly. However, our 1995-96 review indicated that the department has not yet fully implemented these corrective actions to strengthen controls over its spending of HOME funds or program income.

When we reviewed for fiscal year 1995-96 the administrative and planning costs that the department charged to the 1993 HOME grant, we found that the amounts recorded in its accounting records, totaling approximately \$3.46 million, exceeded the spending limit by approximately \$580,000. To request HOME funds for administrative and program costs, the department uses the Cash and Management Information System (CMIS) of the federal

Department of Housing and Urban Development (HUD). However, the amount of administrative costs reported in the CMIS differs from the amount recorded in the department's accounting records by approximately \$580,000. The department could not explain the difference between the two amounts because it has not yet developed procedures to reconcile expenditure information from the CMIS with balances in the department's program and accounting records.

In addition, federal regulations allow the department to use up to 10 percent of program income for administrative costs. However, we found that the department used 100 percent of the program income it received during fiscal year 1995-96, totaling approximately \$85,500, to pay administrative costs. The department established a policy of using 100 percent of program income to pay administrative costs during the fiscal year and then adjusting its grant records at year-end to ultimately apply 90 percent of the program income to program costs, as required by federal regulations. However, according to the manager of its Fiscal Services Section, the department's current procedures to adjust its records to allocate program income properly would cause a discrepancy between those records and similar information tracked in HUD's CMIS. As a result, the department did not make any adjustments to properly allocate program income to administrative and program costs at year-end.

We also found the department does not always properly record administrative costs in its accounting records and this reduces its ability to monitor the amount of HOME funds that it spends for administrative costs to ensure that the department complies with program requirements. We reviewed a sample of 12 payments and found that 4 of the payments, totaling \$57,348, went toward administrative costs. However, the department recorded the payments as HOME program costs. These errors occurred because the department did not properly assign separate accounting codes to accumulate HOME program and administrative costs for some housing projects. After we reported a similar finding in our fiscal year 1994-95 audit, the department stated that it would review the funding codes for its projects and establish separate accounting codes for the administrative costs. However, according to the manager of the Fiscal Services Section, the department mistakenly did not include four projects in its review.

Recommendations

To strengthen controls over its use of HOME program funds for administrative and planning costs so that it complies with program spending restrictions and requirements, the department should do the following:

- Develop and implement procedures for reconciling expenditure information in its accounting and program records with expenditures reported in the CMIS. Such reconciliations will allow the department to monitor administrative costs and ensure those costs do not exceed allowable limits;
- Establish procedures to ensure that the department allocates program income to administrative and program costs as required by federal regulations; and
- Ensure that it codes administrative costs properly and spends funds for HOME program costs in accordance with program requirements.

View of Department

The department agrees with the recommendations and will implement the following corrective actions:

- The Federal Fiscal Section within the Community Affairs Division has developed procedures to reconcile program and accounting records of administrative costs. The Federal Fiscal Section has reconciled administrative costs recorded in the HOME subsidiary program records, the accounting records, and disbursement records maintained by HUD. The department will complete the adjustments to its records before June 30, 1997.
- During fiscal year 1996-97, the department will implement a new procedure to ensure that program income will be treated in accordance with federal regulations. Using a specific project cost account, the department will account for program income separately from the HOME grant and apply 90 percent of program income to HOME program costs.
- To address a recommendation from our fiscal year 1994-95 audit, the Fiscal Services Section reviewed the funding codes for its projects and established accounting codes for the administrative costs of subrecipients. However, the review mistakenly omitted the projects of four subrecipients. The department has identified all projects initiated during fiscal year 1995-96 with an accounting code for program costs and a separate accounting code for administrative costs.

Reference Number:	96-16-2-14.228, 14.239
Federal Catalog Number:	14.228 14.239
Federal Program Title:	Community Development Block Grant— State's Program Home Investment Partnerships Program
Federal Award Number and Period:	CDBG: B 93-DC 060001; FFY 1993-94 CDBG: B 94-DC 060001; FFY 1994-95 CDBG: B 95-DC 060001; FFY 1995-96 HOME: M 92-SG 060100; FFY 1992-93 HOME: M 93-SG 060100; FFY 1993-94 HOME: M 94-SG 060100; FFY 1994-95 HOME: M 95-SG 060100; FFY 1995-96
Category of Finding:	Special Reporting Requirements
State Administering Department:	Department of Housing and Community Development (department)

Criteria

In our review of the Community Development Block Grant program (CDBG) and the Home Investment Partnerships Program (HOME), we determined the following compliance requirements were necessary for annual program reports. The Code of Federal Regulations, Title 24, Section 91.520, requires the State to annually review and report on the progress it has made in carrying out its strategic plan and action plan for the HOME and CDBG programs. This performance report must describe available resources and how the state invests them, the geographic distribution and location of investments, and the racial and ethnic demographics of the persons and families served by the program. In addition, the section requires that the report include the amount and use for projects of the repayment of, and interest earned from, loans of HOME funds. Finally, the Department of Housing and Community Development's (department) CDBG Grant Manual requires that subgrantees submit annual performance reports to the department by August 15.

Condition

The department is responsible for preparing a comprehensive annual performance report on the implementation of its strategic and action plans for the CDBG and the HOME programs, and submitting the report to the federal Department of Housing and Urban Development (HUD). However, the department's system of internal administrative controls is not sufficient to assure that the reported statistical and fiscal information is complete and supported by accurate statistical data. In addition, the department did not comply with all of the reporting requirements. We reported a similar finding in our fiscal 1994-95 audit. In response, the department stated that it agreed with our finding.

We found that CDBG statistical and fiscal information contained in the annual report for fiscal year 1995-96 was incomplete. Because the department had not received timely performance reports from some subgrantees, it could not include their statistical and fiscal data in its performance report to HUD. We found that 95 of 366 subgrantees submitted their annual activity reports from 1 to 179 days late. Furthermore, as of March 14, 1997, 22 subgrantees had not submitted annual activity reports due on August 15, 1996. Timely reports are essential for the department to provide meaningful reports to the federal government and to ensure that subgrantees use funds appropriately and achieve the objectives of the CDBG program.

Similarly, we found that the HOME program information contained in the report covering fiscal year 1995-96 contained errors, was not always supported by accurate statistical data collected by the department, or was incomplete. For example, the department overstated HOME awards by \$3.5 million, or 10 percent, because it had incorrectly included amounts awarded for the Real Estate Owned program. In addition, program reporting guidelines require the department to report the number of households it served during the fiscal year and characterize the income level and racial and ethnic composition of the households. However, because the department did not maintain this information, for fiscal year 1995-96 it reported summary statistical information extracted from HUD's Cash and Management Information System for the period June 2, 1995, through June 28, 1996. Moreover, because the department did not maintain information on income or racial and ethnic composition of the households it served, it divided the summary totals evenly to those categories. As a

result, the department has used incorrect data and misreported the income and racial and ethnic characterization of these households during fiscal year 1995-96. Finally, the department did not include in its comprehensive annual performance report the amount and use for projects of the repayment of, and interest earned from, loans of HOME fund (program income), as required by federal regulations.

Recommendation

The department should ensure that statistical data included in annual reports to HUD are supported by accurate detailed data collected by the department. In addition, the department should report relevant financial information to meet program requirements. Finally, the department should ensure that it receives timely activity reports from CDBG subgrantees so that it can include complete statistical and fiscal information in its annual performance report to HUD.

View of Department

The department agrees with our recommendation and provides the following comments. Effective fiscal year 1996-97, the department has employed a management services technician to maintain the database needed to accumulate and report the detailed statistical financial information required for the programs' annual reporting. For the fiscal year 1996-97 annual reports, the department will develop a conforming methodology to support the information provided in the annual report that allocates summary totals to the appropriate categories.

Reference Number:	96-17-1-14.228, 14.239
Federal Catalog Number:	14.228 14.239
Federal Program Title:	Community Development Block Grant— State's Program Home Investment Partnerships Program
Federal Award Number and Period:	CDBG: B 92-DC 060001; FFY 1992-93 CDBG: B 93-DC 060001, FFY 1993-94 HOME: M 92-SG 060100; FFY 1992-93 HOME: M 93-SG 060100; FFY 1993-94 HOME: M 94-SG 060100; FFY 1994-95 HOME: M 95-SG 060100; FFY 1995-96
Category of Finding:	Special Tests and Provisions
State Administering Department:	Department of Housing and Community Development (department)

Criteria

In our review of the Community Development Block Grant (CDBG) program and the Home Investment Partnerships Program (HOME), we determined the following compliance requirements relate to the awarding of grants to subrecipients. The Code of Federal Regulations, Title 24, Section 92.504(e), requires that the State must review no less than once a year the performance of each HOME contractor and subrecipient. The section further requires the State to conduct on-site reviews of HOME multi-family rental housing projects to determine compliance with housing codes and the requirements of the program.

The Code of Federal Regulations, Title 24, Section 85.40, requires the State to monitor activities supported by the CDBG subgrant to ensure compliance with the requirements of the CDBG program.

Condition

The Department of Housing and Community Development (department) needs to further improve its monitoring of HOME and CDBG subrecipients to ensure compliance with requirements of their respective programs. We reviewed the department's fiscal year 1995-96 monitoring activities for HOME subrecipients and found that the department has not fully developed and implemented a strategy to meet the program's monitoring requirement. In addition, we found that the department does not always comply with its own procedures for monitoring CDBG subgrantees.

We reported a similar finding in our fiscal year 1994-95 audit. In response, the department stated that it revised its monitoring procedures to include a one-time review of HOME projects completed during a contract period. The one-time review includes certifying eligibility and ensuring that subrecipients comply with other program requirements during the implementation of the program. The department also stated that it would implement procedures for on-site monitoring of HOME-funded multi-family rental housing by September 30, 1996. Further, the department stated that it would monitor HOME subrecipients by reviewing milestone schedules, progress on project set-ups and completions, funds expended, and compliance with periodic report requirements. Finally, the department stated that it had strengthened its CDBG monitoring practices by requiring managerial oversight of monitoring reports.

Although the department has made some improvements in reviewing the performance of HOME subrecipients, during our fiscal year 1995-96 audit we found that it has not developed and implemented adequate written procedures to ensure that it meets HOME's monitoring requirements. For example, the department's strategy for evaluating the performance of subrecipients does not include specific procedures to ensure that the department has met the annual monitoring requirements specified by federal regulations. Furthermore, the department does not have a tracking system to determine which subgrantees the department has reviewed nor does it maintain records documenting the extent of its monitoring activities. As a result, the department had not yet performed the monitoring review for 59 of the completed contracts eligible to receive one-time monitoring. Moreover, as of February 1997 the department could not provide the monitoring checklist for one of the nine contract reviews it conducted during fiscal year 1995-96. We also determined that the department has not developed or implemented procedures for HOME's required on-site review of multi-family rental housing projects to determine compliance with housing codes and program requirements.

In addition to auditing the department's monitoring related to HOME projects, we reviewed the department's fiscal year 1995-96 monitoring of local governments that receive CDBG funds. We found that the department cannot be certain that CDBG subgrantees comply with program requirements because it does not always comply with its own procedures for notifying subgrantees about the results of the department's monitoring activities or ensure that it monitors all subgrantees. Specifically, the department's monitoring procedures require it to document its conclusions on subgrantee performance and to communicate those conclusions to the subgrantee within 45 days after the review. However, the department notified one subgrantee about the results of the department's review 349 days after the monitoring visit had ended. For a second subrecipient, as of February 21, 1997, the department had not documented conclusions about the subgrantee's performance or communicated the results of the review to the subgrantee even though the department had completed its monitoring visit 519 days earlier. Further, because of a prior-year change in the method the department uses to track CDBG subgrant awards, the department mistakenly did not perform program monitoring for one subgrantee.

Recommendation

The department should develop and implement the necessary procedures to ensure that it complies with HOME's monitoring requirements. In addition, the department should follow its review procedures for monitoring CDBG subgrantees.

View of Department

The department agrees with our recommendations and provides the following comments. The department is currently revising its monitoring strategy for HOME. The department plans to implement a revised monitoring strategy in fiscal year 1997-98 that will include procedures for on-site monitoring for HOME-funded multi-family rental housing. The department uses a tracking system to monitor the status of CDBG subgrants. However, during fiscal year 1995-96, the position assigned to maintain the tracking system was vacant. In fiscal year 1996-97, the department employed a management services technician to maintain the tracking system.

Reference Number:	96-11-1-14.228, 14.239
Federal Catalog Number:	14.228 14.239
Federal Program Title:	Community Development Block Grant— State's Program Home Investment Partnerships Program
Federal Award Number and Period:	CDBG: B 95-DC 060001; FFY 1995-96 HOME: M 95-SG 060100; FFY 1995-96

Category of Finding: Administrative Requirements
State Administering Department: Department of Housing and Community Development (department)

Criteria

In our review of the Community Development Block Grant (CDBG) program and the Home Investment Partnerships Program (HOME), we determined the following compliance requirements relate to the administration of the programs. The Code of Federal Regulations, Title 24, Section 85.20, requires the State to maintain accurate accounting records that permit preparation of reports, tracing of funds, and accurate, current, and complete disclosure of its financial activities relating to federal grants.

The State Administrative Manual, Section 7900, says that regular reconciliations of an agency's accounts and verifications of certain agency accounts with like accounts maintained in the State Controller's Office (SCO) may disclose some types of errors in the agency accounts or in the central accounts maintained by the SCO. The agency can then correct the accounts before preparing financial reports.

Condition

Although it has improved its procedures for reporting financial information for HOME and CDBG the Department of Housing and Community Development (department) still needs to improve some of its accounting methods to avoid errors and omissions. In our prior years' audits, we found that the department did not reconcile the receipts and disbursements of federal funds that it reported to the federal government with accounts maintained by the department and by the SCO. Although the department now reconciles to its own accounting records, grant receipts, and disbursements included in its federal financial reports, it does not agree the information in its accounting records to balances maintained by the SCO.

Specifically, the department shows differences between its accounting records and the account balances maintained by the SCO for receipts for CDGB administrative costs, HOME administrative costs, and HOME local assistance costs. These differences total approximately \$1,900, \$659,000, and \$105,000, respectively. As a result, the department has lost some assurance that its accounting records are correct and complete.

Recommendation

The department should reconcile regularly the grant revenues and disbursements recorded in its accounting records to account balances maintained by the SCO.

View of Department

The department agrees with the recommendation. According to the chief deputy director, the department is now current on all grant reconciliations except those for CDBG and HOME. The department anticipates reconciling these accounts by June 30, 1997.

Reference Number: 96-11-2-14.228, 14.239

Federal Catalog Number: 14.228
14.239

Federal Program Title: Community Development Block Grant—
State’s Program
Home Investment Partnerships Program

Federal Award Number and Period: CDBG: B 90-DC 060001; FFY 1990-91
CDBG: B 91-DC 060001; FFY 1991-92
CDBG: B 92-DC 060001; FFY 1992-93
CDBG: B 93-DC 060001; FFY 1993-94

HOME: M 92-SG 060100; FFY 1992-93
HOME: M 93-SG 060100; FFY 1993-94

Category of Finding: Administrative Requirements

State Administering Department: Department of Housing and Community
Development (department)

Criteria

During our review of the Community Development Block Grant program (CDBG) and the Home Investment Partnerships Program (HOME), we determined the following was among the compliance requirements for program administration. 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 accurate, current, and complete disclosure of its financial activities relating to federal grants.

Condition

In our fiscal year 1993-94 audit, we reported that the Department of Housing and Community Development (department) had commingled approximately \$258 million from nine federal housing assistance programs in its Federal Trust Fund (fund) since at least fiscal year 1989-90. According to the department, it used the fund as a “melting pot” of federal dollars wherein expenditures for grants lacking available cash were paid for with moneys from other grants. As a result, the department could not determine actual cash balances for specific federal grants. The department has not yet completed its work to identify adjustments resulting from commingling federal housing assistance program funds.

In response to our audit, the department hired an independent CPA firm to reconcile program records of federal and state housing grant receipts and disbursements with the department's official accounting records and create a balance statement for each program. According to the department's contract manager, the consultants planned to complete this task by June 30, 1996, and record any adjustments in the June 30, 1997 account balances.

The chief of the accounting office reported that the department has completed adjustments for three federal programs up to and including fiscal year 1993-94 and also for the CDBG program from 1983 to 1992. The department is presently completing its reconciliation of program and accounting records up to fiscal year 1996-97 and anticipates posting all of the necessary adjusting entries by December 31, 1997.

Recommendation

The department should continue to identify any adjustments to federal grant balances resulting from commingling federal grant funds.

View of Department

The department agrees with the recommendation. According to the chief of the accounting office, the department anticipates that posting of adjusting entries will be completed by December 31, 1997.

Reference Number:	96-11-3-14.228
Federal Catalog Number:	14.228
Federal Program Title:	Community Development Block Grant
Federal Award Number and Period:	B95-DC060001; FFY 1995-96
Category of Finding:	Administrative Requirements
State Administering Department:	Department of Housing and Community Development (department)

Criteria

In our review of the Community Development Block Grant (CDBG) program, we determined the following compliance requirements relate to a state department's awarding of grants to subrecipients. Title 31, Section 205.7, and Title 24, Section 85.21(b), of the Code of Federal Regulations, require the State to minimize the time elapsing between the transfer of funds from the U.S. Treasury and the disbursement of funds by the State and its subrecipients for program purposes. Title 24, Section 85.20(b), requires the State to monitor the cash drawdowns of its subrecipients to assure that they conform substantially to the same standards of amount and timing that apply to the State.

Condition

As in previous years, the Department of Housing and Community Development (department) lacks adequate monitoring of its CDBG subrecipients to ensure that they meet the federal cash management requirements. During fiscal year 1995-96, the department identified approximately \$18.1 million that it had awarded to subrecipients for housing rehabilitation. The department allows CDBG subrecipients to draw federal funds in advance of expenses and to maintain cash balances in housing rehabilitation loan accounts so that the funds are available when contractor billings come due for housing rehabilitation projects. However, once the subrecipients deposit funds in these loan accounts, the department does not adequately monitor the reasonableness of the cash amounts or require the subrecipients to report the cash balances.

According to the CDBG program manager, the department does not review cash balances in these accounts until it performs on-site fiscal monitoring of subrecipients, a practice that usually occurs near the end of the two-year grant term. The CDBG program manager further stated that most subrecipients that draw CDBG funds in this manner take 7 to 90 days to spend the cash balances they maintain in their housing rehabilitation accounts. In response, the department stated it had revised its procedures for federal cash management requirement. We reported this issue in our fiscal year 1994-95 audit.

Recommendation

The department should follow federal regulations' cash management requirements for CDBG funds to ensure that the department minimizes the time between the draw and disbursement of federal funds.

View of Department

The department agrees with the recommendation and provides the following comments. The department has amended its cash request forms for fiscal year 1996-97 to require subrecipients to disclose cash balances in their local housing rehabilitation accounts. In addition, the department will require subrecipients to report any balances that remain in those accounts more than 22 working days. The department has identified a 22-working-day period as a reasonable time between the draw and disbursement of CDBG funds for program purposes.

U.S. Department of Justice

Reference Number: 96-17-2-16.579

Federal Catalog Number: 16.579

Federal Program Title: Drug Control and System Improvement—
Formula Grant

Federal Award Number and Period: 94-DB-CX-0006 and FFY 1993-94
95-DB-CX-0006 and FFY 1994-95

Category of Finding: Special Tests and Provisions

State Administering Department: Office of Criminal Justice Planning (office)

Criteria

In our review of the Drug Control and System Improvement—Formula Grant, we determined that the following were among the compliance requirements related to the awarding of grants to subrecipients. The United States Code, Title 42, Section 3754(f), restricts funding for the same program to no more than four years (48 months in total). Multijurisdictional drug task forces are an exception to this rule.

A United States Department of Justice, Bureau of Justice Assistance (BJA) letter, dated March 25, 1991, provides guidance for implementing the four-year rule. The BJA allows a project to receive funding for more than 48 months if the project undergoes a “fundamental change in focus, scope or approach.” The BJA states that merely adding “new components or activities to a program that do not materially and demonstrably change the form” does not meet their criteria. Such components as the goals, objectives, or purposes of the program must change substantially for an extension of funding.

Condition

The Office of Criminal Justice Planning (office) awarded approximately \$1 million and \$6.3 million of federal Drug Control and System Improvement—Formula Grant funds in fiscal years 1994-95 and 1995-96, respectively, to subrecipients who had already received these funds for the allowed maximum of four years (48 months). We selected 15 grants from awards for fiscal year 1995-96 for review. For each, we reviewed the applicants’ grant proposals for the fiscal years 1990-91 through 1995-96. In 10 of the 15 grants reviewed, the office awarded funds for programs already funded for 48 months.

In making these awards, the office believed the BJA allowed continued funding if a change occurred in target population, program strategy, or target location. For example, the office considered a subrecipient’s four-year program that originally focused on gang-related street drug sales as a new project when the focus changed to include mid-level drug offenders and additional locations. Thus, according to the office’s interpretation, this change qualified the

subrecipient for four additional years' funding. However, we do not consider a change of this nature in line with the BJA's definition of a "fundamental change"; therefore, we find these grants out of compliance.

The Bureau of State Audits reported the same finding for four subrecipients in fiscal year 1994-95; two of the ten grants reported this year were reported in fiscal year 1994-95, as well.

Recommendation

The office should seek approval for its interpretation of the four-year rule from the BJA. Until the BJA grants approval, the office should comply with the BJA's current guidelines in the March 1991 letter.

View of Department

The office does not dispute the audit finding and has requested written clarification from the BJA. According to its executive director, upon receipt of a response from the BJA, the office will implement the ruling. A corrective action plan will take steps to ensure compliance with the federal rules and regulations and will include procedures to advise subrecipients of the federally-approved requirements, review subrecipient files for noncompliance, and develop an internal management process to monitor compliance with the federal requirements.

U.S. Department of Labor

Reference Number:	96-14-1-17.225
Federal Catalog Number:	17.225
Federal Program Title:	Unemployment Insurance
Federal Award Number and Period:	T-06-210-50000; FFY 1995-96
Category of Finding:	Eligibility
State Administering Department:	Employment Development Department (department)

Criteria

In our review of the Unemployment Insurance program, we determined the following was among the compliance requirements related to the prompt payment of unemployment claims. The Code of Federal Regulations, Title 20, Section 640.5, requires the State to pay an average of at least 70 percent of all initial payments for interstate unemployment claims within 14 days following the end of the first compensable week of unemployment.

Condition

The Employment Development Department (department) is responsible for administering the Unemployment Insurance program. Federal regulations contain standards for promptness in processing claims for unemployment benefits. However, the department did not meet the standard that requires it to pay an average of 70 percent of first payments for interstate unemployment claims within the time required by federal regulations. We reviewed the department's reports of first payments for interstate unemployment claims for the period April 1995 through March 1996, and found that the department paid an average of 65.2 percent of the claims within 14 days following the end of the first eligible week of unemployment. According to the employment program manager, the department is unable to meet this desired level of performance for paying first-time interstate unemployment claims because claims received from other states are sometimes incomplete or inaccurate. According to its corrective action plan, the department expects to achieve the 70 percent quota first-payment requirement as a result of the new procedures it has implemented. Under its new procedures, out-of-state claimants can telephone the department directly, enabling department personnel to obtain all the information necessary to file a claim without delay.

Recommendation

To ensure that claimants of interstate unemployment benefits receive payments promptly, the department should continue its efforts to obtain interstate unemployment claim information in a timely and error-free manner.

View of Department

The department agrees with the audit finding. The department has moved to correct the problem of timely payments to interstate claimants by mainstreaming the process. Under the new process, out-of-state claimants may now call the department directly using a toll-free telephone number and provide the information the department needs to process and pay the claims.

Reference Number:	96-16-3-17.225
Federal Catalog Number:	17.225
Federal Program Title:	Unemployment Insurance
Federal Award Number and Period:	T-06-210-50000; FFY 1995-96
Category of Finding:	Special Reporting Requirements
State Administering Department:	Employment Development Department (department)

Criteria

In our review of the Unemployment Insurance program, we determined that the following was among the compliance requirements related to the payment of unemployment benefits to former federal employees and ex-service members. The U.S. Department of Labor's Employment Security Manual, Part V, Section 9336(D)(3), requires that the totals of the quarterly report of expenditures and adjustments of federal funds for unemployment compensation in Section A of the report equal the total charges in Section B of the report. This requirement applies to moneys paid to federal employees and ex-service members assigned to federal agencies.

Condition

The Employment Development Department (department) provides unemployment compensation benefits to former federal employees and ex-service members. The Federal Department of Labor reimburses the department for the benefits it pays. During fiscal year 1995-96, the department did not properly reconcile or explain two sections of the quarterly report it submits to the Department of Labor showing the expenditures of federal funds for unemployment compensation paid to federal employees and ex-service members. Section A of the quarterly report summarizes information on expenditures, and Section B provides details supporting summarized amounts. Our review found that the two sections of the department's December 31, 1995 quarterly report differed by \$83,305 in the section for benefits paid to former federal civilian employees. The department explained the amount as charges yet to be posted to their records. However, it could not provide details for \$78,729 of the \$83,305. In addition, the report's two sections also differed by \$418,429 for benefits paid

to ex-service members. The department attributed the difference to estimated amounts reported in Section B. Furthermore, we found the summary information of expenditures presented in Section A did not include \$165,274 in benefits paid to former military employees.

In its March 31, 1996 quarterly report, the department added charges of \$323,184 in Section B to adjust for the estimated charges from the December 1995 report. However, the department cannot explain remaining differences of \$95,245 for benefits paid to ex-service members or \$78,729 for benefits paid to former federal civilian employees. Further, the department cannot verify it has reported the \$165,274 of benefits paid to former military employees that it omitted from the December 31, 1995 quarterly report. Failure to reconcile the two sections of the quarterly expenditure report may result in over or undercharges to certain federal agencies.

We have reported this issue in prior years. In response, the department stated that a time lag between the two automated systems used to prepare the report caused the majority of the differences. The department further stated that it was working to restructure the database for one system which will allow the department to reconcile the two systems. However, for fiscal year 1995-96, the department had not yet completed its efforts to restructure its database and reconcile the differences in the reports.

Recommendation

To ensure it correctly reports expenditures of federal funds for unemployment compensation paid to federal employees and ex-service members, the department should continue efforts to restructure its database so it can reconcile the two sections of the quarterly expenditure reports.

View of Department

The department agrees with our finding and has completed 9 of 11 data processing changes it has identified to correct the discrepancies in the reports. Other critical programming commitments have delayed completion of the two remaining changes, originally scheduled for completion in January 1997. While these changes remain a programming priority, the department is unable to determine the exact date it will complete the changes or adopt new personal computer software to reconcile the two sections of the reports.

Reference Number:	96-18-2-17.246 to 17.250
Federal Catalog Number:	17.246 to 17.250
Federal Program Title:	Job Training Partnership Act
Federal Award Number and Period:	A-5328-5-00-8150; FFY 1995-96

Category of Finding: Monitoring
State Administering Department: Employment Development Department
(department)

Criteria

In our review of the Job Training Partnership program, we determined the following was among the compliance requirements related to the awarding of grants to subrecipients. The Code of Federal Regulations, Title 20, Section 627.445, requires the State to establish a system to regularly assess compliance with the cost limitations of the Job Training Partnership Act (JTPA). This system must include performing periodic reviews and taking corrective actions, as necessary.

Condition

The Employment Development Department (department) is responsible for administering the JTPA program. Federal regulations outline spending limits for activities funded under the program and for administrative costs of the department and local service providers. While the department has a system for identifying subrecipients who are not complying with the cost limitations of the program, it has not completed the resolution of long-outstanding cost-compliance issues related to subrecipients that receive the JTPA funds.

At the completion of our fiscal year 1994-95 audit, we reported that, as of March 1996, the department had not resolved 75 previously identified cost-compliance issues. Of the 75 issues, 48 had been outstanding for four years or more. To address the long-outstanding issues, the department dedicated one staff person within the Compliance Resolution Unit to resolve these issues.

As of April 1997, the department had reduced the number of unresolved cost-compliance issues to 15. However, of these remaining issues, 11 have been outstanding for more than three years. Without prompt resolution of cost-compliance issues, the department cannot ensure that subrecipients of the JTPA funds are spending those funds within the limits required by federal regulations. According to the manager of the Compliance Resolution Unit, the resolution of the remaining issues was delayed as a result of the transfer of the Compliance Resolution Unit from the Job Training Partnership Division to the Compliance Review Division, and because of concurrent demands on staff assigned to resolve the issues.

Recommendation

The department should continue its efforts to resolve long outstanding cost-compliance issues to ensure that subrecipients of the JTPA funds are spending those funds within the limits required by federal regulations.

View of Department

The department has taken steps to ensure it resolves the JTPA cost-compliance issues promptly. In December 1996, the department transferred the responsibility for resolving issues identified in audits, investigations, cost-compliance reviews, monitoring, and other means from the Job Training Partnership Division to the Compliance Review Division. The reorganization will enable the department to increase its oversight of the JTPA cost-compliance issues by applying the procedures and timelines relating to the resolution of audit findings. In addition, the Compliance Review Division has created a tracking system for the JTPA cost-compliance issues that identifies the date issues are received and establishes timelines for their initial and final determination. Further, the Compliance Resolution Unit manager and the Compliance Review Division chief review weekly status reports of unresolved cost-compliance issues.

For 2 of the 17 cost-compliance issues identified above, the department has reached its final determination. It is currently reviewing the remaining 15 issues and expects to issue a final determination for all remaining cost-compliance issues by June 30, 1997.

U.S. Department of Transportation

Reference Number:	96-12-1-20.205
Federal Catalog Number:	20.205
Federal Program Title:	Highway Planning and Construction
Federal Award Number and Period:	Various
Category of Finding:	Relocation Assistance and Real Property Acquisition
State Administering Department:	California Department of Transportation (department)

Criteria

In our review of the Highway Planning and Construction program, we determined that the following were among the compliance requirements related to Relocation Assistance and Real Property acquisition:

The Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments, Office of Management and Budget Common Rule, Subpart C, Section 40(a), requires that grantees monitor grant and subgrant-supported activities to ensure compliance with applicable federal requirements and that performance goals are achieved. Grantee monitoring must cover each program, function, or activity. Further, the Code of Federal Regulations, Title 23, Section 740.4(e), requires the state highway agency to monitor relocation assistance activities conducted by any state agency, individual, firm, association, or corporation to the extent necessary.

Condition

In the course of planning for the construction of state highways, the California Department of Transportation (department) may need to acquire property and assist in the relocation of property owners and tenants displaced by the acquisition of the property. Federal regulations require the department to monitor these activities to ensure compliance with applicable federal requirements. For example, the department's acquisition compliance review includes a review of condemnation case management procedures and completion of the department's Management Review Acquisition Checklist. For relocation assistance, the department's draft management review plan for fiscal year 1995-96 includes sampling relocation impact documents in five district offices, as well as checking for eligibility and advisory assistance provided to residential owners and tenants in four other district offices. However, the department did not conduct acquisition and relocation assistance compliance reviews during fiscal year 1995-96.

In September 1995, the department sent district directors its Compliance Review Plans for Acquisition and Utilities for fiscal year 1995-96. The plan specified the items for review and included a schedule by quarter of the districts to be reviewed and a detailed review checklist. The objective of the reviews was to determine compliance with state and federal laws and regulations and the department's policies and procedures. Neither its headquarters nor its district offices conducted these reviews.

Also, in September 1995, the department prepared a draft management review plan for relocation assistance that detailed items to be reviewed at the district offices. However, the department did not perform these reviews, either.

Recommendation

The department should perform its compliance reviews to ensure that it effectively monitors its real property acquisition and relocation assistance procedures and complies with federal regulations that protect the rights of the parties involved.

View of Department

The program manager of the department's Right of Way Program concedes that the department did not perform acquisition compliance reviews during fiscal year 1995-96. This decision was based on several factors. Its previous reviews of the districts scheduled for review in fiscal year 1995-96 did not reveal any areas of concern that required immediate attention.

However, the department intends to perform acquisition compliance reviews in fiscal year 1996-97. In place of compliance reviews in fiscal year 1995-96, the department focused its efforts on identifying parcels not yet acquired on certified projects and assisting the districts in finalizing those acquisitions. Finally, the department is developing a more comprehensive district evaluation process to ensure compliance with applicable federal requirements.

In addition, the program manager concurs with our finding that the department did not perform relocation assistance compliance reviews in fiscal year 1995-96. The department anticipates that the district evaluation process being developed will also replace the current relocation assistance compliance reviews.

Federal Emergency Management Agency

Reference Number:	96-13-1-83.516
Federal Catalog Number:	83.516
Federal Program Title:	Disaster Assistance Program
Federal Award Number and Period:	N/A
Category of Finding:	Services Allowed
State Administering Department:	Office of Emergency Services (office)

Criteria

In our review of the Disaster Assistance Program, we determined that the following were among the compliance requirements related to project eligibility:

The Code of Federal Regulations (CFR), Title 44, sections 206.434(b)(1) and 206.435(a), require that hazard mitigation projects funded under the Hazard Mitigation Grant Program (HMGP) be consistent with the State Hazard Mitigation Plan for the type of disaster involved.

The CFR, Title 44, Section 206.435(a), stipulates that it is the State's responsibility to identify and select hazard mitigation projects, and Section 206.435(b)(3) requires the State to establish procedures and priorities for the selection of mitigation projects that best fit within the overall plan and that have the greatest potential impact on reducing future disaster losses.

The CFR, Title 44, sections 206.434 through 206.436, contain several provisions to ensure that the most worthy projects are selected and approved for funding under the HMGP. For example, the minimum-eligibility criteria include a requirement that the project be cost-effective and substantially reduce the risk of future damage. Additionally, the CFR requires that the application for each project include information addressing applicable environmental issues that were taken into consideration. Furthermore, the CFR requires that documentation be provided to substantiate that the project contributes to a long-term solution to the problem addressed and that the project has been determined to be the most practical, effective, and environmentally sound alternative after considering a range of options.

FEMA-1005-DR-CA (disaster 1005) is the agreement the Federal Emergency Management Agency (FEMA) and the State had concerning the Southern California fires that began on October 26, 1993. The agreement stipulates that the State agrees to be the grantee for all grant assistance provided under the federal Stafford Act and that it comply with the requirements of applicable regulations found in Title 44 of the CFR. The Stafford Act established provisions for federally funded disaster assistance programs.

Condition

The Office of Emergency Services (office) did not ensure that all projects funded under the HMGP met the basic project eligibility requirements. During our testing of five payments from the HMGP during fiscal year 1995-96, we found that the office reimbursed the Los Angeles County Fire Department (LACFD) \$375,000 for project costs and \$11,000 for administration fees related to a project that was not consistent with the State Plan in effect for disaster 1005. The funds were used by the LACFD to lease two Canadair SuperScooper water-dropping aircraft for a 66-day evaluation period that ended three days after the date that the LACFD applied for funding under the program. In addition to its nonconformity with the State Plan, the project was also inconsistent with other federal HMGP requirements.

The project application document indicated that no other alternative strategies were considered upon proposing the SuperScooper project. Additionally, there was no documentation submitted with the application to support the cost-effectiveness of the project. Finally, the application did not include sufficient information regarding the recent environmental concerns over the use of saltwater on forest fires and the saltwater's effect on soil.

To support the approval of the project, the office retroactively annexed a report to the State Plan that assessed the effectiveness of emergency management systems in responding to the related disaster. However, the report concluded that the office and the firefighting agencies need to recognize that air operations are shifting away from the use of fixed-wing aircraft.

In its federal grant award letter for the project, the FEMA stated that the project was approved as a pilot research study of a technology that may be useful for responding to wildfires but should not be construed as a precedent for the use of the HMGP for the purchase or lease of response equipment. FEMA eligibility policies indicate that the HMGP should not be used to fund preparedness and response-related activities. The project-evaluation report that was developed at the end of the lease period was inconclusive because the two leased aircraft were used for only 7 of 71 brush fires that they were dispatched to during the period.

Because there are limitations to the total funding available under the HMGP for each disaster, some eligible projects are eliminated during the office's selection process and do not get approved for funding. The \$375,000 in project costs for the SuperScooper lease represented 3.7 percent of the total HMGP funding available under disaster 1005. Office records indicate that there was approximately \$5.5 million in potentially eligible projects that did not get funded under the HMGP for disaster 1005. Although some of these projects may have been ineligible, others were eligible but were eliminated because of funding constraints. Consequently, the decision to fund the SuperScooper project prevented other eligible projects from receiving funding under the program.

Recommendation

In meeting its responsibilities as the State's grantee for federal funding awards under the HMGP, the office should ensure that the projects it selects and recommends for funding meet basic federal eligibility requirements and are those projects that have the greatest potential

impact on reducing future disaster losses to the State. Additionally, the office should ensure that it recommends projects for funding that contribute to a long-term solution and reduce vulnerability to hazards within a project area rather than recommending projects related to disaster response activities.

View of Department

According to the program branch chief, and as indicated within the office's project-approval notification letter to the FEMA, the office director, FEMA director, and the FEMA regional director discussed the project and reached an agreement that the project was eligible under the HMGP.

Reference Number:	96-16-4-83.516
Federal Catalog Number:	83.516
Federal Program Title:	Disaster Assistance Program
Federal Award Number and Period:	N/A
Category of Finding:	Special Reporting Requirements
State Administering Departments:	Office of Emergency Services (office)

Criteria

In our review of the Disaster Assistance Program, we determined that the following was among the compliance requirements related to reporting. The Code of Federal Regulations Title 44, Section 206.438(c), requires the State to submit quarterly progress reports to FEMA indicating the status and completion dates for each project funded under the Hazard Mitigation Grant Program (HMGP). The HMGP is a federally authorized disaster assistance program that is implemented upon federal declaration of a disaster. The program provides funding to the State and to local governments for projects that mitigate the effects from future disasters on environments or structures.

Condition

During fiscal year 1995-96, the Office of Emergency Services (office) failed to prepare and submit 22 of the 36 quarterly reports to FEMA. Quarterly reports are used to monitor projects approved for funding under the HMGP for each disaster. The reports address the status of funded projects and identify changes in project costs, schedules, and scope of work.

Recommendation

The office should establish procedures to ensure that it prepares and submits quarterly reports for each disaster.

View of Department

The office agrees with the finding. According to the program manager, the office failed to submit the required quarterly progress reports during fiscal year 1995-96. Rather, the office simply passed along to FEMA copies of the individual subgrantee reports for some disasters. The office felt that it was acceptable to FEMA to submit the individual reports instead of a compiled report for each disaster. The office has now delegated the responsibility to specific staff to ensure that required quarterly reports are submitted to FEMA for each disaster on a timely basis.

U.S. Department of Education

Reference Number: 96-13-2-84.027

Federal Catalog Number: 84.027

Federal Program Title: Grants to States for the Education of Children With Disabilities

Federal Award Number and Period: H027A50115-96; FY 1995-96

Category of Finding: Allowable Costs

State Administering Department: California Department of Education (CDE)

Criteria

In our review of the grants to States for the Education of Children With Disabilities, we found the following requirements for allowable costs. The Code of Federal Regulations, Title 34, Section 300.321, requires the California Department of Education (CDE) to use federal program funds to provide free appropriate public education to children with disabilities. In addition, Section 300.620 states that the CDE can use administrative funds for administrative costs related to carrying out the federal program. Finally, the Office of Management and Budget, Circular A-87 (January 1981 version), Attachment B, Section D(5), states that costs resulting from violations of, or failure to comply with, federal, state, or local laws and regulations are unallowable. The Office of Management and Budget, Circular A-87 (May 1995 version), Attachment B, Section 20, states that fines, penalties, and other settlements resulting from violations of, or failure of the governmental unit to comply with, federal, state, local, or Indian tribal laws and regulations are unallowable except when incurred as a result of compliance with specific provisions of the federal award or written instructions by the awarding agency authorizing in advance such payments.

Condition

The department used funds from the "Grants to States for the Education of Children with Disabilities" federal grant to pay attorney fees of the parents or guardians of disabled children suing the State. Specifically, the department used federal program and administrative funds to pay plaintiff attorney fees of nearly \$464,000 for the *Lacayo, et al. v. Honig, et al.* case, and \$270,000 for the *Crawford, et al. v. Honig, et al.* case.

The plaintiff attorney fees are from cases where parents or guardians of disabled students sued local educational agencies (LEA) and the State to either stop an inappropriate practice or compel the LEA to perform an appropriate service. Because either case results from violations of, or failure of the governmental unit to comply with, federal, state, or local laws and regulations, the department's use of federal funds to pay these costs may be unallowable.

Furthermore, federal regulations require the State to use both federal program and administrative funds to provide free appropriate public education (FAPE) to the State's disabled students. Payment of plaintiff attorney fees may not be costs that relate to providing FAPE, but rather costs of violating or failing to comply with federal, state, or local laws and regulations.

In determining whether the costs were allowable, we contacted the United States Department of Education (USDE) to obtain its perspective on whether the costs are allowable. The USDE responded with an opinion letter it had provided to the state of Alabama regarding the State's ability to use federal funds for attorney fees resulting from a special education lawsuit. In a footnote to this opinion, the USDE made two points. First, it stated that payments of attorney fees resulting from a failure to comply with federal law would be considered unallowable costs. Second, the footnote explained that a state educational agency could not use federal funds to pay an award of attorney fees as a result of losing a parental appeal of a due process hearing. A due process hearing, as allowed by the United States Code, Title 20, Section 1415(b)(2), is an administrative function that provides for procedural safeguards for children with disabilities and their parents or guardians with respect to the provision of a free appropriate public education.

The CDE's general counsel contends that the USDE's Alabama opinion does not relate to the payments the CDE made in the *Crawford* and *Lacayo* cases because they were not due process hearings. While we agree that the CDE's cases are not due process hearings, the USDE did not limit its opinion to only due process hearings. Moreover, the opinion states that attorney fees paid as a result of losing a parental appeal of a due process decision are very analogous to a cost resulting from a failure to comply with federal law, and, therefore, under the Office of Management and Budget, Circular A-87, allowable costs provisions would not constitute an appropriate use of federal funds. Furthermore, our legal counsel stated that attorney fees awarded against the State as part of a successful action by the parents of disabled children suing the State are not allowable under the provisions of the Office of Management and Budget, Circular A-87, and 17 EHLR 1186 (USDE opinion in the Alabama matter).

The CDE's general counsel also contends that the CDE's use of federal funds for plaintiff attorney fees is allowable because federal law allows plaintiffs to recover attorney fees. While federal law allows a parent or guardian to recover attorney fees and related costs when they prevail in an action related to the provision of a free appropriate public education for their child, it does not provide authority for the State to use federal funds to pay these costs.

Because the department used federal funds to pay for plaintiff attorney fees, the State's LEAs may not have received all the federal funds they should have to provide free appropriate public education to disabled students.

Recommendation

The CDE should seek guidance from the USDE as to the allowability of using federal funds to pay for plaintiff attorney fees.

View of Department

This finding is about payment of attorney fees to prevailing parties in two federal district court cases involving special education matters. [*Lacayo et al. v. Honig, et al. (Lacayo)* and *Crawford, et al. v. Honig, et al. (Crawford)*.] Both cases were atypical. We will provide a brief description of the cases and then we will set forth eight reasons why the Bureau of State Audits (BSA) finding is wrong.

The *Lacayo* case arose when plaintiffs brought a class action against a local educational agency (LEA) alleging that the LEA's behavioral interventions were inappropriate. The LEA settled with the plaintiffs and agreed to pay damages and attorney fees. The plaintiffs had also named the CDE as a defendant. In a separate settlement, the CDE agreed to issue state regulations clarifying appropriate strategies. The CDE did not agree to make any kind of monetary payment to the plaintiffs. Thus, we find no fines, penalties, or damages of any kind were paid by the CDE. As prevailing parties, the plaintiffs were entitled to payment of their costs, including attorney fees.

The *Crawford* case was instituted to reverse a court-ordered across-the-board ban on the use of standardized I.Q. tests to evaluate African-American children referred for special education assessment. The original injunction, issued in 1979, in the case of *Larry P. v. Riles* (EHLR 558:141), addressed I.Q. tests only in the context of the category of "educable mentally retarded" (EMR) students—a category that was later abolished. The 1986 court modification of this injunction was made without evidence or findings to support its extension beyond the context of the old EMR category. The Ninth Circuit Court reversed the lower court's expansion of the injunction. There was no fine, penalty, or punishment meted out by the court, merely a reversal of an earlier federal court order that was being carried out by the CDE. The plaintiffs prevailed—they got what they went to court for—so they were clearly entitled to costs as provided under U.S. Code, Title 20, Section 1415 (20 USC § 1415). The CDE's agreement for payment of these costs was approved by the court.

First, the BSA needs to recognize that neither *Lacayo* or *Crawford* arose after an administrative due process hearing conducted pursuant to the Individuals with Disabilities Education Act (IDEA). The CDE does not pay plaintiff (parents) attorney fees in such cases from federal grant funds (Education Code Section 56507). ①

Second, a federal district court has the power to levy on the state treasury if costs for attorney fees are not paid. In this situation the Budget Act requires the Department of Finance (DOF) to designate from what source of funds the levy is to be paid. Anticipating this, the CDE sought and received advance approval from the DOF to pay attorney fees in the *Lacayo* and *Crawford* cases from federal grant proceeds. ②

Third, the finding relies on the past and present Office of Management and Budget, Circular A-87 (A-87). It is important to note that the language of the present A-87, which took effect on September 1, 1995, is more expansive, adding to the language on fines and penalties, "damages and other settlements." Only *Crawford* occurred after the changes. Neither version of A-87 states that payment of plaintiff attorney fees in cases against a state education agency (in this situation the CDE) is unallowable. Both versions, in identical language, state that payment for only one type of legal expense—not the type for which payment was made in *Lacayo* and *Crawford*—is unallowable. Both explicitly state: "Legal expenses for the prosecution of claims against the federal government are unallowable." ③

Fourth, in order to reach its finding, the BSA equated payment of an award of attorney fees with payment of a fine, penalty, damages, or settlement of a claim. We have found no authority that treats payment of an award of attorney fees in this manner. Even the comptroller general appears to have formally recognized a distinction. [See, e.g. 69 Comp. Gen. (1990) 469, 470 wherein the comptroller general frames the issue for decision by characterizing it as concerning “a claim for attorney fees incident to settlement of an employee’s complaint of discrimination ...”] The Congressional Record relating to the enactment of the current 20 USC § 1415 says nothing that would even suggest that Congress considered the payment of attorney’s fees to be the same or similar to the payment of a fine, a penalty, or damages. ④

Fifth, the BSA necessarily concluded that payment resulted from a violation or alleged violation of law specifically by the CDE. The BSA’s conclusion is factually incorrect. ⑤

Sixth, the BSA relied on an August 10, 1990, letter from the Director of the Office of Special Education Programs to the Alabama Superintendent of Education published at 17 EHLR 1186. BSA is incorrect in denominating this a USDE decision. It is not. An official at the level of the author of this letter is not even considered a cognizant federal agency official. In addition, *Lacayo* and *Crawford* are factually distinguishable from the letter. The letter discusses payment of attorney fees awards after administrative due process hearings. Although we do not necessarily agree with the letter based on federal law alone, it is moot. As stated, the CDE and DOF, in accordance with state law, have not allowed payment for attorney fees awards from the federal grant in cases that arose after administrative due process hearings. ⑥ ⑦

Seventh, IDEA was enacted under the Spending Power. In order to require the sovereign State of California to pay a fine, penalty, or damages, California would have to knowingly acquiesce to such. This, in turn, would require a specific abrogation of the Eleventh Amendment in the enabling legislation. 20 USC § 1415 does not contain an abrogation of sovereign immunity. If the BSA is correct in concluding that the payment of attorney fees is tantamount to payment of a fine, a penalty, or damages, then 20 USC § 1415 is unconstitutional and no state education agency would have to pay any attorney fees under this section. ⑧

Eighth and finally, the statement that the State’s LEAs did not receive all the funds that they should have to provide free appropriate public education to pupils with exceptional needs is simply not accurate. The State’s LEAs receive a specific amount of special education funding each year based on instructional personnel services; support services; pupils in nonpublic, nonsectarian schools and agencies; and instruction time (Education Code, Section 56711). In addition to revenue limit amounts, property taxes and other local general fund contributions for special education pupils and programs, federal special education funding is subtracted from the total LEA entitlement for special education to determine the LEA’s state apportionment for special education (Education Code, Section 56712). All other factors held equal, if federal special education funding decreases, State apportionment for special education will increase and vice versa. The amount of special education funding is dependent on the types and amount of services provided as specified in Education Code, Section 56711, not the amount of federal and state funds available. ⑨

Rebuttals to CDE’s Response

① In the fourth paragraph of our condition section, we recognize that the CDE’s cases are not due process hearings.

② Although the DOF may have approved the use of federal grant proceeds to pay attorney fees, such approval does not necessarily establish such costs allowable to the federal program.

③ As stated in our criteria section, the earlier version of OMB Circular A-87 states that costs resulting from violations of, or failure to comply with, federal, state, and local laws and regulations are unallowable. According to our counsel, an award of attorney fees against the CDE in favor of a successful plaintiff in a disability rights case would be considered such a cost.

④ According to our counsel, the questioned costs could also be considered a penalty for the State's violation of the rights of the disabled individual. Therefore, the costs would be unallowable under either version of OMB Circular A-87. Also, the citation to the comptroller general reference is distinguishable because it relates to an employment discrimination case and does not address the language of A-87.

⑤ As stated in the second paragraph of our condition section, LEAs' actions gave rise to these cases. However, the department was included in the lawsuits and as a result used federal funds to pay plaintiff attorney fees. Further, the plaintiffs brought claims for violation of, or failure to comply with, applicable laws. The plaintiffs prevailed on these claims as evidenced by the payment of fees to the prevailing parties.

⑥ We modified the reference we make to the information we received from the USDE to characterize it as an opinion rather than a decision.

⑦ As stated in the fourth paragraph of our condition section, while we agree that the CDE's cases did not result from due process hearings, the USDE opinion letter was not limited to due process hearings.

⑧ The scope of our audit does not examine the constitutional basis for the CDE's payment of attorney fees in the *Lacayo* and *Crawford* cases or the constitutionality of 20 USC § 1415. It relates only to whether payments with moneys from the Grants to States for the Education of Children with Disabilities are allowable.

⑨ The text of the finding was revised to clarify that the State's LEAs did not receive all the federal funds they should have to provide free appropriate public education to disabled students.

Reference Number:	96-13-3-84.126
Federal Catalog Number:	84.126
Federal Program Title:	Rehabilitation Services— Vocational Rehabilitation Grants to States
Federal Award Number and Period:	H126A60005; FFY 1995-96
Category of Finding:	Services Allowed
State Administering Department:	Department of Rehabilitation (department)

Criteria

Various federal regulations dictate the manner in which the Department of Rehabilitation (department) must develop and oversee rehabilitation programs for clients under the federal Rehabilitation Services—Vocational Rehabilitation Grants to States program. In certain instances, the federal regulations provide general guidance, while the California Code of Regulations provides the specific guidelines for implementation. The following are some of the federal and state regulations that govern the department's development and oversight of rehabilitation programs:

- The Code of Federal Regulations, Title 34, Section 361.41 (a) (6), requires each individualized written rehabilitation program (IWRP) to include a procedure and schedule for periodic review and evaluation of progress toward achieving rehabilitation objectives, as well as a record of these reviews and evaluations. The California Code of Regulations, Title 9, Section 7132 (d), defines "periodic" by requiring the counselor to evaluate the clients' progress at least every 90 days or to record the reason an evaluation was not completed.
- The Code of Federal Regulations, Title 34, Section 361.40 (c), requires the State to review the IWRP at least on an annual basis.
- The Code of Federal Regulations, Title 34, Section 361.34 (b), states that a client may receive an extended evaluation to determine vocational rehabilitation potential for a total period not longer than 18 months.
- The Code of Federal Regulations, Title 34, Section 361.40 (b), requires that the IWRP be initiated after certification of eligibility or certification for extended evaluation to determine rehabilitation potential. The California Code of Regulations, Title 9, Section 7132 (a), defines the initiation period of the IWRP by requiring that the IWRP be developed and implemented within 90 days of the intake interview unless the rehabilitation supervisor has authorized a continuation.
- The Code of Federal Regulations, Title 34, Section 361.30, requires the State to establish and maintain written standards and procedures to assure expeditious and equitable handling of referrals and applications for vocational rehabilitation services. The California Code of Regulations, Title 9, Section 7041 (b), defines "expeditious" by requiring that applications be processed within 60 days of receipt. In that period of time, the counselor must certify whether the applicant is eligible for vocational rehabilitation services or approved for an extended evaluation.

Condition

We reviewed 30 client files to assess the department's efforts in developing and overseeing rehabilitation programs as required. For 14 files that were started during fiscal year 1995-96, we assessed department activities that would be performed when a client entered the program as well as assessed ongoing activities. For the remaining 16 files that were started before fiscal year 1995-96, we reviewed only ongoing activities.

Our review of the 30 files noted various instances where the department had not documented that it had monitored the progress of clients' rehabilitation programs in accordance with federal and state regulations. Additionally, in one instance, the department did not develop a rehabilitation program as required by regulations. When the department does not ensure that it follows regulations, it has reduced assurance that it is serving clients in the manner intended.

During our review of the 30 client files, we noted the following deficiencies in the department's efforts in overseeing rehabilitation programs:

- For 8 of the 30 client files, the department did not complete an evaluation of the client's progress within the required 90 days or record an explanation of the delay. For example, for 6 of the 8 client files, the counselor did not evaluate the client's progress for a period ranging from 6 to 18 months. Also, for 2 of the 6 client files, the department did not annually review the clients' IWRPs. The department stated that it lost contact with three of the six clients, which precluded its ability to evaluate client progress and, in the two instances, perform annual reviews. However, we found no documentation of attempts to contact the clients during the periods in question.
- For 1 of the 30 client files, the client remained in extended evaluation for nearly 6 months past the maximum allowable period of 18 months.
- For 1 of the 14 client files that were started during fiscal year 1995-96, we found that the department did not complete the IWRP within 90 days after being approved to receive services nor was a continuation authorized by the rehabilitation supervisor. Specifically, the client was eligible to receive services in April 1996. As of March 1997, 11 months later, the client's IWRP had not yet been completed. Further, the department took 78 days to determine this client's eligibility, exceeding the 60 day limit.

Recommendation

The department should ensure that it develops and oversees rehabilitation programs for clients as required by federal and state regulations. In addition, it should appropriately document all the activities for clients that it performs.

View of Department

The department agreed with the finding and stated the primary issue of client progress evaluations not performed within at least 90 days was either a loss of contact with the client or a lack of documentation when a client received services. In addition, the department stated the lack of annual reviews of IWRPs was also due to a loss of contact with the clients. The department plans to remind staff of the need to contact clients regularly and document those contacts. Regarding the one client for which an IWRP was not established within 90 days, the department stated that this was an exception due to counselor absences and subsequent transfer of the case. The department agreed that this same client's eligibility was not determined within 60 days of his application and responded that the case should have had an approved extension of determination of eligibility. Further, for the client who remained in extended evaluation for nearly two years, the department stated that it would remind staff that extended evaluations cannot exceed an 18-month period.

Reference Number: 96-13-4-84.162
Federal Catalog Number: 84.162
Federal Program Title: Emergency Immigrant Education
Federal Award Number and Period: T162A50033; FY 1995-96
Category of Finding: Allowable Costs
State Administering Department: California Department of Education (CDE)

Criteria

In our review of the Emergency Immigrant Education grant, we found the following requirements for allowable costs. The United States Code, Title 20, Section 7544, provides that each state participating in the Emergency Immigrant Education program will receive an allocation equal to the proportion of such state's immigrant children and youth enrolled in schools relative to the total number of these enrolled in all the states participating in the program. Further, Section 7545 (a)(4) of the code requires the California Department of Education (CDE) to distribute program funds to local educational agencies (LEAs) based upon the number of immigrant children and youth enrolled in each LEA.

Condition

During fiscal year 1995-96, the State received an allocation of \$16,861,453 based on the total number of immigrant children and youth enrolled in schools as reported by the CDE. After reserving \$252,922 for administrative costs as allowed by the code, the CDE had \$16,608,531 available for distribution to the LEAs. However, because some of the LEAs subsequently revised their pupil counts, the CDE distributed a total of only \$16,459,664. As a result, the CDE had excess funds totaling \$148,867. Moreover, rather than increase the amounts it allocated to each of the LEAs throughout the State, the CDE used a portion of the funds to support supplemental programs at only a few of the agencies. Specifically, the CDE used \$72,958 to fund supplemental programs at five LEAs and did not spend the remaining \$75,909. Similarly, in fiscal years 1993-94 and 1994-95, the CDE had approximately \$88,500 in excess funds that it spent on supplemental programs at certain LEAs.

Because the CDE did not allocate the excess program funds based on the proportion of immigrant children and youth enrolled in the local educational agencies throughout the State, some LEAs did not receive the entire amount of funds for which they were eligible.

Recommendation

The CDE should ensure that it properly allocates all program funds to the LEAs.

View of Department

In April 1990, the CDE received authorization from the U.S. Department of Education (USDE) to use unallocated Emergency Immigrant Education funds for technical assistance and staff development for the benefit of California school districts. The CDE believed the USDE authorization to be a policy statement approving California's use of unallocated funds for projects supporting the education of immigrant children. The CDE's Final Fiscal Expenditure Reports submitted to the USDE clearly describe the use of remaining Emergency Immigrant Education funds for conferences to provide technical assistance to all school districts in California and at no time did the USDE indicate that the CDE's practice of using unallocated funds for technical assistance was inappropriate.

However, on April 3, 1997, the CDE received clear direction from the USDE that only 1.5 percent of its Emergency Immigrant Education grant may be used for administrative costs, including technical assistance, and that the remaining 98.5 percent of the grant funds must be distributed to local educational agencies in accordance with the number of eligible immigrant children and youth in the State either on a formula or competitive basis. The CDE will allocate at least 98.5 percent of its 1997-98 grant to LEAs based on the number of eligible immigrant children.

Reference Number:	96-13-5-84.186
Federal Catalog Number:	84.186
Federal Program Title:	Safe and Drug-Free Schools and Communities— State Grants
Federal Award Number and Period:	S186A40062; 7/14/94 - 9/30/95
Category of Finding:	Allowable Costs—Exceeding Limit on Administrative Costs
State Administering Department:	Department of Alcohol and Drug Programs (department)

Criteria

In our review of the Safe and Drug Free Schools and Communities—State Grants, we determined that the following was among the compliance requirements related to administrative costs. The United States Code, Title 20, Section 3191(a)(2), requires that the department not expend more than 2.5 percent of the grant award for administrative costs.

Condition

Although the U.S. Department of Education has imposed a 2.5 percent limit on the amount of the grant that can be spent for administrative expenses, it has not defined which expenses should be classified as such. Thus, we cannot precisely determine the amount that the Department of Alcohol and Drug program's (department) administrative expenses have exceeded this limit. Depending on how administrative expenses are defined, we can only state that departmental administrative expenses may have exceeded the 2.5 percent limit by between \$6,561 to \$1,763,166.

The department spent approximately \$2,028,015 in federal funds to support the Safe and Drug-Free Schools and Communities (SDFSC) grant. Support costs included personal services, distributed administration, and allocated and other expenses. Following is a summary of these expenditures:

Type of Expenditures	Total Expenditures	Percent of Total Expenditures
Support:		
Personal services	\$ 1,065,440	10.0%
Distributed administration	406,945	3.8
Allocated expenses	273,635	2.6
Other expenses	281,995	2.6
Total Support	2,028,015	19.0
Local Assistance	8,648,164	81.0
Total	\$ 10,676,179	100.0%

Personal Services consist of employee salaries and benefits. Distributed administration expenses include leadership and support services, such as the legal, audit, accounting, human resources, budget, and legislative affairs offices. Allocated expenses are allocated to the grant and include office supplies, equipment rental, postage, and office leasing. Other expenses comprise costs charged directly to the grant, such as travel, consultant contracts, supplies, and postage.

The department defines administrative expenses as activities related to compliance with state or federal law, including fiscal and federally mandated reports, contract negotiations over federal and state regulations and data collection, and site visits to monitor regulatory compliance. The department excludes any program operations, such as designing and distributing program materials, developing requests for proposals, executing site visits to check activities or give technical assistance, reviewing project results and monthly progress reports, and preparing all necessary communications.

Based on a time study employing its definitions of administrative expenses, the department determined that 13.55 percent of all support costs, except consultant contracts, should be classified as administrative expenses. Using this calculation, the department classifies approximately \$271,410 as administrative expenses. Since 2.5 percent of the grant award is

\$264,849, the department's administrative expenses exceeded this limit by \$6,561. Alternatively, if all \$2,028,015 in support costs were considered administrative expenses, the department would have exceeded the limit by \$1,763,166.

Recommendation

The department should request that the U.S. Department of Education provide suitable definitions of administrative expenses so the department can ensure that its expenses do not exceed the grant limits.

View of Department

The department disagrees with the finding. According to the department's deputy director, the department believes it is complying with the 2.5 percent limit on administrative expenses. In addition, the department will continue to pursue a clear definition of administrative expenses from the U.S. Department of Education.

Reference Number:	96-14-2-84.032
Federal Catalog Number:	84.032
Federal Program Title:	Federal Family Education Loans
Federal Award Number and Period:	FFY 1995-96
Category of Finding:	Eligibility
State Administering Department:	California Student Aid Commission (commission)

Criteria

In our review of the Federal Family Education Loans program, we determined that the following were among the compliance requirements related to limits on student loans:

The Code of Federal Regulations, Title 34, Section 682.400, states that in order for the California Student Aid Commission (commission) to participate in the Federal Family Education Loans program, it must enter into various agreements with the federal government. As part of these agreements, the commission must ensure that its loan program meets the requirements that the total amount of student loans made to each borrower not exceed specified limits.

The United States Code, Title 20, Section 1078(b)(1)(B), provides for certain aggregate loan limits for guaranteeing subsidized loans. Subsidized loans are loans for which the federal government pays a portion of the interest charges on behalf of the qualifying students. These limits are based on the student's grade level and the amount of the student's total outstanding loans for the loan program.

Condition

As we reported in previous years, we found that the commission is not fully complying with the terms of its agreement to participate in the Federal Family Education Loans program. Specifically, federal law allows graduate and undergraduate students to have up to \$65,500 and \$23,000, respectively, in total subsidized student loans that are outstanding. However, in fiscal year 1995-96, the commission guaranteed an undergraduate subsidized student loan that exceeded the \$23,000 maximum loan limit by \$1,813. This loan exceeded the limit because, although the commission's automated system has data processing edits to prevent loans from exceeding the allowable maximum loan limits, these edits are not applied in all cases.

Specifically, the commission's automated system does not apply the maximum loan limit edits when processing a loan that consolidates a borrower's loans into one loan. For example, in one case, a lender reported the status of previously guaranteed loans as "paid-in-full." Subsequently, the lender submitted a consolidated loan for guarantee processing by the commission through its automated system. Between the two-year period that the status of the prior loans was changed to paid-in-full and the commission's guarantee of the consolidated loan, the commission guaranteed an additional student loan for the borrower. However, when the lender subsequently submitted its consolidated loan for processing through the commission's system, the additional loan and the consolidated loan amounts together exceeded the maximum limit for subsidized loans.

The commission's automated system did not detect and report an over-limit exception because the system does not apply the maximum loan limit edits when processing loans that consolidate previously guaranteed loans. The commission became aware of the exception when a school reviewing this particular student's borrowing history identified the exception. The commission subsequently corrected the exception by reclassifying the amount over the maximum limit for the subsidized loan category to an unsubsidized loan category.

Although the commission issued an operations memorandum in February 1997 advising lenders to submit consolidation loans more promptly, the commission's current automated system does not have an effective process to prevent similar situations from occurring. The commission plans to make system modifications to ensure loans that are being consolidated are included in the calculation of a borrower's maximum loan limits. Additionally, the commission plans to develop and use "exception reports" to query the commission's system to identify and investigate other loans that may have exceeded the maximum loan limits. However, until the commission does this, it cannot determine the full extent and incidence of loans exceeding the maximum limits.

Noncompliance with federal loan limits could result in a loss to the commission's guaranteed loan reserve fund if the borrower defaults. This is because in a default situation, the commission will pay the lender for the defaulted loan; in turn, the federal government will reimburse the commission the amount the commission paid the lender. However, the federal government may not reimburse the commission for the portion of the loan that exceeded the amount authorized by regulations.

Recommendation

The commission should modify its system to prevent loans from exceeding the maximum loan limits. Further, the commission should establish a procedure to periodically query its system to identify and correct any loans that exceed the maximum loan limit amounts.

California Student Aid Commission

Federal Catalog Number: 84.032
Federal Program Title: Federal Family Education Loans
Federal Award Number and Period: FFY 1995-96
Category of Finding: Special Reporting Requirements
State Administering Department: California Student Aid Commission (commission)

Criteria

In our review of the Federal Family Education Loans program, we determined that the following were among the compliance requirements related to the federal reinsurance rate:

In accordance with the Code of Federal Regulations, Title 34, Section 682.404(a) - (c), the federal government reimburses the California Student Aid Commission (commission) a percentage of losses on defaulted loan claim payments to lenders. The federal government bases this percentage, called the reinsurance rate, on the amount of claims paid during the fiscal year and the reported loans in repayment at the end of the prior fiscal year. If the total claims paid during the fiscal year exceed 5 percent of the loans in repayment, the federal government pays the commission less reinsurance for loans. When the total claims paid exceed 9 percent of loans in repayment, the reinsurance rates drop again. Additionally, the federal regulations require the commission to report complete and accurate data to the federal government so that a correct reinsurance rate can be calculated.

Further, the California Code of Regulations, Title 5, Section 30124, requires that lenders report to the commission any loan transaction within 45 days of the date a loan transaction occurs or the date the lenders learn of the transaction.

Condition

We found that the information the commission reports to the federal government to compute the reinsurance rate is not always accurate. Specifically, for the ten loans we tested to determine if the commission's records properly reflected the status of the loan, we found four instances in which the records were inaccurate. Specifically, we reviewed the commission's reporting of the repayment status for five of the ten loans, and we found that although the commission reported the loans as being in repayment status, three of the five loans had actually been paid-in-full approximately five to eight years earlier. Additionally, we reviewed the commission's reporting of the student status for the other five loans and found one where the commission's records showed the student as being in school, when actually the school had reported, more than 1 1/2 years earlier, that the student had withdrawn from the school. The commission continued to report the student as being in school because it had not yet heard from the lender. When we contacted the lender, the lender reported that not only had the student withdrawn from school, but the loan was paid-in-full two years ago.

Repayment status and student status are two elements that affect the "loans-in-repayment" amount. The loans-in-repayment amount is used to calculate the reinsurance rate, which is used to determine the extent to which the federal government will reimburse the commission for defaulted loans that the commission has paid. If the commission does not report accurate information, it may not be receiving the proper amount of funds from the federal government.

The commission's records did not reflect accurate information because it did not receive information regarding the change in status for the loans from the lenders. In each of the four instances where we found that the commission's information was inaccurate, the commission made some attempts to contact the lender to receive updated information. Specifically, we noted that the commission sent system-generated "paid-in-full tickler reports" on a quarterly basis to the lenders that held the three loans with the incorrect repayment status. The tickler report identifies loans currently in repayment status that are at least 12 months past their scheduled maturity date. In earlier guidance, the commission instructed lenders to use this report to update and report more recent information about the loans to the commission. The commission has sent these system-generated tickler reports since it implemented its Financial Aid Processing System in 1993. Additionally, for the one loan with the incorrect student status, the commission notified the lender in August 1995 that it had been informed by the school that the student had withdrawn. However, despite the commission's efforts to obtain updated information on these four loans, the lenders did not submit accurate information. A lender did subsequently update the status of two loans in April 1997 after our inquiry.

The commission recognizes that its system does not always reflect accurate information regarding its loans. The commission is presently conducting a reconciliation project for loans guaranteed before January 1, 1995. The objective of this project, which was designed with the input of the United States Department of Education, is to ensure that the data in the commission's system is accurate and matches that of the lenders. The commission estimates that the project will be complete by September 30, 1997.

Recommendation

The commission should continue with its reconciliation project. Additionally, the commission should work with lenders to ensure they report promptly changes in student and loan status so that the information the commission reports to the federal government is as accurate as possible.

View of Department

The commission agrees its loan records are not always accurate but believes that lenders are primarily responsible for ensuring that they properly notify the commission of changes in loan information. Additionally, the commission believes it is doing what it can in this area by notifying lenders when updated information appears necessary and by working on the reconciliation project. Finally, the commission has recently established a quality control unit within the Origination and Guarantee Services Branch. The staff in this unit correct problems and identify lenders who need assistance by monitoring and analyzing information that lenders submit and that cannot be processed in the commission's automated system.

View of Department

The commission agreed with the finding reported above and plans to improve its system to prevent and detect other consolidation loans that could have exceeded the maximum loan limits. The commission believes that exceptions similar to the one reported would be very limited because of the unusual combination of circumstances that would have to converge to result in guarantees in excess of the maximum limits.

Reference Number:	96-17-3-84.032
Federal Catalog Number:	84.032
Federal Program Title:	Federal Family Education Loans
Federal Award Number and Period:	FFY 1995-96
Category of Finding:	Special Tests and Provisions
State Administering Department:	California Student Aid Commission (commission)

Criteria

In our review of the Federal Family Education Loans program, we determined that the following were among the compliance requirements related to preclaims assistance and supplemental preclaims assistance activities performed on delinquent loans:

The Code of Federal Regulations, Title 34, Section 682.404(a), requires the California Student Aid Commission (commission), upon receipt of a request from the lender, to begin "preclaims assistance" activities on a delinquent loan prior to the loan entering default status. Preclaims assistance means collection assistance the commission provides to the lender designed to encourage the borrower to begin or resume repayment of the delinquent loan. These collection efforts include making, or attempting to make, contact with the borrower by mail or telephone. The commission must initiate at least three collection efforts, including at least one letter to the borrower.

When the loan is at least 120 days delinquent and when the lender makes a request to the commission, the commission is to exercise "supplemental preclaims assistance" activities on the delinquent loan prior to the lender filing a claim with the commission. Supplemental preclaims assistance involves initiating at least two more collection efforts designed to encourage the borrower to begin or resume repayment. In accordance with the United States Code, Title 20, Section 1078(l)(2), the federal government pays the commission 1 percent of the total unpaid principal and accrued interest for each loan on which supplemental preclaims assistance was performed and which the lender did not submit as a defaulted-loan claim on or before 270 days of delinquency.

Condition

We found that the commission did not always ensure compliance with the preclaims assistance requirements. Specifically, for the ten loans we reviewed, the commission's system indicated it had sent letters to borrowers. However, the system did not indicate the date the letters were sent. As a result, we could not always relate the letters to the specific loans and lender requests for preclaims assistance. Further, we could not always conclude that the letters demonstrated that the commission sent at least one letter to encourage the borrower to begin or resume repayment for each lender's preclaims assistance request. After our inquiries, the commission subsequently modified its system in April 1997 to include the date it sent the letters to make it possible in the future to relate the letters to specific loans and lender preclaims assistance requests.

We also found that, for three of the ten loans, the commission did not demonstrate that it performed the three required preclaims assistance activities. In each instance, not including the above mentioned letters, the commission performed only one telephone contact in its collection attempts. In all three instances, the commission made a successful telephone contact with the borrower or a representative in the borrower's household and discontinued additional collection attempts. The commission's practice was to consider a successful telephone contact with the borrower or a household representative as a completed effort; it considered additional attempts unnecessary. However, failure to provide the required preclaims assistance activities could jeopardize the commission's reinsurance agreement with the federal government.

Additionally, the commission received payments from the federal government for supplemental preclaims assistance but did not always meet the requirements to receive the payment. Specifically, for one of the ten loans we reviewed, the commission received payment from the federal government for the supplemental preclaims assistance even though the lender had submitted the defaulted-loan claim to the commission when the loan was delinquent only 201 days, rather than the required 270 days. As a result, the commission did not ensure that it only received payment for supplemental preclaims assistance on eligible defaulted-loan claims.

Recommendation

The commission should review its procedures to ensure that it makes at least three preclaims assistance collection efforts, including at least one letter. The commission should also review its procedures for requesting payment from the federal government for supplemental preclaims assistance to ensure that the lender did not submit a defaulted-loan claim prior to the loan being delinquent 270 days.

View of Department

The commission agreed with the finding reported above and plans to take action to correct the reported deficiencies. Specifically, the commission plans to change its practice of not making additional collection attempts when it makes successful telephone contact with the borrower or a household representative during its preclaims assistance activities. Instead, the commission plans to follow up successful telephone contacts with either an additional letter or telephone attempt to determine if the borrowers have resolved their delinquent status.

With respect to the one supplemental preclaims assistance payment that the commission received for which it was not eligible, the commission is investigating the circumstances under which this exception occurred. The commission plans to immediately seek a solution, whether through systematic or manual intervention, to correct any supplemental preclaims assistance payments for which it is not eligible to receive.

Reference Number:	96-17-4-84.032
Federal Catalog Number:	84.032
Federal Program Title:	Federal Family Education Loans
Federal Award Number and Period:	FFY 1995-96
Category of Finding:	Special Tests and Provisions
State Administering Department:	California Student Aid Commission (commission)

Criteria

In our review of the Federal Family Education Loans program, we determined that the following were among the compliance requirements related to the federal share of borrower payments:

The Code of Federal Regulations, Title 34, Section 682.404(g)(3), requires the California Student Aid Commission (commission) to report to the federal government the federal share of borrower payments for defaulted student loans. These amounts must be remitted within 45 days of receipt of funds from the borrower.

Condition

The commission receives borrower payments for defaulted student loans directly or through collection agencies. The federal government is entitled to receive a share of these moneys. However, the commission did not report approximately \$29 million (29 percent) of the collections due to the federal government for fiscal year 1995-96 within the required 45 days. Although approximately \$28.1 million of these collections were no more than one month late, over \$58,000 were more than one year late. We have reported this issue in previous years.

Recommendation

The commission should minimize the time lapsed between receipt of collections and reporting of those collections to the federal government on the monthly claims and collections report.

View of Department

The commission concurs with the recommendation and believes that the incidence of late reporting of collections can be reduced by decreasing the turnaround time for completion and submission of the monthly claims and collections report to the federal government by five to seven days. Because collections are reported to the federal government once a month, a decrease in processing time of five to seven days could result in certain collections being reported within the required time.

U.S. Department of Health and Human Services

Reference Number: 96-13-6-93.536

Federal Catalog Number: 93.568

Federal Program Title: Low-Income Home Energy Assistance Program

Federal Award Number and Period: 6G992201, FFY 1995-96

Category of Finding: Services Allowed

State Administering Department: Department of Community Services and Development (department)

Criteria

In our review of the Low-Income Home Energy Assistance Program (LIHEAP), we determined the following were compliance requirements related to providing energy assistance to eligible applicants:

The United States Code, Title 42, Section 8624, in part requires that the State prepare and submit to the U.S. Department of Health and Human Services a plan that describes its strategy for implementing the LIHEAP. The plan must include, but is not limited to, a description of the Department of Community and Services Development's (department) calculation of the benefit levels for each type of assistance it provides to eligible applicants under the program. In addition, the section requires that the State must expend LIHEAP funds in accordance with the State plan. Finally, Section 8624 requires that the State must provide fiscal control and fund-accounting procedures to ensure that federal funds paid to the State are properly disbursed of and accounted for.

The State's plan for the 1996 LIHEAP grant states that its home-energy assistance element of the LIHEAP provides one-time assistance, per household, per program year.

Condition

The department is responsible for developing and implementing a plan to provide home-energy assistance to eligible low-income Californians under the LIHEAP. The federal laws governing the LIHEAP require the department to provide the highest level of assistance to households that have the lowest incomes and the highest energy costs or needs. The department provides energy assistance that is noncrisis in nature through the home-energy assistance program (HEAP) element of its LIHEAP. As part of its plan for implementing the LIHEAP, the department established a policy to make only one HEAP payment to an eligible applicant during each program year. However, for fiscal year 1995-96, we found the department does not have adequate controls over HEAP payments to ensure it makes only one payment to an eligible applicant each program year as required.

The department provides HEAP payments to eligible applicants directly from the department or through local public or nonprofit agencies contracted by the department to provide LIHEAP services. During fiscal year 1995-96, the department typically provided HEAP payments to assist applicants who could not pay their utility bills. During the same period, local agencies typically made HEAP payments directly to applicants who used bulk fuels such as wood, propane, or oil to heat their homes.

However, the department did not have the controls in place to ensure that applicants did not receive both a payment from the department and a payment from a local agency. According to the program manager, the possibility for more than one payment to applicants for HEAP payments resulted from outreach activities conducted by the department. The department mailed applications to potential HEAP payment recipients and directed the applicants to return the applications to the department for processing. However, because the department did not have a record of individuals and households who received payments for bulk fuel from local agencies, it could not be certain it was not providing a second payment to the applicants who responded to the department's mailings. As a result, the department cannot be certain it is following its policy designed to assure it is providing the highest level of assistance to the households with the lowest level of income or highest level of need, as required by the LIHEAP. According to the program manager, for program year 1997 local agencies will process applications for HEAP assistance that result from the department's outreach activities. Local agencies can then determine whether applicants seeking the department's assistance with paying their utility bills have already received a payment for bulk fuel from a local agency.

Recommendation

The department should implement its procedures to ensure it provides only one HEAP payment to an individual or household for each program year.

View of Department

The department agrees with the finding and recommendation. In the future, the department will forward applications for HEAP assistance payments it receives as a result of outreach mailings to local agencies for processing.

Reference Number:	96-13-7-93.568
Federal Catalog Number:	93.568
Federal Program Title:	Low-Income Home Energy Assistance Program
Federal Award Number and Period:	5G992201, FFY 1994-95
Category of Finding:	Services Allowed
State Administering Department:	Department of Community Services and Development (department)

Criteria

In our review of the Low-Income Home Energy Assistance Program (LIHEAP), we determined that the following were among the compliance requirements related to allowable services:

The United States Code, Title 42, Section 8624(b)(9), requires that no more than 10 percent of LIHEAP funds payable to the State may be used for planning and administrative costs.

The Code of Federal Regulations, Title 45, Section 96.30, requires that a grant recipient establish sufficient fiscal control and accounting procedures to permit the tracing of funds to a level of expenditure adequate to demonstrate that program funds have been used in compliance with federal requirements.

Condition

The Department of Community Services and Development (department) is responsible for administering the LIHEAP. Our analysis reveals that the department spent more than federal regulations allow to administer the 1995 LIHEAP grant. The department believes it has not exceeded allowable limits; however, it does not accumulate LIHEAP planning and administrative costs in its accounting or program records in a manner that allows it to identify and summarize those costs for the department and local service providers. Therefore, the department cannot be certain it has complied with the spending limitations of the program.

Federal regulations allow the department to use up to 10 percent of grant funds to pay the department's and the local service providers' costs of planning and administering the LIHEAP. During fiscal year 1995-96, the department spent LIHEAP funds, totaling approximately \$6.7 million to pay the planning and administrative costs of the department and local service providers. Using financial data provided by the department's fiscal and program units for the 1995 LIHEAP grant, we determined that the department overspent the amount of grant funds allowed for the planning and administrative costs by approximately \$626,000.

According to the department's chief of fiscal operations, the administrative cost we identified for local service providers includes costs that are funded by sources other than the LIHEAP grant. However, the department could not identify those costs in its records. As a result, the department cannot determine whether it has met the spending limitations for its administrative costs of the LIHEAP. When the department overspends LIHEAP funds for administrative costs it reduces the amount of program funds available to assist the home energy needs of the State's low-income population. We reported a similar finding as a result of our fiscal year 1994-95 audit.

Recommendation

The department should establish procedures to identify and summarize LIHEAP expenditures to ensure it uses program funds in compliance with spending limitations for planning and administrative costs.

View of Department

The department agrees with the findings and provides the following comments. According to the department's director, the department agrees that it did not have a system in place to identify LIHEAP administrative costs paid by the department. The fiscal information the department provided to us that showed LIHEAP administrative costs in excess of the allowable 10 percent includes total administrative costs reported by the department's contractors. The total administrative costs of the contractors, however, include some costs that are not related to the LIHEAP grants.

However, the department did not have a system in place to capture the contractors' administrative costs related to the LIHEAP grant. Currently, the department's audit staff is reviewing the 1995 LIHEAP contracts and has found that the amount of LIHEAP funds the department has paid to contractors for administrative costs is at least \$200,000 less than the amount shown in the fiscal information provided to the Bureau of State Audits. While conducting this review, the department's audit staff has put in place a system to capture the administrative costs of the department's contractors that are paid from LIHEAP funds. Furthermore, the department's auditors are currently reviewing the department's administrative costs that have been charged to the LIHEAP. While the review is not complete, the department's auditors have also found that there are charges included in the department's fiscal year 1995-96 administrative expenditures that should have been recorded as fiscal year 1996-97 administrative expenditures.

Reference Number:	96-15-2-93.917
Federal Catalog Number:	93.917
Federal Program Title:	HIV Care Formula Grants
Federal Award Number and Period:	BRX/070041-95-0, 4/1/95 to 3/31/96
Category and Finding:	Earmarking
State Administering Department:	Department of Health Services (department)

Criteria

In our review of the HIV Care Formula Grants, we determined that the following was among the compliance requirements pertaining to the level of effort. The United States Code, Title 42, Subchapter XXIV, Section 300ff-22(b), requires that a state use not less than 15 percent of funds allocated under this act to provide health and support services to infants, children, women, and families with the HIV disease.

Condition

The Department of Health Services (department) cannot demonstrate that it is complying with the requirement to use at least 15 percent of funds from the HIV Care Formula Grants (grant) to provide health and support services to infants, children, women, and families with the HIV disease. According to the chief of the department's Care Section of the Office of AIDS, in the first six years of the Comprehensive AIDS Resources Emergency (CARE) Act legislation, the State demonstrated to the satisfaction of the federal government that it met this requirement. However, to demonstrate its compliance, the department has simply provided an assurance in the grant application prior to spending the funds. Because it does not have a monitoring system to identify and track specific costs, the department cannot document that it is complying with the grant's spending requirements.

Recommendation

The department should develop and implement a system to track costs of services provided to infants, children, women, and families with the HIV disease.

View of Department

Beginning in fiscal year 1996-97, the Ryan White CARE Act Amendments of 1996 specify that each state calculate a minimum spending percentage to be used for providing health and support services to infants, children, women, and families with the HIV disease. This minimum percentage is the ratio of the state's population of women, infants, and children with the HIV disease to the state's total population with the HIV disease. The chief of the Care Section indicated that the department is complying with the new requirement by providing to the subrecipient HIV CARE consortia the estimated proportion of women, infants, and children living with AIDS and the minimum amount the consortia must spend on this population. The department is requiring each consortium to document how it plans to meet this requirement and to provide quarterly reports on its progress.

Reference Number:	96-16-5-93.994
Federal Catalog Number:	93.994
Federal Program Title:	Maternal and Child Health Services Block Grant to the States
Federal Award Number and Period:	95B1CAMCHS-04 October 1, 1994 to September 30, 1995
Category of Finding:	Special Reporting Requirements
State Administering Department:	Department of Health Services (department)

Criteria

In our review of the Maternal and Child Health Services Block Grant to the States, we determined that the following was among the compliance requirements pertaining to special reporting requirements. The Code of Federal Regulations, Title 45, Section 96.30(b), requires that a state's fiscal control and accounting procedures must be sufficient to permit the tracing of funds to a level of expenditure adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of the statute authorizing the block grant.

Condition

The Department of Health Services (department) was unable to provide clear documentation that its accounting records support certain expenditures it recorded in the annual report for the Maternal and Child Health Services Block Grant to the States (grant). For the portion of expenditures that we reviewed, the department reported approximately \$28.9 million. However, the accounting records list only \$27.7 million in expenditures. Without clear documentation, the department cannot show that it spent funds in accordance with the grant application or that amounts reported to the federal government are accurate.

Recommendation

The department should prepare and retain documentation that clearly links the information in its annual report for the grant with the department's official accounting records.

View of Department

The chief of the department's Maternal and Child Health Branch acknowledged that the department's accounting records were not the source for the expenditure information in the annual report. According to the chief, her staff plans to meet with the department's accounting section to develop a protocol within the automated accounting system that will verify when the department has fully spent the block grant.

Reference Number:	96-17-5-93.568
Federal Catalog Number:	93.568
Federal Program Title:	Low-Income Home Energy Assistance Program
Federal Award Number and Period:	5G992201, FFY 1994-95
Category of Finding:	Special Tests and Provisions
State Administering Department:	Department of Community Services and Development (department)

Criteria

In our review of the Low-Income Home Energy Assistance Program (LIHEAP), we determined the following were compliance requirements related to the prompt expenditure of LIHEAP funds:

The United States Code, Title 42, Section 8626(b), allows that the State may request up to 10 percent of its allotted LIHEAP funds to be carried over for use in a second year. In addition, Section 8626(b) states that any unused LIHEAP funds in excess of 10 percent of an allotted amount are subject to reallocation by the federal government.

The Code of Federal Regulations, Title 45, Section 96.81, requires in part, that the Department of Community Services and Development (department) report the amount of LIHEAP funds it requests to remain available for obligation in the succeeding year.

The Code of Federal Regulations, Title 45, Section 96.30, requires that a grant recipient establish sufficient fiscal control and accounting procedures to permit the tracing of funds to a level of expenditure adequate to demonstrate that program funds have been used in compliance with federal regulations.

Condition

The department is responsible for providing home energy assistance to low-income Californians through the LIHEAP. However, the department does not always follow federal law and regulations concerning the prompt expenditure of LIHEAP funds. We found that the department did not ensure that it spent or obligated at least 90 percent of its 1995 LIHEAP grant within the first year of availability as required by federal law. The department asked the U.S. Department of Health and Human Services (DHHS) to carry over approximately \$5.9 million, or 10 percent, of the 1995 LIHEAP grant for use in the second year of the grant period. However, the department could not provide us program or accounting records showing that it had \$5.9 million of unspent or unobligated funds.

The department was awarded approximately \$58.9 million for its 1995 LIHEAP grant. We reviewed the department's expenditures of the 1995 LIHEAP grant and found it had spent or obligated only approximately \$51.3 million, or 87 percent, of the grant amount. As a result, the department carried over approximately \$7.7 million, or 13 percent, of the grant for expenditure in the second year of the grant period. Federal regulations require that the department must spend or obligate 90 percent of its LIHEAP award in the first year of the grant period or return the unused award to the federal government for reallocation. According to the chief of fiscal operations, at the end of the first year of the grant period the department had obligations for assistance payments that would bring it into compliance with the 10 percent carry-over requirement of the program. However, he could not identify the amounts in the department's accounting records. The chief of fiscal operations further stated that the department did not have procedures in place to adequately identify LIHEAP obligations to ensure that it has obligated 90 percent of the 1995 LIHEAP grant award within the first year of the grant period. Beginning with the 1996 LIHEAP grant, the department has implemented procedures to identify the amounts it plans to pay to energy utility companies during the second year of the grant period and enter into the necessary agreements with the utility companies to obligate the grant funds. The new procedures will allow the department to monitor LIHEAP obligations to ensure it complies with the requirements of the program.

Recommendation

To provide the information it needs to ensure compliance with the 10 percent grant carry-over limitations of the LIHEAP, the department should ensure it maintains LIHEAP expenditures and obligations in its accounting records. In addition, the department should ensure that the grant amounts it requests to the federal DHHS for carry-over to a succeeding year are supported by information contained in its program and accounting records.

View of Department

The department agrees with the findings. The department points out that we used reports the department provided from its accounting system (CALSTARS) to identify that the department had carried over 13 percent of fiscal year 1995-96 LIHEAP funds to the following year when a maximum of only 10 percent is allowed. According to the department's director, the department now feels that the CALSTARS reports that were provided to us during the audit are inaccurate because of errors originating several years ago. The department has retained the services of a retiree to review, audit, and correct the CALSTARS system. Once this has been accomplished, the department feels that the CALSTARS system and all departmental records will show that the department did not carry over more than the allowable 10 percent.

Reference Number:	96-17-6-93.959
Federal Catalog Number:	93.959
Federal Program Title:	Block Grant for Prevention and Treatment of Substance Abuse
Federal Award Number and Period:	95B1CASAPT-04; 10/1/94 - 9/30/96
Category of Finding:	Special Tests and Provisions
State Administering Department:	Department of Alcohol and Drug Programs (department)

Criteria

In our review of the Block Grant for Protection and Treatment of Substance Abuse (SAPT), we determined that the following were among the compliance requirements related to independent peer reviews:

The United States Code, Title 42, Section 300x-53(a)(1)(a) and the Code of Federal Regulations, Title 45, Section 96.136(a), require the department to contract for periodic independent peer reviews to assess the quality, appropriateness, and efficacy of treatment services provided by entities receiving funds from the SAPT block grant. In addition, these codes require that not fewer than 5 percent of the entities be reviewed.

Condition

The Department of Alcohol and Drug Programs (department) has not contracted for independent peer reviews of the alcohol and drug treatment providers receiving funds from the SAPT block grant. The Code of Federal Regulations required that the independent peer review begin in fiscal year 1993-94, with at least 5 percent of providers reviewed annually. Although the department solicited and received bids to perform these reviews, as of February 1997, it was unable to find a suitable contractor. Without these reviews, the department cannot ensure the alcohol and drug treatment providers are meeting performance goals or providing services consistent with the objective of the block grant.

The Bureau of State Audits had similar findings in fiscal years 1993-94 and 1994-95.

Recommendation

To ensure that subrecipients comply with the requirements for the SAPT block grant program, the department should immediately take steps to organize independent peer reviews. At least 20 percent of the entities that provide alcohol and drug treatment services should be covered by these reviews, which would bring the department up to date with the requirement that at least 5 percent of the entities be reviewed each fiscal year starting in fiscal year 1993-94.

View of Department

The department agrees with the finding but does not agree with our recommendation that it review at least 20 percent of the entities. According to the department, as of May 1997, it had identified a potential contractor, using an Invitation for Bid process. The department expects to have a contract by June 1997 and plans to review 5 percent of the entities.

Reference Number:	96-11-4-93.778
Federal Catalog Number:	93.778
Federal Program Title:	Medical Assistance Program
Federal Award Number and Period:	05-9605CA5028 FFY 1995-96
Category of Finding:	Administrative Requirements (Program Income)
State Administering Department:	Department of Health Services (department)

Criteria

In our review of the Medical Assistance Program (Medi-Cal), we determined that the following were among the compliance requirements related to the collection and accountability of program income:

The United States Code, Title 42, Section 1396r-8(b)(1)(A), requires a drug manufacturer who has entered into a rebate agreement with the federal government or the State to provide a rebate for all covered outpatient drugs paid for by the federal government and the State.

The United States Code, Title 42, Section 1396r-8(b)(1)(B), requires that the State offset amounts received from drug rebates against expenditures for the Medical Assistance Program.

The State Administrative Manual, Section 8776.6, requires that each department develop collection procedures that will ensure prompt follow-up on amounts owed the department.

The State Administrative Manual, sections 7900 and 7920, recommends that each department be able to reconcile records with the same information from different sources, such as the department's accounting system and program tracking system.

Condition

As of April 1997, the Department of Health Services (department) had not fully implemented procedures to monitor and collect drug rebates. The department also had not finished establishing steps for performing monthly reconciliations between the department's accounting records and its records for the drug rebate program. Without such procedures and steps, the department cannot verify the proper recording of these transactions and the completeness of its financial records. In addition, the absence of established procedures increases the risk that the department may not collect drug rebates that are legally owed to the State and the federal government.

According to the department's director, the department is currently updating the drug rebate tracking system used to record invoice and payment information for each drug manufacturer. The department and its fiscal intermediary contractor are jointly developing methods to streamline the billing and tracking of drug rebates by consolidating these activities under the responsibility of the contractor. This transition should be complete by June 1997. The director expects the new system to improve timeliness of invoicing, accuracy of payment tracking, and availability of management information concerning the collection of drug rebates. The chief of the Medi-Cal Contracting Section stated that the department currently maintains invoice and payment information for manufacturers, but cannot promptly access this information because it has not completely entered this information into the automated tracking system.

Further, the acting chief of the department's Financial Management Branch indicated that his staff has already developed the programming necessary to update the drug rebate tracking system. Once the department has fully updated the tracking system, the Financial Management Branch will be responsible for reconciling the cash receipts recorded in the automated accounting system to the data in the tracking system.

In our 1994-95 audit, we reported a similar weakness in the department's system for tracking drug rebates. The department responded that it would implement new policies and procedures for monitoring and collecting drug rebates by early 1997. According to the department's director, the department will finish implementing its procedures in June 1997.

Recommendation

The department should continue to implement its comprehensive policy for monitoring, reconciling, and collecting drug rebates.

View of Department

The department agrees with the finding and is currently implementing the corrective action described above.

**Schedule of Audit Reports
Involving Federal Grants From
July 1, 1995 to December 31, 1996**

From July 1, 1995, to December 31, 1996, 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' responses to these findings are included in each of the separate audit reports.

Federal Department/Federal Grant and Catalog Number	Report Title and Description
<p>Department of Agriculture</p> <p>Cooperative Forestry Assistance 10.664</p>	<p>Investigations of Improper Governmental Activities: January 1 through June 30, 1995 (195-2, 8-8-95)</p> <p>(1) A manager at the California Department of Forestry and Fire Protection made gifts of public funds in the form of Smokey Bear merchandise to state employees, volunteers, and others. The manager also authorized unnecessary and wasteful purchases of Smokey Bear memorabilia and related materials. Finally, the manager placed personal long-distance calls at the State's expense.</p>
<p>Cooperative Forestry Assistance 10.664</p>	<p>Department of Forestry and Fire Protection: A Review of Allegations Concerning the State's Management of the Federal Excess Personal Property Program (94101, 11-21-95)</p> <p>(1) The Bureau of State Audits reviewed the Department of Forestry and Fire Protection (CDF) investigation of 28 allegations relating to potential theft and misuse of aircraft and aircraft parts loaned to the CDF through the Federal Excess Personal Property (FEPP) Program. The CDF determined that no action was called for in five of the allegations. The CDF took defensible disciplinary or corrective action for eight allegations. No additional action was necessary for eight other allegations because the evidence did not substantiate the allegations and no action was necessary for four allegations because the evidence did not indicate a violation of any law or regulation. However, for three allegations, the CDF determined that its employees did not comply with state or federal regulations.</p> <p>(2) A review of the CDF's internal controls over the acquisition, disposal, loan, security, and physical inventory count revealed several weaknesses. The CDF is not counting, tagging, and reconciling its FEPP inventory, and the CDF does not accurately record FEPP property in its inventory records. In addition, the CDF is not adequately safeguarding its FEPP property.</p>
<p>Department of Commerce</p>	<p>Trade and Commerce Agency: More Can Be Done To Measure the Return on the State's Investment and To Oversee Its Activities</p>

Federal Department/Federal Grant and Catalog Number	Report Title and Description
Economic Development— Technical Assistance 11.303	(95118, 4-24-96) The following issues related to federal grants were reported at the Trade and Commerce Agency (agency).
Special Economic Development and Adjustment Assistance Program—Sudden and Severe Economic Dislocation and Long-Term Economic Deterioration 11.307	<ul style="list-style-type: none"> (1) The Office of Strategic Technology did not have a monitoring process in place to review federally required audits of subrecipients. (2) The agency needs to improve its administrative and operational controls in certain areas. Certain operational policies and procedures need to be addressed by the Office of Business Development. Specifically, the Sudden and Severe Economic Dislocation Revolving Loan Program did not comply with all of its loan requirements, and the Old Growth Diversification Revolving Loan Fund program needs to address future monitoring responsibilities.
Department of Transportation	Investigations of Improper Governmental Activities: January 1 through July 31, 1996 (I96-2, 9-16-96)
Highway Planning and Construction 20.205	<ul style="list-style-type: none"> (1) An engineer at the Department of Transportation (department) had conflicts of interest when he participated in decision-making processes for the Devil's Slide project while maintaining a financial interest in a business entity that would benefit from the decisions. As a result, the department incurred unnecessary costs of approximately \$12,500, and the project was delayed.
Highway Planning and Construction 20.205	Orange County Transportation Authority: An Analysis of Its Financial Resources and Obligations (95121, 2-27-96)
Federal Transit Capital Improvement Grants 20.500	<ul style="list-style-type: none"> (1) Since its inception, Orange County Transportation Authority (OCTA) has received more than \$2.1 billion from various revenue sources and spent approximately \$1.7 billion on operations, capital projects, long-term debt, and possible losses resulting from the county's bankruptcy. The use of approximately 98 percent of OCTA's fiscal year 1994-95 revenues is limited to transportation purposes. Interest earnings and miscellaneous revenues not restricted by statutes, contracts, and official statements of debt previously issued make up the remainder of the revenues.
Federal Transit Capital and Operating Assistance Formula Grants 20.507	<ul style="list-style-type: none"> (2) Based on legislation approved by the governor in October 1995, OCTA and the county exchanged revenue sources that can be used only for various transportation purposes. The purpose of the legislation was to aid in the county's recovery from bankruptcy. The net result over the 17 years of the mandated exchange will be a \$202 million loss in revenues to OCTA.
Capital Assistance Programs for Elderly Persons and Persons With Disabilities 20.513	

Federal Department/Federal Grant and Catalog Number	Report Title and Description
<p>Small Business Administration</p> <p>Small Business Development Center 59.037</p>	<p>Trade and Commerce Agency: More Can Be Done To Measure the Return on the State's Investment and To Oversee Its Activities (95118, 4-24-96)</p> <p>(1) The Trade and Commerce Agency (agency) needs to improve its administrative and operational controls in certain areas. For example, the Office of Small Business has not been proactive in providing needed guidance to and monitoring of some of the programs it administers. Specifically, the Office of Small Business has not provided approved and updated policies and procedures to the eight small business development corporations it contracts with to administer the Loan Guarantee Program, it has not ensured that it properly carried out its monitoring responsibilities for the Loan Guarantee Program or the Small Business Development Center Program, and it has not ensured that it is receiving accurate management information for its small Business Development Center Program.</p>
<p>Federal Emergency Management Agency</p> <p>Disaster Assistance 83.516</p>	<p>Office of Emergency Services: Has Met Most of Its Emergency Management Responsibilities Despite Administrative Problems (95114, 1-31-96)</p> <p>(1) The Office of Emergency Services (OES) is very effective in responding to emergencies, quickly directing state and local resources to assist areas struck by disaster. In general, the OES is also doing a good job assisting the State and local governments prepare for emergencies to help mitigate the effects of disasters.</p> <p>(2) The OES's effectiveness in coordinating the disaster recovery effort is significantly impaired by certain policies and practices of the Federal Emergency Management Agency (FEMA), which provides most of the funding for state and local government recovery efforts, and by its own inadequate practices. The OES's lack of an adequate system for managing documents created during the recovery process, tracking related costs for each disaster, and identifying its costs for reimbursement from FEMA delays access to important information needed for effective management of the recovery process.</p> <p>(3) Although it is able to meet its emergency management responsibilities, the OES has serious administrative problems. A series of major disasters in California since 1989 has overwhelmed the OES's ability to perform some of its basic functions, such as budgeting, hiring, and using information technology, exposing many inefficiencies in its administration. These inefficient practices have resulted in an administrative crisis in which the OES uses more resources than necessary and incurs extra costs for the State.</p>

Federal Department/Federal Grant and Catalog Number	Report Title and Description
<p>Department of Education</p> <p>Vocational Education—Basic Grants to States 84.048</p>	<p>California Community Colleges: The Chancellor's Office Inadequately Controlled Its Economic Development Program and, Along With the Department of Education, Circumvented State Contracting Procedures (94123, 1-4-96)</p> <p>The following issues affecting federal grant moneys were reported.</p> <ol style="list-style-type: none"> (1) The Chancellor's Office and the Department of Education (department) circumvented state controls by using fiscal agents to obtain the services of The Resource Group (contractor) to prepare both the Vocational Education needs assessment and state plan. The Chancellor's Office and the department paid these fiscal agents approximately \$62,000 in administrative fees. Furthermore, the \$1.2 million paid to the contractor exceeded the budget for the needs assessment and the state plan by approximately \$120,000. (2) The Chancellor's Office and the department submitted erroneous and misleading information to the Department of General Services as support for requests for approval of contracts and amendments. (3) The Chancellor's Office allowed the contractor to begin work prior to approval of its sole-source contract, and the department allowed the contractor to perform services without having any formal agreement with either the department or its fiscal agent. (4) Employees at two of the entities that the Chancellor's Office and the department used as fiscal agents, Chaffey College and East San Gabriel Valley Regional Occupational Program, had recently been employed by the contractor. Therefore, by using them as fiscal agents, the Chancellor's Office and the department may have caused them to violate the common law doctrine against conflicts of interest. (5) By using fiscal agents, the Chancellor's Office and the department lacked control over payments made for the needs assessment and the state plan. Therefore, the two agencies cannot ensure that the amounts paid to the contractor were appropriate or reasonable.
<p>Vocational Education—Basic Grants to States 84.048</p>	<p>Investigative Report: Misappropriation of Public Funds, False Claims, and Gross Mismanagement by Employees of the Department of Education (1940262, 9-9-96)</p> <ol style="list-style-type: none"> (1) We received an allegation under the Reporting of Improper Governmental Activities Act that a manager of the California Department of Education (department) improperly managed the funds of a statewide student vocational club under the department's jurisdiction and the funds of a charitable corporation that received payments from departmental contracts. It was also alleged that he had a conflict of interest

Federal Department/Federal Grant and Catalog Number	Report Title and Description
Rehabilitation Services— Vocational Rehabilitation 84.126	<p>relating to his position as a monitor of departmental contracts and his position as an officer of the charitable corporation.</p> <ol style="list-style-type: none"> (2) The manager submitted false claims that resulted in improper payments totaling over \$17,745 for his travel expenses. (3) The manager illegally exchanged at least \$4,100 in airline tickets purchased with federal funds for other tickets, which he used to take personal trips. (4) The manager appears to have influenced decisions by the department's fiscal agents to do business with his business associate, resulting in payments totaling more than \$26,300. (5) The manager was able to gain the above personal benefit at least in part because he used his various roles to improperly divert more than \$95,900 from a number of sources into the account for the California Association of Vocational Industrial Clubs of America Leadership Foundation. (6) The manager made an improper political contribution. (7) The department may have violated limits on the amount of federal grants that can be spent for administrative expenses and the State's budgetary controls.
Department of Health and Human Services Child Support Enforcement 93.563	<p>Department of Rehabilitation: Business Enterprise Program for the Blind Financial Report Year Ended June 30, 1994 (93031, 8-22-95)</p> <ol style="list-style-type: none"> (1) The financial condition of the Department of Rehabilitation's (department) Business Enterprise Program for the Blind (program) is sound. The program's revenues exceeded its expenses by approximately \$1 million. In addition, at June 30, 1994, the program had approximately \$4 million in cash and pooled investments, and its total assets exceeded its total liabilities by approximately \$14 million. (2) Although the financial condition of the program is sound, certain weaknesses were noted in the internal control structure. Specifically, the department does not ensure it receives all monthly operating reports, fees, vending machine commissions, and loan payments due from blind vendors. In addition, the department improperly used federal funds to pay for parts and materials associated with equipment repair, did not accurately report its liabilities at June 30, 1994, and has not adequately separated certain incompatible duties. <p>Child Support Pilot Projects: Effectiveness Cannot Be Determined With Existing Data (93023, 9-12-96)</p> <ol style="list-style-type: none"> (1) The federal government and the State provide incentive payments to the counties based on certain standards of performance in the Child Support Enforcement Program,

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which is administered at the state level by the Department of Social Services (department). Some counties accumulate "excess incentive funds" when incentive payments exceed the costs of administering their Child Support Enforcement programs.

- (2) Special legislation allowed Merced and San Luis Obispo counties to divert a portion of their excess incentive funds to establish two-year pilot projects that addressed child-related issues outside their Child Support Enforcement programs.
- (3) The same legislation required the Bureau of State Audits to evaluate the effectiveness of the pilot projects using specified data pertaining to each county's Child Support Enforcement Program. However, we could not do this for two reasons. First, a direct relationship does not exist between the Child Support Enforcement Program data and the success of the pilot projects and second, even if the data did apply, our review indicates the data and statistics may not be reliable or comparable.
- (4) We also found that neither the counties nor the department developed any other type of relevant data or performance measures to evaluate the pilot projects. As a result, we were unable to determine whether the projects, which appear to provide worthwhile services, achieved their expressed statutory purpose of improving the counties' Child Support Enforcement programs.

Child Care and Development
Block Grant
93.575

Department of Education: Has Not Spent Millions for Child Care and Development Services (94111, 8-2-95)

- (1) The Department of Education (department) could not tell us the demand for services offered by the child care and development programs it funded during fiscal years 1991-92 through 1993-94. The department also could not tell us the actual number of children currently served by its programs. In April 1995, the department reported to the Legislature that California provides subsidized child care and development services to less than 20 percent of eligible low-income families.
- (2) The department did not maximize its efforts to ensure the delivery of child care and development services; therefore, millions of dollars in state and federal funds remain unspent. For example, contractors providing child care and development services did not spend \$84.7 million that the department had allocated them. In addition, the department did not allocate all of the federal Child Care and Development Block Grant funds it received.
- (3) Two department practices for reviewing and scoring applications for awarding child care and development contracts increased the risk that biased scoring decisions were made. In addition, the department did not

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	consistently process appeals of contract awards, and the department's process for reviewing annual audit reports submitted by contractors was deficient.
Foster Care 93.658	Los Angeles County: The Department of Children and Family Services Can Improve Its Processes To Protect Children From Abuse and Neglect (96106, 10-23-96)
Adoption Assistance 93.659	<ol style="list-style-type: none">(1) The Department of Children and Family Services (DCFS) does not always comply with its own risk assessment policies related to protecting children from abuse, neglect, and exploitation. For 6 of 24 cases we reviewed, the risk assessment documentation was either missing, incomplete, or inadequately prepared. In addition, the risk assessment method used by the DCFS does not result in a standardized risk rating and, thus, it has less assurance that the most intense services are given to the most at-risk cases. Finally, when compared to different risk assessment methods used in some other states, the DCFS's method does not appear to be the best available.(2) The DCFS does not always comply with other child safety procedures. In particular, we found it does not always follow its own policy to visit children and their parents or caregivers once per month. Also, we noted that required criminal background checks on adults caring for children were not always obtained by the DCFS. Finally, we found that children's medical assessments were not obtained in a timely manner and required reports were not submitted to the court on time.
State Survey and Certification of Health Care Providers and Suppliers 93.777	Department of Health Services: The Orange County District Office Needs to Further Improve Its Oversight of Health Care Facilities (94117, 7-27-95) <ol style="list-style-type: none">(1) The Department of Health Services Orange County District Office (district office) responded from 1 to 213 days late for 35 percent of the complaints reviewed relating to health care facilities, with late responses in all three fiscal years reviewed from July 1992 through March 1995. In addition, the district office incorrectly assessed priority levels for 2 of 60 complaints reviewed.(2) The district office has not established guidelines for timely investigations and processing of citations and deficiency notices and, as a result, took longer than allowed to investigate and process them. The district office issued deficiency notices instead of higher level citations in 4 of 20 cases reviewed, and issued 29 percent of the citations we reviewed from 2 to 12 days late.

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Medical Assistance Program
93.778

- (3) The district office did not perform all required inspections of health care facilities during our review period and performed some inspections late. In addition, the district office did not always ensure health care facilities submitted timely plans of corrective action, as required, in 13 of 20 cases reviewed.

Department of Health Services: Drug Treatment Authorization Requests Continue To Increase (95011, 8-1-95)

- (1) From December 1994 through May 1995, the Department of Health Services (department) processed approximately 319 percent more drug treatment authorization requests (TARs) than it did in the first six months of our review in 1990. The department had a backlog of 1,113 unprocessed TARs in May 1995. In comparison, its backlog of unprocessed TARs in November 1990 was 2,311.
- (2) During the six-month period of December 1994 through May 1995, both in the department's drug units (located in Stockton and Los Angeles) generally met the state requirement for processing mailed-in TARs. We also found that the Stockton drug unit processed 92 percent of its FAX TARs within 24 hours of receipt; however, the Los Angeles drug unit processed only 53 percent of its FAX TARs within 24 hours of receipt. The average turnaround time for all FAX TARs reviewed at Los Angeles was 29 hours. Finally, during January and April 1995, the Los Angeles drug unit generally met the 24-hour turnaround requirement for drug TARs received via the Voice Drug TAR System (VDTS).
- (3) From December 1994 through May 1995, 84 fair hearing requests were submitted to the Department of Social Services to appeal a denied TAR, which represents a 31 percent increase over the six months ending November 1994. Of those, 4 were dismissed, 39 were withdrawn before the cases were heard, 3 were denied, 3 were approved, and the decisions on the remaining 35 were still pending at the time of our review. In addition, the department reported that it received few or no complaints from providers related to the amount of time taken to process TARs from December 1994 through May 1995.

Medical Assistance Program
93.778

Department of Health Services: Drug Treatment Authorization Requests Continue To Increase (96011, 1-30-96)

- (1) This report focuses on the drug Treatment Authorization Requests (TARs) the Department of Health Services (department) processed during the six months from June 1995 through November 1995. During this six-month period, the department's processes for compiling drug TAR statistics were accurate. The department received 354,855 drug TARs from June to November 1995. This figure represents an increase of 276,357 (352 percent) received over the first six-month review period of June through November 1990 and is the highest level

of activity since the beginning of these reviews. This increase was primarily due to changes in the governing code and a 41 percent increase in the number of people eligible to obtain drugs through Medi-Cal.

- (2) Of the drug TARs received from June 1995 through November 1995, the department processed 354,702. This figure represents an increase of 30,558 (10 percent) over the prior six-month period from December 1994 through May 1995. In November 1990, the department's backlog consisted of 2,311 unprocessed drug TARs. In comparison, the backlog in November 1995 was only 1,266 drug TARs.
- (3) Both of the department's drug units (located in Stockton and Los Angeles) met the state requirement for processing mailed-in drug TARs in one working day.
- (4) We also found that the drug units generally met the state requirement for processing FAX and Voice Drug TAR System (VDTS) drug TARs within one working day. Based on samples of FAX drug TARs randomly selected at each drug unit, we found that the Stockton drug unit met the requirement 99 percent of the time and the Los Angeles drug unit met the requirement 98 percent of the time. Based on a sample of VDTS drug TARs randomly selected at the Los Angeles drug unit, we found that the drug unit met the requirement 100 percent of the time. The Stockton drug unit did not process any VDTS drug TARs during the review period. We also found that the department's methods of measuring the time it takes to process a drug TAR were accurate.
- (5) From June 1995 through November 1995, 201 fair hearing requests to appeal denials of drug TARs were submitted to the Department of Social Services. This figure represents an increase of 139 percent over the prior review period, from December 1994 to May 1995. Of the 201 requests submitted, 75 percent were withdrawn or dismissed, 14 were denied, and 15 were approved. The decisions on the remaining 21 were still pending at the time of our review.

Medical Assistance Program
93.778

Department of Health Services: Has Not Collected \$40 Million in Supplemental Rebates From Drug Manufacturers (95109R, 3-27-96)

- (1) The Department of Health Services (department) has not collected approximately \$40 million in supplemental rebates owed to the State and the federal government by drug manufacturers because it has not adequately administered the California Medical Assistance Program drug rebate program. The department does not calculate, bill, and monitor specific supplemental rebate amounts owed by manufacturers who do not remit the required amounts owed to the State and the federal government. As a result, the State has not received \$20 million in supplemental rebates, and the federal

Federal Department/Federal Grant and Catalog Number	Report Title and Description
Medical Assistance Program 93.778	<p>government has not received its \$20 million share in supplemental rebates.</p> <p>Los Angeles County: Balanced Budgets Will Be a Continuing Challenge (96018, 3-28-96)</p> <p>The following issues related to the Medical Assistance Program were reported.</p> <ol style="list-style-type: none"> (1) In January 1996, Los Angeles County (county) announced that its shortfall for fiscal year 1996-97 is \$517 million. In addition, the likelihood of the county's achieving a balanced budget in fiscal year 1995-96 was subject to its successfully obtaining approval by the federal government of a \$346 million health-relief package and having many of its departments meet their targeted 20 percent net county cost reduction, producing a savings of \$155 million. (2) The county has been limited in the actions it can take to address budget shortfalls due to provisions in past collective bargaining agreements and employee contracts that have stipulated increases in employees' salaries and benefits. Also, the county has limited discretion over the spending of 90 percent of its General Fund revenue because these funds are specifically designated for operation of state and federal programs.
Medical Assistance Program 93.778	<p>Department of Health Services: Drug Treatment Authorization Requests Continue To Increase (96012, 8-1-96)</p> <ol style="list-style-type: none"> (1) The Department of Health Services (department) processed 402,424 drug Treatment Authorization Requests (TARs) from December 1995 through May 1996. This figure represents an increase of 421 percent over the number processed during the first six-month period that we reviewed in 1990 and an increase of 13 percent over the number of drug TARs processed in the prior six-month period. (2) Although the number of processed drug TARs has continually increased since June 1990, the number of unprocessed drug TARs has diminished. In November 1990, the department's backlog consisted of 2,311 drug TARs, whereas the backlog in May 1996 was 1,743, a decrease of 25 percent. From December 1995 through May 1996, the department's processes for compiling drug TAR statistics were appropriate. (3) During the six-month period we reviewed, both the Los Angeles and Stockton drug units met the new requirement for processing drug TARs received by mail in one working day. (4) In previous audits, we validated the methods used by the drug units to calculate the length of time it took to process mailed-in drug TARs. However, the department conducted a study in March 1996 and determined that the method used to

prepare the calculations was inefficient. As a result, in April 1996, the drug units discontinued calculating their turnaround time for mailed-in drug TARs. At the time of our review, the department still had not developed and implemented a new method. As a result, we were unable to validate the department's current methods for calculating the amount of time it takes to process a drug TAR in this audit.

- (5) From December 1995 through May 1996, 93 fair hearing requests were submitted to the Department of Social Services. This figure represents a decrease of 54 percent from the number of requests submitted during the prior review period.

Of the 93 requests submitted, 64 were withdrawn or dismissed, 4 were denied, 4 were approved, and the decisions on the remaining 21 were still pending at the time of our review.

**Schedule of Minor Federal Issues for the
Year Ended June 30, 1996**

Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Description of Issue
California Community Colleges, Chancellor's Office	Vocational Education—Basic Grants to States 84.048	<p>(1) We examined 10 of 71 community college districts (CCD) for certification of the number of students participating in the Vocational Education program and found that one certification could not be located. While the California Community Colleges, Chancellor's Office could not find the certification, it was able to input the headcount from a computer disk submitted by the CCD.</p> <p>(2) For 3 of 71 Vocational Education program student head counts we reviewed, the Chancellor's Office could not provide documentation from the CCD for adjustments made to the final head counts used to allocate the apportionment. The Vocational Education Division's records consist of staff notes regarding telephone conversations.</p> <p>(3) The Chancellor's Office made a clerical error when it calculated the apportionment allocations. As a result, one CCD received approximately \$20,000 more than its entitlement and the 70 other CCDs received up to approximately \$2,600 less than their entitlements.</p>
California Student Aid Commission	Federal Family Education Loan Programs 84.032	<p>(1) For 2 of the 20 defaulted loan claims we reviewed, the California Student Aid Commission (commission) took longer than the 45-day maximum allowed by federal regulations to request reimbursement from the federal government. Specifically, the commission requested reimbursement for the claims 7 and 8 days late.</p>

Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Description of Issue
Developmental Services, Department of	Special Education—Grants to Infants and Families With Disabilities 84.181	<p>(2) The commission did not provide the federal government with the required names and addresses of the five collection contractors and two supplemental preclaims assistance contractors who served as third-party servicers in the 1995-96 fiscal year. Upon our inquiry in April 1997, the commission notified the federal government of the names of the seven third-party servicers during this time period.</p> <p>(1) Although the Department of Developmental Services (department) has adopted complaint procedures, the department's written procedures do not specifically address notifying parents and other interested individuals of the complaint process as required by federal regulations. The department has developed draft written procedures, dated November 1996, that will meet the federal requirement, but as of March 1997, the procedures had not been formally adopted.</p>
Education, California Department of	Job Training Partnership Act 17.250	<p>(1) The Department of Education (department) did not review an audit report submitted by a Community Based Organization (CBO) for the Job Training Partnership Act grant within six months of the date of receipt. Specifically, as of November 1996, the department had not completed its review of an audit of a CBO for fiscal year 1992-93, even though the department received the audit report in October 1994. In addition, the department had not reviewed audit reports for the same CBO for fiscal years 1993-94 and 1994-95, that it received in March 1996.</p>
Adult Education—State Grant Program 84.002	Administered Basic	<p>(1) The department's final financial status report that it prepared during fiscal year 1995-96 for the grant period ending September 1995, did not agree to the accounting records. As a result, the department overstated by approximately \$2,000 total reported expenditures of approximately \$28 million.</p>

Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Description of Issue
	Vocational Education—Basic Grants to States 84.048	(1) The department's final financial status report that it prepared during fiscal year 1995-96 for the grant period ending September 1995, did not agree to the accounting records. As a result, the department overstated by approximately \$17,000 total reported expenditures of approximately \$98 million.
Employment Development Department	Employment Service 17.207	(1) For one of the seven items we tested, the Employment Development Department (department) incorrectly charged travel costs, totaling \$22, to the Employment Service Program when the purposes of the travel benefited the Job Training Partnership Program.
	Labor Certification for Alien Workers 17.203	(1) The department uses ledger codes established by the Department of Labor to record cash received under the Labor Certification for Alien Workers Program. However, the department misreported approximately \$91,000 as Employment Service Program receipts to the State Controller's Office. As a result, the department's cash balances for those programs do not agree with balances maintained by the State Controller.
Health Services, Department of	Maternal and Child Health Services Block Grant to the States 93.994	(1) Although the Department of Health Services used special consideration to continue funding special projects originally funded prior to August 1981, it did not provide this required assurance in advance in its 1996 grant application.
Housing and Community Development, Department of	Community Development Block Grants—State's Program 14.228	(1) During fiscal year 1995-96, the Department of Housing and Community Development (department) did not reconcile its quarterly reports of federal cash transactions with its accounting records. Subsequently, the department corrected this problem and reconciled the federal cash transaction reports to its accounting records for the first two quarters of fiscal year 1996-97.

Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Description of Issue
Mental Health, Department of	Block Grants for Community Mental Health Services 93.958	(1) During fiscal year 1995-96, the California Mental Health Planning Council had 16 out of 35 members who were not state employees or providers of mental health services, which was less than the 50 percent minimum required by federal regulations. In January 1997, the department appointed new members to meet this requirement.
Social Services, Department of	Social Security Disability Insurance 96.001	(1) For the quarter ending June 30, 1996, the Department of Social Services understated the time charged to the program by approximately 321 hours.
State Controller's Office	Various	(1) The State Controller's Office did not complete the single audit of one local educational agency for June 30, 1995, by the required deadline of June 30, 1996. The audit report was more than five months late. (2) The State Controller's Office did not resolve audit findings identified in three of the ten audit reports we tested within the required six-month time frame. However, the findings were resolved two weeks after the required date.
State Water Resources Control Board	Capitalization Grants for State Revolving Funds 66.458	(1) For 1 of 57 loan repayments received during fiscal year 1995-96, the State Water Resources Control Board did not deposit the repayment until approximately two weeks after its receipt, resulting in lost interest to the program of approximately \$3,400.

Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Description of Issue
Youth Authority, Department of the	School Breakfast Program and National School Lunch Program 10.553 and 10.555	(1) For 1 of the 12 monthly reimbursement claims we reviewed, the Department of the Youth Authority (department) incorrectly calculated the federal reimbursement. Specifically, the department did not use the revised copy of the monthly meals served report for one of the institutions. This resulted in the department overclaiming by \$2,259. In addition, for the three institutions reviewed, there were numerous instances in which the supporting detail for the monthly meals served reports contained errors. The errors ranged from underclaiming by \$283 to overclaiming by \$158. The net effect of the various errors resulted in the department underclaiming by \$41.

**Independent Auditors' Report on the
Schedule of Federal Assistance**

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, 1996, and have issued our report thereon dated November 27, 1996. 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 (OMB) 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's automated accounting system separately identifies revenues for each federal assistance program, it does not separately identify expenditures for each program. As a result, the State presents the schedule of federal assistance on a 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, 1996. 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. A copy of California State University Schedule of federal assistance is presented on pages 195 through 202. These revenues were audited by other independent auditors, and our opinion, insofar as it relates to the California State University revenues, is based solely on the report provided by these auditors. The schedule does not include federal revenue received by the University of California. These revenues are audited by other independent auditors in accordance with the OMB Circular A-133, *Audits of Institutions of Higher Education and Other Nonprofit Organizations*.

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 "Philip Jelicich".

PHILIP J. JELICICH, CPA
Deputy State Auditor

May 16, 1997

**State of California
Schedule of Federal Assistance for the
Fiscal Year Ended June 30, 1996**

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received	
Department of Agriculture:			
Agricultural Conservation Program	10.063	\$ 26,670	
Forestry Incentives Program	10.064	11,928	
Farm Labor Housing Loans and Grants	10.405	335,230	
Food Distribution	10.550	72,546,704	A *
Food Stamps	10.551	2,612,363,227	A *
School Breakfast Program	10.553	155,556,809	A
National School Lunch Program	10.555	605,496,300	A
Special Milk Program for Children	10.556	828,794	
Special Supplemental Food Program for Women, Infants, and Children	10.557	551,727,957	A
Child and Adult Care Food Program	10.558	171,543,229	A *
Summer Food Service Program for Children	10.559	3,486,535	*
State Administrative Expenses for Child Nutrition	10.560	11,801,601	
State Administrative Matching Grants for Food Stamp Program	10.561	253,929,337	A
Nutrition Education and Training Program	10.564	772,466	
Commodity Supplemental Food Program	10.565	5,873,171	**
Emergency Food Assistance Program (Administrative Costs)	10.568	4,988,421	
Nutrition Program for the Elderly	10.570	11,869,944	

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received	
Food Commodities for Soup Kitchens	10.571	831,703	**
Cooperative Forestry Assistance	10.664	1,051,732	B
Schools and Roads—Grants to States	10.665	43,045,671	A
National Forest—Dependent Rural Communities	10.670	624,293	
Resource Conservation and Development	10.901	19,820	
Other—U.S. Department of Agriculture	10.999	3,332,400	
Department of Commerce:			
Trade Development	11.110	82,006	
Economic Development—Support for Planning Organizations	11.302	206,539	
Economic Development—Technical Assistance	11.303	10,415	B
Economic Development—State and Local Economic Development Planning	11.305	160,632	
Special Economic Development and Adjustment Assistance Program—Sudden and Severe Economic Dislocation and Long-Term Economic Deterioration	11.307	1,554,665	B
Anadromous Fish Conservation Act Program	11.405	515,655	
Interjurisdictional Fisheries Act of 1986	11.407	172,208	
Coastal Zone Management Administration Awards	11.419	3,058,681	
Coastal Zone Management Estuarine Research Reserves	11.420	102,933	
Financial Assistance for Ocean Resources Conservation and Assessment Program	11.426	110,000	
Marine Sanctuary Program	11.429	102,812	

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Public Telecommunications Facilities—Planning and Construction	11.550	167,504
Other—U.S. Department of Commerce	11.999	70,177
Department of Defense:		
Navigation Projects	12.107	65,275
Planning Assistance to States	12.110	1,108,758
State Memorandum of Agreement Program for the Reimbursement of Technical Services	12.113	17,113,310
National Guard Military Operations and Maintenance Projects	12.401	4,040,060
National Guard Special Military Operations and Projects	12.402	59,827
National Guard Civilian Youth Opportunities Programs	12.404	9,238,040
Community Economic Adjustment Planning Assistance	12.607	1,587,493
Research and Technology Development	12.910	1,000,000
Other—U.S. Department of Defense	12.999	1,017,834
Department of Housing and Urban Development:		
Community Development Block Grants—State's Program	14.228	34,956,750 A
Emergency Shelter Grants Program	14.231	3,934,912
Supportive Housing Program	14.235	1,086,966
Home Investment Partnerships Programs	14.239	33,727,405 A
Housing Opportunities for Persons with AIDS	14.241	2,682,426

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Equal Opportunity in Housing	14.400	888,280
Section 8 Rental Voucher Program	14.855	693,493
Lower Income Housing Assistance Program—Section 8 Moderate Rehabilitation	14.856	391,185
Section 8 Rental Certificate Program	14.857	2,189,294
Lead-Based Paint Hazard Control Program	14.900	1,743,563
Department of Interior:		
Small Reclamation Projects	15.503	136,950
Anadromous Fish Conservation	15.600	315,150
Sport Fish Restoration	15.605	8,597,711
Environmental Contaminants	15.607	29,215
Fish and Wildlife Management Assistance	15.608	10,000
Wildlife Restoration	15.611	7,109,269
Endangered Species Conservation	15.612	1,419,506
Cooperative Endangered Species Conservation Fund	15.615	51,418
Clean Vessel Act	15.616	248,760
Geological Survey—Research and Data Acquisition	15.808	51,070
Historic Preservation Fund Grants-In-Aid	15.904	2,189,328
Outdoor Recreation—Acquisition, Development and Planning	15.916	1,454,526
Research Information	15.975	278,255
Other—U.S. Department of Interior	15.999	6,890,871
Shared Revenue—Potash/Sodium Lease	15.999	28,103,729 A

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Department of Justice:		
Juvenile Justice and Delinquency Prevention—Allocation to States	16.540	6,920,662
Juvenile Justice and Delinquency Prevention—Special Emphasis	16.541	1,026,749
National Criminal History Improvement Program	16.554	1,745,837
Justice Research, Development and Evaluation Project Grants	16.560	213,250
State Criminal Alien Assistance Program	16.572	30,508,880 A
Criminal Justice Discretionary Grant Program	16.574	7,624,944
Crime Victim Assistance	16.575	6,859,763
Drug Control and System Improvement—Formula Grant	16.579	40,131,052 A
Edward Byrne Memorial State and Local Law Enforcement Assistance Decretionary Grants Program	16.580	33,000
Other—U.S. Department of Justice	16.999	966,023
Department of Labor:		
Labor Force Statistics	17.002	6,403,603
Compensation and Working Conditions Data	17.005	828,789
Labor Certification for Alien Workers	17.203	10,308,733
Employment Service	17.207	103,418,924 A
Unemployment Insurance	17.225	397,186,126 A
Senior Community Service Employment Program	17.235	6,558,562

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>	
Trade Adjustment Assistance—Workers	17.245	12,877,798	
Employment and Training Assistance—Dislocated Workers	17.246	219,040,275	A
Migrant and Seasonal Farmworkers	17.247	416,910	
Employment Services and Job Training—Pilot and Demonstration Programs	17.249	654,034	
Job Training Partnership Act	17.250	342,608,608	A
Occupational Safety and Health—State Program	17.503	19,387,664	
Consultation Agreements	17.504	4,105,616	
Mine Health and Safety Grants	17.600	263,732	
Women’s Special Employment Assistance	17.700	56,863	
Disabled Veterans Outreach Program	17.801	11,381,292	
Veterans’ Employment Program	17.802	866,342	
Local Veterans’ Employment Representative Program	17.804	6,833,339	
Department of Transportation:			
Boating Safety Financial Assistance	20.005	1,402,429	
Airport Improvement Program	20.106	189,380	
Highway Planning and Construction	20.205	1,981,056,609	A B
Motor Carrier Safety	20.217	2,961,827	
Motor Carrier Safety Assistance Program	20.218	23,259	
Railroad Safety	20.301	21,363	
Local Rail Freight Assistance	20.308	149,000	
Federal Transit Capital Improvement Grants	20.500	10,999,865	B

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Federal Transit Technical Studies Grants	20.505	7,857,542
Public Transportation for Nonurbanized Areas	20.509	8,392,015
State and Community Highway Safety	20.600	13,550,485
Alcohol Traffic Safety and Drunk Driving Prevention Incentive Grants	20.601	7,418,529
Motorcycle Helmets and Safety Belt Incentive Grants	20.602	889,277
Pipeline Safety	20.700	1,708,723
Interagency Hazardous Materials Public Sector Training and Planning Grants	20.703	652,216
Other—U.S. Department of Transportation	20.999	113,140
Department of Treasury:		
Other—U.S. Department of Treasury	21.999	300
Equal Employment Opportunity Commission:		
Employment Discrimination—State and Local Fair Employment Practices Agency Contracts	30.002	2,520,500
General Services Administration:		
Donation of Federal Surplus Personal Property	39.003	10,027,792
National Foundation on the Arts and the Humanities:		
Promotion of the Arts—Art In Education	45.003	41,000
Promotion of the Arts—State and Regional Program	45.007	706,875
Promotion of the Arts—Local Arts Agencies Program	45.023	36,000
Institute of Museum Services	45.301	13,556

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Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
National Science Foundation:		
Engineering Grants	47.041	24,804
Mathematical and Physical Sciences	47.049	95,492
Education and Human Resources	47.076	1,323,598
Small Business Administration:		
Procurement Assistance to Small Businesses	59.009	3,284,352
Small Business Development Center	59.037	6,287,423 B
Department of Veterans Affairs:		
Grants to States for Construction of State Home Facilities	64.005	9,251,722
Veterans State Domiciliary Care	64.014	3,607,523
Veterans State Nursing Home Care	64.015	5,758,270
Veterans State Hospital Care	64.016	162,784
All-Volunteer Force Educational Assistance	64.124	38,165
Other—U.S. Department of Veterans Affairs	64.999	913,307
Environmental Protection Agency:		
Air Pollution Control Program Support	66.001	6,736,789
Air Pollution Technical Information Services	66.006	73,250
Air Pollution Control—National Ambient Air and Source Emission Data	66.007	39,990
State Indoor Radon Grants	66.032	192,937
Construction Grants for Wastewater Treatment Works	66.418	207,504

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Water Pollution Control—State and Interstate Program Support	66.419	4,157,869
State Underground Water Source Protection	66.433	398,160
Water Pollution Control—Lake Restoration Cooperative Agreements	66.435	177,009
Construction Management Assistance	66.438	6,933
Water Quality Management Planning	66.454	1,073,428
National Estuary Program	66.456	929,507
Capitalization Grants for State Revolving Funds	66.458	145,860,315 A
Nonpoint Source Implementation Grants	66.460	6,599,298
Wetlands Protection—State Development Grants	66.461	691,821
EPA New Coastal Waters Program	66.462	2,348
National Pollutant Discharge Elimination System Related State Program Grants	66.463	323,594
Near Coastal Waters	66.464	119,451
Air Pollution Control Research	66.501	167,889
Water Pollution Control—Research, Development, and Demonstration	66.505	199,191
Safe Drinking Water Research and Demonstration	66.506	4,417,467
Toxic Substances Research	66.507	55,408
Consolidated Pesticide Compliance Monitoring and Program Cooperative Agreements	66.700	1,876,408
Toxic Substances Compliance Monitoring Cooperative Agreements	66.701	57,557
Pollution Prevention Grants Program	66.708	287,130

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Hazardous Waste Management State Program Support	66.801	7,945,160
Superfund State Site—Specific Cooperative Agreements	66.802	4,102,219
State Underground Storage Tanks Program	66.804	403,830
Leaking Underground Storage Tank Trust Fund Program	66.805	3,795,438
Solid Waste Management Assistance	66.808	178,689
Other—U. S. Environmental Protection Agency	66.999	495,788
Department of Energy:		
State Energy Conservation	81.041	1,790,527
Weatherization Assistance for Low-Income Persons	81.042	4,694,628
Environmental Research and Impact Assessments	81.046	145,751
Energy Conservation for Institutional Buildings	81.052	1,790,684
Conservation Research and Development	81.086	200,000
Environmental Restoration	81.092	917,852
National Industrial Competitiveness Through Energy, Environment, and Economics	81.105	295,000
Other—U. S. Department of Energy	81.999	4,500
Federal Emergency Management Agency:		
Civil Defense—State and Local Emergency Management Assistance	83.503	6,148,048
State Disaster Preparedness Grants	83.505	3,236
Disaster Assistance	83.516	384,759,140 A B

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Earthquake Hazards Reduction Grants	83.521	1,466,490
National Urban Search and Rescue (US&R) Response System	83.526	264,364
Emergency Management Institute—Field Training Program	83.528	619,390
State and Local Emergency Management Assistance—Other Assistance	83.531	894,272
Facilities and Equipment	83.532	2
Other—Federal Emergency Management Agency	83.999	200
Department of Education:		
Adult Education—State Administered Basic Grant Program	84.002	30,771,895 A
Desegregation Assistance, Civil Rights Training, and Advisory Services	84.004	550,081
Education of Children with Disabilities in State Operated or Supported Schools	84.009	43,967
Title I Grants to Local Educational Agencies	84.010	715,968,996 A
Migrant Education—Basic State Grant Program	84.011	110,115,585 A
Educationally Deprived Children—State Administration	84.012	410,503
Title I Program for Neglected and Delinquent Children	84.013	4,430,696
Services for Children with Deaf—Blindness	84.025	534,713
Special Education—Grants to States	84.027	285,160,674 A
Special Education—Personnel Development and Parent Training	84.029	395,280
Federal Family Education Loans	84.032	331,636,212 A

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Public Library Services	84.034	7,674,582
Interlibrary Cooperation and Resource Sharing	84.035	2,315,092
Vocational Education—Basic Grants to States	84.048	102,799,971 A B
Vocational Education—Consumer and Homemaking Education	84.049	1,043,266
Vocational Education—State Councils	84.053	497,303
State Student Incentives Grants	84.069	9,771,908
Special Education—Program for Severely Disabled Children	84.086	117,848
Rehabilitation Services—Vocational Rehabilitation Grants to States	84.126	200,082,765 A B
Rehabilitation Services—Service Projects	84.128	971,424
Centers for Independent Living	84.132	2,996,174
Chapter 2—State Block Grants	84.151	935,923
Public Library Construction and Technology Enhancement	84.154	1,782,334
Secondary Education and Transitional Services for Youth with Disabilities	84.158	562,980
Immigrant Education	84.162	24,202,681 A
Eisenhower Mathematics and Science Education—State Grants	84.164	3,055,151
Eisenhower Professional Development—Federal Activities	84.168	23,198
Independent Living—State Grants	84.169	1,166,514
Special Education—Preschool Grants	84.173	52,660,001 A

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Vocational Education—Community Based Organizations	84.174	198,978
Douglas Teacher Scholarships	84.176	444,454
Special Education—Grants for Infants and Families with Disabilities	84.181	44,676,657 A
Byrd Honors Scholarships	84.185	848,325
Safe and Drug-Free Schools—State Grants	84.186	47,108,281 A
Supported Employment Services for Individuals with Severe Disabilities	84.187	3,603,109
Christa McAulliffe Fellowships	84.190	95,097
Adult Education—Literacy Training for Homeless Adults	84.192	485,475
Bilingual Education Support Services	84.194	1,011,146
Education for Homeless Children and Youth	84.196	3,370,275
Even Start—State Educational Agencies	84.213	9,657,932
Even Start—Migrant Education	84.214	158,326
Fund for the Improvement of Education	84.215	186,130
Capital Expenses	84.216	19,800
State Program Improvement Grants	84.218	1,921,293
Student Literacy Corps and Student Mentoring Corps	84.219	579,500
State Grants for Assistive Technology	84.224	528,569
Tech-Prep Education	84.243	14,419,967
Foreign Languages Assistance	84.249	973,601
State Literacy Resource Centers	84.254	1,043,333

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Rehabilitation Training—State Vocational Rehabilitation Unit In-Service	84.265	345,323
State Postsecondary Review	84.267	261,112
National Early Intervention Scholarship and Partnership	84.272	247,207
Goals 2000—State and Local Education Systemic Improvement Grants	84.276	8,201,607
Eisenhower Professional Development State Grants	84.281	24,124,637 A
Innovative Education Program Strategies	84.298	39,465,956 A

Department of Health and Human Services:

Public Health and Social Services Emergency Fund	93.003	3,860,102
Special Programs for the Aging—Title VII, Chapter 3—Programs for Prevention of Elder Abuse, Neglect and Exploitation	93.041	194,876
Special Programs for the Aging—Title VII, Chapter 2—Long-Term Care Ombudsman Services for Older Individuals	93.042	305,603
Special Programs for the Aging—Title III, Part F—Disease Prevention and Health Promotion Services	93.043	943,539
Special Programs for the Aging—Title III, Part B—Grants for Supportive Services and Senior Centers	93.044	27,676,597 A
Special Programs for the Aging—Title III, Part C—Nutrition Services	93.045	41,690,582 A
Special Programs for the Aging—Title III, Part D—In Home Services for Frail Older Individuals	93.046	861,437
Special Programs for the Aging—Title IV—Training, Research and Discretionary Projects and Programs	93.048	3,473,194

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Special Programs for the Aging—Title VII, Chapter 6—Allotments for Vulnerable Elder Rights Protection Programs	93.049	112,862
Special Programs for the Aging—Title II—Preconference Programs for the White House Conference on Aging	93.050	3,750
Grants for Residential Treatment Programs for Pregnant and Postpartum Women	93.101	4,820,865
Demonstration Grants for Residential Treatment for Women and Their Children	93.102	2,152,290
Food and Drug Administration—Research	93.103	1,314,109
Comprehensive Community Mental Health Services for Children with Serious Emotional Disturbances	93.104	3,183,728
Maternal and Child Health Federal Consolidated Programs	93.110	9,742
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	93.116	6,694,975
Acquired Immunodeficiency Syndrome (AIDS) Activity	93.118	12,523,039
Mental Health Planning and Demonstration Projects	93.125	1,189,859
Emergency Medical Services for Children	93.127	103,814
Grants for Technical Assistance Activities Related to the Block Grant for Community Mental Health Services—Mental Health Statistics Improvement Program	93.128	150,765
Injury Prevention and Control Research and State Grants Projects	93.136	174,649
Projects for Assistance in Transition from Homelessness (PATH)	93.150	3,898,456
Health Program for Toxic Substances and Disease Registry	93.161	661,803

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>	
Grants for State Loan Repayment	93.165	778,659	
Community Youth Activity Program Demonstration Grants	93.170	20,290	
Disabilities Prevention	93.184	375,957	
Cooperative Agreements for Drug Abuse Treatment Improvement Projects in Target Cities	93.196	1,421,538	
Demonstration Cooperative Agreements for Development and Implementation of Criminal Justice Treatment Networks	93.229	283,220	
Mental Health Research Grants	93.242	564,004	
Childhood Immunization Grants	93.268	72,290,667	A *
Centers for Disease Control and Prevention—Investigations and Technical Assistance	93.283	640,352	
Cancer Control	93.399	73,792	
Emergency Protection Grants—Substance Abuse	93.554	51,822	
Family Preservation and Support Services	93.556	10,052,936	
Family Support Payments to States—Assistance Payments	93.560	3,435,082,516	A
Job Opportunities and Basic Skills Training	93.561	123,069,215	A
Assistance Payments—Research	93.562	127,759	
Child Support Enforcement	93.563	288,597,969	A B
State Legalization Impact Assistance Grants	93.565	18,967,034	
Refugee and Entrant Assistance—State Administered Programs	93.566	56,025,812	A
Low-Income Home Energy Assistance	93.568	40,884,130	A B

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>	
Community Services Block Grant	93.569	22,170,709	A B
Community Services Block Grant Discretionary Awards—Community Food and Nutrition	93.571	591,487	
Emergency Community Services for the Homeless	93.572	1,713,573	
Child Care for Families At-Risk of Welfare Dependency	93.574	40,340,838	A
Child Care and Development Block Grant	93.575	126,472,044	A B
Refugee and Entrant Assistance—Discretionary Grants	93.576	159,032	
U.S. Repatriate Program	93.579	39,855	
Refugee and Entrant Assistance—Targeted Assistance	93.584	11,612,282	
Empowerment Zones Program	93.585	2,566,036	
Refugee Assistance—Naturalization and Citizenship Activities	93.589	293,412	
Head Start	93.600	132,826	
Developmental Disabilities Basic Support and Advocacy Grants	93.630	6,077,071	
Children’s Justice Grants to States	93.643	1,109,681	
Child Welfare Services—State Grants	93.645	30,949,196	A
Social Services Research and Demonstration	93.647	84,167	
Adoption Opportunities	93.652	2,169	
Temporary Child Care and Crisis Nurseries	93.656	873,109	
Foster Care—Title IV-E	93.658	622,724,341	A
Adoption Assistance	93.659	57,305,701	A
Social Services Block Grant	93.667	360,988,306	A

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received	
Child Abuse and Neglect State Grants	93.669	2,591,207	
Child Abuse and Neglect Discretionary Activities	93.670	230,139	
Family Violence Prevention and Services—Grants to States and Indian Tribes	93.671	1,983,372	
Community-Based Prevention Program	93.672	151,200	
Grants to States for Planning and Development of Dependent Care Programs	93.673	1,590,474	
Independent Living	93.674	11,555,317	
Medicare—Supplementary Medical Insurance	93.774	13,644,930	
State Medicaid Fraud Control Units	93.775	8,318,470	
State Survey and Certification of Health Care Providers and Suppliers	93.777	32,668,525	A B
Medical Assistance Program	93.778	8,778,415,593	A B
Health Care Financing Research, Demonstrations and Evaluations	93.779	704,866	
Model Comprehensive Drug Abuse Treatment Programs for Critical Populations	93.902	6,794,508	
Model Criminal Justice Drug Abuse Treatment for Incarcerated Populations, Nonincarcerated Populations, and Juvenile Justice Populations	93.903	3,851,276	
Grants to States for Operation of Offices of Rural Health	93.913	586,324	
HIV Care Formula Grants	93.917	32,470,460	A
Cooperative Agreements for State-Based Comprehensive Breast and Cervical Cancer Early Detection Programs	93.919	4,992,808	
Demonstration Grants to States for Community Scholarships	93.931	7,563	

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems	93.938	361,702
Assistance Program for Chronic Disease Prevention and Control	93.945	82,918
HIV/AIDS and Related Diseases Among Substance Abusers: Community-Based Outreach and Intervention Demonstration Programs	93.949	1,093,518
Demonstration Grants to States with Respect to Alzheimer's Disease	93.951	387,836
Block Grants for Community Mental Health Services	93.958	35,460,823 A
Block Grants for Prevention and Treatment of Substance Abuse	93.959	167,670,953 A
Preventive Health Services—Sexually Transmitted Diseases Control Grants	93.977	2,201,723
Mental Health Disaster Assistance and Emergency Mental Health	93.982	3,423,799
Health Programs for Refugees	93.987	138,858
Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation of Surveillance Systems	93.988	298,865
Preventive Health and Health Services Block Grant	93.991	9,870,790
Maternal and Child Health Services Block Grant to the States	93.994	38,543,758 A
Other—Department of Health and Human Services	93.999	5,366,744
Corporation for National and Community Service:		
Service America/Higher Education	94.001	2,471,150
State Commission	94.003	1,133,231

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Americorps	94.006	12,563,805
Summer of Safety Youth Corps	94.008	37,819
Foster Grandparent Program	94.011	1,272,537
Social Security Administration:		
Social Security—Disability Insurance	96.001	154,659,273 A
Social Security—Research and Demonstration	96.007	427,343
Miscellaneous Grants and Contracts:		
Shared Revenue—Flood Control Lands	98.002	144,403
Shared Revenue—Grazing Land	98.004	182,158
U.S. Department of the Interior—Fire Prevention/Suppression Agreement	98.015	76,760
U.S. Department of Agriculture and Various Other U.S. Department—Fire Prevention/Suppression	98.016	13,107,369
Miscellaneous Federal Receipts	98.099	2,706,233
Total Grants Received		<u>\$25,511,457,043</u>
Total Major Grants Audited in Compliance With OMB, Circular A-128		<u>\$24,802,498,807</u>

A The Bureau of State Audits reviewed these major grants for fiscal year 1995-96 in compliance with the OMB's Circular A-128.

B The Bureau of State Audits reviewed this grant in conjunction with various reports issued from July 1, 1995 to December 31, 1996. See the Schedule of Audit Reports Involving Federal Grants from July 1, 1995, to December 31, 1996, beginning on page 151 for a description of these reports.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
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* This amount includes cash and the value of commodities or cash and the value of food stamps.

** This amount represents the value of commodities or surplus property.

**California State University
Schedule of Federal Assistance
for the Fiscal Year Ended June 30, 1996**

Federal Agency/Pass-Through Grantor/Program Title	Federal Catalog Number	Federal Disbursements/ Expenditures
Department of Education:		
Federal Supplemental Education Opportunity Grant Program	84.007	\$ 10,531,103
Federal Work-Study Program	84.033	10,000,914
Federal Perkins Loan Program	84.038	17,802,232 *
Federal Pell Grant Program	84.063	148,700,293 *
National Science Scholars	84.242	10,472
Federal Family Education Loan Program	84.032	266,966,664 *
Special Education—Innovation	84.023	174,727
Services for Children with Deaf-Blindness	84.025	322,349
Special Education—Personnel Development	84.029	934,890
Higher Education—Cooperative Education	84.055	133,704
Postsecondary Education Program for Persons with Disabilities	84.078	116,558
Harris Fellowship	84.094	67,414
Fund for the Improvement of Postsecondary Education	84.116	73,761
Rehabilitation Long-Term Training	84.129	319,369
National Institute on Disability and Rehabilitation Research	84.133	21,333
Budget Assistance in Area of National Need	84.200	390,323
Women and Minority Participation in Graduate Education	84.202	71,386

Federal Agency/Pass-Through Grantor/Program Title	Federal Catalog Number	Federal Disbursements/ Expenditures
Urban Community Services	84.252	243,093
Rehabilitation Training	84.263	38,939
Training in Early Childhood Education	84.266	312,781
Student Support Services	84.042a	163,977
Critical Language and Area Studies	84.273a	97,070
Douglas Teacher Scholarship	84.176	10,000
William Ford Direct Loan Program	84.268	211,080,812 *
Byrd Honors Scholarships	84.185	18,000
		668,602,164
Federal Emergency Management Agency—Passed Through the California State Office of Emergency Services—Disaster Recovery Assistance	83.516	30,627,276 *
Department of Labor—Employment and Training Assistance	17.246	\$ 120,698
Department of Health and Human Services:		
Professional Nurses Traineeship	93.358	28,080
Nursing Student Loan	93.364	74,805
Scholarship for the Disadvantaged	93.925	95,287
Social Services	93.576	117,829
Child Support Enforcement	93.023	74,425
Minority International Research Grant	93.106	283,526
Biological Response to Environmental Health Hazards	93.113	4,482
Minority Community Health Coalition	93.137	255,568

Federal Agency/Pass-Through Grantor/Program Title	Federal Catalog Number	Federal Disbursements/ Expenditures
Community Youth Activity Program	93.171	60,382
Drug Abuse Treatment Improvement Project	93.196	147,149
Biological Models Research	93.198	5,167
Health Services Research Grant	93.226	139,720
Advanced Nurse Education	93.299	171,999
General Clinical Research Centers	93.333	7,732
Biomedical Research Support	93.337	131,174
Professional Nurse Traineeships	93.358	101,542
Academic Research Enhancement Award	93.390	54,853
Assistance Payment—Research	93.562	22,633
Biophysics and Physiological Science	93.821	33,859
Digestive Diseases Research	93.848	5,498
HIV Demonstration Research and Education	93.941	114,544
Community Service Learning	94.005	12,087
		1,942,341
Department of Housing and Urban Development—Community Development Block Grant	14.228	5,000
Department of the Interior:		
Fish and Wildlife Services	15.612	65,585
Endangered Species	15.162	847,690
Endangered Species RT	None	711
Geological Survey—Research	15.808	33,466

Federal Agency/Pass-Through Grantor/Program Title	Federal Catalog Number	Federal Disbursements/ Expenditures
Bureau of Indian Affairs	None	12,768
Natural Landmark Program	15.910	4,860
		<u>965,080</u>
Department of Agriculture:		
Grants for Agriculture	10.206	\$ 11,815
Multicultural Scholars Program	10.217	14,000
Agricultural Clinic Program	10.217	8,350
Forestry Research	10.652	69,117
		<u>103,282</u>
Department of Commerce:		
Coastal Zone Management Estaurine Research Reserve	11.420	16,877
Marine Sanctuary Program	11.429	58,304
Marine Fisheries Initiative	11.433	2,500
		<u>77,681</u>
Department of Defense:		
Navigation Projects	12.107	65,936
Selected Reserve Educational Assistance	12.609	370,642
Language Grant Program	12.900	56,270
Mathematical Sciences Grant	12.901	4,968
		<u>497,816</u>

Federal Agency/Pass-Through Grantor/Program Title	Federal Catalog Number	Federal Disbursements/ Expenditures
Department of Justice—Juvenile Justice and Delinquency Prevention	16.540	78,801
Department of Transportation—State Marine Schools	20.806	200,000
National Aeronautics and Space Administration:		
Aerospace Education Service Program	43.001	319,950
Technology Transfer	43.002	21,245
		341,195
National Foundation on the Arts and Humanities:		
Promotion of the Arts—Media	45.006	22,220
Promotion of the Arts—Arts Fellows Program	45.021	8,100
		30,320
National Science Foundation:		
Biology Interactive Curriculum	47.076	\$ 14,482
Engineering Grants	47.041	34,878
Mathematical and Physical Sciences	47.049	16,117
Geosciences	47.050	121,362
Biological—Behavioral Science	47.051	200,454
Teacher Preparation and Enhancement	47.066	106,498
Material Development and Information	47.067	71,837
Studies, Evaluation and Dissemination	47.068	1,273,156
Computer and Information Science	47.070	90,032
Science and Technology	47.073	522,755
Biological Sciences	47.074	450,293

Federal Agency/Pass-Through Grantor/Program Title	Federal Catalog Number	Federal Disbursements/ Expenditures
Social Behavioral Sciences	47.075	42,046
Education and Human Resources	47.076	240,243
Academic Research Facilities	47.077	38,290
		<u>3,222,443</u>
Small Business Administration—Business Development Assistance	59.005	10,141
Environmental Protection Agency:		
Air Pollution Training Program	66.000	62,102
Hazardous Waste Management Support	66.801	7,462
		<u>69,564</u>
Department of Energy—Basic Energy Sciences	81.049	151,040
United States Information Agency—Educational Exchange	82.002	<u>6,592</u>
		<u>\$707,051,434</u>

*The California State University's independent auditors reviewed these major grants for fiscal year 1995-96 in compliance with the OMB's Circular A-128.

**NOTES TO SCHEDULES OF FEDERAL ASSISTANCE
FISCAL YEAR ENDED JUNE 30, 1996**

1. General

The accompanying State of California Schedule of Federal Assistance presents the total amount of federal financial assistance programs received by the State of California for the fiscal year ended June 30, 1996. This schedule does not include federal revenue received by the University of California. The revenues of the University of California are audited by other independent auditors in accordance with the Office of Management and Budget (OMB), Circular A-133, *Audits of Institutions of Higher Education and Other Nonprofit Organizations*.

The accompanying California State University (CSU) Schedule of Federal Financial Assistance presents the total amount of federal assistance expended by the CSU for the year ended June 30, 1996. The CSU receives federal assistance directly from the federal government and other sources. The federal assistance programs administered by the CSU are based on the expenditures/ disbursements of grant funds. For fiscal year ended June 30, 1996, the CSU reported grant expenditures of approximately \$707 million, which closely approximates the amount the CSU received during that period. These federal grants were audited by other independent auditors in accordance with OMB, Circular A-128, *Audits of State and Local Governments*.

2. Basis of Accounting

The OMB, 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 its Schedule of Federal Assistance on a revenue basis. The schedule shows the amount of federal funds and the estimated value of food stamps, commodities, and surplus property received by the State for the year ended June 30, 1996.

The CSU prepares its Schedule of Federal Assistance on an expenditures and/or disbursements basis (cash basis).

3. Definition of Major Program

The Single Audit Act of 1984 established the criteria for determining if a federal financial assistance program is a major federal program. The State considers federal financial assistance, including value of food stamps, commodities, and surplus property of \$20 million or more, as major federal assistance programs.

The accompanying CSU Schedule of Financial Assistance presents the total amount of federal assistance expended by the CSU for the year ended June 30, 1996.

4. Other

The State received \$11,484,283 in Petroleum Violation Escrow Funds that can be used to supplement four federal energy-related conservation and assistance programs and for various federally-approved projects. The funds were audited to the extent required by the OMB's Circular A-128.

The State was also loaned \$29,740,724 in federal excess personal property (FEPP) from the U.S. Forest Service during the period October 1, 1995 to September 30, 1996. The U.S. Forest Service was unable to provide us with the FEPP loaned to the State during the State's fiscal year. Also, the U.S. Forest Service and the State maintain the FEPP program at federal acquisition costs of the related property which does not represent the properties fair market value.

**Independent Auditors' Report on Compliance With
State Laws and Regulations**

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, 1996, and have issued our report thereon dated November 27, 1996. We did not audit the financial statements of the pension trust funds, which reflect total assets constituting 82 percent of the fiduciary funds. We also did not audit the financial statements of certain enterprise funds, which reflect total assets and revenues constituting 86 percent and 90 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 97 percent and 95 percent, respectively, of the component unit authorities. The financial statements of the pension trust funds, certain enterprise funds, and the University of California funds referred to above were audited by other auditors who furnished their reports to us, and our opinion, insofar as it relates to the amounts included for the pension trust funds, certain enterprise funds, and the University of California funds, is based solely upon the reports of other independent auditors.

We 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 9 through 46 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


PHILIP J. JELICICH, CPA
Deputy State Auditor

May 16, 1997

Appendix A Reports Issued by the Bureau of State Audits From July 1, 1995, to December 31, 1996

Date of Issue	Report Title	Report No.
<u>1995</u>		
July 27	Department of Health Services: The Orange County District Office Needs To Further Improve Its Oversight of Health Care Facilities	94117
Aug 1	Department of Health Services: Drug Treatment Authorization Requests Continue to Increase	95011
Aug 2	Department of Education: Has Not Spent Millions for Child Care and Development Services	94111
Aug 8	Investigations of Improper Governmental Activities January 1 Through June 30, 1995	195-2
Aug 22	Department of Rehabilitation: Business Enterprise Program for the Blind Financial Report Year Ended June 30, 1994	93031
Sept 12	State Departments: Many Do Not Comply With Consultant Contract Requirements	94015
Sept 13	Los Angeles County Metropolitan Transportation Authority	95117
Oct 11	Department of Fish and Game: Administrative Processes Need Improvement	94106
Nov 1	Trade and Commerce Agency: The Effectiveness of the Employment and Economic Incentive and Enterprise Zone Programs Cannot Be Determined	93109
Nov 15	Department of Motor Vehicles: No Firefighters' License Plates Have Been Issued to the Public	93033

Date of Issue	Report Title	Report No.
Nov 15	Department of Motor Vehicles: Collegiate License Plate Revenues Have Been Overallocated	95020
Nov 21	Department of Forestry and Fire Protection: A Review of Allegations Concerning the State's Management of the Federal Excess Personal Property Program	94101
Nov 29	CSU and UC: Campuses Generally Provide Access for Students With Disabilities	94120
Dec 12	Student Aid Commission: Problems Continue With Its Automated Financial Aid Processing System	95021
Dec 12	Treasurer's Cash Count (May 31, 1995)	95007
<u>1996</u>		
Jan 3	Board of Equalization: Policies and Cost Assessment Methods for Special Tax Jurisdictions Need Reconsideration	95022
Jan 4	California Community Colleges: The Chancellor's Office Inadequately Controlled Its Economic Development Program and, Along With the Department of Education, Circumvented State Contracting Procedures	94123
Jan 9	Department of Insurance: Needs To Refine Its Cost Model for Insurance Examination and Proposition 103 Fees	95018
Jan 17	The California Cemetery Board: Incompatible Activities and Breaches of Fiduciary Duties Over Cemetery Trust Funds	1950038
Jan 30	Department of Health Services: Drug Treatment Authorization Requests Continue To Increase	96011
Jan 31	Office of Emergency Services: Has Met Most of Its Emergency Management Responsibilities Despite Administrative Problems	95114

Date of Issue	Report Title	Report No.
Feb 27	Orange County Transportation Authority: An Analysis of Its Financial Resources and Obligations	95121
Feb 28	State of California: Financial Report Year Ended June 30, 1995	95001
Feb 29	California Transportation Commission and Department of Transportation: The State's Use of Transportation Funds Generated by the 1989 Transportation Blueprint Legislation	95014
Mar 5	Investigations of Improper Governmental Activities: July 1 Through December 31, 1995	196-1
Mar 12	Oakland Unified School District: A Review and Comparison of Various Costs	96105
Mar 27	Department of Health Services: Has Not Collected \$40 Million in Supplemental Rebates From Drug Manufacturers	95109
Mar 28	Los Angeles County: Balanced Budgets Will Be a Continuing Challenge	96018
Apr 3	Department of Insurance: The Management of Conserved Insurers Has Improved, but Problems With Liquidation and Administration Continue	94118
Apr 4	Metropolitan Water District of Southern California: A Review of Evaluations and Audits Conducted by Other Entities	95105
Apr 9	Prison Industry Authority: Statutory and Cost Control Problems Adversely Affect the State	95106
Apr 15	University of California: The Award and Administration of the Tobacco and Breast Cancer Research Grant Programs Need Improvement	96101

Date of Issue	Report Title	Report No.
Apr 24	Trade and Commerce Agency: More Can Be Done To Measure the Return on the State's Investment and To Oversee Its Activities	95118
Apr 29	Treasurer's Cash Count (June 30, 1995)	95006
May 8	State of California: Statement of Securities Accountability of the State Treasurer's Office June 30, 1995	95008
May 20	California Community Colleges: The State Paid Millions of Dollars to Community Colleges for Questionable Training Agreements	96103
May 21	State Bar of California: Opportunities Exist To Reduce Fees, Better Control Administration and Planning, and Strengthen an Improved Discipline Process	96021
June 27	State of California: Improvements Have Occurred in Controlling Costs, but Some Problems Remain (\$10)	95002
June 30	State of California: Single Audit Report Year Ended June 30, 1995 (Copies can be obtained through DOF, 322-2985)	95003
July 2	California Department of Food and Agriculture: Improvement Is Needed in the Oversight of Market Enforcement Activities	96102
Aug 1	Department of Health Services: Drug Treatment Authorization Requests Continue To Increase	96012
Aug 15	State Contracting: Reforms Are Needed To Protect the Public Interest	95015
Aug 21	Oakland Unified School District: Current Practices Have Improved Its Financial Condition	96105.1

Date of Issue	Report Title	Report No.
Aug 22	California State Lottery: Opportunities Exist To Improve Planning, Reduce Administrative Costs, and Increase Sales Efficiency	96107.1
Aug 28	Los Angeles County Metropolitan Transportation Authority: Planning and Budgeting of Its Operations and Bus Plan Need Improvement	96114
Aug 30	Treasurer's Cash Count (Feb. 29, 1995)	96005
Sept 9	Investigative Report: Misappropriation of Public Funds, False Claims, and Gross Mismanagement by Employees of the Department of Education	1940262
Sept 12	Child Support Pilot Projects: Effectiveness Cannot Be Determined With Existing Data	93032
Sept 16	Investigations of Improper Governmental Activities: January 1 Through July 31, 1996	196-2
Oct 1	Employment Training Panel: Has Achieved Many of Its Training Program Responsibilities Despite Some Administrative and Planning Problems	96023
Oct 2	Office of Historic Preservation: Did Not Always Comply With Requirements for Sole-Source Contracts	95115
Oct 3	California Conservation Corps: Further Revisions Would Improve Its Performance-Based Budgeting Plan	95124
Oct 16	Investigative Report: Theft of Funds From a Long-Term Savings Plan by a State Employee	1960030
Oct 23	Los Angeles County: The Department of Children and Family Services Can Improve Its Processes To Protect Children From Abuse and Neglect	96106

Date of Issue	Report Title	Report No.
Nov 14	Department of Transportation: Further Improvements Can Be Made in the Management of Properties Along the State Route 710 Right-of-Way	95111
Nov 19	Statewide Redevelopment Agencies: Broad Project Discretion and Inadequate Information Make Comparison and Evaluation Difficult	95125
Nov 21	Los Angeles County: Budget Challenges Continue, and the Sheriff's Department Could Achieve Savings	96019
Dec 27	Treasurer's Cash Count (June 30, 1996)	96006
Dec 30	State of California: Financial Report Year Ended June 30, 1996	96001
Dec 31	Department of Transportation: No Activity in the Seismic Retrofit Bond Fund for the Fiscal Year Ended June 30, 1996	96022

Appendix B Index By State Department

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Department of Transportation	19, 45, 116
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DEPARTMENT OF FINANCE
OFFICE OF THE DIRECTOR
STATE CAPITOL, ROOM 1145
SACRAMENTO, CA 95814-4998



June 20, 1997

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

Dear Mr. Sjoberg:

STATE OF CALIFORNIA: INTERNAL CONTROL AND STATE AND FEDERAL COMPLIANCE AUDIT REPORT FOR THE YEAR ENDED JUNE 30, 1996

Thank you for the opportunity to respond to the internal control and compliance audit report. This report was the result of your examination of the State's general purpose financial statements for the fiscal year ended June 30, 1996, and will be part of the Single Audit Report covering this period. 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 process 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 meeting our responsibility for financial leadership and oversight, the Department of Finance conducts internal control reviews of state departments and reviews areas of potential weakness in the State's fiscal systems. In addition, we provide oversight of internal audit units at individual departments, including the providing of audit guidelines and conducting quality assurance reviews of their work. Further, several years ago, we started a process of issuing Audit Memos to departments to establish policy or provide technical advice on various audit related issues. We will soon be issuing an Audit Memo concerning the results of the fiscal year 1995-96 Single Audit.

Mr. Kurt R. Sjoberg
Page 2

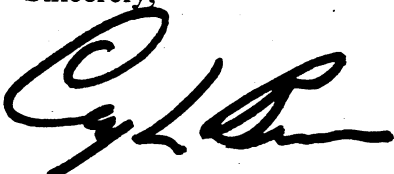
The head of each state department is responsible for establishing and maintaining internal control within their department. This responsibility includes documenting the controls, communicating control requirements to employees, and assuring that controls are functioning as prescribed and are modified for changes in conditions. Moreover, all levels of management of state departments must be involved in assessing and strengthening the internal controls to minimize fraud, errors, abuse, and waste of government funds.

Each department for which you have identified internal control weaknesses is responsible for developing corrective action plans. We will monitor the corrective actions included in their responses to your findings.

The Department of Finance will continue to provide the leadership to ensure the proper financial operations and business practices of the State, and to ensure that internal controls exist for the safeguarding and effective use of assets and resources.

If you have any questions concerning this letter, please contact Samuel E. Hull, Chief, Office of State Audits and Evaluations, at (916) 322-2985.

Sincerely,

A handwritten signature in black ink, appearing to read 'C. L. Brown', written in a cursive style.

CRAIG L. BROWN
Director