



Transmitted via e-mail

July 12, 2011

Ronald W. Chapman, M.D., M.P.H., Director
California Department of Public Health
1615 Capitol Avenue, MS 0500
P.O. Box 997377
Sacramento, CA 95899-7377

Dear Dr. Chapman:

Final Report—California Department of Public Health, 2008-09 Review of Special Funds

The Department of Finance, Office of State Audits and Evaluations, has completed its fiscal review of the Environmental Laboratory Improvement Fund and the Childhood Lead Poisoning Prevention Fund at the California Department of Public Health (CDPH) for fiscal year 2008-09.

The enclosed report is for your information and use. CDPH's response to the report observations are incorporated into this final report. CDPH agreed with our observations and we appreciate its willingness to implement corrective actions. The observations in our report are intended to assist management in improving the effectiveness and efficiency of its operations.

This report will be placed on our website. Additionally, pursuant to Executive Order S-20-09, please post this report in its entirety to the Reporting Government Transparency website at <http://www.reportingtransparency.ca.gov> within five working days of this transmittal.

We appreciate the assistance and cooperation of CDPH. If you have any questions regarding this report, please contact Susan Botkin, Manager, or Alexis Calleance, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

David Botelho, CPA
Chief, Office of State Audits and Evaluations

Enclosure

cc: On following page

cc: Mr. Daniel C. Kim, Chief Deputy Director of Operations, California Department of Public Health
Ms. Kathleen Billingsley, Chief Deputy Director of Policy and Programs, California Department of Public Health
Mr. Alan Lum, Deputy Director of Administration, California Department of Public Health
Mr. Rufus Howell, Deputy Director, Center for Environmental Health, California Department of Public Health
Ms. Linda Rudolph, Deputy Director, Center for Chronic Disease Prevention & Health Promotion, California Department of Public Health
Ms. Karen Petruzzi, Audit Coordinator, California Department of Public Health

A SPECIAL REPORT

California Department of Public Health
Review of Special Funds

Prepared By:
Office of State Audits and Evaluations
Department of Finance

MEMBERS OF THE TEAM

Susan M. Botkin, CGFM
Manager

Alexis Calleance
Supervisor

Staff
Douglas Evans
David Munoz

Final reports are available on our website at <http://www.dof.ca.gov>

You can contact our office at:

Department of Finance
Office of State Audits and Evaluations
300 Capitol Mall, Suite 801
Sacramento, CA 95814
(916) 322-2985

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EXECUTIVE SUMMARY

The Department of Finance, Office of State Audits and Evaluations (Finance), contracted with the California Department of Public Health (CDPH) to conduct a review of special funds for fiscal year 2008-09. Working collaboratively, Finance and CDPH management selected the Environmental Laboratory Improvement Fund 0179 (ELIF) and Childhood Lead Poisoning Prevention Fund 0080 (CLPPF) for review. Each review had a unique set of objectives and was conducted independent of the other; therefore, each review is addressed separately below and throughout this report.

Environmental Laboratory Improvement Fund 0179

The review of ELIF identified critical programmatic and administrative weaknesses as follows:

- Approximately 58 percent of the accredited laboratories within California have not received the required on-site laboratory assessment. Providing accreditation to laboratories prior to inspection or evaluation may lead to false reliance by the public and other stakeholders.
- One employee is performing multiple incompatible duties including approval, authorization, recording, and custody of receipts.
- Sufficient documentation supporting revenue and expenditure transactions is not retained.

Childhood Lead Poisoning Prevention Fund 0080

Generally, the revenue collecting and reporting processes performed by the Board of Equalization (BOE) for CLPPF are functioning properly and result in adequate overall control for the billing and collection of revenue. However, the following weaknesses were identified:

- CDPH Administrative Branch does not regularly and routinely review the reports and other information prepared by BOE regarding activities of the CLPPF.
- A spike in revenue collections of approximately \$26 million occurred in 2007-08. The increase was the result of fee payments received related to outstanding litigation. Similar legal matters facing CDPH could result in additional revenues or liabilities to the fund.
- Budgeting processes within the Administrative Branch could improve by including communication with the BOE about actual and projected collection of fee payments.

BACKGROUND, SCOPE, AND METHODOLOGY

BACKGROUND

The California Department of Public Health (CDPH) is dedicated to optimizing the health and well-being of the people in California. CDPH administers more than 300 public and environmental health programs. CDPH budget was \$3.12 billion for fiscal year 2008-09 which includes funding from more than 50 special funds.

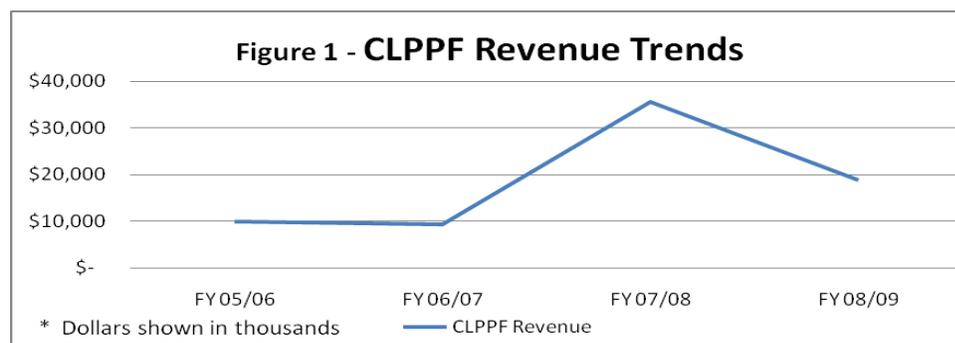
The Department of Finance, Office of State Audits and Evaluations (Finance), has an ongoing interagency agreement with CDPH to perform a review of special funds. This review focused on two specific special funds within CDPH for 2008-09: the Environmental Laboratory Improvement Fund (ELIF) and the Childhood Lead Poisoning Prevention Fund (CLPPF).

ELIF provides funding for the Environmental Laboratory Accreditation Program Branch (ELAPB). ELAPB performs evaluations and accreditation of environmental testing laboratories to ensure the quality of analytical data used for regulatory purposes meets the requirements of the state's food, drinking water, wastewater, shellfish, and hazardous waste programs. ELIF is sustained primarily by accreditation fees.

CLPPF provides resources for the Childhood Lead Poisoning Prevention Branch (CLPPB), a children's environmental health program offering multi-layered solutions to childhood lead poisoning. CLPPB supports local programs to detect, manage, and prevent childhood lead poisoning through initiatives to inform the public of potential lead exposures, develop the capacity to track statewide lead exposure, and monitor the management of care for afflicted children.

Funding for CLPPF is comprised of fees assessed on industries that currently or historically put lead into the environment. These industries include motor vehicle fuel, architectural coatings, and those emitting lead into the air. CDPH determines parties subject to the CLPPF fee and the State Board of Equalization (BOE) is responsible for administering, assessing and collecting the fees. CLPPF fiscal oversight and responsibility is shared by both CDPH and BOE.

Fee collections were relatively consistent in 2005-06 and 2006-07 (see Figure 1 below); however, in 2007-08 fee collections spiked by approximately \$26 million.



Source: CDPH, Childhood Lead Poisoning Prevention Branch

SCOPE

Finance was tasked with reviewing the fund balance and related processes over revenues and expenditures of ELIF. The review included an examination of an increase in the fund balance.

The scope also included a review of the revenue and related processes of CLPPF to evaluate whether BOE's processes for billing, collecting, and recording of revenue were consistent with state revenue accounting guidelines. Finance also determined the basis for the increase in fee collections in 2007-08.

METHODOLOGY

To review fiscal and related processes for, and the fund balance of ELIF, the following procedures were performed:

- Obtained an understanding of the special fund and the entities responsible for its administration.
- Obtained an understanding of the fiscal and administrative processes associated with the fund, including revenues, expenditures, budgeting, and monitoring.
- Reviewed revenue and expenditure trends.
- Validated the fund balance of ELIF.
- Tested revenues and expenditures for accuracy and proper authorization on a sample basis.

To review the fiscal and related processes for collection of fees and activities of CLPPF, including the fund balance, the following procedures were performed:

- Obtained an understanding of CDPH's administrative and expenditure processes through interviews and review of relevant documents.
- Obtained an understanding of BOE's process for billing, collecting, and recording of fees for CLPFF.
- Tested billing, collection, recording, and reporting of revenue on a sample basis.
- Evaluated BOE's revenue processes for compliance with state accounting guidelines.

Fieldwork was conducted from May 2010 through November 2010. Review conclusions and observations are discussed in the Results section of this report.

RESULTS—ENVIRONMENTAL LABORATORY IMPROVEMENT FUND

Our review of the Environmental Laboratory Improvement Fund (ELIF) determined the fund balance as reported in the Governor's budget is correctly stated. Overall, the fiscal and program processes are inadequate. We identified multiple administrative and programmatic weaknesses that if not corrected could compromise the mission and goals of the Environmental Laboratory Accreditation Branch (ELAPB).

OBSERVATION 1: Granting Accreditation Prior to Performing an Onsite Assessment

The ELAPB is providing accreditations to laboratories prior to performing an onsite assessment of their facilities. Of the 24 receipt transactions sampled, only 9 could be verified as to passing an onsite assessment *prior* to receiving accreditation. Further inquiry and investigation identified of the 636 accredited laboratories within ELAPB, 368, or approximately 58 percent, have not had an onsite assessment as of June 2010. Consequently, stakeholders and the general public placing reliance on the data provided by ELAPB accredited laboratories may be misinformed.

ELAPB management stated they have not been able to fill vacant positions with full-time staff to perform the onsite assessment. However, a review of the fund balance (\$826,000 for fiscal year 2008-09) revealed sufficient funding for the positions. ELAPB asserts challenges with recruitment and retention has resulted in insufficient staffing to perform the onsite assessments.

Recommendation

Develop and implement a plan to ensure timely evaluation and inspection of all accredited laboratories. The plan should consider high risk laboratories as top priority and should require evaluation and inspection of all laboratories before granting accreditation.

OBSERVATION 2: Inadequate Supporting Documentation for Revenue and Expenditures

Adequate documentation was not available to support several revenue and expenditure transactions. Specifically, of the 24 revenue transactions reviewed, supporting documentation was not available for 9 of the transactions. Additionally, supporting documentation was not available for 11 of the 21 expenditure transactions selected for review. Consequently, CDPH is unable to ensure these transactions are valid. Retaining supporting documentation for financial transactions is critical to effectively monitor, validate, and control program activities.

Recommendation

Retain documents supporting revenue and expenditure transactions.

OBSERVATION 3: Inadequate Separation of duties

One person within ELAP is responsible for performing incompatible duties, preventing an effective system of internal controls. One person is responsible for the following:

- Authorization of invoices
- Endorsement of receipts
- Records receipts
- Maintains custody of the receipts

Without effective internal control, ELAPB is unable to prevent and detect possible misappropriation of receipts.

Recommendation

Separate authorization and custody functions to strengthen internal control over receipts.

RESULTS—CHILDHOOD LEAD POISONING PREVENTION FUND

The Board of Equalization (BOE) correctly establishes accounts receivable when bills are sent annually to each business. When the business receives the bill, it can do one of three things:

1. Pay the amount billed as an accurate assessment of the amount owed to the California Department of Public Health (CDPH).
2. Refuse to pay the amount billed and appeal or litigate the assessment. (If the business loses its appeal or lawsuit, penalties and interest are assessed and payable to CDPH, in addition to the original fee assessment.)
3. Pay the amount billed, but appeal or litigate the amount of the assessment. (This action stops BOE from assessing penalties and interest.)

In scenario 1, the balance of the Childhood Lead Poisoning Prevention Fund (CLPPF) is accurate and reflects the amount of money available to CDPH to spend as authorized.

In scenario 2, the balance of CLPPF could be understated if the business is not successful in reducing or eliminating the assessment through litigation and appeals. All or part of the original assessment would have to be paid into the fund, as well as penalties and interest accrued during the process.

In scenario 3, the balance of CLPPF could be overstated if the business is successful in reducing or eliminating the assessment through litigation and appeals. All or part of the original assessment would have to be refunded to the business.

The amount CDPH may receive or have to repay will vary from year-to-year and throughout any given year, depending on when appeals and lawsuits are settled. BOE identifies and tracks the amount of each of these appeals and lawsuits on an ongoing basis.

Generally, BOE follows the appropriate revenue procedures when assessments are paid by businesses into the CLPPF, resulting in adequate control over the billing and collection of revenue. However, the following observations were made:

OBSERVATION 1: Lack of CDPH Management Oversight of CLPPF Balances

Currently, CDPH does not maintain adequate management oversight of the CLPPF balance. Specifically, CDPH does not perform a comprehensive review of the fund. Although this is a shared fund, CDPH has ultimate oversight responsibility for the fund and should actively monitor and communicate with BOE regarding fund revenues, balance, and the impact of potential liabilities. Because responsibilities are divided, there is an increased need for a comprehensive review of the fund revenues and expenditures by both CDPH administrative and program branches.

This lack of oversight has resulted in the publishing of inaccurate financial statements, when errors in year-end entries were not identified and corrected timely. The 2009-10 financial statements included a \$5 million accrual to an asset account in error (which had no effect on the fund balance) and a failure to close an expenditure account, resulting in the fund balance being overstated by \$79,281. Had CDPH management reviewed the statements and information prepared by BOE, these errors could have been readily identified and corrected.

Not regularly or routinely reviewing information prepared and provided by BOE also resulted in CDPH Administrative Branch not being aware of the reasons behind the significant increase in fee collections in 2007-08. In April 2008, the Superior Court decided a legal dispute between a motor vehicle fuel distributor and CDPH in the state's favor. When the Superior Court made its ruling, many fee payers also in appeal with CDPH for similar matters paid their outstanding fees. Collectively, the payments resulted in more than \$26 million being paid into the fund in 2007-08. In October 2010, the California Court of Appeals upheld the Superior Court's decision. Currently fee payers are engaged in settlement proceedings for fees appealed in subsequent years, which could result in an additional significant increase in revenues.

Recommendation

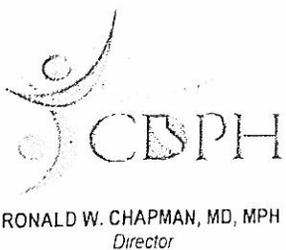
Implement policies and procedures to effectively review and monitor revenues and expenditures reported by BOE.

OBSERVATION 2: Budget Processes Could be Improved

CDPH budgeting staff do not communicate directly with BOE regarding current revenue collections or future revenue projections. This lack of communication and information could result in incorrect estimates being used for the budget process.

Recommendation

CDPH budgeting processes should include direct communication with BOE to develop realistic revenue estimates for budgetary and planning purposes.



State of California—Health and Human Services Agency
California Department of Public Health



EDMUND G. BROWN JR.
Governor

JUN 30 2011

David Botelho, Chief
Department of Finance
Office of State Audits and Evaluations
300 Capitol Mall, Suite 801
Sacramento, CA 95814

Dear Mr. Bothello:

The California Department of Public Health (CDPH) has prepared and enclosed its response to the Department of Finance, Office of State Audits and Evaluations' (Finance) draft report entitled, "California Department of Public Health Review of Special Funds June 2011 Report 104265129." The CDPH appreciates the opportunity to provide Finance with its response.

If you have any questions, please contact Karen Petruzzi, CDPH Audit Coordinator, at (916) 650-0266.

Sincerely,

Original signed by:

Ronald W. Chapman, MD, MPH
Director

Enclosure

ENVIRONMENTAL LABORATORY IMPROVEMENT FUND

OBSERVATION 1: Granting Accreditation Prior to Performing an Onsite Assessment

Recommendation 1:

Develop and implement a plan to ensure timely evaluation and inspection of all accredited laboratories. The plan should consider high risk laboratories as top priority and should require evaluation and inspection of all laboratories before granting accreditation.

CDPH Response 1:

The California Department of Public Health (CDPH) partially agrees with this recommendation. CDPH agrees that it is important to have a plan for timely evaluation of all accredited laboratories, and that high priority should be given to laboratories that are most at risk of failure to meet requirements; CDPH through its existing procedures believes that it has already implemented this recommendation.

State law does not mandate inspection prior to renewals of accreditation. Accreditation certificates are issued for a two-year period. CDPH Environmental Laboratory Accreditation Program (ELAP) currently has procedures to evaluate and inspect laboratories in compliance with state law (Health and Safety (H&S) Code Section 100850(d)). ELAP is required to conduct on-site assessments prior to approving new applications for accreditation and prior to amending accreditation certificates to add methods of testing. In addition, ELAP seeks to inspect all accredited laboratories at least once within the two-year certification period.

As mentioned, CDPH agrees at risk laboratories should be given priority so ELAP prioritizes its schedule of site visits as follows:

1. Investigations – based on complaints from regulatory agencies and/or reports of laboratory fraud
2. New applicants/Initial certification (site visit is required prior to accreditation pursuant to H&S Code Section 100850(d))
3. Amendments involving new methods (site visit is required prior to accreditation pursuant to H&S Code Section 100850(d))
4. Sale or transfer of ownership
5. Relocation or major structural alterations
6. Renewals (prioritized based on revisits to check for corrective actions – deficiencies)

Laboratories applying for renewal of their certificates are allowed to continue without on-site assessment if the renewal applications are submitted prior to the expiration of their certificates. In accordance with H&S Code Section 100845(a), the certificates for laboratories are renewed if applicable fees have been paid and the laboratories are in good standing with proficiency testing studies (H&S Code Section 100870). H&S Code Section 100845(a) states, "An application for renewal shall be filed with the department prior to the expiration date of the certificate. Failure to make timely application for renewal shall result in expiration of the certificate." No mandated requirement exists for on-site assessments by ELAP within specified time lines for renewal of certificates.

OBSERVATION 2: Inadequate Supporting Documentation for Revenue and Expenditures

Recommendation 2:

Retain documents supporting revenue and expenditure transactions.

CDPH Response 2:

CDPH agrees with the recommendation to retain documents supporting revenue and expenditure transactions. CDPH has partially implemented this recommendation by retaining backup documentation for transactions. To further address this recommendation, CDPH is preparing a procedure manual for document retention and billing and fee collections to ensure that the proper documents are retained to support ELAP revenue and expenditure transactions. CDPH will complete the procedure manual for ELAP by August 1, 2011.

OBSERVATION 3: Inadequate Separation of Duties

Recommendation 3:

Separate authorization and custody functions to strengthen internal control over receipts.

CDPH Response 3:

CDPH agrees with the recommendation to separate authorization and custody functions to strengthen internal control over receipts. CDPH has partially implemented this recommendation by separating functions among five different ELAP staff. The separate functions are: receipt and logging of checks, processing of checks for deposit, reviewing deposits and mailing to CDPH Accounting, preparing invoices, and reconciling deposits.

To further address this recommendation, CDPH is preparing a procedure manual for authorization and custody functions to ensure that separation of duties, proper document retention, and appropriate employee classifications are used to strengthen

internal controls. CDPH anticipates completing the procedure manual for ELAP by August 1, 2011.

CHILDHOOD LEAD POISONING PREVENTION FUND (CLPPF):

OBSERVATION 1: Lack of CDPH Management Oversight of CLPPF Balances

CLPPF Recommendation 1:

Implement policies and procedures to effectively review and monitor revenues and expenditures reported by the Board of Equalization (BOE).

CDPH Response 1:

CDPH agrees with the recommendation to implement policies and procedures to effectively review and monitor revenues and expenditures reported by BOE.

While policies and procedures are currently in place for CDPH and the Childhood Lead Poisoning Prevention (CLPP) Branch to monitor ongoing revenues and expenditures and communicate with BOE, CDPH agrees that communication between CDPH and BOE could be improved. CDPH has implemented additional procedures, as discussed below.

Currently the CLPP Branch tracks CLPPF expenditures on an ongoing basis and is in direct communication with BOE on CLPPF issues. CLPP Branch requests and receives periodic information from BOE detailing current fee collections and payments of overdue fees. CLPP Branch also receives updated, compiled information on annual billing and collection of fees once the annual fee billings are paid (payments are due April 1). Additionally, CLPP Branch receives quarterly appeals reports on appealed fee amounts, payment status, and any applicable interest and penalties.

CDPH and the CLPP Branch are actively involved in appeals and legal challenges to fee payments. The CLPP Branch and individuals in CDPH working on CLPPF issues have always been aware of increases in fee collections and why fee collections increased in 2007-08. CDPH participates in settlement decisions and is informed when settlement payments are made and delinquent fees are paid to BOE for the CLPPF.

CLPP Branch is very aware of factors that may increase and decrease fee collections and that could result in additional revenues or liabilities to the CLPPF. Forecasts of revenue collections and expenditures are provided by the CLPP Branch to CDPH Budgets and Accounting at least twice a year.

CDPH will now additionally request that BOE more formally report CLPPF revenue amounts to both CLPP Branch and CDPH Budgets semi-annually. The timeline for this will be in October and April, beginning in October 2011. A follow-up discussion between CLPP Branch, CDPH Budgets and BOE will then be held to raise any issues or

questions on revenues received versus those anticipated, and any issues or questions on fund administration. CLPP Branch and CDPH Budgets will discuss expenditure tracking and compiled expenditures in semi-annual discussions. The timeline for this will be in October and April, after the revenue reporting and discussions with BOE have occurred.

While BOE is legally responsible for administering and collecting the CLPPF fee, CDPH will request that BOE work with CDPH to institute an annual procedure for comparing payment and billing records. CDPH CLPP Branch will compare BOE documentation of payments made (back payments and payments from current fiscal year, annual billings) against the fees assessed by CDPH CLPP Branch and other information that CDPH has received on back payments and settlements of fee challenges. CDPH will alert BOE to any discrepancies, so that they can re-check the payments and their entries. BOE will then be asked to provide CDPH with their findings on any issues raised. The timeline for this will be annually after the close of the fiscal year and will begin with looking at the 2010-11 fiscal year. Each year, CLPP Branch will also request a copy of BOE's CLPPF year-end Financial Statements for review prior to it being provided for development of the Governor's budget.

OBSERVATION 2: Budget Processes could be Improved

CLPPF Recommendation 2:

CDPH budgeting processes should include direct communication with BOE to develop realistic revenue estimates for budgetary and planning purposes.

CDPH Response 2:

CDPH agrees with the recommendation that its budgeting processes should include direct communication with BOE to develop realistic revenue estimates for budgetary and planning purposes.

CDPH believes that it currently develops realistic revenue estimates, but agrees that communication between BOE and CDPH relating to these estimates could be further improved.

CLPPF revenue estimates are based on prior revenue projection drills and conservative projections based upon several years of prior revenues. CDPH has been aware of legal disputes that have gone on for years before being settled. Settlement in favor of CDPH has allowed for substantial increases to the CLPPF that were not part of the annual revenue estimates. Because CDPH does not know when cases may be settled and does not know how much cases may settle for, CDPH believes leaving the values associated with the cases out of estimates, provides the most realistic estimates for budgeting and planning purposes.

It is anticipated that the procedures, processes and timelines discussed under CLPPF Recommendation 1 will improve direct communication between BOE and CDPH and specifically include CDPH Budgets in these processes. This should assure that all pertinent issues affecting revenue are considered in developing revenue estimates.