DEPARTMENT OF FINANCE

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January 31, 2008

Stephen W. Mayberg, Ph.D., Director
California Department of Mental Health
1600 Ninth Street, Room 151
Sacramento, CA 95814

Dear Dr. Mayberg:

Final Report: California Department of Mental Health—Internal Control Review

The Department of Finance, Office of State Audits and Evaluations (Finance), has completed its internal control review of the California Department of Mental Health (DMH). This report will satisfy the DMH's Financial Integrity and State Management Accountability Act provisions per Government Code Section 13400 et seq.

The findings in our report are intended to assist DMH management in focusing attention on areas of risk, strengthening internal control, and improving operations. The DMH's response to our issues is incorporated into this final report. In accordance with Finance's policy of increased transparency, this report will be placed on our website.

FISMA requires you to submit copies of this report to the State Legislature, the State Auditor, the Governor, the Director of the Department of Finance (Director), and the State Library. The report, along with your response to the report's recommendations, should be signed by the DMH Director and submitted to your agency secretary. FISMA also requires you to provide an updated corrective action plan every six months until all corrections are completed. Mail the Director's copy and your corrective action plans to:

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

We appreciate the assistance and cooperation of the DMH. If you have any questions regarding this report, please contact Frances Parmelee, Manager, or Rick Cervantes, 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. Joe Munso, Deputy Secretary, California Health and Human Services Agency
Mr. Jim Alves, Assistant Secretary, California Health and Human Services Agency
Ms. Elaine Bush, Chief Deputy Director, California Department of Mental Health
Mr. Sean Tracy, Special Projects Manager, Director's Office, California Department of Mental Health
Mr. Stan Bajorin, Deputy Director of Administration and Fiscal Services, California Department of Mental Health
Ms. Denise Blair, Chief Information Officer, California Department of Mental Health
Ms. Cynthia Radavsky, Deputy Director, Long Term Care Services, California Department of Mental Health
Mr. Mark Heilman, Acting Deputy Director, Systems of Care, California Department of Mental Health
Mr. Rollin Ives, Deputy Director, Program Compliance, California Department of Mental Health
Mr. Jon DeMorales, Executive Director, Atascadero State Hospital, California Department of Mental Health
Mr. Tom Voss, Executive Director, Coalinga State Hospital, California Department of Mental Health
Ms. Sharon Smith-Nevins, Executive Director, Metropolitan State Hospital, California Department of Mental Health
Mr. Ed Foulk, Executive Director, Napa State Hospital, California Department of Mental Health
Mr. Octavio Luna, Executive Director, Patton State Hospital, California Department of Mental Health
Mr. Victor Brewer, Executive Director, Salinas Valley and Vacaville Psychiatric Care Programs, California Department of Mental Health

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An Internal Control Review

California Department of Mental Health

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

084450016

December 2007

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EXECUTIVE SUMMARY

The Department of Finance, Office of State Audits and Evaluations (Finance), was requested to review and determine the adequacy of the California Department of Mental Health's (DMH) design and operation of internal accounting and administrative controls. This report meets DMH's requirement to comply with the reporting provisions of the Financial Integrity and State Manager's Accountability Act of 1983, Government Code Section 13400, et. seq.

Our review includes DMH headquarters as well as the five state hospitals and two acute psychiatric programs (hospitals) administered by DMH. Finance identified areas where controls are not in place or working as intended. Overall, we determined the controls to be weak.

HEADQUARTERS ISSUES

Fiscal Integrity At Risk

Our review identified weak budgetary controls, lack of communication and coordination, and weak fiscal oversight among units.

The following budgetary controls are lacking or weak: organizational and programmatic budgets; a cost allocation plan; a review and approval process of the hospitals' budgets; written procedures over the hospitals' budget development process; and hospital operating expense and equipment budget projections and allocations.

Communication and coordination among administrative, program, and hospital units need improvement. For example, standardized policies and procedures for the hospitals' administrative and fiscal operations have not been issued, hampering the hospitals' ability to operate efficiently and comply with state and DMH management directives.

Due to weak fiscal oversight, DMH has not effectively or timely prevented or detected budgeting and accounting errors which have resulted in lost opportunities to fund critical needs.

To ensure a high degree of fiscal integrity, DMH needs to institute organizational and programmatic budgets, proper accounting structures and allocation methods, document and communicate fiscal processes and control activities, and monitor mechanisms at all levels within the department.

Inadequate Cash Flow Management

Significant control weaknesses in the accounts receivable function negatively impact cash flow and DMH's ability to meet its obligations as they become due. Control deficiencies include: lack of knowledgeable staff; lack of policies and procedures for billing, collecting, and writing-off receivables; inadequate cost recovery techniques; lack of review and reconciliations; and lack of collection efforts. At June 30, 2007, receivable balances totaling $156.7 million remained outstanding for over 120 days. DMH should provide proper training to staff, and develop policies and procedures to ensure timely billing, collecting, and writing-off of receivables.

Other Headquarters issues

The Information Security Officer (ISO) does not report directly to the DMH Director. The lack of direct access prevents the ISO from discharging its authority, and fulfilling its responsibilities effectively. Specifically, the ISO has not certified the Information Technology (IT) Risk Management Plan, designed an adequate Operational Recovery Plan, classified sensitive data, and adequately controlled computer access and programming rights. To ensure the effectiveness of the ISO, DMH should revise the reporting structure of the ISO to provide direct access to the DMH Director.

System development and IT project management procedures are outdated. DMH's IT project management does not meet the state minimum requirements for planning, tracking, risk management, and communication. DMH should develop and communicate IT policies and procedures, and adhere to the minimum requirements to ensure successful projects.

HOSPITAL ISSUES

Inadequate Personnel Practices

Personnel practices at the hospitals do not provide assurance that attendance records are correct and accurate, and that payroll is proper, especially regarding overtime. Hospitals are highly susceptible to payroll fraud and abuse. DMH should institute adequate timekeeping procedures, including overtime pre-approvals and random audits.

Acquisition Controls Need Improvement

Contract executions are not timely, contract language provisions are vague, and state contracting procedures are circumvented. DMH needs to strengthen acquisition controls to ensure the legality of acquisitions and that the best interest of DMH is served.

Ineffective Accounting and Oversight of Accounts Receivable

Accounts receivable are not correctly recorded, costs are not always recovered, billings are late, and collection efforts are weak. As of June 30, 2007, receivables totaling $763,874 may be uncollectible. DMH should strengthen accounting and oversight of accounts receivable to ensure the timely collection of amounts due.

Other Hospital Issues

Other control weaknesses identified at the hospitals include: inadequate safeguarding of assets, incomplete or outdated employee housing rental agreements, weak controls over accounting and trust, and financial statement preparation need improvement.

Finance met with DMH management and staff to discuss opportunities for enhancements to activities designed to achieve DMH's mission and goals. This report is intended to assist DMH management in focusing attention on strengthening internal controls, preventing and mitigating risks, and improving operations. To strength controls, DMH should develop a plan to address the observations and recommendations noted in this report.

Background, Objectives, Scope and Methodology

Background

The California Department of Mental Health (DMH) leads the state's mental health system, ensuring the availability and accessibility of effective, efficient, and culturally competent mental health services. To administer its programs, DMH has oversight of a $5 billion budget. DMH has experienced tremendous growth in both its Community Services (CS) and Long-Term Care Services programs (LTCS). This growth has been driven primarily by new laws, regulations, and regulatory agency reviews, and has proved to be a challenge to the administrative infrastructure, directly impacting DMH's ability to efficiently manage its programs. In recent years, the programs have experienced deficiencies and have become the subject of multiple reviews by both state and other regulatory agencies.

Community Services Program

The CS program coordinates delivery of mental health treatment and support services. It also sets overall policy for the delivery of mental health services statewide; develops and oversees performance contracts with county mental health departments; monitors compliance with state and federal statutes; and administers various state-funded programs and projects. Funding assists counties in providing a broad array of mental health treatment and rehabilitative services in a local setting that promotes recovery and integration into the community for patients with mental illness and children and youth with serious emotional disturbance. The CS program has experienced growth due to the Early and Periodic Screening Diagnosis and Treatment program and the Proposition 63 Mental Health Initiative.

Long-Term Care Services Program

The LTCS program administers the California state hospital system which includes five state hospitals (state hospitals) and two acute psychiatric programs. For purposes of this report, the term hospitals is used when referring to the five state hospitals and two acute psychiatric programs. The acronyms below are used when referring to each individual entity:

- Atascadero State Hospital (ASH)
- Coalinga State Hospital (CSH)
- Metropolitan State Hospital (MSH)
- Napa State Hospital (NSH)
- Patton State Hospital (PSH)
- Salinas Valley Psychiatric Program at Salinas Valley State Prison (SVPP)
- California Medical Facility in Vacaville (VPP)

Forensic patients are generally committed by the courts to hospitals under one of four categories: incompetent to stand trial, mentally disordered offender, not guilty by reason of insanity, and sexually violent predator (SVP). Some patients of the California Department of Corrections and Rehabilitation (CDCR) receive care on the prison grounds while others are transferred to the state hospitals for mental health treatment. Counties also contract with the state hospitals to purchase beds for adults and children committed for mental health treatment under the Lanterman-Petris-Short Act (LPS).

About 90 percent of occupied beds are for forensic patients and 10 percent are purchased by the counties for patients committed under the LPS. The cost of care for forensic patients is supported by the state's General Fund. The LTCS program faces major challenges including the Civil Rights Institutionalized Person's Act Consent Order, the Proposition 83 Initiative (Jessica's law), and two lawsuits—*Ralph Coleman, et al., vs. Arnold Schwarzenegger et al.*, and *Marciano Plata et al., vs. Arnold Schwarzenegger, et al.*—which ordered salary increases for CDCR staff triggering a mass exodus of DMH staff.

Objectives and Scope

The Legislature enacted the Financial Integrity and State Manager's Accountability Act of 1983 (FISMA), Government Code Section 13400, et. seq. which charged each state agency with the responsibility of maintaining effective systems of internal accounting and administrative program control as an integral part of its management practices. The Legislature also mandated that the systems of internal accounting and administrative program control be evaluated on an ongoing basis.

To assist DMH in complying with the reporting provisions of FISMA, the Department of Finance, Office of State Audits and Evaluations (Finance), performed this internal control review at headquarters, the five hospitals, and the two acute psychiatric programs. Our objectives were to determine whether:

- Assets are safeguarded from unauthorized use or disposition.
- Financial transactions are executed in accordance with management's authorizations and recorded properly to permit the preparation of reliable financial statements.
- Financial operations are conducted in accordance with State Administrative Manual guidelines.
- Information technology security and risk management controls are functioning as prescribed.

This review did not include an assessment of the efficiency or effectiveness of DMH's program operations, or the accomplishment of program goals and objectives. In addition, this review did not include an assessment of the efficiency or effectiveness of information technology project management as this responsibility lies with DMH; the Health and Human Services Agency; and the Department of Finance, Office of Technology Review, Oversight, and Security.

Methodology

An understanding of DMH's environment, including mission-critical program objectives and business functions, was gained and was followed by a risk assessment to discover where the greatest vulnerabilities lie. Our risk assessment included a review of industry-specific risk factors; prior audit findings reported by Finance, the Bureau of State Audits, and the Department of General Services; court orders; interviews with executive and key staff; and identification of accounting and administrative controls critical to DMH's mission. Based on that information, our strategy was to (1) identify any mitigating controls or lack thereof, (2) evaluate whether mitigating controls are functioning as intended, and (3) identify and recommend controls that need to be in place to mitigate risks.

In order to document current fiscal processes, we observed operations, reviewed policies and procedures, and conducted interviews with DMH headquarters and hospital staff, including management and consultants. To test controls, we inspected, on a sample basis, accounting and personnel records, and contract files. Organization charts, laws, regulations, and internal policies and procedures were also reviewed.

During the course of our review, we identified best practices at the hospitals (Appendix III). However, this compilation of best practices was not tested or evaluated and is provided for informational purposes only. Additional analysis is required to validate the effectiveness and efficiency of these practices.

Our recommendations were developed based on the State Administrative Manual, State Contracting Manual, State Information Management Manual, best business practices, and DMH's policies and directives. For reference, criteria used to develop our issues are cited in Appendix I. This review was conducted during the period July 2007 through December 2007.

During our review, we identified the following control deficiencies that could hinder the California Department of Mental Health's (DMH) ability to operate an effective internal control system.

Issue 1: Fiscal Integrity At Risk

The expansion of mental health programs has increased the complexity of DMH's accounting and administrative functions. Our review identified weak budgetary control and lack of communication, coordination, and oversight among units.

Weak Budgetary Control

Weak budgetary control hampers reliable financial reporting and operational efficiency. Without accurate and timely financial data, management is prevented from adequately prioritizing needs and making the best use of available resources. DMH is also at risk of incurring deficiencies.

A clear symptom of weak budgetary control is the numerous adjustments and revisions made during the year-end process due to inadvertent omission of expenditures. Adjustments included transfers between funds and appropriation schedule items. Had proper fiscal planning taken place, errors could have been avoided and available funds could have been put to good use. The following deficiencies were noted:

- Organizational and programmatic budgets are not developed. Without this level of detail, DMH is prevented from adequately prioritizing activities, promoting responsible resource allocation, and establishing fiscal accountability.

- An indirect cost allocation plan has not been prepared and the distribution of administrative costs to programs appears to be inequitable. For example, the Long Term Care Services (LTCS) program is allocated an excessive share of administrative costs in relation to the Community Services (CS) program. For fiscal year 2006-07, the distribution of administrative costs for the LTCS and CS programs was 46 percent and 54 percent, respectively. Based on the Budget Act 2006-07, the proportion of the support appropriation and authorized positions for the two programs indicates a 20 percent and 80 percent allocation to the LTCS and CS programs, respectively. Inequitable distribution of administrative costs impacts program operational efficiency.

- The Budget Office does not review or approve the hospitals' distribution of budget allocations or DMH's Strategic Capital Outlay Plan.

- Written procedures do not exist over the LTCS program's budget development process. This includes policies and procedures for developing hospital patient population projections, the sexually violent predator (SVP) evaluations' estimates, and distribution of budget allocations to hospitals.

- The documentation of the hospital population estimate methodology excludes level of care staffing ratios and other factors. Although the methodology is documented, it is not sufficient.

- The hospitals' operating expense and equipment (OE&E) budget projections could be improved. The current projection is based on a three-year regression of historical expenditures and ignores user service level utilization factors that include level of care, outpatient care costs, and patient treatments, such as dialysis and pharmaceutical costs. For equipment, projections do not take into consideration actual recurring maintenance needs.

- The hospitals' special repairs budget has not changed over a decade and the allocation methodology is inadequate. The four older hospitals receive the same allocation amount (approximately $450,000 per year) regardless of actual repair needs and the newest hospital, Coalinga State Hospital, does not receive an allocation for special repairs. As a result, the hospitals' accumulated deferred maintenance needs are estimated at $17 million. Adequate maintenance funding, planning, and monitoring are necessary to reduce expensive emergency repairs.

- The methodology to allocate and distribute OE&E funds to hospitals needs improvement. Under the current allocation method, available OE&E funds (net of funds set aside for headquarters and hospital projects) are allocated to hospitals using an average patient cost rate multiplied by actual hospital population. While this method may work for variable costs such as level of care personnel services, it ignores fixed costs such as administrative overhead and other direct costs not driven by population. Under the current allocation method, hospitals with underutilized beds and high fixed costs, such as Metro State Hospital, may be inadequately funded. Also, hospitals with a large number of patients requiring expensive treatment may also be under funded. As illustrated by the table below, the level of patient care costs, such as outpatient care and pharmaceutical costs, are significant cost drivers that do not directly correlate with patient population.

Comparison of Cost Drivers for 2006-07

Cost Drivers	ASH	CSH	MSH	NSH	PSH	Total[1]
Outpatient Care	$12,151,819	$7,978,909	$1,077,211	$4,861,899	$12,403,573	$38,473,411
% of total	32%	21%	3%	13%	32%	100%
Pharmaceuticals	$11,545,926	$2,461,067	$6,144,454	$9,398,553	$12,472,802	$42,022,802
% of total	27%	6%	15%	22%	30%	100%
Patient Population as of 6/30/07	1,208	633	647	1,195	1,500	5,183
% of total	23%	12%	12%	23%	29%	100%

Source: Provided by the DMH Accounting Office. The acute psychiatric care programs are not included in the above table because those costs are funded by CDCR.

[1] Immaterial mathematical errors exist due to rounding.

Lack of Communication and Coordination

Integral components of internal control are information and communication. Information must be identified, captured, and communicated in a form and time frame that enable employees to carry out their responsibilities. Based on the conditions below, the DMH needs to improve communication and coordination efforts.

- Policies and procedures for hospitals are not standardized. Headquarters does not issue standardized policies and procedures for hospital administrative and fiscal operations. As a result, each hospital developed its own or does not have documented procedures. Standardized procedures improve efficiency, training, compliance, and oversight of hospital operations.

- Guidance on proper accounting of patient type expenditures has not been provided to hospitals. As a result, actual patient type costs are not reflected in the hospital accounting records. Instead, costs are allocated among program elements based on the prior quarter's patient population. For example, outpatient care, pharmaceutical costs, and other costs incurred by critically ill patients are distributed equally amongst all patients. The actual costs to treat forensic or civil patients may be different than the costs reflected in the accounting records. Without actual costs, DMH is unable to adequately identify cost drivers and control costs, resulting in ineffective negotiation and recovery of patient costs. Further, this practice prevents the preparation of accurate budgets and justification of additional resources.

- A method to track and account for costs related to the Civil Rights Institutionalized Person's Act (CRIPA) was not planned or developed, hampering the hospitals' ability to adequately account for, control, and monitor expenditures. In an effort to exhaust the CRIPA funding, the Budget Office provided direction but not until year end.

- Criteria and guidance on special repairs have not been developed or disseminated to hospital staff. Without such guidance, hospitals may not adequately prioritize repair projects.

Weak Fiscal Oversight

Assessing the quality of the internal control system's performance over time is necessary and can be accomplished through ongoing monitoring activities, separate evaluations, or a combination of the two. The following errors were not timely identified or corrected due to weak fiscal oversight:

- Medicare Part D expenditures totaling $312,355 were incorrectly charged to the 2006 enactment year appropriation instead of the approved funding source, a 2005 re-appropriation. At year-end, the Accounting Office accrued the whole re-appropriation amount of $330,000, resulting in double counting and incorrect reporting. Consequently, DMH lost the opportunity to use these funds for other needs.

- The Mental Health Services Oversight and Accountability Commission exceeded its budgeted contract authority for 2006-07. The approved budget for professional services

was $357,000; however, the expenditures and encumbrances totaled $511,925 as of June 30, 2007.

- Licensing and certification activities totaling $357,000 were incorrectly charged to the General Fund instead of the Licensing and Certification Fund. Also, labor costs charged to the Mental Health Services Act (MHSA) program appear to be excessive. Four employees charged 100 percent of their time to the MHSA program for the period January 2007 to June 2007. Three of those employees only worked on the MHSA program part time and the fourth employee did not work on it at all.

- The hospitals typically incur deficiencies in program elements 20.10 (Lanterman-Petris-Short) and 20.30 (California Department of Corrections and Rehabilitation). The cost overruns are covered by transferring expenditures to those program elements with remaining funds at year-end, which typically are from program elements 20.20 (Penal Code and Judicially Committed) and 20.40 (Other Long Term Community Services).

Recommendations

To ensure a high degree of fiscal integrity, exercise the Budget Office's fiscal policy and approval authority over all fiscal matters. Develop and communicate policies and procedures to fiscal and program units. Oversight of expenditures can be strengthened by ensuring proper accounting structures and allocation methods are established at the appropriate levels. Specifically:

- Develop organizational and programmatic budgets and an indirect cost allocation plan.

- Improve and document the hospitals' budget projections and allocation methodologies by including appropriate cost drivers such level of care, actual maintenance, and fixed costs.

- Ensure maintenance funding is adequate, develop criteria and methodologies to prioritize funding for hospitals, and perform onsite reviews of major special repair projects.

- Develop standardized policies and procedures for hospital fiscal and administrative operations to ensure consistency. Non-adherence to policies should only be granted on an exception basis.

- Determine accurate patient bed costs to ensure appropriate reimbursements from the counties and CDCR.

- Require Budget Office approval for all budget documents and institute fiscal monitoring practices to ensure expenditures are appropriately charged to the correct funding source.

- Monitor hospital expenditures at the program element level and determine if a budget revision is necessary.

Issue 2: Inadequate Cash Flow Management

Significant control weaknesses exist in the accounts receivable function. Inadequate controls over accounts receivable have a negative impact on cash flow and DMH's ability to meet its obligations as they become due.

Lack of Knowledgeable Staff

Accounting staff responsible for billing do not possess adequate knowledge of federal cost accounting principles and federal program requirements to ensure the accuracy of invoices. This lack of knowledge and training precludes staff from knowing what information is needed to perform their duties. Many accounting staff did not even have complete copies of contracts.

Ineffective Cash Management Methods

There is a lack of policies and procedures for billing, collecting, and writing-off receivables. A policy directive for Short Doyle/Medi-Cal (SD/MC) administrative expenses has not been updated since 1989.

SD/MC and Pre-Admission Screening and Resident Review (PASRR) administrative costs for July 2006 through December 2006 were not billed until March 2007, creating significant cash flow problems for DMH. Also, DMH has interagency agreements with the Department of Developmental Services, Department of Rehabilitation, and CDCR but does not bill timely. Some costs under these agreements were only billed once or twice a year even though the contracts allowed for monthly invoicing.

The Accounting Office does not review or follow up on aged receivable balances. At June 30, 2007, receivable balances totaling $156.7 million remained outstanding for over 120 days. Because of late billing and poor collection efforts, reconciliation of amounts paid and billed for Federal Participation Program funds have not been completed.

The review process over billings is inadequate. Data for invoices, including SD/MC and PASRR administrative costs, is extracted from CALSTARS, and then converted to an Access database where it is aggregated for invoice purposes. However, the Access output is not reconciled to source data to ensure the accuracy and completeness of the invoices.

Lack of Adherence to Cost Recovery Principles

Labor costs billed are not based on actual time reported. Although DMH has instituted timesheet reporting practices, that data is not transferred to CALSTARS for billing purposes. Therefore, the CALSTARS labor costs billed may not be supported or correct.

Allowable federal costs are not fully recovered. The indirect rate billed to federal programs and grants is 48 percent and not the 48.8 percent approved rate. For 2006-07, unrecovered costs totaled $56,673.

Treatment Authorization Appeal Review fees may not be adequate to recover DMH's costs. These fees were last revised June 2003 but the Welfare and Institutions Code requires the fees to be calculated and adjusted annually.

Recommendations

To improve DMH's cash flow management:

- Ensure accounting staff have the necessary information to perform their duties effectively and efficiently. Provide training on federal cost accounting principles and programs (e.g., the Office of Management and Budget Circular A-87 and Social Security Act program requirements).

- Develop policies and procedures for timely billing, collecting, and writing-off receivables and ensure all costs billed are proper and supported.

- Reconcile billing amounts to source data.

- Use the approved indirect billing rate and adjust the Treatment Authorization Appeal Review fees annually to ensure adherence to full cost recovery principles.

Issue 3: Reporting Structure of the Information Security Officer is Ineffective

The Information Security Officer (ISO) does not report directly to the Director which prevents the ISO Office from executing its responsibilities in an effective and independent manner. The current ISO is a Staff Systems Analyst reporting to a Staff Services Manager II. In this reporting structure, the ISO cannot be effective due to the lack of authority for the responsibilities that must be performed. In addition, the ISO may have difficulties enforcing compliance and fairly representing management in confidential investigations involving employees and unions. Lack of Director accessibility has resulted in noncompliance with numerous State Administrative Manual (SAM) and Statewide Information Management Manual (SIMM) requirements:

- The information technology (IT) Risk Management Plan was not updated or certified to Department of Finance, Office of Technology Review, Oversight, and Security (OTROS) this year.

- Data has not been formally classified. DMH handles personal, fiscal, and IT data that are often considered confidential or sensitive. DMH's Policy Manual does not state when and what data is confidential versus public. Agencies are required to classify data elements as public, confidential, sensitive, and personal to provide protection from unauthorized use, access, disclosure, modification, loss, or deletion.

- The Operational Recovery Plan designated recovery site, Napa State Hospital (NSH), is inadequate to handle a successful recovery of headquarters operations. NSH lacks the space and air conditioning necessary to house, operate, and keep servers and computer equipment at the proper temperature.

- Access and programming rights to systems, applications, and files are not adequately controlled. Below are some examples:

    - Consultant access rights are not restricted to only those files required to perform their tasks, and access is not modified or removed upon project completion. For example, IT consultants have access to DMH's intranet and project file directories, where confidential documents such as Special Project Reports and

Feasibility Study Reports reside. Such documents include plans on future contracting opportunities. This access provides consultants an unfair advantage over their competitors.

- Database administrators have programming access to the systems they control and maintain. This lack of separation of duties may allow improper and unauthorized changes to be made to computer programs or data.

- Access to CALSTARS functions is not adequately restricted to employees requiring it in the performance of their duties. As of August 9, 2007, the CALSTARS Security File listed access for 14 former accounting employees who should have been removed. Also, input access was not restricted to only those employees requiring it to perform their job duties.

Recommendations

To emphasize the importance of the ISO's role, revise the reporting structure of the ISO to provide Director accessibility and consider modifying the position to have a "confidential" designation. In addition:

- Institute an IT Risk Management Plan and update it on a regular basis.
- Complete and submit all reports in accordance with the SAM and SIMM requirements.
- Locate an adequate recovery site for headquarters or properly equip NSH to ensure successful recovery operations.
- Classify data to protect against unauthorized access.
- Restrict consultant access to files necessary for contracted tasks and promptly modify or remove access upon completion of the contract.
- Modify database administrators' programming rights to ensure adequate separation of duties.
- Remove separated employees from the CALSTARS Security File and modify employee access to ensure fiscal data integrity.

Issue 4: Project Management Practices Do Not Meet Minimum Requirements

System development and IT project management procedures are outdated. In response to our review, the IT Unit prepared new guidance on system development. However, the new guidelines were not communicated or disseminated to employees.

DMH's IT project management does not meet the SIMM's minimum requirements for planning, tracking, risk management, and communication. Without adequate project management practices, the DMH is at risk that projects will neither be completed timely and within budget, nor accomplish the project objectives. Further, failure to meet minimum requirements will require OTROS approval before expending funds on IT projects. Project management requirements not met include:

- Development and maintenance of project cost estimates for all projects. DMH only applies this practice to IT projects reportable to OTROS.

- Recording of actual costs by cost category and comparing actual costs to budgeted amounts.

- Tracking and reporting of work plan activities, schedules, and milestones for all projects. Tracking is limited to scheduling and tracking tasks for each employee.

- Regular status reporting to key stakeholders, including budgets and milestones.

Recommendations

Develop and document policies and procedures for IT functions. Institute minimum project management practices to support successful projects.

Issue 5: Inadequate Contract Development and Monitoring

Contract controls are not in place or working as intended to ensure that DMH's best interests are served. Without adequate contracting controls, the propriety and legality of contracts cannot be assured, and timely delivery of quality goods and services may be compromised. Specifically:

- Policies and procedures for contract splitting and monitoring do not exist. Also, a policy prohibiting disclosure of confidential contract information is not in place. Such controls are necessary to prevent conflict of interest and unfair advantages over contracting opportunities. There is also a lack of procedures over the hiring of SVP evaluators and how their caseloads are assigned.

- Ranking of proposals is not independent. The same staff initiating the contract request is also responsible for evaluating, ranking, and ultimately selecting the proposal. Further, the same staff monitors the contract and authorizes invoices for payment. For IT consulting contracts, the project manager requesting the contract selects the consultant, monitors performance, and indirectly approves payment by certifying the consultant's timesheet records.

- Contract budget language for non-profit organizations lacks adequate details for personnel costs. The contract budgets do not include vendor positions/titles, and the maximum billable rates and hours. Detailed budgets for personnel costs are necessary to reduce inappropriate billings.

- Contract monitoring provisions are weak. Contract language lacks adequate details, such as a schedule of tasks, deliverables, progress reports, and corresponding deadlines. As a result, the contract managers do not always have status reports or documentation supporting operating costs. For the status reports submitted by IT consultants, status reports did not contain sufficient detail regarding the work performed.

- Training contracts do not include provisions for reporting and disposition of training fee revenue.

Recommendations

- Develop contract monitoring best practices to ensure contract managers exercise due diligence when reviewing and approving status reports and claimed costs.
- Ensure critical policies and procedures are documented, revised periodically, and are communicated to employees timely.
- Form evaluation panels to ensure the objectivity of bid ranking.
- Develop standardized contract provisions to include personnel service costs, contract budgets, positions/titles, maximum hourly rates, fringe benefits, overhead, and hours.
- Ensure all contract language includes details, such as a schedule of tasks, deliverables, progress reports, and corresponding deadlines.
- Document provisions for reporting and disposition of training contract revenue.

Issue 6: Inadequate Safeguarding of Assets

Controls are not in place to ensure adequate safeguarding of assets. Numerous conditions exist that increase the risk of errors, irregularities, and material misstatements. Some examples include:

- A system of authorization is not documented. A record of staff authorized to approve internal documents is non-existent in numerous areas—budgets, contract requisition and approval, purchasing, and payment authorization.
- Inadequate separation of duties exists. Refer to Appendix II for details.
- The Director's signature plate is not removed from the check signing machine after checks are signed. Employees with access to the accounting area can steal the signature plate and issue fraudulent checks.

Our review also determined DMH does not adequately review disbursements. The following control weaknesses were noted:

- Policies and procedures for reviews, approvals, and reconciliations are not documented.
- Encumbrance, disbursement, and adjustment postings to the general ledger are not reviewed for accuracy and propriety.
- The bank, State Controller's Office (SCO), and Revolving Fund reconciliations do not have evidence of independent review.
- American Express credit card payments are made prior to verification and approval from program staff. As a result, DMH incurred $7,154 in fraudulent charges in December 2006 and January 2007. DMH failed to report the fraud to the Bureau of State Audits (BSA) and Department of Finance.

- The costs claimed for SVP patients placed in the community by a third party vendor are not matched against the patient's approved plan of expenditures prior to payment.

Accountability over property, including capitalized and non-capitalized items, is weak. Adequate controls are not in place to ensure effective asset identification, inventory, and safeguarding. Therefore, misappropriation of assets can occur and remain undetected given the following circumstances:

- Policies and procedures for acquisitions and dispositions have not been developed.

- DMH lacks a centralized property inventory register. Various property listings maintained by the Business Services and IT units lacked information for several items-property identification tag numbers, serial numbers, and cost information. The lack of adequate property subsidiary records prevents DMH from periodically reconciling its general fixed assets account balances and ensuring the accuracy of the records.

- A physical inventory of property has not been conducted in the past three years. The latest inventory was completed in approximately 1996.

Recommendations

Implement the following to achieve adequate safeguarding of assets:

- Maintain a documented system of authorization and reassign incompatible duties to achieve the required separation.

- Ensure the signature plate is removed from the check signing machine after checks are signed and safeguarded.

- Develop and communicate policies and procedures for critical processes.

- Review all postings to the general ledger.

- Require the preparer and reviewer to sign and date reconciliations.

- Compare credit card charges to appropriate approvals and supporting documentation before payments are made. Report fraud to BSA and Department of Finance.

- Compare the SVP claimed costs to the patient approved plan of expenditures prior to payment.

- Prepare accurate and complete property registers and include the required details for each item including the property identification tag number, serial number, and cost information.

- Reconcile the property register with the general ledger quarterly.

- Conduct a physical inventory of all property and reconcile the results with the property register and general ledger.

Issue 7: Financial Statement Preparation Needs Improvement

Weak budgetary and fiscal controls not corrected could result in unreliable financial statements. Report disclosures are inadequate, resulting in improper certified year-end statements and misstatements. Report No.19, Statement of General Fixed Assets, states that physical inventories are conducted every three years and subsidiary fixed asset records are in agreement with the general ledger control accounts. Neither of these footnotes is correct. Also, Report No. 22, Statement of Contingent Liabilities, does not disclose 21 pending cases against DMH that represent a potential fiscal liability of nearly $33 million.

In addition, the year-end reporting process neither ensures the reliability of financial statements nor promotes responsible resource allocation. Examples include:

- Accounts Payable accrual transactions are not reviewed and approved.
- The Accounting Office accrued remaining appropriation balances at year-end based on expenditure projections in early May. Such timing is inappropriate for the development of accurate year-end accrual estimates. Best practices are to develop accrual estimates mid-June.
- Prior-year financial statement accruals in the amount of $796,868 were not reversed and were reported again in the 2006-07 financial statements.
- Of ten accrual transactions totaling $8,903,183, five were not supported by invoices and two were overstated, resulting in an overstatement of $1,905,741.
- Encumbrances totaling $157,081 were not supported by adequate documentation.

Recommendations

Institute a year-end work plan with reasonable deadlines that includes a review of accrual transactions and encumbrance balances for validity. Ensure proper disclosures are made in the year-end statements.

As stated in the Background section of this report, the term hospitals is used when referring to the five state hospitals and two acute psychiatric programs. The acronyms below are used when referring to each individual entity:

- Atascadero State Hospital (ASH)
- Coalinga State Hospital (CSH)
- Metropolitan State Hospital (MSH)
- Napa State Hospital (NSH)
- Patton State Hospital (PSH)
- Salinas Valley Psychiatric Program at Salinas Valley State Prison (SVPP)
- California Medical Facility in Vacaville (VPP)

Described below are control deficiencies identified during our review. Some issues are pervasive throughout all the hospitals while others are not (Refer to Appendix IV). In order to promote consistency and standard operations at the hospitals, our recommendations should be considered and implemented by all hospitals even though only certain hospitals are identified with each issue. Implementation of a hospital peer review process would also be instrumental to ensure standardized application of policies and procedures, and increase communication and coordination among the hospitals.

Hospital Issue 1: Inadequate Personnel Practices

Personnel practices at the hospitals are inadequate to ensure accurate attendance records and propriety of payroll, especially overtime. As evidenced by the conditions below, the hospitals are highly susceptible to payroll fraud and abuse.

- ASH: Overtime worked is not always pre-approved as evidenced by lack of approved overtime slips. For one employee, 20 overtime slips were not approved by a Unit Supervisor and 8 were not pre-approved by the Supervisor. Consequently, suspected fraudulent overtime claims were found by ASH but were not reported to the Bureau of State Audits (BSA) and Department of Finance. Also, timesheets for employees who worked in more than one position are missing or lacked proper certification by the employee or supervisor. In addition, employees on alternate work schedules do not mark the appropriate box on the Absence and Additional Time Worked Report Form (STD. 634) and do not indicate their regular day off.

- CSH: Overtime is not pre-approved. Also, errors in processing pay were identified. One employee is under investigation for fraudulent reporting.

- MSH: Employee attendance records, such as leave requests and separation logs, are not properly maintained. Employee salary overpayments result from untimely processing of docked time, reduced time schedules, and disability. Another condition

exists where two supervisors approved their own Monthly Attendance Reports (STD. 681).

- NSH: Overtime is not properly certified. Forty-six daily overtime worked logs were reviewed and none were certified by the Nursing Coordinator. In addition, five log sheets were not certified by the Unit Supervisor and nine were not timely certified. Currently, fraudulent claims for time not worked are under investigation; however, these suspected fraud activities have not been reported to BSA and the Department of Finance. In addition, payroll processing errors were identified.

- SVPP: Payroll processing errors result in multiple salary overpayments to employees. For example, one employee has up to 7 accounts receivable balances totaling $10,447 due to a classification error. Another employee was given a salary advance including payment of the above-the-minimum salary rate (HAM). It was later determined that the employee was not entitled to the HAM.

In addition, proper exit clearance procedures are not followed at ASH, CSH, NSH, and PSH. Exit clearance forms are missing or incomplete and final timesheets are not always prepared or signed. Exit documents should be completed, reviewed, and signed to ensure that outstanding receivables are cleared, final paychecks are accurate, and hospital property is returned.

Recommendations

To ensure adequate personnel practices:

- Institute timekeeping procedures to ensure attendance records are adequately prepared, certified, and retained for audit.

- Require overtime be reviewed and pre-approved by a designated supervisor and second level reviewer. The second level review should be performed outside the requestor's unit. For example, Central Staffing Services should perform a second review and provide final approval for level of care overtime requests. Ensure these reviews and approvals are adequately documented in personnel records.

- Conduct random overtime audits to reduce fraud and abuse. If suspected fraud is discovered, timely report the activity to the appropriate parties.

- Complete exit clearance procedures correctly and include all pertinent documents in the separated employee files.

- Institute payroll procedures to ensure correct classification of employees.

Hospital Issue 2: Acquisition Controls Need Improvement

The hospitals are not complying with state execution and approval requirements for purchases and contracts. Also, hospitals appear to be circumventing state contracting procedures by splitting contracts.

Purchase and Contract Execution

- ASH: Four medical contracts and eight purchase orders were prepared after services were provided; however, no information was available to indicate that these were emergency contracts. In addition, purchase orders are not adequately completed or certified. Of 21 purchase orders tested, all were not dated and 4 were not signed.

- CSH: Medical contract amendments were not timely executed. Amendments were initiated after the contract expiration date.

- MSH: The contract amount was amended without obtaining adequate approvals.

- CSH, NSH, and PSH: Cal-Card purchases are paid without a pre-approved purchase order. Cal-Card is a payment method, not a purchase approval method.

Language Provisions

- MSH: Contracts do not always clearly describe the contract's scope or contain billable hourly rates or specific service rates.

- ASH and NSH: Contracts do not always contain adequate budget detail. For example, 13 contracts at NSH include either an email attachment as the budget detail or only had a lump sum amount in the contract.

Contract Processing

- MSH: The list of contracts is incomplete and inaccurate. Additionally, contract files are missing.

- ASH, CSH, MSH, NSH, and PSH: When the combination of contracts for the same vendor exceeded the $10,000 or $50,000 thresholds, state contracting procedures were circumvented by splitting contracts. As such, opportunities to take advantage of potential pricing discounts were lost. Moreover, the required number of bids was not always obtained. The contract files lack evidence of bids or exemption from bidding.

Recommendations

To strengthen acquisition controls:

- Ensure payments are made with properly executed contracts and approved purchase orders.

- Begin the contract amendment process prior to the contract expiration date to ensure adequate time to obtain the necessary approvals.

- Include all the necessary information, such as a clear scope and adequate budget detail, in all contracts.

- Ensure contract logs are accurate and complete.

- Document the bidding process and include the supporting documentation in the contract and purchase order files.

- Combine contracts and purchases from the same vendor to avoid the appearance of circumvention of state policies. For contracts over $10,000, follow the standard agreement contract requirements. For contracts over $50,000, obtain Department of General Services (DGS) approval.

Hospital Issue 3: Ineffective Accounting and Oversight of Accounts Receivable

Significant control weaknesses exist in the accounts receivable function. Inadequate controls over accounts receivable have a negative impact on cash flow and DMH's ability to meet its obligations as they become due. Hospital procedures need improvement to ensure that accounts receivable are adequately recorded and supported. Specifically:

- ASH: The Due from Other Funds or Appropriations Receivable are not properly cleared. In the Revolving Fund, we identified $149,919 listed as Due from the General Fund even though ASH has been reimbursed by the State Controller's Office (SCO). Also, credit balances are not correctly recorded, promptly investigated, and closed.

- CSH: Invoices for leases and contracts are not prepared timely or recorded. For example, one lessee was not billed until two years after the due date.

- MSH: Inadequate documentation supports a $4,463 payroll receivable write-off request.

- NSH: Employee housing and vocational services receivable are not recorded.

- PSH: Receivable transactions are not correctly recorded and credit balances are not promptly investigated and closed. Also, transactions that had been cleared by the SCO are not removed from the receivable ledger.

Lease agreements also need to be updated on a regular basis and forwarded to the Accounting Office for proper billing. The following issues were identified:

- ASH: The Accounting Office does not have complete copies of all the leases and does not record or invoice for amounts due. Consequently, $11,335 in utilities from two lessees was not billed and collected.

- CSH: Invoices to lessees for rent and services are not issued.

- MSH: Operating costs for leases with two non-profit organizations may be potentially under-recovered. The lease amounts for utilities, maintenance, and administrative charges have not changed since 1992 for one lease and 1999 for the second lease.

- NSH: Invoices are not issued monthly. Invoices include retroactive utility service charges for up to five months.

Collection efforts, especially in the area of employee receivables, salary advances, and travel advances, are not timely or consistently applied. In some instances, no collection efforts are

made at all. As a result, hospital receivables totaling $763,874 may be uncollectible. As of June 30, 2007, the following accounts receivable balances are outstanding for over 120 days:

ASH	$ 59,116
CSH	55,754
MSH	191,712
NSH	167,613
PSH	261,668
SVPP	13,365
VPP	14,646
Total	$ 763,874

Recommendations

To strengthen accounting and oversight of accounts receivable:

- Record accounts receivable timely and accurately.
- Review postings and the accounts receivable ledger for accuracy.
- Apply collection procedures promptly and systematically on delinquent accounts receivable balances. Ensure all collection efforts are made and documented to substantiate receivable write-off requests.
- Write-off uncollectible accounts receivable.
- Update lease agreements on a regular basis to include current reimbursable operating costs. Obtain the necessary approvals from DGS or the Legislature, if necessary.

Hospital Issue 4: Inadequate Safeguarding of Assets

Controls are not in place to ensure assets are safeguarded from fraud, waste, and abuse. Numerous conditions exist that increase the risk of errors, irregularities, and material misstatements. Examples include:

- The hospitals did not always have a record of staff authorized to approve internal documents. Our review identified the following:

Lack of Designation Over:	ASH	CSH	MSH	NSH	PSH	SVPP	VPP
Invoice Approval	x		x		x		x
Check Signing							x
Acquisitions/Dispositions		x	x			x	x
Purchase Approval	x	x	x			x	x
Contract Approval	x	x	x				x
Cal-Card Approving Official	x			x			

- Inadequate separation of duties at the hospitals exists. Refer to Appendix II for details.

- Inadequate control over checks exists. ASH, CSH, NSH, and VPP do not adequately safeguard the blank check stock, and/or check signing machine, and signature plate. At ASH, CSH, and PSH, a record of undeliverable warrants is not maintained. At NSH, a record of program staff authorized to pickup salary warrants is not maintained.

Access to systems and applications are not restricted to those employees requiring access for the performance of their duties. As such, incompatibilities exist over various DMH systems. For the ONTRAC Property Inventory Database at ASH, all warehouse personnel can add, delete, or modify property transactions. For the Trust Accounting Computerized System (TACS) and CALSTARS, staff have access rights to these systems which are not required to perform their duties:

Hospital	# of Staff with Unnecessary Access	
	TACS	CALSTARS
ASH	5[2]	2
CSH	5	3
MSH	4	3
NSH	6	6
PSH	0	4

Lastly, accountability over property, including the pharmacy, is weak. Adequate controls are not in place to ensure effective asset identification, inventory, and safeguarding. Therefore, misappropriation of assets can occur and remain undetected. For pharmaceutical drugs, each hospital typically spends $750,000 to $1 million a month[3]. However, an inventory system for non-controlled drugs is not maintained at the hospitals. Lack of an inventory system increases the risk of fraud, waste, and abuse. For property, physical inventory, record keeping, reconciliations, and surveys are not properly completed. Adequate property procedures are needed to ensure proper safeguarding and reporting. Specifically:

- ASH: The physical inventory is not reconciled to the General Ledger Fixed Assets Account Group. Also, property is disposed prior to obtaining DGS approval, and certificates of disposition are not always completed.

- PSH: Acquisitions and dispositions are not properly recorded in the property ledger and general ledger. Reconciliations are not properly prepared. Property dispositions are not timely and surveyed property is removed from the property ledger prior to actual disposition.

- CSH and NSH: Equipment received during 2006-07 totaling $180,843 and $146,454 for CSH and NSH, respectively, are not timely capitalized in the general ledger and are excluded from the financial statements. In addition, the property ledger is not reconciled to the general ledger.

- NSH and SVPP: The property ledger is incomplete, preventing a proper reconciliation to the general ledger and identification of lost or stolen property.

[2] One of the five staff includes a canteen director who is an outside vendor.
[3] This amount does not include costs incurred by the acute psychiatric care programs because those costs are funded by CDCR.

- ASH, MSH, NSH, and PSH: The Statement on Changes in General Fixed Assets is not reconciled to the DGS Statewide Real Property Inventory amounts.

- MSH, NSH, PSH, SVPP, and VPP: Inventories are not conducted every three years.

Recommendations

To promote adequate safeguarding of assets:

- Maintain a documented system of authorization and reassign incompatible duties to achieve the required separation.

- Secure assets such as the blank check stock, the check signing machine key, and the signature plate. Maintain a record of undeliverable salary warrants and persons authorized to pickup warrants.

- Restrict system and application access rights to only those employees requiring it in the performance of their job duties.

- Develop an inventory system to safeguard pharmaceutical drugs.

- Institute adequate inventory procedures, which should include the performance of physical inventories.

- Ensure property acquisitions and dispositions are adequately prepared, approved, and timely recorded in the property ledger and accounting records.

- Conduct quarterly fixed asset reconciliations and annual real property reconciliations.

Hospital Issue 5: Incomplete or Outdated Employee Housing Rental Agreements

Employee housing rental agreements are not always up-to-date or properly prepared. For example, two ASH employees do not have properly executed rental agreements while six PSH rental agreements do not state the monthly rent. At MSH, rental agreements are outdated and do not reflect the amount of rent charged to employees.

At NSH, rental agreements are not always properly prepared and do not include the monthly rent amount. Rent amounts are not always collected timely or in full; uncollected rent totals $5,271. Fringe benefits are not always properly and timely reported to the SCO. This includes a potentially incorrect interpretation of the "Condition of Employment" provision resulting in NSH's failure to report $14,505 in fringe benefits to the SCO.

Additionally, NSH waived three cleaning deposits without Hospital Administrator approval. When the housing units are used for family visits or recruitment purposes, waivers of liability from guests are not obtained.

Recommendations

To improve management of employee housing rental agreements:

- Ensure rental agreements are prepared, enforced, and include necessary terms, such as rent amounts. Update the rental agreements to ensure the appropriate rent is charged.
- Require all employees to pay the appropriate rent and cleaning deposits.
- Report fringe benefits correctly and timely to the SCO.
- Require waivers of liabilities from guests.

Hospital Issue 6: Accounting Controls Need Improvement

Accounting controls over critical processes need improvement to ensure that all disbursements are properly approved, accurately recorded, and made only for allowable purposes; cash receipts are deposited timely; advances are only made when necessary; and bank accounts are timely reconciled. Weak controls exist in the areas of cash disbursements, cash receipts, Revolving Fund, and bank reconciliation preparation.

Disbursements

- ASH, CSH, and NSH: Cal-Card user account setup forms are not retained and statement balances are paid without the appropriate Cal-card user and approving official signatures.
- ASH: One employee allows another employee to use his Cal-Card. Also, the Accounting Office pays invoices without evidence that the items are received and acceptable.
- ASH, CSH, and NSH: Voyager Fleet Card invoices are not reviewed and compared to receipts prior to payment.
- MSH: Gift card purchases for patients are allowed by MSH but the purchases are not reviewed for propriety. Also, contractor invoices did not always explain billable hourly rates.
- NSH: Checks are not posted to the accounting system on the same day they are written.

Cash Receipts

At NSH, posting of receipts to the cash receipts register is only done once a month. In addition, collections totaling $108,035 at June 30, 2007 have not been posted to the general ledger and are carried as a reconciling item on the bank reconciliation.

Revolving Fund

- NSH: Original forms are not maintained for numerous travel and expense advances. Also, salary advance documents do not always specify the reason for the advance and are not independently reviewed or certified.

- ASH and MSH: The specific reason for the advance is not always written on the salary advance request form and amounts advanced are greater than the employee's net salary.

Bank Reconciliations

Bank reconciliations are not properly prepared. For ASH, the bank reconciliation is not dated, preventing a determination of timeliness. Further, there has been a $54,416 reconciling item since 2005. At SVPP, the bank and revolving fund reconciliations are not dated or signed by the preparer or reviewer.

Recommendations

To ensure adequate accounting controls over critical processes:

- Compare Cal-Card and Voyager Fleet Card charges to appropriate approvals and supporting documentation before payments are made. Institute independent reviews of all expenditures, including gift card purchases, to ensure accuracy, propriety, and evidence of receipt.

- Ensure that only authorized employees use Cal-Card and Voyager Fleet Cards.

- Update accounting records promptly by posting checks and cash receipts.

- Maintain supporting documents for travel and salary advances, ensure that salary advances do not exceed the employee's net salary, and document the reason for the advance.

- Prepare reconciliations and include preparation dates and necessary signatures. Promptly reconcile, investigate, and close any reconciling items.

Hospital Issue 7: Weak Controls over Trust Accounting

The fiduciary duty of the Trust Office is to ensure the fiscal integrity over trust accounting. Our review identified issues or weaknesses at the hospitals:

- ASH: One patient's bank account, which is outside the State Treasury System, is in excess of $100,000 and does not have approval from the Department of Finance, Fiscal Systems and Consulting Unit. Also, the Trust Office does not prepare a listing of the checks routed to the programs for patient signature. Lastly, the correct amount from canteen lease rent revenue is not deposited into the Client Benefit Fund.

- CSH: The Client Benefit Fund balance of $2,600 is not recorded in the general ledger. Also, addresses are not properly verified when mailing discharged patients' monies or property. Such items are released and mailed to addresses verified from a telephone conversation and not a certified letter. Lastly, profit and loss statements are not prepared and therefore the profitability of the canteen is unknown. Canteens are required to operate on a nonprofit basis and any profits made, if any, should be deposited in the Client Benefit Fund.

- NSH: At June 30, 2007, the Client Benefit Fund, Vocational Services, and Special Purpose Trust Accounts totaling $174,138 are not recorded in the general ledger. Further, subsidiary records are not reconciled to the general ledger. In addition, the Client Benefit Fund Committee has not developed or recommended an annual expenditure plan for the special purpose trust accounts.

- PSH: The Canteen Correctional Services' receipt for goods is not reviewed by the Trust Office prior to debiting the patient's account. There is the risk patient's orders are fraudulently placed. Also, written approval from patients is not obtained when establishing savings accounts and automatic transfers. Lastly, trust monies are not always returned to discharged patients or their beneficiaries. As of August 31, 2007, trust funds for discharged patients totaled $84,421.

- NSH and PSH: Personal checks and money orders deposited into patient accounts are not always placed on hold for ten days prior to crediting to the account. Holding periods are necessary to ensure the checks and money orders are valid.

- ASH, MSH, and NSH: Inactive special purpose trust accounts are not promptly closed and liquidated. As a result, patients may not benefit from these funds.

- ASH, CSH, and MSH: The trust reconciliations for ASH, CSH, and MSH had unexplained reconciling items of $2,558, $9,487, and $15,349, respectively.

Recommendations

To improve trust accounting practices:

- Obtain approval from Department of Finance, Fiscal Systems and Consulting Unit, for bank accounts outside the State Treasury System.

- Prepare a listing or transfer receipts for checks and money orders transferred between employees.

- Record funds in the accounting records on a timely basis and perform reconciliations. Identify and timely clear reconciling items.

- Post receipts to the Client Benefit Fund.

- Review canteen charges for propriety prior to payment.

- Obtain and document patient approval prior to establishing other accounts or transferring funds.

- Timely remit discharged patient trust monies. Verify their addresses via certified mail.
- Close inactive special purpose trust accounts and develop an annual expenditure plan for such trust accounts.
- Establish an adequate hold policy for checks and money orders received for patients.

Hospital Issue 8: Financial Statement Preparation Needs Improvement

Certain hospitals reported incorrect accruals and encumbrances. As a result, the year-end reporting process does not ensure the reliability of financial statements.

- ASH: A prior year payroll accrual of $1.5 million was not reversed in 2006-07 and was re-reported.
- ASH and CSH: In 2006-07, encumbrances were overstated $3.5 million and $497,789 at ASH and CSH, respectively, for pending operations in 2007-08.
- ASH, MSH, and NSH: Both ASH and MSH failed to accrue $2.9 and $3.5 million, respectively, in salary increases related to the lawsuit *Ralph Coleman, et al., vs. Arnold Schwarzenegger et al.* NSH under-accrued these salary increases by $3.2 million thereby understating expenditures and liabilities for 2006-07 financial statements.

Recommendation

Properly report accrued expenditures in the year-end financial statements.

CONCLUSION

The Department of Finance, Office of State Audits and Evaluations (Finance), identified areas where controls are not in place or working as intended. Overall, the controls at the California Department of Mental Health (DMH) are weak and need improvement. Finance met with DMH management and staff to discuss opportunities for enhancements to activities designed to achieve DMH mission and goals. This report is intended to assist DMH management in focusing attention on areas of risk, strengthening internal control, and improving operations.

This report meets DMH's requirement to comply with the reporting provision of the Financial Integrity and State Manager's Accountability Act of 1983, Government Code Section 13400, et. seq.

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APPENDIX I
CRITERIA

Below is a compilation of the criteria used to develop each issue cited in our report.

HEADQUARTERS ISSUES

Issue 1: Fiscal Integrity At Risk

- State Administrative Manual (SAM) Section 8301 states that if a greater degree of budgetary control is necessary, additional allotments, other than those shown in the Governor's Budget, may be maintained.
- SAM Sections 9200 through 9244 provide guidelines on cost allocation and documentation requirements.
- SAM Section 6140 states that departments have the primary responsibility to operate within budgeted levels and to comply with any restrictions or limitations enacted by the Legislature. Further, Budget Act Control Section 26 provides that intra-schedule transfers within individual items of appropriation, when necessary for the efficient and cost effective implementation of the programs, may be made with the authorization of the Director of Finance and proper notification to the legislature.
- Government Code (GC) Section 13324 states that persons who incur expenditures in excess of budget are liable.
- SAM Section 20050 requires documentation of policies and procedures.

Issue 2: Inadequate Cash Flow Management

- GC 13403 states the elements of a satisfactory system of internal accounting and administrative controls include personnel of a quality commensurate with their responsibilities.
- SAM Section 8776.2 states that an invoice will be prepared and sent out as soon as possible after the recognition of a claim.
- SAM Section 8776.6 provides procedures and guidelines for the collection of receivables and discharge of accountability of uncollectible balances.
- Sound cash management techniques require the State to minimize the number of days that elapse between the disbursement of state funds for federal program purposes and the receipt of federal reimbursing funds.
- SAM Section 7920 states that each agency is responsible to complete any reconciliation necessary to safeguard the State's assets and ensure reliable financial data.
- OMB Circular A-87, Attachment A, Section C provides guidelines on allowable costs including the requirement for documentation. Attachment A, Section E provides that direct costs include compensation of employees for the time devoted and identified

specifically to the performance of those awards. Attachment B, Section 8h requires charges to federal awards for salaries and wages be based on payrolls documented in accordance with generally accepted practices of the governmental unit and approved by a responsible official(s) of the governmental unit. Where employees work on multiple activities or cost objectives, a distribution of their salaries or wages will be supported by personnel activity reports or equivalent documentation.

- Welfare and Institutions Code Section 14684.1 (c) states the amount of Treatment Authorization Appeal Review fees shall be calculated and adjusted annually

Issue 3: Reporting Structure of the Information Security Officer Is Ineffective

- SAM Section 4841.1 states that the Information Security Officer (ISO) is required to oversee agency compliance with policies and procedures regarding the security of information assets. The ISO must be directly responsible to the agency director for this purpose and be of a sufficiently high-level classification that he or she can execute the responsibilities of the office in an independent manner.
- SAM Section 4841.1 states that the Director must certify that the agency is in compliance with state policy governing information technology (IT) security and risk management by submitting the Risk Management Certification.
- SAM Section 4841 requires an IT risk management program, including a risk analysis process (SAM Section 4842.1). The Statewide Information Management Manual (SIMM) Section 05A requires this document be submitted annually by January 31.
- SAM Section 4843.1 requires each agency to maintain an Operational Recovery Plan including the agency's plans for resuming operations following an unplanned disruption of critical applications.
- SAM Sections 4841.2 and 4841.3 requires each agency to provide integrity and security ensuring that each automated file or database is classified as public or confidential information. Files and databases containing sensitive and/or personal information require special precautions to prevent inappropriate disclosure. When sensitive or personal information is contained in public records, care must be taken to protect it from inappropriate disclosure.
- GC 13403 states an element of a satisfactory system of internal accounting and administrative controls is a plan that limits access to state assets to authorized personnel who require these assets in the performance of their assigned duties.
- SAM Section 4841.5 requires information owners to define precautions for controlling access to and preserving the security and integrity of files and data bases that have been classified as requiring such precautions; and authorizing access to the information in accordance with the classification of the information and the need for access to the information.
- SAM Management Memo 06-12 regarding Protection of Information Assets provides guidance on the security of information assets, including but not limited to, electronic and paper.
- SAM Section 8080.1 provides that programming should be separate from system maintenance (maintaining records file) and reconciliation of input to output.

Issue 4: Project Management Practices Do Not Meet Requirements

- GC Section 13403 states that elements of a satisfactory system of internal accounting and administrative control includes established practices to be followed in performance of duties and functions.
- SAM Section 4800 states that each agency shall employ proven management methodologies to guide and control the planning, acquisition, development, operation, maintenance, and evaluation of information management applications.
- SAM Section 4819.31 requires each state agency to manage IT projects following the established IT Project Oversight Framework (SIMM Section 45) minimum requirements.

Issue 5: Inadequate Contract Development and Monitoring

- California Department of Mental Health (DMH) Policy Directive 402 requires evaluation panels to evaluate each proposal bid.
- State Contracting Manual (SCM) Section 5.15 provides that where services are complex, uncommon, or unique, evaluation committees should be used to select the most qualified bidder (secondary method).
- SCM Section 7.30 provides that reimbursable contract budgets must include personal service costs showing individual or position rates per unit of time, and fringe benefit costs citing actual benefits or a percentage of personal services costs among other costs.
- SCM Section 2.04 states that management of the contract must be built into the contract to facilitate measurement of achievement and measurement of contractor performance including: identifying the deliverables and ensuring satisfactory delivery; monitoring progress, especially for quality and performance deadlines; reviewing invoices for contract compliance, accuracy, and prompt payment; and tracking deadlines and use of funds.
- SCM Section 9 lists the responsibilities of contract managers including monitoring of contracts.

Issue 6: Inadequate Safeguarding of Assets

- GC Section 13403 states the elements of a satisfactory system of internal accounting and administrative controls include: a system of authorization and record keeping procedures adequate to provide effective accounting control over assets, liabilities, revenues and expenditures; a plan of organization that provides segregation of duties appropriate for proper safeguarding of state assets; and an effective system of internal review.
- SAM Sections 1208 and 3507, and SCM Section 2.06 state that authority to sign purchase and contract documents is limited to those officers with statutory authority or have been authorized in writing by one who has statutory authority. A written record of employees authorized to enter into and sign contracts, purchase requisitions, etc. is also required.
- Criteria regarding separation of duties are stated in Appendix II: Separation of Duties.

- SAM Section 8082 requires the signature plate to be locked when not in use, in a secure place with the key in the custody of the person authorized to sign checks.
- SAM Section 8422 requires invoices to be audited to ensure they comply with the provision of purchase orders, contracts, and similar documents, and authority existed to obtain the goods or services.
- SAM Section 7908 requires the preparer's name, reviewer's name, date prepared, and date reviewed on all reconciliations.
- SAM Section 20080 requires notification in writing of actual or suspected fraud and irregularities to the Department of Finance and the Bureau of State Audits on the first business day following the actual or suspected fraud, theft, or irregularity.
- SAM Section 8650 requires recording of all property in a property accounting system (e.g. property register) showing detailed information.
- SAM Section 7924 provides for the reconciliation of acquisitions and dispositions of capitalized property with the property register monthly or quarterly.
- SAM Section 8652 requires a physical count of all property and reconciliation to the accounting records at least once every three years.

Issue 7: Financial Statement Preparation Needs Improvement

- SAM Section 8751 defines a contingent liability as an obligation relating to a past transaction or event that may be payable in the future. A contingent liability exists when it is only possible that the payment will be made. A statement of all contingent liabilities and liabilities payable from a future appropriation will be prepared at year-end. These liabilities will be reported in Statement No. 22, Statement of Contingent Receivables and Contingent Liabilities.
- SAM Section 7980 states that agencies will establish appropriate memorandum accounts as a record of these liabilities.
- SAM Section 7950 states that agencies prepare year-end reports as soon after June 30 to meet the required due dates and to estimate accruals with reasonable accuracy.
- CALSTARS Procedures Manual, Volume 7, Chapter 1 suggests mid-June is a reasonable date to obtain accrual information from programs.
- SAM Sections 10608 and 10609 provide the entries for accruing payables and reversing payables in the new fiscal year. Further, SAM Section 10608 also requires a review of all encumbrances unliquidated as of June 30 for validity and accuracy.

HOSPITAL CRITERIA

Hospital Issue 1: Inadequate Personnel Practices

- SAM Section 8539 requires maintenance of complete records of attendance and absences for each employee during each pay period. These records will be properly certified. When individual time records are maintained by employees, they will be signed by both the employee and the employee's supervisor. Persons certifying attendance reports cannot certify his/her own attendance report.

- SAM Section 8540 provides that compensation for overtime should be based upon prior written approval signed by a designated supervisor, and authorized and issued in accordance with bargaining unit agreements.
- SAM Section 20080 requires notification in writing of actual or suspected fraud and irregularities to the Department of Finance and the Bureau of State Audits on the first business day following the actual or suspected fraud, theft, or irregularity.
- SAM Section 8580.4 recommends that a check-out list acknowledging the return of state-owned items such as credit cards, keys, state records, and equipment be completed for separating employees prior to the release of the final warrant. The check-out list may also include the verification from the office revolving fund staff that there are no outstanding travel or salary advances.

Hospital Issue 2: Acquisition Controls Need Improvement

- SCM Section 1.06 states that circumvention of required competitive bidding or contract approval is unlawful.
- SCM Section 4.04 indicates the Department of General Services (DGS) approval is required for contracts over $50,000, unless otherwise exempted from the DGS.
- SCM Section 2.05 provides that contracts must include a term for the performance or completion of the contract to be valid.
- SCM Section 7.30 provides that reimbursable contract budgets must include personal service costs showing individual or position rates per unit of time, and fringe benefit costs citing actual benefits or a percentage of personal services costs among other costs.

Hospital Issue 3: Ineffective Accounting and Oversight of Accounts Receivable

- SAM Sections 8776.1 and 8776.2 provide guidance on the establishment of receivables including standard entries. Further guidance is provided in SAM Section 10506.
- SAM Section 7814 states that when a receivables ledger is used, an account for each debtor is debited when amounts become due and credited when payments are received.
- SAM Section 10506 provides standard receivable entries and guidance on the accounting treatment of accounts receivable when billed, collected, and cleared.
- SAM Section 1323.1 states that the Director of DGS, with the consent of the state agency concerned, may lease state-owned real property to others for a period not to exceed five years. Leases of state-owned property are required to reflect fair market rental, with certain exceptions.
- SAM Sections 8776.6 and 8776.7 provide procedures for the timely and systematic collection of employee and non-employee receivables and write-off procedures.
- SAM Sections 8593.1 through 8593.3 provide guidance on the recovery of payroll overpayments.
- SAM Section 8116.3 provides guidance for timely recovery of travel advances.

Hospital Issue 4: Inadequate Safeguarding of Assets

- SAM Section 20050 requires an effective internal review process.
- SAM Sections 1208 and 3507, and SCM Section 2.06 state that authority to sign purchase and contract documents is limited to those officers with statutory authority or have been authorized in writing by one who has statutory authority. A written record of employees authorized to enter into and sign contracts, purchase requisitions, etc. is also required.
- SAM Section 8041 states that no person will sign checks until an authorization card bearing his signature has been prepared and filed by the agency.
- Criteria regarding separation of duties are stated in Appendix II: Separation of Duties.
- SAM Section 8041 states that agencies will keep check stock under strict control at all times and in accordance with SAM Section 8080.
- SAM 8081 requires the check signing machine operator to lock the machine and remove the key or keys whenever the machine is not in use.
- SAM Section 8082 requires the signature plate to be locked when not in use, in a secure place with the key in the custody of the person authorized to sign checks.
- SAM Section 8580.5 requires a written record of all undelivered warrants.
- SAM Section 4841.5 requires information owners to define precautions for controlling access to and preserving the security and integrity of files and data bases that have been classified as requiring such precautions; and authorizing access to the information in accordance with the classification of the information and the need for access to the information.
- SAM Section 8080.1 provides that programming should be separate from system maintenance (maintaining records file) and reconciliation of input to output.
- Best business practices provide that high cost susceptible items need to be adequately controlled.
- SAM Section 8650 requires recording of all property in a property accounting system (e.g. property register) showing detailed information.
- SAM Section 8652 requires a physical count of all property and reconciliation to the accounting records at least once every three years.
- SAM Section 7924 provides for the reconciliation of acquisitions and dispositions of capitalized property with the property register monthly or quarterly.
- SAM Section 8640 provides that DGS must approve all property dispositions and requires preparation and approval of property survey reports and timely disposition of property. Further, items held in the suspense file more than 30 days must be reviewed by an agency official to determine why the disposition has not been completed.

Hospital Issue 5: Incomplete or Outdated Employee Housing Rental Agreements

- SCM Section 2.05 provides that contracts must include a term for the performance or completion of the contract to be valid.
- California Code of Regulations, Title 2, Division 1, Chapter 3, Subchapter 1, Article 3, Section 599.646 delegates to state agencies administering rental schedule for employee

housing the responsibility to apply rental rates in accordance with regulations and to adjust the rates as required by changes in age and other factors.

- DMH Special Order No. 213.01 provides guidance on employee housing.
- State Controller's Office (SCO) Payroll Procedures Manual Section N-135 provides guidance on housing and condition of employment requirements.
- SAM Section 8572 provides guidance on the reporting of fringe benefits.
- SCO Payroll Letter #06-006 requires timely and accurate reporting of fringe benefits.

Hospital Issue 6: Accounting Controls Need Improvement

Disbursements

- SAM Section 20050 requires an effective internal review process.
- SAM Section 8422 requires invoices to be audited to ensure they comply with the provision of purchase orders, contracts, and similar documents, and authority existed to obtain the goods or services.
- SAM Section 8422.20 states that the accounting officer will compare the stock received report to the purchase order and invoice. If these documents are not available for comparison, claims will not be filed for payment.
- SAM Section 4108 requires agencies to review gasoline credit card charges and monthly billing statements in order to reduce unnecessary and improper charges. Further, it requires agencies to pursue recovery of unauthorized charges.

Cash Receipts

- Preferred accounting practices require that collections be recorded as soon as possible, preferably on the date of receipt.
- SAM Section 8032.3 requires verification of deposits by the person supervising the person depositing cash.
- SAM Section 8032.1 states that accumulated receipts of any amount will not remain undeposited for more than 10 working days.

Revolving Fund

- SAM Section 8110 states that the Revolving Fund may be used only, in accordance with law, for payment of compensation earned, traveling expenses, traveling expense advances, or where immediate payment is otherwise necessary (GC Section 16401).
- SAM Section 8595 states that payroll advances shall be issued for amounts as close as possible to the actual net payments which will be made by the SCO less other amounts due to the agency for advances, maintenance, etc.

Bank Reconciliations

- SAM Section 7908 requires the preparer's name, reviewer's name, date prepared, and date reviewed on all reconciliations.
- SAM Section 7923 requires errors on the bank statement to be corrected. The person reconciling the bank statement will trace every reconciling item between the bank and the agency's records and include an explanation on the reconciliation.

- SAM Section 8070 states that state officers and employees who receive and disburse money will be held accountable for the money in their custody. They will be held personally responsible for any cash discrepancies.

Hospital Issue 7: Weak Controls over the Trust Accounting

- SAM Section 19462 provides the requirements for bank accounts for trust activities.
- DMH Special Order No. 216 provides guidance on canteen operations.
- SAM Section 8021 requires the use of transfer receipts to localize accountability for cash or negotiable instruments to a specific employee from the time of its receipt to its deposit.
- SAM Section 19425.1 requires unclaimed cash be remitted to the State Treasurer's Office for deposit in the Unclaimed Property Fund one year after the death of the inmate. SAM Section 19425.2 provides the same requirement but after seven years of the escape, discharge, or parole of inmates.
- SAM Section 7923 requires errors on the bank statement to be corrected. The person reconciling the bank statement will trace every reconciling item between the bank and the agency's records and include an explanation on the reconciliation.

Hospital Issue 8: Financial Statement Preparation Needs Improvement

- SAM Section 7950 states that agencies prepare year-end reports as soon after June 30 to meet the required due dates and to estimate accruals with reasonable accuracy.
- SAM Sections 10608 and 10609 provide the entries for accruing payables and reversing payables in the new fiscal year. Further, SAM Section 10608 also requires a review of all encumbrances unliquidated as of June 30 for validity and accuracy.

Appendix II

Segregation of Duties

A key element in a system of internal control is separation of duties. The table below summarizes the incompatible separation of duties identified at headquarters and the hospitals. Industry best practices and the State Administrative Manual were the criteria used to identify conflicting duties. Refer to the legend below when analyzing the Segregation of Duties table.

LEGEND

Criteria	Conflicting Duty Identifier
Industry best practices recommends the approval, recordkeeping, and custody functions be separated.	A = Approval R = Recordkeeping C = Custody
SAM Section 8080 states that no one person will perform more than one of 7 types of duties.	1 = Receiving and depositing remittances 2 = Authorizing disbursements 3 = Preparing checks 4 = Operating a check signing machine* 5 = Comparing machine-signed checks with authorizations and supporting documents (or signing checks manually after personally comparing them with authorizations and supporting documents)* 6 = Reconciling bank accounts and posting the General Ledger or any subsidiary ledger affected by cash transactions* 7 = Initiating or preparing invoice * = Will not have access to or control blank check stock. ** = Checks will not be routed for mailing or distribution through the person who authorized the disbursement or prepared the check.
SAM Section 8652 states inventories will not be exclusively controlled by the custodian of the property records; and the person in charge of the stockroom, if one is used, will not be in charge of maintaining the inventory records nor the taking of physical inventories.	SAM Section 8652

Hospital	Issue	Conflicting Duties
	General	
SVPP	One staff receives and deposits cash receipts, has access to the blank check stock and prepares and distributes checks, and posts receipts and disbursement to subsidiary and general ledgers.	1,3**,6*
	Two staff approve purchases, sign checks, and control blank check stock.	5* A,C
VPP	One staff receives and deposits cash receipts, prepares checks, and posts checks to the disbursement register.	1,3,6
	One staff reconciles bank accounts and post to the general ledger, operates check signing machine, and controls blank check stock.	6, 4*
	Cash Receipts	
MSH	One staff receives and deposits cash receipts and posts receipts to the cash receipts register.	1,6
NSH	In the Trust Office, one staff receives cash receipts and posts to the cash receipts register.	1,6
	Accounts Receivable	
ASH	One staff initiates/prepares invoices, maintains the rents receivable ledger, prepares checks for rent refunds, and prepares adjustments.	3, 6, 7
NSH	Two staff initiate/prepare invoices and maintain the accounts receivable ledger.	6, 7
	Another staff prepares invoices, receives payments, and maintains the receivable ledgers.	1,6,7
	Disbursements	
HQ	One staff prepares and distributes checks, and has control over the blank check stock. This staff is also responsible for cashiering duties including receiving, posting, and depositing of cash receipts.	1, 3,6*,**
	One staff prepares checks, reconciles the revolving fund and bank account, and posts to the disbursement register and general ledger.	3, 6
	One staff prepares and distributes checks, and posts to the disbursements register.	3**
	One staff operates the check signing machine, has access to blank check stock, and distributes checks.	4*,**
ASH	One staff prepares checks, posts disbursement to the general ledger, and controls the blank check stock.	3,6*
	In the Trust Office, two staff prepare checks, have access to TACS for posting, and have access to the blank check stock.	3,6*
CSH	One staff prepares checks and distributes them, posts to the cash disbursements register, and has access to blank check stock.	3**, 6*
	One staff signs checks and controls blank check stock.	5*
	One staff prepares the bank reconciliation and has access to the blank check stock. Also, this staff initiates invoices and posts receivable transactions to the receivables register.	6*,7
	One staff operates the check signing machine and has access to the blank check stock. The staff also deposits checks.	1,4*
	In the Trust Office, one staff receives cash receipts, posts receipts and disbursements, and controls the blank check stock.	1,6*
	In the Trust Office, one staff operates the check signing machine and has access to the blank check stock.	4*

Hospital	Issue	Conflicting Duties
	Disbursements (continued)	
MSH	One staff has custody of gift cards, makes the purchases, and keeps the expenditure records such as receipts.	A,R,C
	One staff prepares disbursement requests and checks, controls the blank check stock, and prepares the bank reconciliation.	3, 6*
	In the Trust Office, one staff authorizes disbursement requests for Medicare Part B and D premiums, prepares the disbursement requests, and reviews and mails the signed checks.	A,R,C
NSH	One staff prepares checks, posts to the disbursements ledger, and has access to the blank check stock.	3,6*
	Two staff prepare and distribute checks.	3**
	In the Trust Office, five staff operate the check signing machine and have access to blank check stock. Three of the staff also post to the disbursements register and one of the three prepares checks.	3, 4*, 6
PSH	Three staff sign checks and have access to the blank check stock.	5*
	Four staff prepare checks and distribute them.	3**
	Fixed Assets	
ASH	All warehouse personnel maintain the property ledger file (ONTRAC) and conduct inventory.	R,C
NSH	One staff has property custody duties, maintains the property subsidiary ledger, and reconciles the property ledger to the general ledger.	SAM Section 8652
HQ, CSH, MSH, PSH	Property controllers have custody of property and recordkeeping duties.	SAM Section 8652

Appendix III

Hospital Best Practices

During the course of our review, we identified best practices at the hospitals. This compilation of best practices was not tested or evaluated in detail and is provided for informational purposes only. Additional analysis is required to validate the effectiveness and efficiency of these practices.

Hospital	Procedures	Description
		Disbursements
ASH	Medicare Part B and D Patient Database	ASH has designed an in-house database to track patients with Medicare Part B and D premium payments. In addition, ASH has an in-house program that will initially determine if the patient will qualify for Medicare Part D insurance.
CSH	Outpatient Medical Bills	Prior to processing payment, accounting staff verifies that a contract exists, and services were rendered by tracing the date of service to the outside schedule prepared by the medical clinic or the emergency services log prepared by the utilization review nurses.
PSH	Medicare Part B Premium Payment	Medicare Part B payment is set up electronically with the Center for Medicare and Medicaid Services. This allows PSH to effective pay the premium for patients with Medicare Part B.
		Trust
ASH	Return of Patient Monies upon Discharge	ASH has a Receiving and Release (R&R) Department that notifies the Trust Office when a patient is discharged. This allows the Trust Office to return monies to patients upon discharge.
CSH and MSH	Canteen/Patient Accounts	To ensure that the MSH patients are only charged for what they ordered through the Canteen Services, receipts are traced through the order and vendor invoice on a sample basis prior to debiting the patient's account. Both CSH and MSH provide monthly account statements (listing their deposits and withdrawals) to patients.
		Acquisitions
ASH	Employee Housing	Housing Agreement Forms contain most of the agreement elements as required by the Special Order, and ASH charges a security (cleaning) deposit.
PSH	Contracts and Purchasing Desk Procedures	Desk procedures are well written, easily understood, and help expedite training.
PSH	Total Package	Allows purchase orders to be prepared and tracked in one database electronically. The database includes inventory tracking and reporting capabilities.
PSH	Cal-Card Program	Provides ongoing training to users (both US Bank and in house procedures)
		Personnel
ASH	Personnel Specialist Desk Procedures	ASH keeps approximately 5 large binders full of step by step procedures, memos, etc, filed by topic, which cover most transactions.
ASH	Travel Advances	Only 90 percent of the total travel expense costs are advanced to ensure that a Travel Expense Claim will be submitted timely.
ASH	Time Reporting – more than one position	Requires all staff who work more than one position to complete a timesheet to increase accountability.
ASH	Real Time Removal of Exiting Staff	An internal program allows the Personnel and Hospital Police Department to disable exiting staff access to the facility as well as the computer network on a real time basis.
NSH	Staff Termination	NSH has the most comprehensive employee separation forms.
NSH	Media Usage for Recruitment	Human resources has a video on its website with level of care staff emphasizing job satisfaction to attract new candidates.
ASH and SVPP	Payroll Audits	ASH conducts random overtime audits to uncover potential abuse and fraud. SVPP requests HQ Personnel to conduct a review of salaries and overtime.

Appendix IV

Hospital Issues Matrix

No.	Issue	ASH	CSH	MSH	NSH	PSH	SVPP	VPP
	Personnel							
1	Inadequate attendance records and improper payroll, including overtime	●	●	●	●		●	
1	Inadequate employee separation process	●	●		●	●		
	Acquisitions							
2	Purchase and contract execution	●	●	●	●	●		
2	Contract language provisions	●		●	●			
2	Contract processing	●	●	●	●	●		
	Accounts Receivable							
3	Unrecorded or unsupported accounts receivable	●	●	●	●	●		
3	Lease accounts receivables need improvement	●	●	●	●			
3	Inadequate collection efforts	●	●	●	●	●	●	●
	Safeguarding of Assets							
4	Inadequate approval delegation	●	●	●	●	●	●	●
4	Inadequate separation of duties	●	●	●	●	●	●	●
4	Inadequate controls over checks	●	●		●	●		●
4	Inadequate access right to system applications	●	●	●	●	●		
4	Inadequate inventory controls in pharmacy	●	●	●	●	●		
4	Controls over property need improvement	●	●	●	●	●	●	●
	Employee Housing							
5	Inadequate employee housing rental agreements	●		●	●	●		
	Accounting Controls							
6	Inadequate controls over disbursements	●	●	●	●	●		
6	Controls over cash receipts are weak				●		●	●
6	Controls over Revolving Fund are weak	●		●	●			
6	Bank reconciliations procedures need improvement	●					●	
	Trust Accounting							
7	Controls over trust accounting could be improved	●	●	●	●	●		
	Financial Reporting							
8	Inadequate accruals and encumbrances	●	●	●	●			

CALIFORNIA DEPARTMENT OF
Mental Health

1600 9th Street, Sacramento, CA 95814
(916) 654-2309

January 22, 2008

Ms. Janet I. Rosman, CPA, CGFM
Acting Chief, Office of State Audits and Evaluations
California Department of Finance
300 Capitol Mall Suite, 801
Sacramento, CA 95814

Dear Ms. Rosman:

The Department of Mental Health is in receipt of your January 2008 report, "Final Review -- California Department of Mental Health – Internal Controls." We would like to compliment your staff for a professional approach to this project, and their effective communication and collaboration with our management throughout the review.

This report supports our new management team's continuing initiatives and focus on prevention and mitigation of financial and administrative risks through enhanced internal controls, rigorous program assessment, and performance measurement tools and activities. We continue to utilize your Supervising Auditors to implement Control Self Assessment (CSA) and other management evaluation and reporting tools that will help us continue improvements to our program, fiscal, information technology, and administrative operations.

We recognize and appreciate that this review was large in scope and comprehensive in regard to our fundamental internal controls in our Headquarters, five State Hospitals, and two Psychiatric Programs. In total, the 15 Issues and 75 Recommendations will be monitored and implemented through a Corrective Action Plan that we will develop and provide to your office by March 3, 2008.

During our management team's evaluation and consideration of the issues and recommendations, there were several points we determined should be communicated in response, including:

- Your efforts to appendix "Hospital Best Practices" is appreciated as we will be looking to implement system-wide reforms that will improve the administrative services to better serve all of our individuals in these care and treatment facilities;

- The appendix which breaks out issues by Hospitals is very helpful in our collaborative efforts to manage the corrections and issues specifically at each location, as well as a system-wide tool;

- We will identify in our Corrective Action Plan many of these issues which have been immediately corrected to effectively reduce the internal control risk;

- As your review identifies issues at a certain place and time during the process, we want to make you aware that we have made organizational changes to elevate the reporting relationship of the Information Security Officer to the Directorate. As of November 2007, the Information Security Officer reports to my Chief Counsel. Our lead attorney reports to the Director, and we believe that this meets State Administrative Manual (SAM) Section 4841.1 requirements; and

- As your report indicates, this evaluation will also serve to satisfy our Financial Integrity and State Management Accountability Act (FISMA) provisions per Government Code Section 13400 et seq..

On behalf of the California Department of Mental Health, thank you for this important review of our administrative and fiscal system Internal Controls. We are also appreciative of your continued support to help us improve the management, accountability, effectiveness, and efficiencies of our department through the professionalism and expertise provided by your staff.

Sincerely,

Original signed by:

STEPHEN W. MAYBERG, Ph.D.
Director