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February 11, 2009

Mark B. Horton, M.D., M.S.P.H., Director
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Dear Dr. Horton:

Final Report—California Department of Public Health, 2006-07 Evaluation of Special Funds

The Department of Finance, Office of State Audits and Evaluations (Finance), has completed its evaluation of special funds of the California Department of Public Health (DPH) for the fiscal year 2006-07. This evaluation was performed in accordance with Interagency Agreement 06-55416.

The enclosed report is for your information and use. The DPH's response to the reported observations and our evaluation of the response are incorporated into this final report.

In accordance with Finance's policy of increased transparency, this report will be placed on our website.

We appreciate the assistance and cooperation of the DPH's staff during this evaluation. If you have any questions regarding this report, please contact Susan M. Botkin, Manager, or Chikako Takagi-Galamba, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

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

Enclosure

cc: Mr. David Whitsell, Chief, Internal Audits, California Department of Public Health
Ms. Mary Cody, Audit Coordinator, Internal Audits, California Department of Public Health
Ms. Karen Petruzzi, Health Program Auditor, Internal Audits, California Department of Public Health

A SPECIAL REPORT

California Department of Public Health
Evaluation of Special Funds
Fiscal Year 2006-07

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

084265051

November 2008

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EXECUTIVE SUMMARY

The Department of Finance, Office of State Audits and Evaluations (Finance), completed an evaluation of special funds administered by the California Department of Public Health (DPH) for fiscal year 2006-07 in accordance with Interagency Agreement 06-55416. The objectives of the evaluation included the following:

1. Evaluate the financial conditions of the Health Statistics Special Fund (HSSF) and Genetic Disease Testing Fund (GDTF) and, if applicable, identify factors contributing to negative financial conditions over revenues and expenditures.
2. Evaluate the prenatal screening (PNS) and newborn screening (NBS) test fee structures to ensure fees are aligned with associated costs in administering the Genetic Disease Screening Program.
3. Evaluate the current status of the DPH's corrective actions to resolve prior observations reported in Finance's 2005-06 Review of Special Funds.

Summary of Results:

1. **Evaluation of Financial Condition**
   No recurring deficits that affect the HSSF's financial condition were observed. However, there are two issues that could negatively affect the fund's financial condition if unresolved: (1) a vital statistics revenue variance of $1.2 million between program and general ledger records, and (2) inadequate procedures causing a delay in revenue collections.

   It is anticipated that the GDTF will experience a deficit in 2008-09; the fund reserve might decline to a negative fund balance of $2.1 million at the end of 2008-09. Factors contributing to the fund's negative financial condition include: revenue variances between program and general ledger records, need for a review of revenue projections, need for improvements over billing and collection procedures, Richmond debt service charges above their fair share, and vendor invoice created and approved by using the Screening Information System.

2. **Evaluation of Fee Structure**
   The genetic disease test fee structures should be reevaluated to better realign the patients' fees with associated costs in the following fee components: contracted services and laboratory services for PNS; and contracted services, laboratory services, pro rata, general expenses, and other operating expenses for NBS. The General Fund loan repayment fee component should also be reevaluated once loans are fully repaid.

   If the issues described in items 1-3 are unresolved, they could adversely affect the financial solvency of the DPH's cash, budgetary, and service levels, resulting in an inability to: meet cash flow needs, generate revenues to meet expenditures, and provide services required for the health, safety, and welfare of Californians. Therefore, the DPH management should review each observation and develop corrective actions to resolve these issues.

3. **Prior Observation Follow-up**
   Of the seven prior observations evaluated, one observation has been resolved, two observations are partially resolved, and four observations had not been resolved. As a result of the prior observation follow-up, two new issues were identified: (1) improvements are required for the Clinical Laboratory Improvement Fund's (CLIF) fiscal accountability, and (2) a Tissue Bank License Program Fund employee's full-time salary was paid by CLIF.

BACKGROUND, SCOPE, AND METHODOLOGY

BACKGROUND

Pursuant to Senate Bill 162 (Chapter 241 of the Statutes of 2006), effective July 1, 2007, the former California Department of Health Services was split into two new departments. A wide range of public and environmental health programs and responsibilities were transferred to the newly established California Department of Public Health (DPH). The mission of the DPH is to protect and improve the health of all Californians.

Many of DPH's programs are fully funded by special revenue funds. As defined by Generally Accepted Accounting Principles, special funds are used specifically to account for revenue sources restricted to expenditures for particular purposes. Special fund revenues include user fees, license fees, and other fees mandated for specific purposes. To maintain the current level of the public health programs and to minimize potential negative impacts to Californians, it is essential for the DPH to adequately manage and track resources.

The DPH entered into a three-year interagency agreement with the Department of Finance, Office of State Audits and Evaluations (Finance), to perform special fund evaluations for fiscal years 2005-06, 2006-07, and 2007-08. During the year one evaluation for 2005-06, a risk analysis of DPH special funds was performed, and nine observations associated with revenues and expenditures were reported. Further, the preliminary analysis of the fund conditions presented in the Governor's Budget has identified declining trends in fund balances for some special funds. These trends could potentially affect the DPH's ability to carry out the objectives of the special funds. Therefore, the year two evaluation is conducted to: (1) evaluate the financial conditions for selected funds, (2) evaluate the fee structure for a selected fund, and (3) evaluate the status of the DPH's corrective actions to resolve prior year observations.

SCOPE AND LIMITATIONS

Finance performed the year two evaluation of the DHS' special funds for the fiscal year 2006-07. The objectives of the evaluation include the following:

- Evaluate the financial conditions of the Health Statistics Special Fund (HSSF) and Genetic Disease Testing Fund (GDTF) and, if applicable, identify factors contributing to negative financial conditions over revenues and expenditures.
- Evaluate the prenatal screening (PNS) and newborn screening (NBS) test fee structures to ensure fees are aligned with associated costs in administering the Genetic Disease Screening Program (GDSP).
- Evaluate the current status of the DPH's corrective actions to resolve prior observations reported in Finance's 2005-06 Review of Special Funds.

The evaluation excludes or does not address the following:

- A workload study of special funds.
- An efficiency and effectiveness assessment of operations.
- An evaluation of the information systems used in administering special fund programs.
- An evaluation of the special funds' compliances with applicable laws and regulations.
- An evaluation of the general internal controls over collections and disbursements functions.

In general, the evaluation used transactions and processes completed or implemented during 2006-07. The evaluation period was expanded where additional procedures were necessary.

METHODOLOGY

To evaluate the financial conditions of the HSSF and GDTF, the following procedures were performed:

- Reviewed DPH records over revenues and expenditures obtained from the program and California State Accounting and Reporting System (CALSTARS) records.
- Using DPH records, if applicable, recalculated the projected fund reserve balance.
- Identified factors affecting the financial condition through interviews of the DPH staff and review of relevant documents.
- Gained an understanding of the billing and collection process through interviews of key staff, walkthroughs, and review of relevant documents.
- Conducted testing of billing and collection procedures on a sample basis and determined if weaknesses in collection procedures are negatively affecting the fund's financial condition.
- Gained an understanding of budget and expenditure monitoring through interviews of DPH staff.
- Analyzed the adequacy of cost controls through review of monitoring procedures for selected contracts.
- Gained an understanding of the revenue estimate methodology through interviews of DPH staff and review of relevant documents.
- Analyzed the reasonableness of the revenue estimate methodology, if applicable.

To evaluate the current fee structure for the GDTF, the following procedures were performed:

- Gained an understanding of the PNS and NBS fee structures through semi-structured interviews with management and staff and review of the fee structure documentation.
- Identified cost components included in the fee structures.
- Used revenue and expenditure figures obtained from the program and CALSTARS records to compare patients' fees to associated costs.

The documentation, describing how the costs for each fee component were arrived at, was not available at the time of the evaluation. Therefore, actual expenditures were compared to the current fee component amounts.

To determine whether appropriate actions have been taken to resolve prior observations, the following procedures were performed:

- Reviewed the prior evaluation work.
- Reviewed the DPH's corrective action plans, if any.
- Interviewed the DPH staff and reviewed policies and procedures to gain an understanding of the current procedures.
- Performed limited testing to determine whether the DPH implemented appropriate corrective actions to resolve prior observations.
    - A sample of transactions was selected from 2006-07 transactions.
    - If observations were not corrected during 2006-07, the evaluation was expanded to 2007-08 transactions.

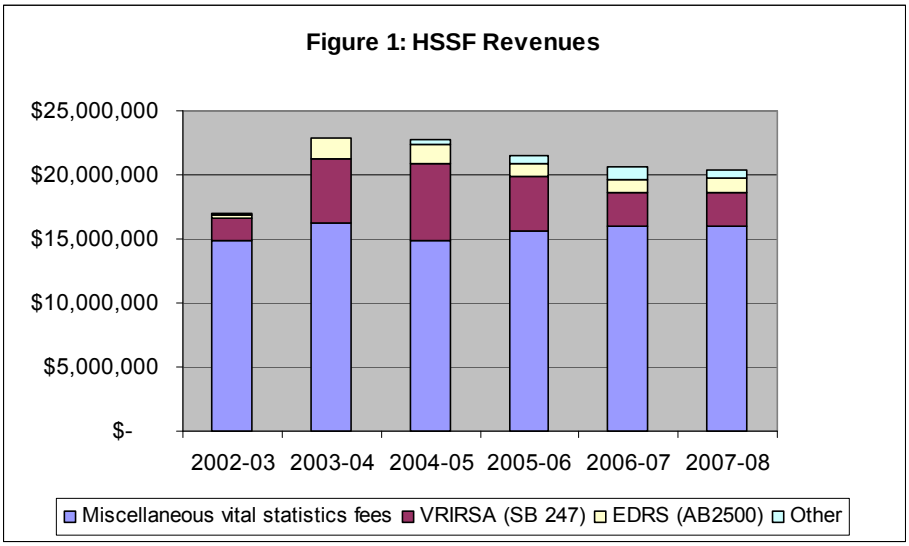
The fieldwork began on March 17, 2008 and was completed on July 10, 2008. The detailed results of the evaluation are discussed in the Results of the Evaluation of Special Funds section of this report.

Pursuant to the interagency agreement between the California Department of Public Health (DPH) and the Department of Finance, Office of State Audits and Evaluations (Finance), an evaluation of special funds for the fiscal year 2006-07 was performed. The results are discussed below.

1. Evaluation of Financial Condition

We evaluated the financial conditions of the Health Statistics Special Fund (HSSF) and the Genetic Disease Testing Fund (GDTF) and identified factors contributing to negative financial conditions over revenues and expenditures.

Health Statistics Special Fund:
The HSSF revenues primarily consist of three components: (1) fees to provide miscellaneous vital statistics documents to the public, (2) additional fees to implement Senate Bill (SB) 247 (Chapter 914 of the Statutes of 2002), and (3) additional fees to implement Assembly Bill (AB) 2550 (Chapter 857 of the Statues of 2002). See Attachment B of this report which describes the special funds and the applicable state laws and regulations that govern the program expansion.



Source: Finance's analysis of the HSSF records

Beginning January 1, 2003, the Center for Health Statistics (CHS) was allowed to charge an additional $2 for birth and death records to develop the Vital Records Image Redaction Statewide Access (VRIRSA) in accordance with SB 247. The fee was then lowered to $1 on January 1, 2006. AB 2550 required the implementation of an Electronic Death Registration System (EDRS) and allowed the CHS to impose an additional $6 charge on the disposition of human remains. This fee was lowered to $4 on January 1, 2005. These additional fees built reserves to fund increased costs associated with the implementation of SB 247 and AB 2550 in

future years. Consequently, revenues as a whole give the appearance of decreasing; however, fees from providing miscellaneous vital statistics remained relatively constant as illustrated in Figure 1. It is anticipated that the HSSF will have a fund reserve of approximately $8 million at the end of 2008-09.

However, the evaluation identified the following issues that could negatively affect the HSSF's financial condition if they are left unresolved:

Observation 1 **Inadequate Procedures Causing Delay in Revenue Collections**

Collection procedures for the HSSF are inadequate. Specifically:

- There is a backlog in billing the federal contracts to provide vital statistics records. In addition, no formal collection procedures are performed, and account receivables are not established in CALSTARS or monitored. As a result, there is a delay in the receipt of revenue; the maximum delay was 641 days during 2006-07. The billing and collection procedures have improved in 2007-08; the longest delay in receipts was 111 days.
- Counties do not submit fees for vital statistics records timely. Of the payments tested, 54 percent had warrants prepared after the payment due date; on average the payments were received 85 days late. Currently, no penalties are imposed for late payments due to the fact that there is no statutory provision. Additionally, there are no formal follow-up collection procedures.

There was also an observation related to accounting records. See General Observation 6.

Genetic Disease Testing Fund:

Based on the recalculation of the fund reserves, it is projected that the GDTF will experience a deficit in 2008-09. The fund balance might decline to a negative balance of $2.1 million in 2008-09. See Table 1 below.

Table 1: Projected Genetic Disease Testing Fund Condition (Dollars in Thousands)

	FY 2006-07	*FY 2007-08*	*FY 2008-09*
Resources:			
Beginning Reserve	$6,586	$22,468	$6,665
Prior Year Adjustments	4,854	-	-
Genetic Disease Testing Fees Generated	100,189	$108,797	115,222
Birth Defects Monitoring Program (BDMP)	1,796	-	-
Other	304	349	349
Transfer To General Fund Loan Repayment	-	(3,289)	(4,500)
Transfer To BDMP Fund	-	(1,796)	-
Total Resources	**$113,729**	**$126,529**	**$117,736**
Expenditures:			
State Controller	53	59	52
California Department of Public Health	91,208	119,805	119,781
Total Expenditures	**$91,261**	**$119,864**	**$119,833**
Reserves	**$22,468**	**$6,665**	**($2,097)**

Source: Finance's recalculation of the fund condition statement using the Genetic Disease Screening Program (GDSP) records

Note:

(1) Because of the timing of the evaluation, fiscal month 13 (close-out) accounting records were unavailable. 2006-07 and 2007-08 expenditures include expenditures recorded in CALSTARS through June 2008 and accruals and encumbrances.

(2) 2006-07 and 2007-08 revenue figures are from June 2008 revenue reconciliations and account receivables.

(3) 2008-09 figures are based on May Revise provided by the GDSP.

Based on the procedures performed, the following factors contributing to the fund's negative financial condition were identified:

Observation 2 **Need for Review of Revenue Estimate Methodology**

The evaluation identified instances where the current revenue estimate methodology[1] may need reexamination. Specifically:

- There is a discrepancy between actual and estimated revenues. Total actual fees generated were $4.2 million less than estimated for 2007-08. The discrepancy was caused by an inaccurate estimate in the number of future tests. The prenatal screening (PNS) to newborn screening (NBS) test ratio shows a declining trend: this ratio was 72 percent in 2003-04; it declined to 65 percent in 2007-08. However, a 70 percent rate was used in estimating the number of tests for 2007-08. This inaccuracy in revenue estimation contributed to the PNS deficit in 2007-08.
- One percent was added to the historical 70 percent in estimating the 2008-09 number of PNS tests as the Genetic Disease Screening Program (GDSP) staff expects PNS testing to increase when inhibin and the first trimester tests are implemented in January 2009. However, it is uncertain if this assumption will materialize because the PNS to NBS ratios show a declining trend as discussed above.
- The current revenue estimate methodology is based on higher collectable rates than historical rates. The 2006-07 actual collection rates are 97 percent for NBS and 90 percent for PNS, whereas the current methodology uses 98 percent for NBS and 93 percent for PNS. Consequently, revenue projected may be higher than what will actually be collected.

Observation 3 **Billing and Fee Collection Procedures Need Improvement**

The GDSP needs to improve its billing and collection procedures. Specifically:

- The average fee collection rate after one year of the service for fiscal years 2005-06 through 2007-08 is 71 percent. As of July 1, 2008, accounts receivable from 2005-06 and 2006-07 totaling $10,375,186, are still outstanding.
- Fees are not collected in a timely manner:
  - For the PNS program, the GDSP does not collect insurance information at the time of service. The program staff send an initial bill to the patient to collect insurance information a few weeks after service. The program then bills the insurance provider. Consequently, on average it took 68 days to send the initial billing to insurance providers. This caused delays in fee collections; only 28.6 percent of bills selected for testing were collected within 30 days. The GDSP is in the process of implementing a new test

[1] The GDSP currently projects its newborn screening (NBS) revenue by first computing the number of future participants based on an increase of the birth rate. The number of estimated tests is then multiplied by the fee to reach the estimated revenue. The NBS revenue estimate is adjusted by the historical collectibility rate of 98 percent. The future number of prenatal screening (PNS) tests is based on the prior year PNS to NBS test ratio. The collectibility rate of 93 percent is used in estimating the PNS revenue.

requisition form requesting insurance information at the time of service to improve the collection process.

- For the NBS program, 98.2 percent of payments tested were not received by the due date. At the time of evaluation, payments from 26 providers (47 percent of the payments tested), totaling $198,072, had not been received. In addition, these payments are overdue by 14 to 20 months.

The GDSP began processing uncollectible fees through the Franchise Tax Board offset program to improve the collection process.

- The GDSP receives overpayments for PNS when both a patient and an insurer pay the bill. However, the GDSP's current policy is not to issue refunds unless refunds are requested. In addition, the GDSP does not keep track of refunds owed. Testing disclosed that 14.3 percent of the 42 transactions tested had outstanding refunds due to the patients of $100 or more; however, the GDSP is holding these funds although it is not the rightful owner of them.

Observation 4 **Richmond Debt Service Allocation Requires Reallocation**

The GDTF's annual debt service payment is approximately $4 million, or 24.3 percent of the total Richmond Laboratory debt. Per the DPH staff, this allocation is based on the original tenants that occupied the Richmond site when the construction took place. Only seven funds currently pay for debt services. However, the review of the *Space Allocation of Richmond Laboratory* spreadsheet revealed that 26 tenants are currently occupying the Richmond site and the space occupied by the GDSP is preliminarily listed at 12.3 percent. Consequently, the GDTF may be paying for more than its proportionate share, causing the GDTF to subsidize other funds. The debt service allocation should be adjusted to reflect the benefit the fund receives once the total space occupied by the GDSP is confirmed.

In addition, there was an observation related to accounting records. See General Observation 6.

2. Evaluation of Fee Structure

We determined if the current prenatal screening (PNS) and newborn screening (NBS) testing fees were aligned with associated costs in administering the Genetic Disease Screening Program (GDSP).

Because the GDSP must be self supporting, the fee structures include costs of various components necessary to administer the program. The primary components include: personnel, laboratory services, contract services, patient education, overhead, the General Fund loan repayments, and the Richmond debt. The GDSP adjusts fees when it expands the program. See Attachment B of this report which details the applicable state laws and regulations that govern the program expansion.

Based on the comparative analysis of fees and associated costs, for 2006-07, there is a $7.5 million excess for PNS and a $1.5 million excess for NBS. Reserves were built in preparation for the PNS program expansion to include inhibin and the first trimester tests scheduled to start in January 2009. Additionally, reserves were built for the General Fund loan repayment which was due at the end of 2007-08. See Table 2 below.

For 2007-08, there is a deficit of $8.3 million for PNS which is partially caused by the inaccurate revenue estimate as described in Observation 2. In addition, the deficit is partially caused by the expansion of testing as discussed above. There is a $6 million deficit for NBS caused by expanded testing to include cystic fibrosis and biotinidase deficiency. Expansion costs for both PNS and NBS were spread over future years to avoid having current patients bear the full expansion costs. See Table 2 below.

Table 2: Comparison of the Testing Fees with Expenditures

Fiscal Year 2006-07	PNS	NBS	Total
Gross Fees	$50,458,000	$54,641,000	$105,099,000
Less: Uncollectible Fees	$3,385,000	$1,525,000	$4,910,000
Total Fees Generated	**$47,073,000**	**$53,116,000**	**$100,189,000**
Total Expenditures	**$39,565,000**	**$51,642,000**	**$91,208,000**
Net Excess	**$7,508,000**	**$1,474,000**	**$8,981,000**
Fiscal Year 2007-08	**PNS**	**NBS**	**Total**
Gross Fees	$55,757,000	$58,105,000	$113,862,000
Less: Uncollectible Fees	$3,903,000	$1,162,000	$5,065,000
Total Fees Generated	**$51,854,000**	**$56,943,000**	**$108,797,000**
Total Expenditures	**$58,363,000**	**$61,442,000**	**$119,805,000**
General Fund Loan Repayment	**($1,777,000)**	**($1,512,000)**	**($3,289,000)**
Net (Deficit)	**($8,286,000)**	**($6,011,000)**	**($14,297,000)**

Source: Finance's comparative analysis of testing fees and associated costs from the GDSP revenue and expenditure records.
Note: Amounts are rounded to thousands; differences in totals due to rounding. There was no General Fund loan repayment due in 2006-07.

Details of the testing fees with associated expenditures for the PNS and NBS are included in Attachment C of this report.

Based on the procedures performed, the following issues were observed:

Observation 5 **Fee Structure Needs Reevaluation**

The current fee structure should be reevaluated to better align fee components to associated costs. Specifically:

- For the PNS, significant variances between fees generated and related costs were noted in various fee components. See Attachment C of this report that provides fees generated with associate expenditures for each fee component.
- For the NBS, the following fee components are not included in the fee structure though the NBS program incurs these expenditures. Fee components for: (1) General Expense, (2) Other Operating Expense, and (3) Pro Rata. Further, significant variances between fees charged and related costs exist. See Attachment C of this report.
- The current fee structure includes a fee component related to the General Fund loan repayments; there is $7.25 and $4 for each PNS and NBS test, respectively, included in the fee structures to repay General Fund loans. The GDSP started collecting fees associated with the General Fund loan repayments of $10.8 million in 2003-04; this has generated $14.9 million by the end of 2007-08. Consequently, this fee component should no longer be necessary once the loans are fully repaid to the General Fund.

General Observations

In performing the evaluation of special funds, the following general observations were identified.

Observation 6 **Accounting Records Require Corrections**

The DPH was newly established effective July 1, 2007 after splitting from the Department of Health Services. DPH Accounting experienced a high staff turnover, causing delays in the posting of revenue and expenditure transactions and resulting in discrepancies between program records and CALSTARS. The following specific issues were noted below:

- There is an overall discrepancy of $1,242,545 between the Health Statistics Special Fund program records and CALSTARS records for 2006-07. Of the $1,242,545, deposits of $481,637 were incorrectly posted to the General Fund. These payments were received in early July 2007, right after the split. In addition, there is a total variance of $8,040 for dissolution of marriage certificates between the amounts posted to the SCO and CALSTARS records and the amounts on *County Transmittal Forms.* The cause of the remainder of the discrepancy balance of $752,868 is unidentified.
- There are revenue variances between fees received by the GDSP and amounts recorded in CALSTARS. Discrepancy amounts are $172,344 and $1,673,283 for 2006-07 and 2007-08, respectively. If these revenues are left unrecorded in CALSTARS, the amount of the negative fund balance shown in Table 1 could increase.

These errors and the errors discussed in Observation 9 had not been corrected at the time of evaluation.

Because corrections will both increase and decrease the various funds' account balances, the net effect may or may not be material to the accounting records as a whole. However, these misstatements to the individual funds are significant and require correction.

Observation 7 **Vendor Invoice Created and Approved by GDSP Staff Using SIS**

There is a GDSP staff dedicated to preparing and distributing Prenatal Diagnostic Center (PDC) vendor invoices through the Screening Information System (SIS). The GDSP prepared invoices are distributed to the PDCs for certification by financial officials. The current process is inadequate because SIS is used to both create and approve invoices, and GDSP staff time is used to prepare, distribute, and follow-up on invoices.

3. Prior Observations Follow-up

We evaluated the current status of the DPH's corrective actions to resolve prior Observations 2 through 8 reported in Finance's 2005-06 Review of Special Funds. Prior Observation 1 was not reviewed because the current status of inactive funds could be determined through alternative sources. In addition, prior Observation 9 related to information technology infrastructure cost allocation variance was not included due to the recent split of the DPH from the former California Department of Health Services.

The evaluation results of the prior observations follow-up are summarized in the table below. Of the seven prior observations followed up, one observation has been resolved, two observations are partially resolved, and four observations have not been resolved. The DPH should strive to fully resolve all observations. See Attachment A of this report which discusses the results in detail.

Table 3: Summary Results of Prior Observations Follow-up

Prior Reported Observations	Observation Resolved	Observation Partially Resolved	Observation Not Resolved
Prior Observation 2: Clinical Laboratory Improvement Fund (CLIF) Revenues Not Monitored for Accuracy		√	
Prior Observation 3: Potential Understatement of Genetic Disease Testing Fund (GDTF) Revenues			√
Prior Observation 4: Ineffective GDTF Collection Process			√
Prior Observation 5: Untimely CLIF Cash Deposits			√
Prior Observation 6: CLIF Pays for Tissue Bank License Program Employee			√
Prior Observation 7: Nursing Home Administrator's State License Examining Fund (NHAF) Employee Paid by General Fund	√		
Prior Observation 8: Inability of the GDTF to Repay the General Fund Loan Timely		√	

Source: Finance's evaluation of prior year observations follow-up

As a result of the prior observations follow-up, the following two new issues were identified:

Observation 8 **Improvements Required for CLIF's Fiscal Accountability**

The CLIF needs to improve its fiscal accountability in managing and keeping track of its resources. Specifically:

- The CLIF does not maintain separate revenue records for new and renewal license categories. All revenue categories are combined together in CALSTARS. As a result, revenues cannot be compared to the costs associated with administering the program by category.
- Receiving and processing checks for license fee payments take place at both Laboratory Field Services (LFS) in Richmond and the DPH Accounting at Sacramento Headquarters. Consequently, the program is administered in a decentralized operational environment and is at a greater risk for loss and errors; revenue could be recorded in a fund other than CLIF.

Observation 9 **Another Tissue Bank License Program Fund (TBLPF) Employee's Full-Time Salary Paid by CLIF**

In addition to the continued funding of the half-time TBLPF's employee position during 2006-07, CLIF inadvertently paid for the full-time salary for another TBLPF employee for the period July 2007 through November 2007, and this employee's overtime salary for February 2008. The regular and

overtime salary paid by CLIF totaled $41,272. This error was caused because there were errors in new program cost account codes and CALSTARS was not available for the DPH to record its activities until November 2007 as a result of the Department split.

ATTACHMENT A

RESULTS OF PRIOR OBSERVATION FOLLOW-UP

This section of the report provides more detailed results of the evaluation of prior observation follow-up. Efforts should continue in order to fully resolve all observations.

Prior Observations	Testing Results
Prior Observation No. 1: Inactive Funds Five special funds and two nongovernmental funds were inactive during fiscal year 2005-06 with fund balances totaling over $1.65 million.	No evaluation performed; information regarding the current status of inactive funds is available through alternative sources.
Prior Observation No. 2: Revenue not Monitored for Accuracy Laboratory Field Services (LFS) management at the Richmond Laboratory does not monitor the Clinical Laboratory Improvement Fund (CLIF) revenues reported on the CALSTARS Summary of Receipts Report (Q24 Report) for accuracy. This is due to the fact that the revenue report from the license tracking system cannot be automatically generated to reconcile with the Q24 Report. A review of the Q24 Report identified $353,937 in revenue for which the source was unrelated to the CLIF Fund.	Revenue monitoring has been partially corrected. Reconciliations are performed for initial personnel license fees on a regular basis. However, reconciliations are not performed for facility initial and renewal licenses and personnel renewal licenses.
Prior Observation No. 3: Potential Understatement of GDTF Revenues The revenues reported for the Genetic Disease Testing Fund (GDTF) may be understated by $2.5 million. GDTF revenues were recalculated based on the number of tests performed multiplied by the fee rates charged for each test for a three month test period. The recalculated revenues totaled $22.2 million; whereas the revenues reported in CALSTARS for the same period was $19.7 million. Also, documentation was not provided for 2 of 9 checks tested to verify whether revenues were accurately recorded as GDTF revenues.	There are revenue discrepancies of $172,344 for 2006-07 and $1,673,283 for 2007-08 between the program and general ledger records.
Prior Observation No. 4: Ineffective Collection Process The GDTF collection process for receivables continues to be ineffective. A management memo identified $6.5 million deemed uncollectible for 2005-06 and earlier. A Bureau of State Audits report indicated that the GDTF collection process was ineffective in 1997.	The GDTF collection process needs improvements. The average collection rate after one year of service for fiscal years 2005-06 through 2007-08 is 71.2 percent. As of July 1, 2008, outstanding accounts receivable from 2005-06 and 2006-07 totaled $10,375,186.

Prior Observations	Testing Results
Prior Observation No. 5: Untimely Cash Deposits The LFS does not remit payments for license fees to DHS Accounting in a timely manner. Checks were held at LFS for an average of 23 days.	Cash remittance process has been improved. However, LFS still does not remit payments for license fees to DHS Accounting in a timely manner. The current average remittance time is 12 days.
Prior Observation No. 6: CLIF Pays for Tissue Bank License Program Employee The salary of a Tissue Bank License Program Fund (TBLPF) employee is half funded by the CLIF because TBLPF could not support the full-time position.	No corrective actions implemented. The CLIF continues to pay 50 percent of the TBLPF employee.
Prior Observation No. 7: Nursing Home Administrator's State License Examining Fund (NHAF) Employee Paid by General Fund. A full time NHAF employee was paid by the General Fund (GF).	The NHAF employee was no longer being paid by the GF during 2006-07.
Prior Observation No. 8: Inability of the GDTF to repay the General Fund (GF) Loan Timely Two GF loans totaling $10.3 million were provided to the GDTF Fund and scheduled for repayment in 2004-05 and 2005-06. Due to cash flow difficulties, the remaining loan balance of $7.24 million was extended to 2007-08 and 2008-09.	Corrective actions have been instituted. Monies are set aside for the GF loan repayments, and a weekly Cash Flow report and payment schedule are prepared for monitoring. The GDTF repaid $3.29 million to the GF in 2007-08. However, GDTF may not be able to repay the remaining $4.5 million in 2008-09 if there is not a sufficient fund reserve. See the Evaluation of Financial Condition section of this report for additional information.
Prior Observation No 9: IT Infrastructure Cost Allocation Variance There is a variance of 6 to 12 percent over the infrastructure cost allocation between the charges allocated by the DPH's automated system and Finance's recalculation. The extent and causes of the variance could not be determined during the review because the supporting records documenting the allocation of IT infrastructure costs were not retained.	No evaluation performed; it is premature to follow up on this prior observation due to limited data available as a result of the Department split.

Attachment B
Special Fund Descriptions, State Laws, and Regulations

This section of the report provides detailed descriptions of the special funds and the applicable state laws and regulations that govern program expansions as discussed in this report.

Clinical Laboratory Improvement Fund
The Clinical Laboratory Improvement Fund utilizes fees collected by Laboratory Field Services located in Richmond to administer the testing, inspection, and licensing of laboratories, blood banks, and laboratory personnel to ensure quality of laboratory testing in California.

Nursing Home Administrator's State License Examination Fund
The Nursing Home Administrator's State License Examination Fund collects fees in accordance with the Nursing Home Administrator's Licensing Act and defrays the costs of administration and enforcement of the licensing program provisions.

Health Statistics Special Fund
The Health Statistics Special Fund was created to collect fees received from document searches, issuance of certificates, and other State Registrar programs. Funds are used to administer the existing State Registrar program and any related newly created programs. In accordance with the Health and Safety Code, Sections 100430 and 100435, the fees are adjusted annually by a percentage change determined by the Department of Finance.

Senate Bill (SB) 247 (Chapter 914 of the Statutes of 2002) was enacted to develop security measures protecting against the fraudulent use of birth and death records; the Vital Records Image Redaction and Statewide Access system is being developed to meet this legislative mandate. This bill allowed the Center for Health Statistics (CHS) to charge an additional $2 for birth and death records beginning January 1, 2003. The fee was lowered to $1 on January 1, 2006, to provide maintenance costs for the system.

Assembly Bill (AB) 2550 (Chapter 857 of the Statues of 2002) required the implementation of an Electronic Death Registration System. Beginning January 1, 2003, the CHS imposed an additional $6 charge on the disposition of human remains in accordance with AB 2550. This fee was lowered to $4 on January 1, 2005.

Genetics Disease Testing Fund
The Genetic Disease Testing Fund was created to support the costs of prenatal and newborn genetic disease screening testing. The purpose of these tests is to detect, as early as possible, phenylketonuria, and other preventable heritable or congenital disorders leading to mental retardation or physical defects. The Genetic Disease Screening Program (GDSP) bills testing fees to patients and insurance providers. The GDSP also operates the Genetic Disease Laboratory that monitors laboratories, which are the contractors of the GDSP, to ensure the quality of the screening program.

California Health and Safety Code, Section124977 provides the Director of the California Department of Public Health authority to charge fees for prenatal screening (PNS) and newborn screening (NBS) tests. This section also states that the Director can periodically adjust these fees in order to meet the costs of the program.

SB 1555 (Chapter 484 of the Statutes of 2006) was enacted to expand the responsibility of PNS to include inhibin and the first trimester tests. The PNS program increased its fee from $105 to $162 in January 2007 to preempt the future expansion to implement SB 1555. The $162 PNS fee increase included $10 to support the California Birth Defect Monitoring Program (CBDMP); $10 is transferred to the CBDMP fund. The expansion of this program is scheduled to begin in January 2009.

AB 1807 (Chapter 74 of the Statutes of 2006) was enacted to expand the testing in NBS to include cystic fibrosis and biotinidase deficiency. To implement this new legislation, the NBS fee was subsequently adjusted, first in August 2006 from $78.00 to $95.75, and then again in January 2007 from $95.75 to $102.75.

ATTACHMENT C

COMPARISON OF THE TESTING FEES WITH ASSOCIATED EXPENDITURES

This section of the report provides more detailed results of testing fees generated with associated expenditures for the prenatal screening and the newborn screening programs for each fee component.

Prenatal Screening Program

Fee Components	2006-2007			2007-2008		
	Fees Generated	Expenditures	Variance	Fees Generated	Expenditures	Variance
Personnel	$4,022,000	$3,586,000	$436,000	$3,892,000	$4,142,000	($250,000)
Laboratory Services	$2,091,000	$5,212,000	($3,121,000)	$1,962,000	$12,145,000	($10,183,000)
Patient & Provider Education	$534,000	$175,000	$359,000	$798,000	$651,000	$147,000
Contracted Services	$34,978,000	$26,724,000	$8,254,000	$38,546,000	$34,500,000	$4,046,000
General Expenses	$193,000	$226,000	($33,000)	$181,000	$456,000	($275,000)
Other Operating Expenses	$555,000	$45,000	$510,000	$918,000	$27,000	$891,000
State Overhead	$1,248,000	$1,040,000	$208,000	$1,170,000	$1,809,000	($639,000)
Pro Rata	$40,000	$50,000	($10,000)	$38,000	$2,198,000	($2,160,000)
Richmond Debt Service	$2,001,000	$2,507,000	($506,000)	$1,876,000	$2,435,000	($559,000)
Expenditure Total	**$45,662,000**	**$39,565,000**	**$6,097,000**	**$49,381,000**	**$58,363,000**	**($8,982,000)**
General Fund Loan Repayment	**$1,411,000**	**$0**	**$1,411,000**	**$2,473,000**	**$1,777,000**	**$696,000**
Grand Total	**$47,073,000**	**$39,565,000**	**$7,508,000**	**$51,854,000**	**$60,140,000**	**($8,286,000)**

Newborn Screening Program

Fee Component	2006-2007			2007-2008		
	Fees Generated	Expenditures	Variance	Fees Generated	Expenditures	Variance
Personnel	$4,081,000	$6,138,000	($2,057,000)	$4,217,000	$6,351,000	($2,134,000)
Laboratory Services	$27,839,000	$19,440,000	$8,399,000	$28,962,000	$24,544,000	$4,418,000
Patient & Provider Education	$1,610,000	$1,150,000	$460,000	$1,640,000	$361,000	$1,279,000
Contracted Services	$14,263,000	$20,611,000	($6,348,000)	$16,703,000	$24,712,000	($8,009,000)
General Expenses	$0	$812,000	($812,000)	$0	$878,000	($878,000)
Other Operating Expenses	$0	$211,000	($211,000)	$0	$175,000	($175,000)
State Overhead	$1,878,000	$1,706,000	$172,000	$1,912,000	$2,097,000	($185,000)
Pro Rata	$0	$50,000	($50,000)	$0	$733,000	($733,000)
Richmond Debt Service	$1,268,000	$1,524,000	($256,000)	$1,292,000	$1,591,000	($299,000)
Expenditure Total	**$50,939,000**	**$51,642,000**	**($703,000)**	**$54,726,000**	**$61,442,000**	**($6,716,000)**
General Fund Loan Repayment	**$2,177,000**	**$0**	**$2,177,000**	**$2,217,000**	**$1,512,000**	**$705,000**
Grand Total	**$53,116,000**	**$51,642,000**	**$1,474,000**	**$56,943,000**	**$62,954,000**	**($6,011,000)**

Department Response

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

MARK B HORTON, MD, MSPH
Director

ARNOLD SCHWARZENEGGER
Governor

FEB 04 2009

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

Dear Mr. Botelho:

The California Department of Public Health (CDPH) has prepared its response to the California Department of Finance's draft report entitled, "California Department of Public Health Evaluation of Special Funds Fiscal Year 2006-07." The CDPH appreciates the opportunity to provide the Department of Finance with a response to the draft report.

Please contact David Whitsell, Chief, Internal Audits, at (916) 324-4370, should you have any questions.

Sincerely,

Original signed by:

Mark B Horton, MD, MSPH
Director

Enclosure

Cc: David Whitsell
Chief, Internal Audits
California Department of Public Health- Internal Audits
P.O. Box 997413,MS 2500
Sacramento, CA 95899-7413

Draft Audit Report Reponses
California Department of Public Health, 2006-07 Evaluation of Special Funds

1. Evaluation of Financial Condition

Observation 1 Inadequate Procedures Causing Delay in Revenue Collections

- Collection Procedures for the HSSF are inadequate. Specifically: There is a backlog in billing the federal contracts to provide vital statistics records. In addition, no formal collection procedures are performed, and account receivables are not established in CALSTARS or monitored. As a result, there is a delay in the receipt of revenue; the maximum delay was 641 days during 2006-07. The billing and collection procedures have improved in 2007-08; the longest delay in receipts was 111 days.

Response:

CDPH agrees.

The backlog in billing the federal contracts was the direct result of delay in sending death data files to the contractors. The death files for calendar year 2005 were not completed until 2007 because of workload related to the implementation of the new Electronic Death Registration System (EDRS). CDPH was not able to bill for services it had not provided, nor could account receivables be established. The audit findings note that CDPH is improving the timeframe for billing; however, the improvement is based on the completion of implementing EDRS and the timely distribution of the death data files. Since the audit, the death data files were processed and distributed for calendar years 2005, 2006, and 2007. CDPH has billed for all data files and has collected $4,071,277, with $429,948 still pending payment. Formal collection procedures have been established, which include accruing account receivables in CALSTARS at the end of each fiscal year pursuant to State Administrative Manual, section 10610.

- Counties do not submit fees for vital statistics records timely. Of the payments tested, 54 percent had warrants prepared after the due date; on average the payments were received 85 days late. Currently, no penalties are imposed for late payments due to the fact that there is no statutory provision. Additionally, there are no formal follow-up collection procedures.

Response:

CDPH agrees.

Vital Record fees are set in statute. County fees are generally due within ten days after the month in which the fees were collected. While many counties are able to prepare warrants within ten days, some counties are not able to meet the timeframe due to established accounting system constraints and levels of review. Collection activities were in process at the time of the audit and formal collection procedures have been established. CDPH staff contacts county offices that are more than 30 days delinquent with transmitting their fees. CDPH is in the process of conducting an analysis of vital record fees, and will evaluate potential options including modifying the timeframe.

- Based on the recalculation of the fund reserves, it is projected that the GDTF will experience a deficit in 2008-09. The fund balance might decline to a negative balance of $2.1 million in 2008-09. See Table 1 below.

Table 1: Projected Genetic Disease Testing Fund Condition (Dollars in Thousands)			
	FY 2006-07	FY 2007-08	FY 2008-09
Resources:			
Beginning Reserve	$6,586	$22,468	$6,665
Prior Year Adjustments	$4,854	-	-
Genetic Disease Testing Fees Generated	$100,189	$108,797	$115,222
Birth Defects Monitoring Program (BDMP)	$1,796	-	-
Other	$304	$349	$349
Transfer to General Fund Loan Repayment	-	($3,289)	($4,500)
Transfer to BDMP Fund	-	($1,796)	-
Total Resources	**$113,729**	**$126,529**	**$117,736**
Expenditures:			
State Controller	$53	$59	$52
Department of Public Health	$91,208	$119,805	$119,781
Total Expenditures	**$91,261**	**$119,864**	**$119,833**
Reserves	**$22,468**	**$6,665**	**($2,097)**

Source: Finance's recalculation of the fund condition statement using the Genetic Disease Screening Program (GDSP) records.

Note:

(1) Because of the timing of the evaluation, fiscal month 13 (close-out) accounting records were unavailable. 2006-07 and 2007-08 expenditures include expenditures recorded in CALSTARS through June 2008 and accruals and encumbrances.

(2) 2006-07 and 2007-08 revenue figures are from June 2008 revenue reconciliations and account receivables.
(3) 2008-09 figures are based on May Revise provided by the GDSP.

Response:

CDPH disagrees that GDSP will experience a deficit in 2008-09 by $2.1 million.

DOF's findings are based on the May 2008 Revise and do not reflect subsequent changes in the projections that will be incorporated in the November 2008 Budget Estimate and reflected in the January 10 Governor's Budget. The changes include a revised projected caseload, which reflect a decline in both caseload and expenditures. In addition to the caseload adjustment, the budget will reflect a 10% provider payment reduction for the Medi-Cal population, and a shift of the repayment of the General Fund loan to FY 2010-11. The net impact of these changes results in a positive reserve balance at the end of FY 2008-09.

Observation 2: Need for Review of Revenue Estimate Methodology

The evaluation identified instances where the current revenue estimate methodology[1] may need reexamination. Specifically:

- There is a discrepancy between actual and estimated revenues. Total actual fees generated were $4.2 million less than estimated for 2007-08. The discrepancy was caused by an inaccurate estimate in the number of future tests. The prenatal screening (PNS) to newborn screening (NBS) test ratio shows a declining trend: this ratio was 72 percent in 2003-04; it declined to 65 percent in 2007-08. However, a 70 percent rate was used in estimating the number of tests for 2007-08. This inaccuracy in revenue estimation contributed to the PNS deficit in 2007-08.

- One percent was added to the historical 70 percent in estimating the 2008-09 number of PNS tests as the Genetic Disease Screening Program (GDSP) staff expects PNS testing to increase when inhibin and the first trimester tests are implemented in January 2009.

[1] The GDSP currently projects its newborn screening (NBS) revenue by first computing the number of future participants based on an increase of the birth rate. The number of estimated tests is then multiplied by the fee to reach the estimated revenue. The NBS revenue is adjusted by the historical collectability rate of 98 percent. The future number of prenatal screening (PNS) tests is based on the prior year PNS to NBS test ratio. The collectability rate of 93 percent is used in estimating the PNS revenue.

- The current revenue estimate methodology is based on higher rates than historical rates. The 2006-07 actual collection rates are 97 percent for NBS and 90 percent for PNS, whereas the current methodology uses 98 percent for NBS and 93 percent for PNS. Consequently, revenue projected may be higher than what will actually be collected.

Response:

CDPH partially agrees.

1. The CDPH does not fully agree with DOF regarding the need to reevaluate the revenue estimate methodology. While CDPH recognizes there have been challenges in predicting the future trend of case load (number of tests), the overall methodology in estimating future revenues is sound. As with any methodology, improvements can be made, and CDPH is committed to continue refining the methodology used. CDPH will continue working toward improving the projections of trend given that case load projections are based on historical data. This is particularly acute in the case of estimating the case load for PNS, where there has been a more recent decline in PNS participation due to the screening program not keeping up with medical standards. The magnitude of the decline during the last quarter of 2007-08 was more notable and was not apparent until after the May Revise 2008 Budget Estimate had been prepared. Specifically, at the time the revenue estimates were calculated for 2007-08, historical data suggested a revenue ratio of 70% for 2007-08 (a decline of 2% from the prior year). However, until the second PNS expansion is completed in the CY, adding 1st trimester screening, GDSP does not expect to see an increase in the case load.

Case load and revenue projections was incorporated in the November Estimate and included in the January 10 Governor's Budget. For future budget estimates the CDPH will continue to review and refine its trend as well as evaluate its methodology and procedures to further improve the accuracy of the revenue projections. The January 10 Governor's Budget reflects a positive reserve balance at the end of FY 2008-09.

2. As indicated above, the 2008-09 revenue and expenditure projections have been revised to reflect the decline in caseload and will be included in the January 10 Governor's Budget.

3. DOF states there may be an overstatement of the projected 2008-09 revenue collection rates, based on 2006-07 data. The data reflects 97% of NBS fees have been collected, as opposed to the 98% budgeted and 90% of PNS fees have been collected, as opposed to 93% budgeted. The CDPH believes that DOF's findings are not accurate due to a misunderstanding of estimated revenue versus when the revenue is actually collected. CDPH has consistently stated it takes 3-5 years to fully collect funds, DOF appears to confuse estimated with actual revenue collected. At the point in time this

data was reviewed, there were still outstanding payments which GDSP expects to receive for the time period DOF references. Based on DOF's findings that 97% of NBS fees and 90% of PNS fees had been collected, CDPH wishes to point out this is consistent with the length of time it takes to fully collect fees. The remaining percentages will be collected in subsequent years.

Observation 3: Billing and Fee Collection Procedures Need Improvement

The GDSP needs to improve its billing and collection procedures. Specifically:

- The average fee collection rate after one year of the service for fiscal years 2005-06 through 2007-08 is 71 percent. As of July 1, 2008, accounts receivable from 2005-06 and 2006-07 totaling $10,375,186, are still outstanding.

- Fees are not collected in a timely manner:

  - For the PNS program, the GDSP does not collect insurance information at the time of service. The program staff sends an initial bill to the patient to collect insurance information a few weeks after service. The program then bills the insurance provider. Consequently, it took 68 days to send the initial billing to insurance providers. This caused delays in fee collections; only 28.6 percent of bills selected for testing were collected within 30 days. The GDSP is in the process of implementing a new test requisition form requesting insurance information at the time of service to improve the collection process.

  - For the NBS program, 98.2 percent of payments tested were not received by the due date. At the time of evaluation, payments from 26 providers (47 percent of the payments tested), totaling $198,072, had not been received. In addition, these payments are overdue by 14 to 20 months.

The GDSP began processing uncollectible fees through the Franchise Tax Board offset program to improve the collection process.

- The GDSP receives overpayments for PNS when both a patient and an insurer pay the bill. However, the GDSP's current policy is not to issue refunds unless refunds are requested. In addition, the GDSP does not keep track of

refunds owed. Testing disclosed that 14.3 percent of the 42 transactions tested had outstanding refunds due to the patients of $100 or more; however, the GDSP is holding these funds although it is not the rightful owner of them.

Response:

CDPH agrees.

1. CDPH agrees that improvements can be made overall in the area of fee collection. There are various reasons for the lag between services provided and payment for those services, and CDPH has taken steps to improve the rate at which the fees are collected, to the extent this is possible.

Even with the challenges presented using an outdated business system, CDPH has made great strides in improving the collection rate. While the collection rate in NBS has consistently been 98%, collection rates in PNS have presented more difficult challenges. A review of historical collection rates for PNS show the following:

2003/04	*84% of the total fees were collected;*
2004/05	*86% of the total fees were collected;*
2005/06	*86% of the total fees were collected, mid year this percent rose to 90%;*
2006/07	*93% of the total fees were collected.*

CDPH would point out that there are some improvements that cannot be made until the current business system is replaced. There is currently a moratorium on all business system replacements, pending the implementation of Fi$CAL which is scheduled for implementation in CDPH in 2016. CDPH is currently seeking an exemption to this moratorium, based on the business need to improve revenue collections at the earliest possible time.

1 - A. DOF states that the average fee collection rate after one year of the service is 71% and that $10.3 million in accounts receivable from 2005-06 and 2006-07 are outstanding as of July 1, 2008. CDPH wishes to point out this collection rate remains consistent with what has been presented, as it takes 3-5 years to fully collect the fees. Over this two year period, CDPH estimated approximately $173 million in accounts receivable, of which all but $10.3 million was collected as of July 1, 2008. The remaining $10.3 million, approximately 6%, will be collected in subsequent years. The revenue cited represents cash and accounts receivable.

2 - A. The CDPH agrees that improvements can be made in the timeliness of the collection of revenue, particularly as it relates to the PNS billings, and has taken steps to improve this process. Some of the delays in collecting revenue have been due to incomplete information on the application form. As noted in DOF's findings, incomplete information such as the insurance information requires researching and

contacting the individuals before collection efforts can be made. Recognizing these difficulties, CDPH has recently implemented steps to improve revenue collections by changing the application form to not only highlight the importance of completing critical participant's information including addresses, phone numbers, and insurance coverage, but that the information on the form should be completed and presented at the time of service. Enhanced efforts are also being made to work with providers and educate them as to the importance and critical need of completed forms prior to services being rendered. Further efforts are also underway to release new patient booklets with the revised forms with clear instructions for participants to submit a copy of their insurance card. Additionally, CDPH is also addressing revenue collection delays involving insurance companies where payments have been denied due to their misunderstanding as to their benefit and payment obligations. CDPH has recently implemented ongoing procedures to identify these insurance carriers and is following up with correspondence to convey and enforce their payment responsibilities in accordance with statute. While the above changes have only been recently implemented, CDPH is already seeing improvement in revenue collections, and expects that the collection rate will improve with these new procedures as well as the implementation of fee collections through the Franchise Tax Board offset program.

In DOF comments, they state that 28.6 percent of PNS bills selected were paid within 30 days, yet it took 68 days to send the initial billing to insurance providers. CDPH believes there is additional information that should be included in this example, otherwise there is a disconnect between the two timeframes.

2 – B. Regarding DOF's comments on the NBS program and the late payments received from the providers, CDPH agrees that improvements can be made in collecting revenue. These late payments are associated with hospitals who fail to render payment for the newborn screening services. In the past, hospitals typically did not pay the program directly, and instead relied upon the fee collection to occur as an offset to future Medi-Cal payments from the fiscal intermediary. In 2000, Department of Health Care Services (DHCS) discontinued these services and GDSP staff resorted to collection efforts through phone calls and correspondence. In April 2008, GDSP engaged in discussions with the DHCS and reached agreement with DHCS that the Medi-Cal offset process will be reinstated.

Processing of these offsets has only recently begun, but CDPH expects significant improvement in the collection of revenues as a result of these renewed procedures. Coupled with GDSP's increased efforts in following up on delinquent payments, CDPH expects there will be a decrease in the rate of payments in arrears over the next year.

3. CDPH agrees that improvements can be made in the timely process of issuing refunds to participants. To that end, CDPH is currently reviewing its procedures and timelines and will evaluate possible changes that can be implemented to improve the identification, tracking and monitoring, and the timely issuance of refund checks to

appropriate parties. Although, CDPH believes improvements can be made, it should be noted that processing of refunds includes verification or receipt of various pieces of information which is often missing (e.g. valid addresses or credit card information), including confirmation that a check has been honored by the bank. Gathering and verifying such information significantly adds to the delays in timely issuances of refunds. As noted above, CDPH has taken steps to improve the participant's reporting of all necessary information on the screening application form, and these changes will also improve the ability to process and issue refunds timely. Further, the replacement of the outdated business system will also be helpful in this area.

CDPH wishes to point out that although DOF states that CDPH is not the rightful owner of the overpayments, holding these funds are in accordance with the State Administrative Manual (SAM) Section 8241, in which overpayments can be:

1) *Applied against other amounts due the State from the payers,*
2) *refunded automatically, or*
3) *held pending receipt of refund requests.*

Any overpayments received by CDPH are posted in the BSS and currently included in the operating revenue subsidiary account. The funds are held pending receipt of refund requests, which is done in many cases. CDPH believes that their current practice in handling overpayments is in accordance with SAM 8241.

Observation 4: Richmond Debt Service Allocation Requires Reallocation

The GDTF'S annual debt service payment is approximately $4 million, or 24.3 percent of the total Richmond Laboratory debt. Per the DPH staff, this allocation is based on the original tenants that occupied the Richmond site when the construction took place. Only seven funds currently pay for debt services. However, the review of the *Space Allocation of Richmond Laboratory* spreadsheet revealed that 26 tenants are currently occupying the Richmond site and the space occupied by the GDSP is preliminarily listed at 12.3 percent. Consequently, the GDTF may be paying for more than its proportionate share, causing the GDTF to subsidize other funds. The debt service allocation should be adjusted to reflect the benefit the fund receives once the total space occupied by the GDSP is confirmed.

Response:

CDPH agrees.

The CDPH concurs that the debt service payment allocation needs to be reexamined and adjusted to reflect an appropriate allocation based on actual tenant space. The CDPH further concurs with DOF that the prior year allocations to GDSP appear to have been overstated. The CDPH also agrees with DOF that although the currently listed tenant space for GDSP has been adjusted to 12.3 percent, it may need to be adjusted further.

The January 10 Governor's Budget reflects a revised debt service assessment for programs occupying the Richmond Campus, including GDSP. We understand there is a further review of the overall allocation methodology and the square footage statistics, by program. Following this review it is expected that appropriate adjustments will be made as necessary to reflect an equitable distribution of the debt service payments across all appropriate funds.

2. Evaluation of Fee Structure

Observation 5: Fee Structure Needs Reevaluation

The current fee structure should be reevaluated to better align fee components to associated costs. Specifically:

- For the PNS, significant variances between fees generated and related cost were noticed in various fee components. See Attachment C of this report that provides fee generated with associated expenditures for each fee component.

- For the NBS, the following fee components are not included in the fee structure though the NBS program incurs these expenditures. Fee components for: (1) General Expense, (2) Other Operating Expense, and (3) Pro Rata. Further, significant variances between fees charged and related costs exist. See Attachment C of this report.

- The current fee structure includes a fee component related to the General Fund loan repayments; there is $7.25 and $4 for each PNS and NBS test, respectively, included in the fee structure to repay General Fund loans. The GDSP started collecting fees associated with the General Fund loan repayments of $10.8 million in 2003-04; this has generated $14.9 million by the end of 2007-08. Consequently, this fee component should no longer be necessary once the loans are fully repaid to the General Fund.

Response:

The CDPH recognizes that the components of the fee structure do not align with the associated costs and agrees that components of the fee structure need to be realigned while all components were included in the fee calculation, they were displayed differently. For example, in NBS, the General Expense, OE&E and Pro Rata were grouped differently and this detail was not shown separately as it was in PNS. The CDPH believes, however, that the larger issue is that a total evaluation is needed for to evaluate the total fee structure compared to various operational cost increases, including the costs of doing business, or consideration of other types of costs that were not initially accounted for in the development of the fee i.e.- the amount assessed for bond repayment; increase Pro-Rata amounts that were not accounted for; contract staff covered under union agreements. Since the fee amounts are set in regulation, any proposed realignment of the components of the fee structure cannot increase or decrease the total net amount. Thus, realignment of the components is currently limited in its application unless the regulations are amended to allow for fee change to account for inflationary cost increases, or costs that are beyond the control of the program. For example, when the fees were established, it was not anticipated that GDSP would cover 25% of the Richmond bond repayment, or that the Pro Rata would increase from approximately $100 k to nearly $4.0 million. Although, the projected revenues for 2008-09 are currently adequate to cover projected expenditures and allow for a small reserve, the current fee amount per case will not sustain program and overhead expenditures in future years as costs continue to climb.

While the CDPH believes there is value in realigning the components of the fee structure, this should be performed in conjunction with an evaluation to determine the extent of the total fee increase needed, in order for the realignment of the fee components to have any value. As to DOF comments that the fee should be reduced accordingly once the General Fund Loan is fully paid, CDPH does not agree for the reasons stated above. Prior to considering a component reduction associated with the impact of the paid off loan, a full analysis of all costs including the components that have since increased must be undertaken before any change is pursued.

General Observations

Observation 6 Accounting Records Require Corrections

The DPH was newly established effective July 1, 2007 after splitting from the Department of Health Services. DPH Accounting experienced a high staff turnover, causing delays in the posting of revenue and expenditure transactions and resulting in discrepancies between program records and CALSTARS. The following specific issues were noted below:

- There is an overall discrepancy of $1,242,545 between the Health Statistics Special Fund program records and CALSTARS records for 2006-07. Of the $1,242,545, deposits

of $481,637 were incorrectly posted to the General Fund. These payments were received in early July 2007, right after the split. In addition, there is a total variance of $8,040 for dissolution of marriage certificates between the amounts posted to the SCO and CALSTARS records and the amounts on County Transmittal Forms. The cause of the remainder of the discrepancy balance of $752,868 is unidentified.

Response:

CDPH agrees.

The DPH Accounting and program experienced high staff turnover and vacancies that resulted in unreconciled revenues. The overall discrepancy of $1,242,545 between the Health Statistics Special Fund program records and CALSTARS records for 2006-07 have been resolved. The major discrepancies were due to program spreadsheet errors and updated CALSTARS totals for June 2007. Of the $752,868 unidentified discrepancy balance, there is a remaining discrepancy balance of only $3,591. The discrepancy is attributed to point-in-time refunds or dishonored payments which were not captured in program's records in the correct fiscal year. Program will revise the process in which refunds and dishonored payments are posted to the program's revenue tracking reports to ensure that they are captured in the same fiscal year that the CDPH accounting office posted to Calstars.

CDPH has discussed the variance of $8,040 for dissolution of marriage certificates with the California Administrative Office of the Courts (AOC.) The discrepancy is a result of the individual county Superior Court staff transmitting forms to CDPH that indicate the full amount for each filing. Courts may later establish payment plans for individuals who cannot pay the full filing fee. Pursuant to Government Code 68085.1 (g)...If the fee is paid by installment payments, the amount distributed to each fund or account from each installment shall bear the same proportion to the installment payment as the full distribution to that fund or account does to the full fee. The AOC's accounting system subsequently distributes the funds to CDPH on a separate report, based on the amounts actually received from the customer. The Vital Record fees are pro-rated and remitted when the payment is received. Therefore, the balance will never reconcile 100% based on this process of collecting information from the courts.

- There are revenue variances between fees received by the GDSP and amounts recorded in CALSTARS. Discrepancy amounts are $172,344 and $1,673,283 for 2006-07 and 2007-08, respectively. If these revenues are left unrecorded in CALSTARS, the amount of the negative fund balance shown in Table 1 could increase.

Response:

CDPH agrees.

The CDPH agrees that due to the reorganization in forming the new department and the high staff turnover there were delays in the posting of revenue and expenditure transactions resulting in discrepancies between program records and CALSTARS. However, significant progress has been made in addressing these issues and improvements (such as hiring staff; posting backlog deposits and expenditures into CalStars; and making corrections on erroneously posted transactions) have been made in more timely postings of both revenues and expenditures. Since DOF's field evaluation on this area, the 2006-07 discrepancies have been reduced from $172,344 to $33,929 and for 2007-08 from $1,673,283 to $318,297.

Observation 7: Vendor Invoice Created and approved by GDSP staff Using SIS

There is a GDSP staff dedicated to preparing and distributing Prenatal Diagnostic Center (PDC) vendor invoices through the Screening Information System (SIS). The GDSP prepared invoices are distributed to the PDCs for certification by financial officials. The current process is inadequate because SIS is used to both create and approve invoices, and GDSP staff time is used to prepare, distribute, and follow-up on invoices.

Response:

CDPH disagrees.

It was unclear what the audit finding was addressing; however, the CDPH disagrees that the vendor invoice created and approved by GDSP staff using SIS is inadequate. The GDSP is using an electronic billing process whereby the information is keyed by the PDCs into a secure electronic screen format. Subsequent reviews and edits are performed by the SIS, and program staff follows up on any inconsistencies. The fact that the SIS provides an itemized invoice following this review does not deem the process in adequate. In fact, the process also allows for a second review by different GDSP staff before approval, and then the invoice is forwarded to the PDCs for their signatures which serves as the PDCs' attestation that the services were performed. It is important to note that because of the volume of participants receiving services by the PDCs through a multitude of vendors it would be time and cost prohibitive to institute a manual process involving the direct receipt of manual invoices or documentation from either the PDC or the vendors, nor would it be practical. The electronic process provides a more efficient and streamlines approach to generating payments and functions in a similar vein as the electronic billing of Medi-Cal claims by the state's fiscal intermediary. Further,

PDCs are also required to maintain documentation on the services rendered and must produce those records as requested by various state representatives in the event they are audited.

3. Prior Observation Follow-up

Prior Observation 2 - Revenue Not Monitored for Accuracy

Laboratory Field Services (LFS) management at the Richmond Laboratory does not monitor the Clinical Laboratory Improvement Fund (CLIF) revenues reported on the CALSTARS Summary of Receipts Report (Q24) for Accuracy. This is due to the fact that the revenue report from the license tracking system cannot be automatically generated to reconcile with the Q24 report. A review of the Q24 report identified $353,937 in revenue for which the source was unrelated the CLIF.

Testing Results: Revenue monitoring has been partially corrected. Reconciliations are performed for initial personnel license fees on a regular basis. However, reconciliations are not performed for facility initial and renewal licenses and personnel renewal licenses.

Response:

CDPH partially agrees.

LFS does monitor revenue and the Q24 report. A partial correction was achieved for initial personnel license fees because this pilot program is web-based, allowing on-line credit card fee payment and routinely reports number of licenses issued per fees collected. It has a single source of revenue processing through LFS/Richmond only and is not decentralized as other revenue processing at LFS is (See new Observation 8 below). The license tracking system referred to above in Prior Observation 2 is the HAL system, a DOS-based mainframe currently in use by CDPH licensing programs. The HAL system is unable to automatically generate the data needed for full reconciliation. LFS is currently working with the Center for Health Care Quality to replace the HAL system with a modern license fee reporting system that will serve both Licensing and Certification and LFS and allow complete reconciliation of the CLIF.

LFS continues to monitor the Q24 report monthly to identify errors and reconcile program internal deposit records to identify errors to the CALSTARS On-Line Reporting Expenditures (CORE) system. The procedure developed to communicate requests for correction with the Accounting section works well and correction requests have been implemented timely.

Prior Observation 3 - Potential Understatement of Genetic Disease Testing Fund Revenues

Response:

CDPH agrees.

Please refer to our response to Observation No. 6. The discrepancies have been significantly reduced and CDPH is continuing to research the records to resolve the remaining differences.

Prior Observation 4 - Ineffective Genetic Disease Testing Fund Collection Process

Response:

CDPH agrees.

Please refer to our response to Observation No. 3.

Prior Observation 5 - Untimely CLIF Cash Deposits

LFS does not remit payments for license fees to DHS Accounting in a timely manner. Checks were held at LFS for an average of 23 days.

Testing Results: Cash remittance process has been improved. However, LFS still does not remit payments for license fees to DHS (eg CDPH) in a timely manner. The current average remittance time is 12 days.

Response:

CDPH agrees.

LFS continues to struggle with staff vacancies which contribute to delays in check processing for deposits. We also note that the auditors' method of conducting their review may have somewhat overstated delays. During the preliminary ("walk away") exit conference, the auditors described their assumption that checks are received by mail at the program office five (5) days after the date on the check. LFS conducted its own review and found that the average mail delivery time was nine (9) days including the distribution from the Richmond Campus mail center to the program. Applicants submitting fee payments do not necessarily mail their payments in the same day as the date on their check.

In order to more accurately track deposit processing, copies of checks will all be date stamped on the day received by LFS and placed in the facility or deposit file. Employees will receive periodic training and reminders of the three day processing requirement.

Administrative staff will conduct random audits that check deposit processing to ensure compliance.

Prior Observation 6 – CLIF Pays for Tissue Bank License Program Employee

The salary of a Tissue Bank License Program Fund (TBLPF) employee is half funded by the CLIF because TBLPF could not support the full-time position.

Testing Results: No corrective action implemented. The CLIF continues to pay 50% of the TBLPF employee.

Response:

CDPH agrees.

Due to previous budget reductions, the budget authority for the Tissue Bank program is insufficient to support its three authorized positions. Efforts to increase spending authority have not been successful despite its $1 million fund reserve. LFS will redirect the 50% CLIF funded employee to CLIF specific activity including Blood Bank and Cytology inspections and application review. The impact of a staff reduction for Tissue Bank activities shall be evaluated.

As a result of the prior observations follow-up, the following two new issues were identified.

Observation 8 Improvements Required for CLIF's Fiscal Accountability

The CLIF needs to improve its fiscal accountability in managing and keeping track of its resources. Specifically:

- The CLIF does not maintain separate revenue records for personnel, facility and new and renewal license categories. All revenue categories are combined together in CALSTARS. As a result, revenue cannot be compared to the costs associated with administering the program by category.
- Receiving and processing checks for license fee payments take place at both Laboratory Field Services (LFS) in Richmond and the DPH Accounting at Sacramento Headquarters. Consequently, the program is administered in a decentralized environment operational environment and is at a greater risk for loss and errors; revenue could be recorded in a fund other than CLIF.

Response:

CDPH partially agrees.

CLIF does maintain separate revenue records for personnel and facility license categories. There are currently 42 categories of revenue representing each license category. Each license category has its own revenue deposit coding. It is true that initial and renewal revenue are mixed in CALSTARS. To create separate codes for initial versus renewal fees will double the number of categories to 84. The increased number of codes required for this essentially manual system will create an increase in workload for both LFS and Accounting Section in Sacramento and contribute to potentially higher error rates. Partial expenditure information is available in CALSTARS for the two basic license types: personnel and facility licensing that make up the CLIF.

In order to address concerns with revenue and expenditure reporting for the two license categories of personnel and facilities, LFS will work with the Accounting Section in Sacramento to develop PCA codes that allow for more accurate tracking without making the coding process overly complex. LFS agrees that separating initial from renewal revenue would be a benefit but would suggest delaying implementation of recommendation until an automated system can be established through current HAL replacement efforts.

It is accurate to state that checks are received at LFS Richmond and Accounting in Sacramento. It is an unwieldy and inefficient arrangement that does not allow for full reconciliation of funds as LFS cannot verify when and what kind of revenue is received in Sacramento. LFS will work with Accounting to determine if there is any way to resolve the problem. LFS would ultimately prefer to receive all fee payment in Richmond, but is understaffed and unable to manage the additional workload this would represent. LFS has proposed expanding its current pilot project that allows on-line credit card fee payments to a secure website as an alternative to paper checks. This would resolve the untimely cash deposit problem as well as the current lack of reconciliation for personnel renewals and facility fees. HAL system replacement efforts include development of on-line fee payment for all LFS programs.

Observation 9 Another Tissue Bank License Program Fund (TBLPF) Employee's Full Time Salary Paid by CLIF

In addition to the continued funding of the half-time TBLPF's employee position during 2006-2007, CLIF inadvertently paid for the full-time salary for another TBLPF employee for the period July 2007 through November 2007 and this employees overtime salary for February 2008. The regular and overtime salary paid by CLIF totaled $41,272 This error was caused because there were program cost account codes and CALSTARS was not available for the DPH to record its activities until November 2007 as a result of the Department split.

Response:

CDPH agrees.

The mistake in fund coding for this employees salary and benefits occurred during the Department re-organization July 1, 2007. The employee record had been correctly fund coded for the year prior to the 'split'. The CORE system that reports CALSTARS data to programs did not come on-line until late September 2007 due to reorganization activities. Personal Services funding was not corrected until November 07.

LFS reviews CORE payroll reports monthly and corrections reported on the Employee Master file. LFS will ensure that corrections to CALSTARS are submitted within two months of after month closing.

The Department of Finance, Office of State Audits and Evaluations (Finance) reviewed the California Department of Public Health (DPH)'s response to the draft report.

The DPH concurred with Observations 1, 3, 4, 6, and 9 and Follow-up of Prior Observations 3, 4, 5, and 6. The DPH partially agrees with Observations 2, 5, and 8, Follow-up of Prior Observation 2, and disagrees with Observation 7 and Projected 2008-09 Genetic Disease Testing Fund (GDTF) Fund Reserve.

Observation 8 was modified to reflect the effect of the DPH's comment related to maintenance of separate revenue records for personnel and facility license categories. All other reported observations and conditions remain as previously stated.

Where the DPH disagrees or partially disagrees with reported observations and conditions in its response, the following comments are provided:

Projected 2008-09 GDTF Fund Reserve
Changes to the 2008-09 budget were made subsequent to the completion of the fieldwork. This additional information related to those changes was not available to Finance during fieldwork, and the DPH did not provide additional documentation for our review. Additionally, without the suspension of the $4.5 million General Fund Loan repayment, the fund could experience a negative fund balance in 2008-09.

Observation 2: Need for Review of Revenue Estimate Methodology

- Finance recognizes the difficulties the Genetic Disease Screening Program (GDSP) faces in predicting the future trend in the number of tests. However, the revenue estimate should reflect the case load trend.
- The 2006-07 collection figures (90 percent for the prenatal screening test and 97 percent for the newborn screening test) reflect collection rates two years after providing the service; therefore, the outstanding account receivables are potentially uncollectible.

Observation 5: Fee Structure Needs Reevalaution
The DPH misinterpreted our observation. Finance does not suggest that the current fee should be reduced. However, the fee components should be realigned to reasonably reflect the related expenditures.

Observation 7: Vendor Invoices Created and Approved by GDSP staff Using SIS
The DPH did not comment on the fact that GDSP staff time is used to prepare, distribute, and follow-up on invoices for services they are purchasing not providing.

Prior Observation 2 Follow-up: Revenue Not Monitored for Accuracy
The DPH addressed how their deposit records are reconciled with the California State Accounting and Reporting System (CALSTARS) Summary of Receipts Report (Q24). However, the DPH did not address the question of how the Laboratory Field Services (LFS) performs revenue reconciliations between the Health Application Licensing system and CALSTARS. This is necessary to ensure the accuracy and completeness of license fee collections.

For the reasons stated above, Finance's reported observations and conditions remain unchanged in the report, except for Observation 8.