Single Audit Report 2006-07

Arnold Schwarzenegger, Governor
State of California

Single Audit Report

2006-07

Arnold Schwarzenegger
Governor, State of California

DEPARTMENT OF FINANCE
OFFICE OF THE DIRECTOR

ARNOLD SCHWARZENEGGER, GOVERNOR
STATE CAPITOL ■ ROOM 1145 ■ SACRAMENTO CA ■ 95814-4998 ■ WWW.DOF.CA.GOV

June 30, 2008

Mr. Daniel R. Levinson, Inspector General
Department of Health and Human Services
Room 5250, Cohen Building
330 Independence Avenue, S.W.
Washington, D.C. 20201

Dear Mr. Levinson:

As the Governor's fiscal representative, I submit to you the State of California Single Audit Report for the fiscal year ended June 30, 2007. The report contains the Independent Auditor's Reports on the state's general-purpose financial statements, compliance and internal control over financial reporting, compliance and internal control related to federal grants, and schedule of federal assistance. Although the Independent Auditor identified significant deficiencies related to internal control over financial reporting, the conditions were not considered material and do not adversely affect the state's general-purpose financial statements. The Independent Auditor also identified significant deficiencies related to internal control over compliance with major federal program requirements and identified several instances of noncompliance that were considered material. Accordingly, we recognize that there are areas where internal controls and administration of federal awards needs to be improved.

California provides its citizens with numerous state and federal programs. The mix of programs provided makes us larger and more complex than most economic entities in the world. Such complexity, along with ever-present budget constraints, challenges us to meet the requirements of those programs and activities efficiently and effectively. Moreover, such operations must exist within a system of internal and administrative control that safeguards assets and resources and produces reliable financial information. Attaining these objectives and overseeing the financial and business practices of the state continues to be an important part of the Department of Finance's (Finance) leadership.

In meeting our responsibility for financial leadership and oversight, Finance provides internal audit related education and training to departments, as well as, oversight of departmental internal audit units by issuing audit guidelines and conducting quality assurance reviews. Further we have an ongoing process of issuing audit memos to departments that establish statewide policy and provide technical advice on various audit related areas. An audit memo concerning the results of the fiscal year 2006-07 Single Audit will be issued to remind all departments of the new internal auditing standards and processes included in California's Omnibus Audit Accountability Act of 2006.

The state is committed to sound and effective fiscal oversight. The head of each state department is responsible for establishing and maintaining a system of internal accounting and administrative control within their department. This responsibility includes documenting the system, communicating system requirements to employees, and assuring that the system is functioning as prescribed and is modified for changing conditions. Moreover, all levels of state management must be involved in assessing and strengthening their systems of internal accounting and administrative controls to minimize fraud, errors, abuse, and waste of government funds. In 2006, the state implemented changes to the Financial Integrity and State Manager's Accountability Act (FISMA) reporting requirements. As a result, each agency must conduct an internal review of its controls and prepare a report of the findings. A certification letter alone does not meet the FISMA requirements. Finance will continue to provide education and guidance to assist agencies in meeting the FISMA requirements.

Each state department with reportable internal control weaknesses or instances of noncompliance is responsible for developing and implementing corrective action plans. We will monitor the findings and reported corrective actions to identify potential changes in statewide fiscal procedures.

Finance is committed to ensuring the proper financial operations and business practices of the state, as well as, ensuring that internal controls exist for the safeguarding and effective use of assets and resources.

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

Sincerely,

Original signed by:

MICHAEL C. GENEST
Director

Enclosure

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Overview of California's Economy
Fiscal Year 2006-07

The California and national economies faced considerable headwinds in 2007—a deepening housing slump, a breakdown in mortgage markets, tighter credit, more volatile financial markets, and rising energy prices. Upward resets of subprime mortgage rates made payments unaffordable for many borrowers and helped push mortgage defaults and foreclosures to record levels. Several large financial institutions reported huge losses on subprime mortgages. Uncertainty about how far the problems with these mortgages would spread increased financial market volatility and prompted lenders to tighten credit standards. The Federal Reserve injected liquidity into the financial markets and eased monetary policy on a number of occasions in the second half of the year, but as 2008 began, financial markets were still not functioning normally.

The effects of the housing slump were evident in a broad range of measures of the national economy. New home sales were down between 35 and 40 percent in 2007 from their peak level in 2005 and new single-family home building, about 25 percent from the peak level in 2006. Total job growth was the smallest since 2004, and real gross domestic product (GDP) growth was the lowest since 2002.

In California, where the housing slump has been deeper than the vast majority of other states, single-family housing permits in the third quarter of 2007 were only about one-third of their level in the third quarter of 2005 and existing home sales, about half of their level two years ago. Personal income held up well, but taxable sales slowed considerably.

The struggling housing sector slowed the national economy in 2007. Home building, home sales, and related retail sales all declined. The slowdown in home building alone reduced national output growth by almost one percentage point. The problems with subprime mortgages have raised financial market volatility and have spurred a credit tightening that not only could delay a housing recovery, but hurt parts of the economy outside the housing sector.

The contraction in residential construction and mortgage finance and a slide in housing-related retailing cooled labor markets in the nation. In 2007, job gains averaged 111,000 per month, a sharp drop from 2006 when the average monthly gain was 189,000.

Total personal income held up surprisingly well in California during the housing slump. This broad measure of the economy was 5.8 percent higher than a year earlier in the first half of 2007, which is not much lower than the 6.5 percent growth in both 2005 and 2006.

However, the housing slump and higher energy prices took a significant toll on taxable sales, another broad measure of the economic performance. After growing by 7.4 percent in 2005, taxable sales increased by only 4 percent in 2006 and 0.8 percent in the first three quarters of 2007. Weaker vehicle sales and sales at home improvement outlets likely played a significant role in the deceleration of taxable sales. New vehicle registrations fell 2.3 percent in 2006 and 7.3 percent from a year ago in the first nine months of 2007. And, no doubt, some of the declines in sales of national home improvement chains were in California.

California home building and residential real estate markets continued to slow in 2007. Single-family residential permits were down 37 percent in 2007, and existing single-family home sales, 26 percent. In December, the number of unsold homes on the market amounted to 14.5 months of sales at the December sales rate. A year earlier, inventories amounted to 5.9 months of sales. The median price of existing single-family homes sold in December, $475,500, was 16.5 percent lower than the median price a year earlier.

Growing private-sector nonresidential building offset some of the drag of residential construction on the California economy in 2007. The value of private-sector nonresidential building permits issued in 2007 was 6.3 percent higher than the year-ago value.

Monthly job gains slowed considerably in the state in 2007, averaging just 6,600. Gains averaged 21,700 in 2006. The state's unemployment rate increased from 4.8 percent in March 2007 to 6.1 percent in December 2007.

The state and national economies will continue to face the same headwinds—a struggling housing sector, problems in mortgage markets, tighter credit, more volatile financial markets, and high energy prices—in 2008 and, to a lesser extent, in 2009, but economic growth should start to pick up in late 2008.

Part One

State of California Financial Report for the Year Ended June 30, 2007

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State Auditor

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INDEPENDENT AUDITOR'S REPORT

THE GOVERNOR AND THE LEGISLATURE OF THE STATE OF CALIFORNIA

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of California, as of and for the year ended June 30, 2007, which collectively comprise the State of California's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the State of California's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the following significant amounts in the financial statements of:

Government-wide Financial Statements

- Certain enterprise funds that, in the aggregate, represent 82 percent, 42 percent, and 56 percent, respectively, of the assets, net assets, and revenues of the business-type activities.
- The University of California, State Compensation Insurance Fund, California Housing Finance Agency, Public Employees' Benefits, and certain other funds that, in the aggregate, represent over 99 percent of the assets, net assets, and revenues of the discretely presented component units.

Fund Financial Statements

- The following major enterprise funds: Electric Power fund, Water Resources fund, Public Building Construction fund, and State Lottery fund.
- Certain nonmajor enterprise funds that represent 89 percent, 79 percent, and 88 percent, respectively, of the assets, net assets, and revenues of the nonmajor enterprise funds.
- The funds of the Public Employees' Retirement System and the State Teachers' Retirement System that, in the aggregate, represent 93 percent, 94 percent, and 75 percent, respectively, of the assets, net assets, and additions of the fiduciary funds and similar component units.
- The discretely presented component units noted above.

Those financial statements were audited by other auditors whose reports have been furnished to us, and our opinions, insofar as they relate to the amounts included for those funds and entities, is based on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America. Those

standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of California, as of June 30, 2007, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, reports on the State's internal control structure and on its compliance with laws and regulations will be issued in our single audit report. These reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The management's discussion and analysis, schedule of funding progress, infrastructure information, budgetary comparison information, reconciliation of budgetary and GAAP-basis fund balances, and related notes are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We and the other auditors have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the State of California's basic financial statements. The combining financial statements and schedules listed in the accompanying table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining statements and schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, based on our audit and the reports of other auditors, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory and statistical sections of this report have not been subjected to the auditing procedures applied by us and the other auditors in the audit of the basic financial statements, and accordingly, we express no opinion on them.

BUREAU OF STATE AUDITS

JOHN F. COLLINS II, CPA
Deputy State Auditor

March 3, 2008

Management's Discussion and Analysis

The following Management's Discussion and Analysis is a required supplement to the State of California's financial statements. It describes and analyzes the financial position of the State, providing an overview of the State's activities for the year ended June 30, 2007. We encourage readers to consider the information we present here in conjunction with the information presented in the Controller's letter of transmittal at the front of this report and in the State's financial statements and notes, which follow this section.

Financial Highlights – Primary Government

Government-wide Highlights

The economic growth that the State experienced in recent years began to slow down in the 2006-07 fiscal year, resulting in a smaller increase in general revenues, primarily in personal income, corporate, and sales tax revenues. However, the growth in expenses for the State's governmental activities continued. In fact, expenses for governmental activities exceeded revenues for the year, resulting in a decrease in net assets. Total expenses for the State's business-type activities also exceeded revenues for the year; therefore, net assets for the 2006-07 fiscal year for both governmental and business-type activities decreased by 2.6% from last year.

Net Assets — The primary government's net assets as of June 30, 2007, were $46.6 billion. After the total net assets are reduced by $81.6 billion for investment in capital assets (net of related debt) and by $19.1 billion for restricted net assets, the resulting unrestricted net assets were a negative $54.1 billion. Restricted net assets are dedicated for specified uses and are not available to fund current activities. Two-thirds of the negative $54.1 billion consists of $36.3 billion in outstanding bonded debt issued to build capital assets for school districts and other local governmental entities. The bonded debt reduces the unrestricted net assets; however, local governments, not the State, record the capital assets that would offset this reduction.

Changes in Net Assets — The primary government's total net assets decreased by $1.2 billion (2.6%) during the year ended June 30, 2007. Net assets of governmental activities decreased by $1.1 billion (3.0%), while net assets of business-type activities decreased by $140 million (1.2%).

Fund Highlights

Governmental Funds — As of June 30, 2007, the primary government's governmental funds reported a combined ending fund balance of $18.0 billion, an increase of $635 million from the previous fiscal year. After the total fund balance is reduced by $24.5 billion in reserves, the unreserved fund balance totaled a negative $6.5 billion.

Proprietary Funds — As of June 30, 2007, the primary government's proprietary funds reported combined ending net assets of $11.6 billion, a decrease of $411 million from the previous fiscal year. After the total net assets are reduced by $370 million for investment in capital assets (net of related debt) and expendable restrictions of $8.6 billion, the unrestricted net assets totaled $2.6 billion.

Noncurrent Assets and Liabilities

As of June 30, 2007, the primary government's noncurrent assets totaled $123.5 billion, of which $98.1 billion is related to capital assets. State highway infrastructure assets of $56.0 billion represent the largest part of the State's capital assets.

The primary government's noncurrent liabilities totaled $98.8 billion, which consists of $50.0 billion in general obligation bonds, $29.8 billion in revenue bonds, and $19.0 billion in all other noncurrent liabilities.

Overview of the Financial Statements

This discussion and analysis is an introduction to the section presenting the State's basic financial statements, which includes four components: (1) government-wide financial statements, (2) fund financial statements, (3) discretely presented component units financial statements, and (4) notes to the financial statements. This report also contains required supplementary information and combining financial statements and schedules.

Government-wide Financial Statements

Government-wide financial statements are designed to provide readers with a broad overview of the State's finances. The government-wide financial statements do not include fiduciary programs and activities of the primary government and component units because fiduciary resources are not available to support state programs.

To help readers assess the State's economic condition at the end of the fiscal year, the statements provide both short-term and long-term information about the State's financial position. These statements are prepared using the economic resources measurement focus and the accrual basis of accounting, similar to methods used by most businesses. These statements take into account all revenues and expenses connected with the fiscal year, regardless of when the State received or paid the cash. The government-wide financial statements include two statements: the Statement of Net Assets and the Statement of Activities.

- The *Statement of Net Assets* presents all of the State's assets and liabilities and reports the difference between the two as net assets. Over time, increases or decreases in net assets indicate whether the financial position of the State is improving or deteriorating.

- The *Statement of Activities* presents information showing how the State's net assets changed during the most recent fiscal year. The State reports changes in net assets as soon as the event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, this statement reports revenues and expenses for some items that will result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave). This statement also presents a comparison between direct expenses and program revenues for each function of the State.

The government-wide financial statements separate into different columns the three types of state programs and activities: governmental activities, business-type activities, and component units.

- *Governmental activities* are mostly supported by taxes, such as personal income and sales and use taxes, and intergovernmental revenues, primarily federal grants. Most services and expenses normally associated with state government fall into this activity category, including health and human services, education (public kindergarten through 12th grade [K-12] schools and institutions of higher education),

business and transportation, correctional programs, general government, resources, tax relief, state and consumer services, and interest on long-term debt.

- *Business-type activities* typically recover all or a significant portion of their costs through user fees and charges to external users of goods and services. The business-type activities of the State of California include providing unemployment insurance programs, providing housing loans to California veterans, providing water to local water districts, providing building aid to school districts, providing services to California State University students, leasing public assets, selling California State Lottery tickets, and selling electric power. These activities are carried out with minimal financial assistance from the governmental activities or general revenues of the State.

- *Component units* are organizations that are legally separate from the State, but are at the same time related to the State financially (i.e., the State is financially accountable for them) or the nature of their relationship with the State is so significant that their exclusion would cause the State's financial statements to be misleading or incomplete. The State's financial statements include the information for blended, fiduciary, and discretely presented component units.

  - *Blended component units*, although legally separate entities, are in substance a part of the primary government's operations. Therefore, for reporting purposes, the State integrates data from blended component units into the appropriate funds. The Golden State Tobacco Securitization Corporation; the California State University, Channel Islands Site and Financing authorities; and certain building authorities that are blended component units of the State are included in the governmental activities.

  - *Fiduciary component units* are legally separate from the primary government but, due to their fiduciary nature, are included with the primary government's fiduciary funds. The Public Employees' Retirement System and the State Teachers' Retirement System are fiduciary component units that are included with the State's pension and other employee benefit trust funds, which are not included in the government-wide financial statements.

  - *Discretely presented component units* are legally separate from the primary government and provide services to entities and individuals outside the primary government. The activities of discretely presented component units are presented in a single column in the government-wide financial statements.

Information on how to obtain financial statements of the individual component units is available from the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, CA 94250.

Fund Financial Statements

Fund financial statements are provided for governmental funds, proprietary funds, fiduciary funds and similar component units, and discretely presented component units. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The State of California, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal and contractual requirements. Following are general descriptions of the three types of funds.

- *Governmental funds* are used to account for essentially the same functions that are reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on short-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end

of the fiscal year. Such information may be useful in evaluating a government's short-term financing requirements. This approach is known as the flow of current financial resources measurement focus and the modified accrual basis of accounting. These governmental fund statements provide a detailed short-term view of the State's finances, enabling readers to determine whether adequate financial resources exist to meet the State's current needs.

Because governmental fund financial statements provide a narrower focus than do government-wide financial statements, it is useful to compare governmental fund statements to the governmental activities information presented in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's short-term financing decisions. Reconciliations located on the pages immediately following the fund statements show the differences between the government-wide statements and the governmental fund Balance Sheet and the governmental fund Statement of Revenues, Expenditures, and Changes in Fund Balances. Primary differences between the government-wide and fund statements relate to noncurrent assets, such as land and buildings, and noncurrent liabilities, such as bonded debt and amounts owed for compensated absences and capital lease obligations, which are reported in the government-wide statements but not in the fund-based statements.

- *Proprietary funds* show activities that operate more like those found in the private sector. The State of California has two proprietary fund types: enterprise funds and internal service funds.

  - *Enterprise funds* record activities for which a fee is charged to external users; they are presented as business-type activities in the government-wide financial statements.

  - *Internal service funds* accumulate and allocate costs internally among the State of California's various functions. For example, internal service funds provide information technology, printing, fleet management, and architectural services primarily for state departments. As a result, their activity is considered governmental.

- *Fiduciary funds* account for resources held for the benefit of parties outside the State. Fiduciary funds and the activities of fiduciary component units are not reflected in the government-wide financial statements, because the resources of these funds are not available to support State of California programs. The accounting used for fiduciary funds and similar component units is similar to that used for proprietary funds.

Discretely Presented Component Units Financial Statements

As discussed previously, the State has financial accountability for discretely presented component units, which have certain independent qualities and operate in a similar manner as private-sector businesses. The activities of the discretely presented component units are classified as enterprise activities.

Notes to the Financial Statements

The notes to the financial statements in this publication provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements, which describe particular accounts in more detail, are located immediately following the discretely presented component units' financial statements.

Required Supplementary Information

A section of required supplementary information follows the notes to the basic financial statements in this publication. This section includes a schedule of funding progress for certain pension trust funds, information on infrastructure assets based on the modified approach, a budgetary comparison schedule, and a separate reconciliation of the statutory fund balance for budgetary purposes and the fund balance for the major governmental funds presented in the governmental fund financial statements.

Combining Financial Statements and Schedules

The Combining Financial Statements and Schedules – Nonmajor and Other Funds section presents *combining statements* that provide separate financial statements for nonmajor governmental funds, proprietary funds, fiduciary funds, and nonmajor component units. The basic financial statements present only summary information for these entities.

Government-wide Financial Analysis

Net Assets

The primary government's combined net assets (governmental and business-type activities) decreased 2.6%, from $47.8 billion as restated at June 30, 2006, to $46.6 billion a year later.

The primary government's $81.6 billion investment in capital assets, such as land, building, equipment, and infrastructure (roads, bridges, and other immovable assets), comprise a significant portion of its net assets. This amount of capital assets is net of any outstanding debt used to acquire those assets. The State uses capital assets when providing services to citizens; consequently, these assets are not available for future spending. Although the State's investment in capital assets is reported in this publication net of related debt, please note that the resources needed to repay this debt must come from other sources because the State cannot use the capital assets themselves to pay off the liabilities.

Another $19.1 billion of the primary government's net assets represents resources that are externally restricted as to how they may be used, such as resources pledged to debt service. Internally imposed earmarking of resources is not presented in this publication as restricted net assets. The State may use a positive balance of unrestricted net assets of governmental activities to meet its ongoing obligations to citizens and creditors. As of June 30, 2007, governmental activities showed an unrestricted net assets deficit of $56.5 billion and business-type activities showed unrestricted net assets of $2.4 billion.

A large portion of the negative unrestricted net assets of governmental activities comprises $36.3 billion in outstanding bonded debt issued to build capital assets for school districts and other local governmental entities. Because the State does not own these capital assets, neither the assets nor the related bonded debt is included in the portion of net assets reported as "investment in capital assets, net of related debt." Instead, the bonded debt is reported as a non-current liability that reduces the State's unrestricted net assets. Readers can expect to see a continued deficit in unrestricted net assets of governmental activities as long as the State has significant outstanding obligations for school districts and other local governmental entities.

Table 1 presents condensed financial information derived from the Statement of Net Assets for the primary government.

Table 1

Net Assets – Primary Government
June 30, 2006 and 2007
(amounts in millions)

	Governmental Activities		Business-type Activities		Total	
	2007	2006*	2007	2006*	2007	2006*
ASSETS						
Current and other assets	$ 51,048	$ 50,240	$ 34,234	$ 34,683	$ 85,282	$ 84,923
Capital assets	91,818	89,763	6,267	5,849	98,085	95,612
Total assets	**142,866**	**140,003**	**40,501**	**40,532**	**183,367**	**180,535**
LIABILITIES						
Noncurrent liabilities	72,970	69,382	25,849	26,093	98,819	95,475
Other liabilities	34,519	33,411	3,438	3,097	37,957	36,508
Total liabilities	**107,489**	**102,793**	**29,287**	**29,190**	**136,776**	**131,983**
NET ASSETS						
Investment in capital assets net of related debt	81,353	83,489	208	818	81,561	84,307
Restricted	10,543	8,431	8,575	8,723	19,118	17,154
Unrestricted	(56,519)	(54,710)	2,431	1,801	(54,088)	(52,909)
Total net assets	**$ 35,377**	**$ 37,210**	**$ 11,214**	**$ 11,342**	**$ 46,591**	**$ 48,552**

* Not restated

Changes in Net Assets

The expenses of the primary government totaled $194.5 billion for the year ended June 30, 2007. Of this amount, $84.2 billion (43.3%) was funded with program revenues (charges for services or program-specific grants and contributions), leaving $110.3 billion to be funded with general revenues (mainly taxes). The primary government's general revenues of $109.1 billion were less than the unfunded expenses. As a result, during the year, total net assets decreased by $1.2 billion, or 2.6%.

Of the total decrease, net assets for governmental activities decreased by $1.1 billion, while those for business-type activities decreased by $140 million. The decrease in governmental activities is primarily due to increased spending for health and human services, resources, and correctional programs that caused total expenses to increase more than revenue increased. The decrease in business-type activities is mainly due to unemployment benefit payments exceeding employer contributions and other revenue for unemployment programs.

Table 2 presents condensed financial information derived from the Statement of Activities for the primary government.

Table 2

Changes in Net Assets – Primary Government
Year ended June 30, 2006 and 2007
(amounts in millions)

	Governmental Activities		Business-type Activities		Total	
	2007	2006	2007	2006	2007	2006
REVENUES						
Program revenues:						
Charges for services	$ 18,822	$ 19,188	$ 20,614	$ 21,540	$ 39,436	$ 40,728
Operating grants and contributions	43,440	42,254	—	—	43,440	42,254
Capital grants and contributions	1,165	1,273	183	57	1,348	1,330
General revenues:						
Taxes	108,016	100,461	—	—	108,016	100,461
Investment and interest	730	505	—	—	730	505
Miscellaneous	334	292	—	—	334	292
Total revenues	**172,507**	**163,973**	**20,797**	**21,597**	**193,304**	**185,570**
EXPENSES						
Program expenses:						
General government	13,314	9,675	—	—	13,314	9,675
Education	61,542	62,653	—	—	61,542	62,653
Health and human services	69,980	65,763	—	—	69,980	65,763
Resources	5,317	4,162	—	—	5,317	4,162
State and consumer services	1,215	596	—	—	1,215	596
Business and transportation	9,763	8,809	—	—	9,763	8,809
Correctional programs	8,945	7,299	—	—	8,945	7,299
Tax relief	948	704	—	—	948	704
Interest on long-term debt	2,596	2,894	—	—	2,596	2,894
Electric Power	—	—	5,865	5,342	5,865	5,342
Water Resources	—	—	952	950	952	950
Public Building Construction	—	—	335	334	335	334
State Lottery	—	—	3,471	3,912	3,471	3,912
Unemployment Programs	—	—	9,136	8,585	9,136	8,585
Nonmajor enterprise	—	—	1,148	814	1,148	814
Total expenses	**173,620**	**162,555**	**20,907**	**19,937**	**194,527**	**182,492**
Excess (deficiency) before transfers	**(1,113)**	**1,418**	**(110)**	**1,660**	**(1,223)**	**3,078**
Transfers	30	23	(30)	(23)	—	—
Special item	—	1,218	—	—	—	1,218
Change in net assets	(1,083)	2,659	(140)	1,637	(1,223)	4,296
Net assets, beginning of year (restated)	**36,460**	**34,551**	**11,354**	**9,705**	**47,814**	**44,256**
Net assets, end of year	**$ 35,377**	**$ 37,210**	**$ 11,214**	**$ 11,342**	**$ 46,591**	**$ 48,552**

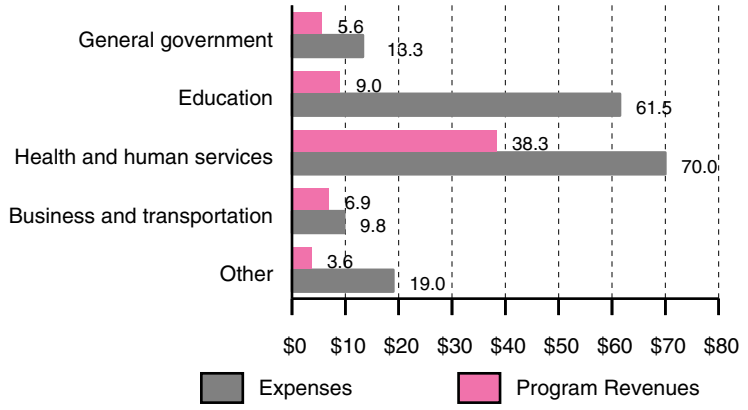
Governmental Activities

Governmental activities expenses totaled $173.6 billion. Program revenues, including $44.6 billion received in federal grants, funded $63.4 billion (36.5%) of that amount, leaving $110.2 billion to be funded with general revenues (mainly taxes). However, general revenues and transfers for governmental activities totaled only $109.1 billion, so governmental activities' total net assets decreased by $1.1 billion, or 3.0%, during the year ended June 30, 2007. The State used reserves to meet its cash flow needs.

Chart 1 presents a comparison of governmental activities expenses by program, with related revenues.

Chart 1

Expenses and Program Revenues – Governmental Activities
Year Ended June 30, 2007
(amounts in billions)



For the year ended June 30, 2007, total state tax revenues collected for governmental activities increased by 7.5% over the prior year. The largest increase in state tax revenue occurred in other taxes. Fuel tax revenue previously reported as additions in an agency fund is now reported as other taxes. Certain fuel tax revenue was reclassified from sales and use taxes to other taxes. Personal income, corporation, and sales tax revenue also increased modestly during the year, due to job growth and increased personal income and retail sales.

Overall expenses for governmental activities increased by $11.0 billion (6.8%) over the prior year. The largest increases in expenses were a $4.2 billion increase in health and human services spending and a $3.6 billion increase in general government. The increase in health and human services spending was the result of increased costs and use of medical services, increased rates for physicians and certain other providers, significant policy changes in Medi-Cal, and ongoing growth in caseloads. The increase in general government spending was the result of the inclusion of fuel tax revenue apportionment payments to local governments previously reported as deductions in an agency fund.

Charts 2 and 3 present the percentage of total expenses for each governmental activities program and the percentage of total revenues by source.

Chart 2

Expenses by Program
Year ended June 30, 2007
(as a percent)

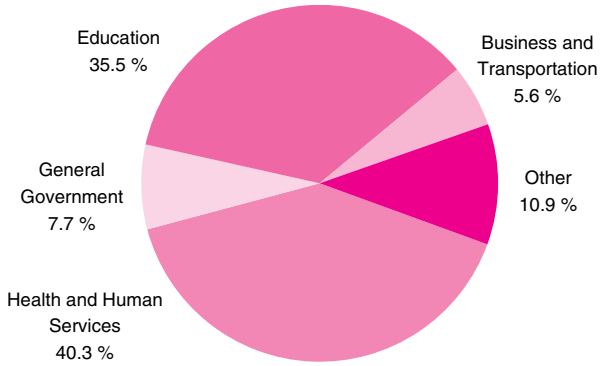
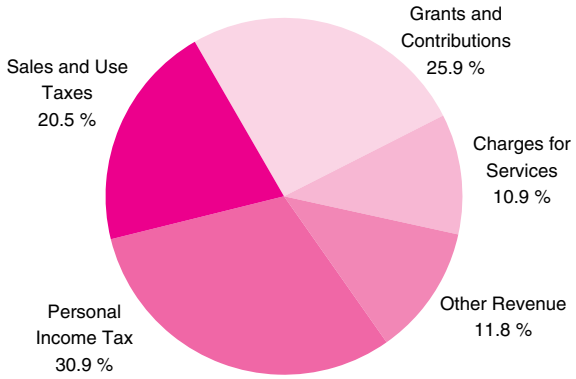


Chart 3

Revenues by Source
Year ended June 30, 2007
(as a percent)



Business-type Activities

Business-type activities expenses totaled $20.9 billion. Program revenues of $20.8 billion were generated primarily from charges for services that fully paid these expenses. Consequently, business-type activities' total net assets decreased by $140 million, or 1.2%, during the year ended June 30, 2007. Most of the decrease was due to a $118 million decrease in the unemployment programs' net assets, discussed in more detail in the Fund Financial Analysis section under Proprietary Funds.

Chart 4 presents a two-year comparison of the expenses of the State's business-type activities.

Chart 4

Expenses – Business-type Activities – Two-Year Comparison
Years Ended June 30, 2006 and 2007
(amounts in billions)

Fund Financial Analysis

The State's slowing economy primarily affected governmental funds, which rely heavily on taxes to support the majority of the State's services and programs. Although tax revenue increased during the year, the increase was lower than the dramatic increases the State experienced in the last three years. The expenditures of the governmental funds increased at a higher rate than revenues. On the other hand, none of the major proprietary funds had total revenues that were significantly different from total expenses during the year ended June 30, 2007; however, increased unemployment did result in Unemployment Programs Fund expenses exceeding its revenues.

Governmental Funds

The governmental funds' Balance Sheet reported $55.4 billion in assets, $37.4 billion in liabilities, and $18.0 billion in fund balance as of June 30, 2007. The largest change in account balances was a $1.1 billion decrease in cash and pooled investments. This decrease is mainly the result of the timing of receipts and disbursement at year end and of Assembly Bill 1802, enacted in July 2006, that authorized all student fees for California State University programs previously deposited in the State Treasury (cash and pooled investments) to be deposited in local banks (investments). This bill also results in increased investments for the universities reported in nonmajor governmental funds. Within the total fund balance, $24.5 billion has been set aside in reserve. The reserved amounts are not available for new spending because they have been committed for outstanding contracts and purchase orders ($6.5 billion), noncurrent interfund receivables and loans receivable ($5.0 billion), continuing appropriations ($11.9 billion), and debt service ($1.1 billion). The unreserved balance of the governmental funds is a negative $6.5 billion.

The Statement of Revenues, Expenditures, and Changes in Fund Balances of the governmental funds shows $172.3 billion in revenues, $182.2 billion in expenditures, and a net $10.5 billion in receipts from other financing sources. The ending fund balance of the governmental funds for the year ended June 30, 2007, was $18.0 billion, a $635 million increase over the previous year's restated ending fund balance of $17.4 billion. Although the State's economy showed signs of slowing in the 2006-07 fiscal year, there was enough growth in personal income and taxable sales to result in increased personal income and sales and use taxes in the governmental funds. Personal income taxes, which account for 49.4% of tax revenues and 30.9% of total governmental fund revenues, increased by $2.5 billion over the previous fiscal year. Sales and use taxes, which account for 32.9% of tax revenues and 20.6% of total govermental fund revenues, increased by $1.2 billion.

The State's major governmental funds are the General Fund, the Federal Fund, and the Transportation Construction Fund. The General Fund ended the fiscal year with a fund deficit of $1.9 billion. The Federal Fund and the Transportation Construction Fund ended the fiscal year with fund balances of $38 million and $5.9 billion, respectively. The nonmajor governmental funds ended the year with a total fund balance of $14.0 billion.

General Fund: As shown on the Balance Sheet, the General Fund (the State's main operating fund) ended the fiscal year with assets of $16.5 billion, liabilities of $18.4 billion, and fund balance reserves of $2.6 billion, leaving the General Fund with an unreserved fund deficit of $4.5 billion. The largest change in asset accounts was in cash and pooled investments, which decreased from $11.7 billion to $6.0 billion. In addition to the change for California State University student fees discussed above, the decrease in cash and pooled investments is also due to current-year expenditures and transfers exceeding revenue collections.

The largest change in liability account balances was a decrease in the amount due to other governments (from $4.6 billion to $4.1 billion). The decrease in the amount due to other governments was caused mainly by the inflation of last year's balance for the accrual of larger-than-usual state-mandated cost reimbursements to schools and other local governments paid in the 2006-07 fiscal year budget.

As shown on the Statement of Revenues, Expenditures, and Changes in Fund Balances of the governmental funds, the General Fund had $96.3 billion in revenues, $96.2 billion in expenditures, and a net $4.7 billion disbursement from other financing sources (uses) for the year ended June 30, 2007. The largest source of General Fund revenue was $93.7 billion in taxes, comprised primarily of personal income taxes ($52.4 billion) and sales and use taxes ($27.4 billion).

The taxes with the largest increase in revenues were personal income taxes, which increased by $2.4 billion (4.9%). This increase can be attributed to a small growth in the job market and increased personal income. Corportation taxes also increased by $500 million (4.7%), to $11.2 billion. The decrease in sales and use tax revenue in the General Fund is mainly due to amounts that were previously reported in the General Fund being reported in nonmajor governmental funds for the repayment of the deficit-financing bonds and deferred Proposition 42 transfers for transportation projects.

General Fund expenditures increased by $7.0 billion, to $96.2 billion. The programs with the largest increases were education, which increased by $2.7 billion, to $49.3 billion, and health and human services, which increased by $2.8 billion, to $28.9 billion. The transfers out of the General Fund to other funds increased by $3.3 billion, to $6.5 billion. The General Fund's ending fund balance (including reserves) for the year ended June 30, 2007, was a negative $1.9 billion, a decrease of $4.6 billion over the previous year's ending fund balance of $2.7 billion.

The increase in education expenditures consists of increased funding for enrollment growth and cost-of-living adjustments; elimination of deficit funding and other historical revenue-limit reductions; and expansion of after school, child care, and preschool programs. Health and human service expenditures increased, primarily due to ongoing growth in medical and social services caseloads, increases in costs and use of medical services, rate increases for physicians and certain other providers, and a number of significant policy changes in Medi-Cal. Transfers out of the General Fund increased mainly as a result of the partial repayment of deferred Proposition 42 transfers to the Transportation Construction Fund. Proposition 42 required, beginning in 2003-04, that revenue from the sales tax on gasoline that previously went to the General Fund be transferred to the Transportation Construction Fund for state and local transportation projects. However, the General Fund transfers were partially suspended in 2003-04 and fully suspended in 2004-05, as allowed by Proposition 42, because the transfers would have had a negative fiscal impact on the General Fund.

Federal Fund: This fund reports federal grant revenues and the related expenditures to support the grant programs. The largest of these program areas is health and human services, which accounted for $32.4 billion (74.1%) of the total $43.7 billion in fund expenditures. The Medical Assistance program and the Temporary Assistance for Needy Families program are included in this program area. Education programs also constituted a large part of the fund's expenditures—$6.7 billion (15.3%)—most of which were apportionments made to local educational agencies (school districts, county offices of education, community colleges, etc.). The Federal Fund's revenues and expenditures increased by approximately the same amount, with revenues increasing slightly more than expenditures, resulting in a $3 million increase in fund balance from the prior year.

Transportation Construction Fund: This fund accounts for fuel taxes, bond proceeds, and other revenues used for highway and passenger rail construction. Expenditures increased by 62.3%, while revenues increased by 48.1% from the prior year. The increased revenues and a majority of the increased expenditures is attributable to the inclusion of certain fuel tax revenue and apportionment payments to local governments that were

previously accounted for as additions and deductions in an agency fund rather than as revenues and expenditures. The remaining increase in expenditures is caused by the reclassification of certain nonmajor governmental funds. Fund expenditures of $7.3 billion exceeded revenues by $1.8 billion. However, the fund balance increased by $1.5 billion, due to the increase in previously deferred Proposition 42 transfers from the General Fund.

Proprietary Funds

Enterprise Funds: In general, the slowing economy did not have as significant an effect on enterprise funds as it did on governmental funds. Most major enterprise funds' activity remained stable, as revenues approximated expenses, resulting in only a $140 million decrease in net assets.

As shown on the Statement of Net Assets of the proprietary funds, total assets of the enterprise funds were $41.0 billion as of June 30, 2007. Of this amount, current assets totaled $13.4 billion and noncurrent assets totaled $27.6 billion. The largest change in asset account balances was a $726 million decrease in noncurrent recoverable power costs (costs that are recoverable through future billings) in the Electric Power Fund. This decrease was due to current year collections of recoverable power costs exceeding current year costs, reducing recoveries due in future billing periods. The total liabilities of the enterprise funds were $29.8 billion. The largest liability accounts were revenue bonds payable of $21.9 billion and general obligation bonds payable of $1.8 billion. Although there was activity during the year—new bonds issued, redemptions, and defeasances—the change in the ending balance of these accounts was minimal.

Total net assets of the enterprise funds were $11.2 billion as of June 30, 2007. Total net assets consisted of three segments: expendable restricted net assets of $8.6 billion; investment in capital assets (net of related debt) of $208 million; and unrestricted net assets of $2.4 billion. The Unemployment Programs Fund had the largest net assets, with $5.6 billion (50% of the enterprise funds' total net assets). The expendable restricted net assets of the Unemployment Programs Fund decreased by $118 million.

As shown on the Statement of Revenues, Expenses, and Changes in Fund Net Assets of the proprietary funds, the enterprise funds ended the year with operating revenues of $19.1 billion, operating expenses of $18.4 billion, and net disbursements from other transactions of $985 million. The largest sources of operating revenue were unemployment and disability insurance receipts of $8.6 billion in the Unemployment Programs Fund and power sales of $4.8 billion collected by the Electric Power Fund. The largest operating expenses were distributions to beneficiaries of $8.9 billion by the Unemployment Programs Fund and power purchases (net of recoverable costs) of $4.8 billion by the Electric Power Fund. The ending net assets of the enterprise funds for the year ended June 30, 2007, were $11.2 billion, or $140 million less than the previous year's restated ending fund balance of $11.4 billion. The decrease was mainly caused by an excess of unemployment claim payments over unemployment insurance receipts as a result of the State's increased unemployment. The employer's contribution rate is currently set at the highest rate allowed, so future increases in unemployment would continue to deplete the current reserves in the Unemployment Programs Fund.

Internal Service Funds: Total net assets of the internal service funds were $394 million as of June 30, 2007. These net assets consist of two segments: investment in capital assets (net of related debt) of $162 million and unrestricted net assets of $232 million.

Fiduciary Funds

The State of California has four types of fiduciary funds: private purpose trust funds, pension and other employee benefit trust funds, investment trust funds, and agency funds. The private purpose trust funds ended the fiscal year with net assets of $2.7 billion. The pension and other employee benefit trust funds ended the fiscal year with net assets of $432.3 billion. The State's only investment trust fund, the Local Agency Investment Fund, ended the fiscal year with net assets of $19.7 billion. Agency funds act as clearing accounts and thus do not have net assets.

For the year ended June 30, 2007, the fiduciary funds' combined net assets were $455 billion, a $73.5 billion increase from prior year net assets. The increase in net assets was mainly attributable to investment income and an increase in the fair value of investments of retirement funds.

The Economy for the Year Ending June 30, 2007

As the 2006-07 fiscal year began, the economy was slowing down, but still moving. Several of the indicators of the slowdown were signaling the way: interest rates had been rising as a result of tightening in the previous year by the Federal Reserve, oil and gasoline prices were continuing a general rise, and residential construction was down 38% from the prior year. Surprisingly though, the overall employment appeared relatively solid. In July 2006, California's year-over-year employment growth was 1.7%, while the State's unemployment rate, at 4.8%, was the lowest since March of 2001.

In December 2006, employment was still growing by 1.3% on a year-over-year comparison, but problems in the real estate market had started to emerge. Housing sales were down 22% compared to December 2005, but statewide prices continued to rise—though by only a modest 3.5% increase. In some regions of California, and particularly in San Diego, prices were beginning to decline. More troubling signs were also being seen, as foreclosures in California more than doubled in the last quarter of 2006 compared to the last quarter of 2005. The problems were concentrated in the subprime portion of the market—loans made to high-risk borrowers. In particular, those subprime loans that were experiencing a "reset" to higher interest rates were seeing escalating delinquency rates.

Evidence of a major crack in the foundations of the real estate boom appeared in February 2007. New Century Financial, a California company that was the nation's second-largest player in subprime lending, announced "accounting errors" that would require the restatement of its 2006 earnings and a loss for the final quarter of 2006. By early April, the company had filed for bankruptcy.

California was at the center of the real estate and financial turmoil as the fiscal year ended in June 2007. The California Association of Realtors reported that in the second quarter of 2007, an estimated 15% of all mortgages in California were subprime. Around the same time period, the Mortgage Bankers Association reported that California represented 17% of subprime loans and over 19% of the foreclosure starts on subprime loans.

Nevertheless, it still appeared that the damage from real estate activities would be confined to real estate sales, construction, and the subprime market. As the fiscal year ended, employment was growing at 1.1%; unemployment was increasing, but was still low at 5.3%. Most of the employment growth was in Education and Health services, Leisure and Hospitality services, and Professional and Business Services.

General Fund Budget Highlights

The original General Fund budget of $102.1 billion was increased by $865 million due to miscellaneous augmentations for emergencies. During the 2006-07 fiscal year, General Fund actual expenditures were $101.5 billion, $1.5 billion less than the final budgeted amounts.

Table 3

General Fund Original and Final Budgets
Year ended June 30, 2007
(amounts in millions)

	Original	Final	Increase/ (Decrease)
Budgeted amounts			
State and consumer services	$ 645	$ 602	$ (43)
Business and transportation	2,649	2,649	0
Resources	1,824	1,720	(104)
Health and human services	29,526	29,866	340
Correctional programs	8,786	9,289	503
Education	49,251	49,321	70
General government:			
Tax relief	977	981	4
Debt service	3,388	3,402	14
Other general government	5,084	5,165	81
Total	**$ 102,130**	**$ 102,995**	**$ 865**

Capital Assets and Debt Administration

Capital Assets

The State's investment in capital assets for its governmental and business-type activities as of June 30, 2007, amounted to $98.1 billion (net of accumulated depreciation). This investment in capital assets includes land, state highway infrastructure, collections, buildings and other depreciable property, and construction in progress. Depreciable property includes buildings, improvements other than buildings, equipment, personal property, intangible assets, certain infrastructure assets, certain books, and other capitalized and depreciable property. Infrastructure assets are items that are normally immovable and can be preserved for a greater number of years than most capital assets. Infrastructure assets include roads, bridges, streets and sidewalks, drainage systems, and lighting systems.

Table 4 presents a summary of the primary government's capital assets for governmental and business-type activities.

Table 4

Capital Assets
Year ended June 30, 2007
(amounts in millions)

	Governmental Activities	Business-type Activities	Total
Land	$ 15,510	$ 47	$ 15,557
State highway infrastructure	55,991	—	55,991
Collections – nondepreciable	21	—	21
Buildings and other depreciable property	21,009	8,662	29,671
Less: accumulated depreciation	(8,590)	(3,618)	(12,208)
Construction in progress	7,877	1,177	9,054
Total	**$ 91,818**	**$ 6,268**	**$ 98,086**

The budget authorized $2.1 billion for the State's capital outlay program in the 2006-07 fiscal year, not including funding for state highway infrastructure, K-12 schools, state conservancies, and state water projects. State highway infrastructure assets are discussed in more detail in the Required Supplementary Information that follows the notes to the financial statements. Of the $2.1 billion authorized, $234 million was from the General Fund; $393 million was from lease-revenue bonds; $1.3 billion was from proceeds of various general obligation bonds; and $236 million was from reimbursements, federal funds, and special funds. The major capital projects authorized include:

- $1.2 billion for numerous construction projects within the University of California, the California State University, and the California Community Colleges;
- $217 million for the Department of Corrections and Rehabilitation for waste-water and potable water treatment projects; housing for inmates with mental health needs; and critical fire, life, and safety projects;
- $161 million for the Department of Forestry and Fire Protection to replace 14 fire stations and two conservation camps, address other significant health and safety issues, and remedy critical infrastructure deficiencies at emergency response facilities; and
- $102 million for the Department of Developmental Services for improvements at Porterville Developmental Center.

Note 7, Capital Assets, includes additional information on the State's capital assets.

Modified Approach for Infrastructure Assets

The State has adopted the Modified Approach as an alternative to depreciating the cost of its infrastructure (state roadways and bridges). Under the Modified Approach, the State will not report depreciation expense for roads and bridges but will capitalize all costs that add to the capacity and efficiency of State-owned roads and bridges. All maintenance and preservation costs will be expensed and not capitalized. Under the Modified Approach, the State must maintain an asset management system and demonstrate that it is preserving the infrastructure at or above established condition levels. The State is responsible for maintaining 49,477 lane miles and 12,155 bridges.

During the 2006-07 fiscal year, the actual amount spent on preservation was 74.1% of the estimated budgeted amount needed to maintain the infrastructure assets at the established condition levels. Although the amount spent fell short of the budgeted amount, the assessed conditions of the State's bridges and roadways are better than the established condition baselines.

The Required Supplementary Information includes additional information on how the State uses the modified approach for infrastructure assets and it presents the established condition standards, condition assessments, and preservation costs.

Debt Administration

At June 30, 2007, the primary government had total bonded debt outstanding of $83.2 billion. Of this amount, $52.2 billion (62.8%) represents general obligation bonds, which are backed by the full faith and credit of the State. Included in the $52.2 billion of general obligation bonds is $9.0 billion of Economic Recovery bonds that are secured by a pledge of revenues derived from dedicated sales and use taxes. The current portion of general obligation bonds outstanding is $2.2 billion and the long-term portion is $50.0 billion. The remaining $31.0 billion (37.2%) of bonded debt outstanding represents revenue bonds, which are secured solely by specified revenue sources. The current portion of revenue bonds outstanding is $1.2 billion and the long-term portion is $29.8 billion.

Table 5 presents a summary of the primary government's long-term obligations for governmental and business-type activities.

Table 5

Long-term Obligations
Year ended June 30, 2007
(amounts in millions)

	Governmental Activities	Business-type Activities	Total
Government-wide noncurrent liabilities			
General obligation bonds	$ 48,224	$ 1,818	$ 50,042
Revenue bonds	7,883	21,891	29,774
Certificates of participation and commercial paper	106	180	286
Capital lease obligations	4,047	—	4,047
Other noncurrent liabilities	12,710	1,960	14,670
Total noncurrent liabilities	**72,970**	**25,849**	**98,819**
Current portion of long-term obligations	4,576	1,842	6,418
Total long-term obligations	**$ 77,546**	**$ 27,691**	**$ 105,237**

The primary government's total long-term obligations increased during the year ended June 30, 2007. The largest change in governmental activities' long-term obligations is an increase of $3.3 billion in general obligation bonds payable.
Note 10, Long-term Obligations, and Notes 11 through 16 include additional information on the State's long-term obligations.

The State's general obligation bond credit ratings remained unchanged during fiscal year 2006-07. The current ratings from the three credit rating agencies are as follows: Standard & Poor's – "A+", Moody's – "A1", and Fitch – "A+".

Recent Economic Events and Future Budgets

Recent Economic Conditions

Real estate market troubles continue to dominate the economic news of both California and the nation. Since the beginning of the 2007-08 fiscal year, the problems of the real estate market have spread into the larger U.S. financial market and even into global financial markets.

In late July 2007, a California-based business, Countrywide Financial—the largest mortgage lender in the nation—sent a tremor through the stock and bond markets when it revealed that delinquencies in both its prime and subprime borrowers were rising. Rising concerns among investors about the risks associated with mortgages and mortgage-backed securities threatened to freeze credit markets.

The Federal Reserve responded and took a series of quick actions to try to calm the markets. On August 10, 2007, the Federal Reserve said it was "providing liquidity to facilitate the orderly functioning of financial markets." On August 17, 2007, the Federal Reserve reduced interest rates by 0.5% and assured banks that they could come to the Federal Reserve to alleviate funding needs caused by "dislocations in money and credit markets." On September 18, 2007, the Federal Reserve dropped interest rates another 0.5%, followed by 0.25% reductions at each of its Federal Open Market Committee meetings in October and December 2007.

By fall 2007, the turmoil in U.S. markets was mirrored in European markets. A British bank, Northern Rock, had to be bailed out by British regulators in September due to its investments in the U.S. subprime market.

As 2007 closed, employment growth in California was slowing and unemployment was rising. By the end of December 2007, employment growth in California had fallen to 0.6% from the 1.1% seen in July 2007, while unemployment had risen to 5.9% from the 5.4% of July.

As 2008 opened, more turmoil hit the stock and bond markets as the problems of risky debt affected more parts of the financial community. Both the Federal Reserve and Congress have stepped in to try to give a floor to the damage done by the credit crisis. The Federal Reserve reduced interest rates by an unprecedented 1.25% in January 2008. A federal tax rebate was approved by Congress, the proceeds of which should reach taxpayers in May 2008. Also to help the housing market, especially in California, the caps on Freddie Mac and Fannie Mae loans were raised for one year. It is hoped that these actions will be enough of an economic stimulus to avoid a national recession in 2008.

California's Future Budgets

California's 2007-08 Budget Act was enacted on August 24, 2007. The total spending plan adopted for the State was $145.5 billion, including the General Fund, special funds, and bond funds. The General Fund's available resources and expenditures were projected to be $105.6 billion and $102.2 billion, respectively. The adopted budget included the largest reserve of any budget act in State history—a $4.1 billion reserve (Reserve for Economic Uncertainties of $2.6 billion and $1.5 billion in the Budget Stabilization Account). However, a current projection by the Legislative Analyst's Office (LAO), California's nonpartisan fiscal and policy advisor, shows that rather than ending the 2007-08 fiscal year with a $4.1 billion reserve, the General Fund will have an

estimated deficit of $106 million. The deterioration of the budget outlook is due to a worsening economy, lower-than-expected revenue collections, delayed benefits from one-time budget-balancing solutions, and higher costs.

General Fund revenues come predominately from taxes, with personal income taxes expected to provide 54% of the revenues. California's major taxes (personal income, sales, and corporation taxes) are projected to supply approximately 94% of the General Fund's budgeted resources in the 2007-08 fiscal year. Since the enactment of the budget, the State's weakening economy—particularly the depressed real estate market and high energy and gasoline prices—has caused year-to-date cash receipts for tax revenues to fall considerably short of budget estimates

Governor's Proposed Budget for 2008-09

The Governor released his proposed budget on January 10, 2008. The 2008-09 proposed spending plan (assuming all proposed budget reductions are enacted) totals $141 billion. This spending plan represents estimated General Fund expenditures of $101 billion, special fund expenditures of $26.2 billion, and bond fund expenditures of $13.8 billion. Proposed General Fund expenditures are 2.3% less than the $103.4 billion expenditures estimated for the 2007-08 fiscal year.

The Governor's budget projects to end the 2007-08 fiscal year with a $2.8 billion General Fund reserve in the Special Fund for Economic Uncertainties. The Governor suspended the annual transfer to the Budget Stabilization Account required by Proposition 58, passed by California's voters in 2004. Proposition 58 requires that, beginning in the 2007-08 fiscal year, the State transfer into the Budget Stabilization Account by September 30 of each year a specified portion of estimated General Fund revenues until the account balance reaches $8 billion or 5% of the estimated General Fund revenues, whichever is greater.

In the 2008-09 *Overview of the Governor's Budget*, the LAO states that the Governor's budget revenue forecast is generally reasonable and the spending proposals are built upon solid assumptions about caseload and program requirements. However, the LAO added that, considering recent cash trends and economic reports, there are some risks in the Governor's assumptions. The proposed budget continues to demonstrate an annual operating shortfall, whereby the General Fund's operating expenses exceed its revenue.

Proposed budget-balancing solutions include issuing $3.2 billion of additional deficit-financing bonds (actually issued on February 14, 2008); suspending the planned supplementary payments for early redemption of $1.5 billion of outstanding deficit-financing bonds; accruing in fiscal year 2008-09 $2.0 billion of the personal income and corporation tax revenue that will be received in fiscal year 2009-10; reducing K-14 education spending by $400 million and suspending the Proposition 98 minimum-funding guarantee, resulting in $4.0 billion additional savings in education spending; and reducing spending in most state programs through $4.0 billion in across-the-board reductions.

Requests for Information

The State Controller's Office designed this financial report to provide interested parties with a general overview of the State of California's finances. Address questions concerning the information provided in this report or requests for additional information to the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250. This report is also available on the Controller's Office Web site at www.sco.ca.gov.

Basic Financial Statements

Government-wide Financial Statements

Statement of Net Assets

June 30, 2007
(amounts in thousands)

	Primary Government			
	Governmental Activities	Business-type Activities	Total	Component Units
ASSETS				
Current assets:				
Cash and pooled investments	$ 23,818,784	$ 5,292,421	$ 29,111,205	$ 2,155,052
Amount on deposit with U.S. Treasury	—	3,455,035	3,455,035	—
Investments	2,186,949	570,525	2,757,474	12,641,306
Restricted assets:				
Cash and pooled investments	—	1,897,014	1,897,014	8,316
Investments	—	636	636	45,981
Due from other governments	—	55,965	55,965	—
Net investment in direct financing leases	—	339,025	339,025	—
Receivables (net)	10,241,248	558,483	10,799,731	3,610,632
Internal balances	91,026	(91,026)	—	—
Due from primary government	—	—	—	258,295
Due from other governments	10,120,093	162,530	10,282,623	630,403
Prepaid items	86,914	9,208	96,122	3,468
Inventories	28,309	22,602	50,911	143,567
Recoverable power costs (net)	—	610,000	610,000	—
Other current assets	333,631	91,545	425,176	197,343
Total current assets	46,906,954	12,973,963	59,880,917	19,694,363
Noncurrent assets:				
Restricted assets:				
Cash and pooled investments	—	1,116,426	1,116,426	128,334
Investments	—	734,112	734,112	63,184
Loans receivable	—	512,173	512,173	—
Investments	—	1,533,945	1,533,945	37,532,121
Net investment in direct financing leases	—	6,130,815	6,130,815	—
Receivables (net)	1,508,848	26,854	1,535,702	968,072
Loans receivable	2,557,843	3,340,818	5,898,661	7,487,539
Recoverable power costs (net)	—	6,503,000	6,503,000	—
Deferred charges	74,615	1,354,142	1,428,757	59,083
Capital assets:				
Land	15,510,432	46,766	15,557,198	762,229
State highway infrastructure	55,991,217	—	55,991,217	—
Collections – nondepreciable	20,682	29	20,711	270,097
Buildings and other depreciable property	21,008,680	8,661,646	29,670,326	27,071,887
Less: accumulated depreciation	(8,589,745)	(3,617,654)	(12,207,399)	(12,538,684)
Construction in progress	7,876,896	1,176,650	9,053,546	3,966,242
Other noncurrent assets	—	6,903	6,903	354,751
Total noncurrent assets	95,959,468	27,526,625	123,486,093	66,124,855
Total assets	**$ 142,866,422**	**$ 40,500,588**	**$ 183,367,010**	**$ 85,819,218**

The notes to the financial statements are an integral part of this statement.

	Primary Government			
	Governmental Activities	Business-type Activities	Total	Component Units
LIABILITIES				
Current liabilities:				
Accounts payable	$ 14,272,044	$ 701,959	$ 14,974,003	$ 1,968,021
Due to component units	252,732	5,563	258,295	—
Due to other governments	8,512,815	116,274	8,629,089	38
Dividends payable	—	—	—	3,100
Deferred revenue	—	58,360	58,360	812,025
Tax overpayments	4,135,882	—	4,135,882	—
Deposits	327,082	3,868	330,950	526,238
Contracts and notes payable	71,495	—	71,495	10,598
Advance collections	649,066	25,712	674,778	140,460
Interest payable	770,737	186,649	957,386	149,802
Securities lending obligations	—	—	—	6,720,587
Benefits payable	—	406,740	406,740	2,236,720
Current portion of long-term obligations	4,575,389	1,842,565	6,417,954	1,704,571
Other current liabilities	951,966	90,378	1,042,344	1,492,033
Total current liabilities	34,519,208	3,438,068	37,957,276	15,764,193
Noncurrent liabilities:				
Loans payable	925,855	—	925,855	—
Benefits payable	—	8,881	8,881	17,004,589
Lottery prizes and annuities	—	1,382,603	1,382,603	—
Compensated absences payable	1,900,114	27,578	1,927,692	212,883
Certificates of participation, commercial paper, and other borrowings	106,119	179,782	285,901	128,925
Capital lease obligations	4,047,186	—	4,047,186	2,115,552
General obligation bonds payable	48,224,339	1,817,790	50,042,129	—
Revenue bonds payable	7,882,593	21,891,372	29,773,965	14,171,930
Other noncurrent liabilities	9,884,140	540,822	10,424,962	1,665,706
Total noncurrent liabilities	72,970,346	25,848,828	98,819,174	35,299,585
Total liabilities	**107,489,554**	**29,286,896**	136,776,450	**51,063,778**
NET ASSETS				
Investment in capital assets, net of related debt	81,352,744	208,268	81,561,012	9,973,008
Restricted:				
Nonexpendable – endowments	—	—	—	3,295,495
Expendable:				
Endowments and gifts	—	—	—	7,675,480
Business and transportation	767,878	140,750	908,628	1,392,047
Resources	1,822,499	1,701,060	3,523,559	—
Health and human services	2,639,357	93,036	2,732,393	—
Education	1,721,735	341,686	2,063,421	1,591,151
General government	3,493,338	678,372	4,171,710	852,703
Unemployment programs	98,795	5,620,028	5,718,823	—
Workers' compensation liability	—	—	—	3,808,975
Total expendable	10,543,602	8,574,932	19,118,534	15,320,356
Unrestricted	(56,519,478)	2,430,492	(54,088,986)	6,166,581
Total net assets	**35,376,868**	**11,213,692**	46,590,560	**34,755,440**
Total liabilities and net assets	**$ 142,866,422**	**$ 40,500,588**	$ 183,367,010	**$ 85,819,218**

The notes to the financial statements are an integral part of this statement.

Statement of Activities

Year Ended June 30, 2007
(amounts in thousands)

FUNCTIONS/PROGRAMS	Expenses	Program Revenues: Charges for Services	Program Revenues: Operating Grants and Contributions	Program Revenues: Capital Grants and Contributions
Primary government				
Governmental activities:				
General government	$ 13,313,463	$ 4,490,117	$ 1,086,838	$ —
Education	61,542,105	2,689,906	6,352,236	—
Health and human services	69,979,980	4,751,011	33,538,232	—
Resources	5,316,769	2,110,593	501,393	—
State and consumer services	1,214,740	704,512	31,045	—
Business and transportation	9,763,200	4,040,268	1,735,395	1,164,526
Correctional programs	8,945,325	30,821	194,963	—
Tax relief	948,127	5,049	—	—
Interest on long-term debt	2,596,316	—	—	—
Total governmental activities	173,620,025	18,822,277	43,440,102	1,164,526
Business-type activities:				
Electric Power	5,865,000	5,865,000	—	—
Water Resources	951,590	951,590	—	—
Public Building Construction	334,777	396,895	—	—
State Lottery	3,470,615	3,461,699	—	—
Unemployment Programs	9,136,218	9,017,969	—	—
High Technology Education	22,704	22,966	—	—
State University Dormitory Building Maintenance and Equipment	844,798	554,851	—	—
State Water Pollution Control Revolving	12,702	78,564	—	182,989
Housing Loan	127,206	130,293	—	—
Other enterprise programs	141,859	134,018	—	—
Total business-type activities	20,907,469	20,613,845	—	182,989
Total primary government	**$ 194,527,494**	**$ 39,436,122**	**$ 43,440,102**	**$ 1,347,515**
Component units:				
University of California	$ 19,572,249	$ 10,714,361	$ 7,475,951	$ 216,783
State Compensation Insurance Fund	3,791,291	3,477,665	—	—
California Housing Finance Agency	536,157	516,398	114,235	—
Public Employees' Benefit Fund	1,903,139	1,649,056	—	—
Nonmajor component units	1,961,587	1,187,287	518,346	14,780
Total component units	**$ 27,764,423**	**$ 17,544,767**	**$ 8,108,532**	**$ 231,563**

General revenues:
- Personal income taxes
- Sales and use taxes
- Corporation taxes
- Insurance taxes
- Other taxes
- Investment and interest
- Escheat
- Other

Transfers

Total general revenues and transfers

Change in net assets

Net assets, July 1, 2006

Net assets, June 30, 2007

* Restated

The notes to the financial statements are an integral part of this statement.

Net (Expenses) Revenues and Changes in Net Assets			
Primary Government			
Governmental Activities	Business-type Activities	Total	Component Units
$ (7,736,508)		$ (7,736,508)	
(52,499,963)		(52,499,963)	
(31,690,737)		(31,690,737)	
(2,704,783)		(2,704,783)	
(479,183)		(479,183)	
(2,823,011)		(2,823,011)	
(8,719,541)		(8,719,541)	
(943,078)		(943,078)	
(2,596,316)		(2,596,316)	
(110,193,120)		(110,193,120)	
	$ —	—	
	—	—	
	62,118	62,118	
	(8,916)	(8,916)	
	(118,249)	(118,249)	
	262	262	
	(289,947)	(289,947)	
	248,851	248,851	
	3,087	3,087	
	(7,841)	(7,841)	
	(110,635)	(110,635)	
(110,193,120)	**(110,635)**	(110,303,755)	
			$ (1,165,154)
			(313,626)
			94,476
			(254,083)
			(241,174)
			(1,879,561)
53,272,229	—	53,272,229	—
35,427,013	—	35,427,013	—
11,211,267	—	11,211,267	—
2,165,567	—	2,165,567	—
5,939,890	—	5,939,890	—
730,066	—	730,066	3,310,604
334,002	—	334,002	—
—	—	—	2,289,508
29,855	(29,855)	—	—
109,109,889	**(29,855)**	109,080,034	**5,600,112**
(1,083,231)	(140,490)	(1,223,721)	3,720,551
36,460,099 *	**11,354,182** *	47,814,281	**31,034,889** *
$ 35,376,868	**$ 11,213,692**	$ 46,590,560	**$ 34,755,440**

The notes to the financial statements are an integral part of this statement.

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Fund Financial Statements

Balance Sheet

Governmental Funds

June 30, 2007
(amounts in thousands)

	General	Federal	Transportation Construction	Nonmajor Governmental	Total
ASSETS					
Cash and pooled investments	$ 5,963,406	$ 464,518	$ 2,858,025	$ 13,748,126	$ 23,034,075
Investments	—	—	—	2,186,949	2,186,949
Receivables (net)	8,442,061	1,854	401,440	1,264,137	10,109,492
Due from other funds	1,169,840	719	1,480,042	2,024,215	4,674,816
Due from other governments	695,527	9,287,856	2,985	116,882	10,103,250
Interfund receivables	83,785	—	1,699,747	726,549	2,510,081
Loans receivable	99,768	43,465	—	2,347,674	2,490,907
Other assets	36,327	—	76,144	169,394	281,865
Total assets	**$ 16,490,714**	**$ 9,798,412**	**$ 6,518,383**	**$ 22,583,926**	**$ 55,391,435**
LIABILITIES					
Accounts payable	$ 1,093,020	$ 1,323,497	$ 106,518	$ 3,140,801	$ 5,663,836
Due to other funds	4,877,236	6,344,969	12,458	1,321,798	12,556,461
Due to component units	185,327	—	—	60,484	245,811
Due to other governments	4,131,316	2,006,709	305,952	2,447,756	8,891,733
Interfund payables	3,350,931	—	—	13,849	3,364,780
Tax overpayments	4,126,462	—	—	9,420	4,135,882
Deposits	7,615	—	10,632	302,493	320,740
Contracts and notes payable	—	—	—	65,706	65,706
Advance collections	40,058	57,980	5,867	300,677	404,582
Interest payable	16,782	9,130	—	200,400	226,312
General obligation bonds payable	—	—	—	189,705	189,705
Other liabilities	569,505	18,403	197,347	536,321	1,321,576
Total liabilities	**18,398,252**	**9,760,688**	**638,774**	**8,589,410**	**37,387,124**
FUND BALANCES					
Reserved for:					
Encumbrances	746,729	—	2,468,256	3,246,260	6,461,245
Interfund receivables	83,785	—	1,699,747	726,549	2,510,081
Loans receivable	99,768	43,465	—	2,347,674	2,490,907
Continuing appropriations	1,666,255	—	4,903,990	5,366,369	11,936,614
Debt service	—	—	—	1,152,990	1,152,990
Unreserved, reported in:					
General Fund	(4,504,075)	—	—	—	(4,504,075)
Special revenue funds	—	(5,741)	(3,192,384)	2,283,282	(914,843)
Capital projects funds	—	—	—	(1,128,608)	(1,128,608)
Total fund balances	**(1,907,538)**	**37,724**	**5,879,609**	**13,994,516**	**18,004,311**
Total liabilities and fund balances	**$ 16,490,714**	**$ 9,798,412**	**$ 6,518,383**	**$ 22,583,926**	

The notes to the financial statements are an integral part of this statement.

Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets

(amounts in thousands)

Total fund balances – governmental funds		**$ 18,004,311**
Amounts reported for governmental activities in the Statement of Net Assets are different from the governmental funds Balance Sheet because:		
• Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds.		91,633,168
• Other long-term assets are not available to pay for current-period expenditures and, therefore, are not reported.		1,526,553
• Internal service funds are used by management to charge the costs of certain activities, such as architectural, procurement, and technology services, to individual funds. The assets and liabilities of the internal service funds are included in governmental activities in the Statement of Net Assets.		393,737
• Bond discounts and premiums are reported as current expenditures in the funds. Deferred issue costs are amortized over the life of the bonds and are included in the governmental activities in the Statement of Net Assets.		74,615
• General obligation bonds totaling $50,624,162 and revenue bonds totaling $8,009,784 are not due and payable in the current period and, therefore, are not reported in the funds.		(58,633,946)
• Certain long-term liabilities are not due and payable in the current period; therefore, adjustments to these liabilities are not reported in the funds:		
Compensated absences adjustments	(1,940,167)	
Certificates of participation and commercial paper adjustments	(1,358,051)	
Capital lease adjustments	(4,335,561)	
Other long-term obligations	(9,987,791)	
		(17,621,570)
Net assets of governmental activities		**$ 35,376,868**

The notes to the financial statements are an integral part of this statement.

Statement of Revenues, Expenditures, and Changes in Fund Balances

Governmental Funds

Year Ended June 30, 2007 (amounts in thousands)	General	Federal	Transportation Construction	Nonmajor Governmental	Total
REVENUES					
Personal income taxes	$ 52,350,764	$ —	$ —	$ 938,760	$ 53,289,524
Sales and use taxes	27,402,715	—	950,814	7,097,782	35,451,311
Corporation taxes	11,210,267	—	—	—	11,210,267
Insurance taxes	2,165,567	—	—	—	2,165,567
Other taxes	537,736	—	3,224,021	2,038,270	5,800,027
Intergovernmental	—	44,590,863	—	1,851,656	46,442,519
Licenses and permits	17,331	—	1,006,343	4,242,468	5,266,142
Charges for services	168,934	—	737	741,716	911,387
Fees	586,448	—	—	4,746,042	5,332,490
Penalties	50,169	1,221	—	710,068	761,458
Investment and interest	561,766	—	146,166	847,270	1,555,202
Escheat	334,002	—	—	—	334,002
Other	923,798	—	83,990	2,724,803	3,732,591
Total revenues	**96,309,497**	**44,592,084**	**5,412,071**	**25,938,835**	172,252,487
EXPENDITURES					
Current:					
General government	2,608,056	1,080,787	1,139,806	8,276,267	13,104,916
Education	49,343,928	6,726,053	980	5,032,047	61,103,008
Health and human services	28,945,062	32,376,784	—	8,835,960	70,157,806
Resources	1,455,477	374,313	12	3,361,276	5,191,078
State and consumer services	538,343	31,033	—	645,376	1,214,752
Business and transportation	13,624	2,824,607	6,112,879	2,533,959	11,485,069
Correctional programs	8,811,099	199,503	—	19,697	9,030,299
Tax relief	958,004	—	—	—	958,004
Capital outlay	178,936	—	—	1,166,085	1,345,021
Debt service:					
Bond and commercial paper retirement	1,416,946	49,190	310	4,225,345	5,691,791
Interest and fiscal charges	1,917,108	22,959	7,110	934,672	2,881,849
Total expenditures	**96,186,583**	**43,685,229**	**7,261,097**	**35,030,684**	182,163,593
Excess (deficiency) of revenues over (under) expenditures	122,914	906,855	(1,849,026)	(9,091,849)	(9,911,106)
OTHER FINANCING SOURCES (USES)					
General obligation bonds and commercial paper issued	—	—	310	9,040,190	9,040,500
Refunding bonds issued	—	—	302,900	8,795,476	9,098,376
Payment to refunding agent	—	—	(302,900)	(7,537,721)	(7,840,621)
Capital leases	178,936	—	—	—	178,936
Transfers in	1,590,173	—	3,385,830	4,335,459	9,311,462
Transfers out	(6,472,376)	(903,571)	(28,687)	(1,838,137)	(9,242,771)
Total other financing sources (uses)	**(4,703,267)**	**(903,571)**	**3,357,453**	**12,795,267**	10,545,882
Net change in fund balances	(4,580,353)	3,284	1,508,427	3,703,418	634,776
Fund balances, July 1, 2006	**2,672,815**	**34,440**	**4,371,182** *	**10,291,098** *	17,369,535
Fund balances (deficits), June 30, 2007	**$ (1,907,538)**	**$ 37,724**	**$ 5,879,609**	**$ 13,994,516**	$ 18,004,311

* Restated

The notes to the financial statements are an integral part of this statement.

Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities

(amounts in thousands)

Net change in fund balances – total governmental funds		**$ 634,776**
Amounts reported for governmental activities in the Statement of Activities are different from the Statement of Revenues, Expenditures, and Changes in Fund Balances of governmental funds because:		
• Governmental funds report capital outlays as expenditures. However, in the Statement of Activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays exceed depreciation in the current period.		2,752,640
• Revenues in the Statement of Activities that do not provide current financial resources are deferred and not reported as revenues in the funds.		299,451
• Bonds and other noncurrent financing instruments provide current financial resources to governmental funds in the form of debt, which increases long-term liabilities in the Statement of Net Assets. Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the Statement of Net Assets. The following amounts represent the difference between proceeds and repayments.		
General obligation bond adjustments	(3,278,017)	
Revenue bond adjustments	(900,237)	
Certificates of participation and commercial paper adjustments	(434,161)	
		(4,612,415)
• Some expenses reported in the Statement of Activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds.		
Compensated absences	(226,062)	
Lease adjustments	119,146	
Other long-term obligations	219,514	
		112,598
• Internal service funds are used by management to charge the costs of certain activities, such as architectural, procurement, and technology services, to individual funds. The net revenue (expense) of the internal service funds is reported with governmental activities.		(270,281)
Change in net assets of governmental activities		**$ (1,083,231)**

The notes to the financial statements are an integral part of this statement.

Statement of Net Assets

Proprietary Funds

June 30, 2007
(amounts in thousands)

	Electric Power	Water Resources
ASSETS		
Current assets:		
Cash and pooled investments	$ —	$ 391,517
Amount on deposit with U.S. Treasury	—	—
Investments	—	—
Restricted assets:		
Cash and pooled investments	1,716,000	—
Investments	—	—
Due from other governments	—	—
Net investment in direct financing leases	—	—
Receivables (net)	—	151,009
Due from other funds	41,000	8,230
Due from other governments	—	15,381
Prepaid items	—	—
Inventories	—	12,606
Recoverable power costs (net)	610,000	—
Other current assets	91,000	—
Total current assets	2,458,000	578,743
Noncurrent assets:		
Restricted assets:		
Cash and pooled investments	942,000	120,703
Investments	600,000	99,958
Loans receivable	—	—
Investments	—	—
Net investment in direct financing leases	—	—
Receivables	—	—
Interfund receivables	—	91,517
Loans receivable	—	25,928
Recoverable power costs (net)	6,503,000	—
Deferred charges	—	1,239,653
Capital assets:		
Land	—	—
Collections – nondepreciable	—	—
Buildings and other depreciable property	—	4,584,669
Less: accumulated depreciation	—	(1,800,158)
Construction in progress	—	253,152
Other noncurrent assets	—	—
Total noncurrent assets	8,045,000	4,615,422
Total assets	**$ 10,503,000**	**$ 5,194,165**

The notes to the financial statements are an integral part of this statement.

Business-type Activities – Enterprise Funds					Governmental Activities
Public Building Construction	**State Lottery**	**Unemployment Programs**	**Nonmajor Enterprise**	**Total**	**Internal Service Funds**
$ —	$ 350,836	$ 2,490,806	$ 2,059,262	**$ 5,292,421**	$ 784,709
—	—	3,455,035	—	**3,455,035**	—
—	314,702	—	255,823	**570,525**	—
109,524	—	—	71,490	**1,897,014**	—
636	—	—	—	**636**	—
—	—	—	55,965	**55,965**	—
324,416	—	—	14,609	**339,025**	—
133,157	225,278	152,488	31,079	**693,011**	117,209
28,814	6,298	36,853	31,009	**152,204**	328,806
—	—	30,720	116,429	**162,530**	16,843
—	8,630	—	578	**9,208**	69,209
—	6,314	—	3,682	**22,602**	28,309
—	—	—	—	**610,000**	—
—	—	—	545	**91,545**	50,751
596,547	912,058	6,165,902	2,640,471	**13,351,721**	1,395,836
38,353	—	—	15,370	**1,116,426**	—
22,915	—	—	11,239	**734,112**	—
—	—	—	512,173	**512,173**	—
—	1,472,958	—	60,987	**1,533,945**	—
6,029,202	—	—	101,613	**6,130,815**	—
—	—	26,854	—	**26,854**	—
—	—	—	2,188	**93,705**	—
—	—	—	3,314,890	**3,340,818**	—
—	—	—	—	**6,503,000**	—
65,712	13,027	—	35,750	**1,354,142**	—
—	4,923	—	41,843	**46,766**	231
—	—	—	29	**29**	—
—	98,398	14,458	3,964,121	**8,661,646**	569,030
—	(53,118)	(4,982)	(1,759,396)	**(3,617,654)**	(387,803)
676,642	—	—	246,856	**1,176,650**	3,536
—	—	—	6,903	**6,903**	—
6,832,824	1,536,188	36,330	6,554,566	**27,620,330**	184,994
$ 7,429,371	**$ 2,448,246**	**$ 6,202,232**	**$ 9,195,037**	**$ 40,972,051**	**$ 1,580,830**

(continued)

Statement of Net Assets (continued)

Proprietary Funds

June 30, 2007
(amounts in thousands)

	Electric Power	Water Resources
LIABILITIES		
Current liabilities:		
Accounts payable	$ 453,000	$ 107,968
Due to other funds	—	195
Due to component units	—	—
Due to other governments	—	99,462
Deferred revenue	—	—
Deposits	—	—
Contracts and notes payable	—	—
Advance collections	—	—
Interest payable	55,000	19,278
Benefits payable	—	—
Current portion of long-term obligations	487,000	145,556
Other current liabilities	—	—
Total current liabilities	995,000	372,459
Noncurrent liabilities:		
Interfund payables	—	—
Benefits payable	—	—
Lottery prizes and annuities	—	—
Compensated absences payable	—	—
Certificates of participation, commercial paper, and other borrowings	—	133,362
Capital lease obligations	—	—
General obligation bonds payable	—	584,395
Revenue bonds payable	9,508,000	2,492,548
Other noncurrent liabilities	—	405,970
Total noncurrent liabilities	9,508,000	3,616,275
Total liabilities	**10,503,000**	**3,988,734**
NET ASSETS		
Investment in capital assets, net of related debt	—	98,490
Restricted – Expendable:		
Construction	—	1,106,941
Debt service	—	—
Security for revenue bonds	—	—
Lottery	—	—
Unemployment program	—	—
Other purposes	—	—
Total expendable	—	1,106,941
Unrestricted	—	—
Total net assets	**—**	**1,205,431**
Total liabilities and net assets	**$ 10,503,000**	**$ 5,194,165**

The notes to the financial statements are an integral part of this statement.

Business-type Activities – Enterprise Funds					Governmental Activities
Public Building Construction	State Lottery	Unemployment Programs	Nonmajor Enterprise	Total	Internal Service Funds
$ 18,005	$ 38,347	$ 5	$ 58,815	$ 676,140	$ 200,268
116,758	292,466	51,068	34,607	495,094	523,483
—	—	—	5,563	5,563	6,921
897	—	14,618	1,297	116,274	13
—	—	—	58,360	58,360	—
—	—	—	3,868	3,868	6,342
—	—	—	—	—	5,789
19,037	2,570	—	4,105	25,712	244,484
64,251	—	—	48,120	186,649	—
—	—	406,740	—	406,740	—
348,674	630,374	—	230,961	1,842,565	15,052
—	—	85,441	4,937	90,378	3,115
567,622	963,757	557,872	450,633	3,907,343	1,005,467
—	—	—	2,188	2,188	95,737
—	—	—	8,881	8,881	—
—	1,382,603	—	—	1,382,603	—
—	5,162	14,855	7,561	27,578	46,912
—	—	—	46,420	179,782	—
—	—	—	—	—	9,115
—	—	—	1,233,395	1,817,790	—
6,567,593	—	—	3,323,231	21,891,372	—
—	1,409	—	133,443	540,822	29,862
6,567,593	1,389,174	14,855	4,755,119	25,851,016	181,626
7,135,215	**2,352,931**	**572,727**	**5,205,752**	29,758,359	**1,187,093**
—	50,203	9,477	50,098	208,268	162,222
262,461	—	—	290,071	1,659,473	—
31,695	—	—	54,393	86,088	—
—	—	—	568,138	568,138	—
—	95,315	—	—	95,315	—
—	—	5,620,028	—	5,620,028	—
—	—	—	545,890	545,890	—
294,156	95,315	5,620,028	1,458,492	8,574,932	—
—	(50,203)	—	2,480,695	2,430,492	231,515
294,156	**95,315**	**5,629,505**	**3,989,285**	11,213,692	**393,737**
$ 7,429,371	**$ 2,448,246**	**$ 6,202,232**	**$ 9,195,037**	$ 40,972,051	**$ 1,580,830**

(concluded)

The notes to the financial statements are an integral part of this statement.

Statement of Revenues, Expenses, and Changes in Fund Net Assets

Proprietary Funds

Year Ended June 30, 2007
(amounts in thousands)

	Electric Power	Water Resources
OPERATING REVENUES		
Unemployment and disability insurance	$ —	$ —
Lottery ticket sales	—	—
Power sales	4,843,000	222,206
Student tuition and fees	—	—
Services and sales	—	729,384
Investment and interest	—	—
Rent	—	—
Other	—	—
Total operating revenues	**4,843,000**	**951,590**
OPERATING EXPENSES		
Lottery prizes	—	—
Power purchases (net of recoverable power costs)	4,813,000	374,568
Personal services	—	203,021
Supplies	—	—
Services and charges	30,000	116,471
Depreciation	—	78,065
Distributions to beneficiaries	—	—
Interest expense	—	—
Amortization of deferred charges	—	—
Other	—	—
Total operating expenses	**4,843,000**	**772,125**
Operating income (loss)	—	179,465
NONOPERATING REVENUES (EXPENSES)		
Investment and interest income	1,022,000	—
Interest expense and fiscal charges	(1,022,000)	(151,746)
Lottery payments for education	—	—
Other	—	(27,719)
Total nonoperating revenues (expenses)	**—**	**(179,465)**
Income (loss) before contributions and transfers	—	—
Capital contributions	—	—
Transfers in	—	—
Transfers out	—	—
Change in net assets	—	—
Total net assets, July 1, 2006	**—**	**1,205,431**
Total net assets, June 30, 2007	**$ —**	**$ 1,205,431**

* Restated

The notes to the financial statements are an integral part of this statement.

Business-type Activities – Enterprise Funds					Governmental Activities
Public Building Construction	**State Lottery**	**Unemployment Programs**	**Nonmajor Enterprise**	**Total**	**Internal Service Funds**
$ —	$ —	$ 8,607,112	$ —	$ 8,607,112	$ —
—	3,318,346	—	—	3,318,346	—
—	—	—	—	5,065,206	—
—	—	—	499,667	499,667	—
—	—	126,741	91,451	947,576	2,205,471
33,075	—	—	184,492	217,567	289
363,818	—	—	43,031	406,849	—
2	—	—	14,205	14,207	—
396,895	**3,318,346**	**8,733,853**	**832,846**	19,076,530	**2,205,760**
—	1,765,643	—	—	1,765,643	—
—	—	—	—	5,187,568	—
—	42,225	138,191	153,299	536,736	640,715
—	12,524	—	—	12,524	11,766
3,699	336,423	65,194	622,653	1,174,440	1,461,437
—	9,100	716	87,837	175,718	39,926
—	—	8,932,117	—	8,932,117	—
324,246	—	—	231,567	555,813	734
6,832	—	—	874	7,706	—
—	—	—	36,942	36,942	—
334,777	**2,165,915**	**9,136,218**	**1,133,172**	18,385,207	**2,154,578**
62,118	1,152,431	(402,365)	(300,326)	691,323	51,182
—	142,153	284,116	87,681	1,535,950	2,931
—	(127,771)	—	(9,208)	(1,310,725)	(357)
—	(1,176,929)	—	—	(1,176,929)	—
—	1,200	—	(6,724)	(33,243)	(285,201)
—	**(1,161,347)**	**284,116**	**71,749**	(984,947)	**(282,627)**
62,118	(8,916)	(118,249)	(228,577)	(293,624)	(231,445)
—	—	—	182,989	182,989	—
66,601	—	—	1,571	68,172	—
—	—	—	(98,027)	(98,027)	(38,836)
128,719	(8,916)	(118,249)	(142,044)	(140,490)	(270,281)
165,437	**104,231**	**5,747,754**	**4,131,329** *	11,354,182	**664,018** *
$ 294,156	**$ 95,315**	**$ 5,629,505**	**$ 3,989,285**	$ 11,213,692	**$ 393,737**

Statement of Cash Flows

Proprietary Funds

Year Ended June 30, 2007
(amounts in thousands)

	Electric Power	Water Resources
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers/employers	$ 4,836,000	$ 946,659
Receipts from interfund services provided	—	—
Payments to suppliers	(4,719,000)	(494,782)
Payments to employees	—	(203,021)
Payments for interfund services used	—	—
Payments for Lottery prizes	—	—
Claims paid to other than employees	—	—
Other receipts (payments)	42,000	(68,037)
Net cash provided by (used in) operating activities	**159,000**	**180,819**
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Changes in interfund payables and loans payable	—	—
Proceeds from bonds	—	—
Receipts of bond charges	865,000	—
Retirement of general obligation bonds	—	—
Retirement of revenue bonds	(447,000)	—
Interest paid on operating debt	(448,000)	—
Transfers in	—	—
Transfers out	—	—
Grants received	—	—
Lottery payments for education	—	—
Net cash provided by (used in) noncapital financing activities	**(30,000)**	**—**
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Changes in interfund payables and loans payable	—	—
Acquisition of intangible assets	—	—
Acquisition of capital assets	—	(95,124)
Proceeds from sale of capital assets	—	—
Proceeds from notes payable and commercial paper	—	4,621
Principal paid on notes payable and commercial paper	—	—
Retirement of general obligation bonds	—	(48,965)
Proceeds from revenue bonds	—	250,000
Retirement of revenue bonds	—	(70,860)
Interest paid	—	(152,571)
Net cash provided by (used in) capital and related financing activities	**—**	**(112,899)**
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investments	—	—
Proceeds from maturity and sale of investments	—	—
Change in interfund receivables and loans receivable	—	475
Earnings (loss) on investments	159,000	(22,335)
Net cash provided by (used in) investing activities	**159,000**	**(21,860)**
Net increase (decrease) in cash and pooled investments	288,000	46,060
Cash and pooled investments at July 1, 2006	**2,370,000**	**466,160**
Cash and pooled investments at June 30, 2007	**$ 2,658,000**	**$ 512,220**

The notes to the financial statements are an integral part of this statement.

Business-type Activities – Enterprise Funds					Governmental Activities
Public Building Construction	**State Lottery**	**Unemployment Programs**	**Nonmajor Enterprise**	**Total**	**Internal Service Funds**
$ 671,331	$ 3,335,785	$ 8,796,746	$ 682,564	$ 19,269,085	$ 2,255,046
—	—	—	7,702	7,702	90,015
(3,573)	(131,240)	(65,200)	(628,438)	(6,042,233)	(1,411,186)
—	(37,758)	(131,072)	(157,652)	(529,503)	(647,139)
—	(9,418)	—	(18,562)	(27,980)	(81,591)
—	(2,119,823)	—	—	(2,119,823)	—
—	(233,771)	(8,869,062)	(14)	(9,102,847)	(12,819)
(277,522)	58,565	28,418	(179,934)	(396,510)	87,195
390,236	**862,340**	**(240,170)**	**(294,334)**	1,057,891	**279,521**
—	—	—	4,938	4,938	1,640
—	—	—	735,235	735,235	—
—	—	—	—	865,000	—
—	—	—	(319,280)	(319,280)	—
—	—	—	(315,311)	(762,311)	—
—	—	—	(10,655)	(458,655)	(61)
10,671	—	—	1,571	12,242	—
—	—	—	(55,409)	(55,409)	(38,836)
—	—	—	184,160	184,160	—
—	(1,236,996)	—	—	(1,236,996)	—
10,671	**(1,236,996)**	**—**	**225,249**	(1,031,076)	**(37,257)**
(17,711)	—	—	8,301	(9,410)	—
—	—	—	(527)	(527)	(2,831)
(604,201)	(2,340)	(728)	(495,769)	(1,198,162)	(57,333)
—	7	—	313,569	313,576	514
—	—	—	67,367	71,988	—
—	—	—	(85,277)	(85,277)	(1,227)
—	—	—	—	(48,965)	—
384,796	—	—	359,639	994,435	—
(365,953)	—	—	(60,575)	(497,388)	—
—	—	—	(99,598)	(252,169)	(1,030)
(603,069)	**(2,333)**	**(728)**	**7,130**	(711,899)	**(61,907)**
(19,596)	(287,421)	(609,623)	(255,824)	(1,172,464)	—
—	625,942	—	109,100	735,042	—
—	—	—	—	475	—
—	22,642	284,116	85,749	529,172	2,782
(19,596)	**361,163**	**(325,507)**	**(60,975)**	92,225	**2,782**
(221,758)	(15,826)	(566,405)	(122,930)	(592,859)	183,139
369,635	**366,662**	**3,057,211**	**2,269,052**	8,898,720	**601,570**
$ 147,877	**$ 350,836**	**$ 2,490,806**	**$ 2,146,122**	$ 8,305,861	**$ 784,709**

(continued)

Statement of Cash Flows (continued)

Proprietary Funds

Year Ended June 30, 2007
(amounts in thousands)

	Electric Power	Water Resources
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES		
Operating income (loss)	$ —	$ 179,465
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:		
Interest expense on operating debt	—	—
Depreciation	—	78,065
Accretion of capital appreciation bonds	—	—
Provisions and allowances	—	—
Accrual of deferred charges	—	—
Amortization of discounts	—	—
Amortization of deferred charges	—	(10,955)
Other	—	(68,037)
Change in assets and liabilities:		
Receivables	—	(41,057)
Due from other funds	—	—
Due from other governments	—	(7,786)
Prepaid items	—	—
Inventories	—	845
Net investment in direct financing leases	—	—
Recoverable power costs (net)	223,000	—
Other current assets	—	—
Loans receivable	—	—
Interfund receivable	—	—
Accounts payable	(59,000)	38,039
Due to other funds	—	(7,164)
Due to component units	—	—
Due to other governments	—	17,927
Deposits	—	—
Contracts and notes payable	—	—
Advance collections	—	—
Interest payable	—	—
Other current liabilities	—	—
Deferred revenue	—	—
Benefits payable	—	—
Lottery prizes and annuities	—	—
Compensated absences payable	—	1,477
Capital lease obligations	—	—
Other noncurrent liabilities	(5,000)	—
Total adjustments	159,000	1,354
Net cash provided by (used in) operating activities	**$ 159,000**	**$ 180,819**
Noncash capital and related financing and investing activities		
Interest accreted on annuitized prizes	$ —	$ —
Unclaimed Lottery prizes directly transferred to Education Fund	—	—
Unrealized loss on investment	—	—
Acquisition of equipment accrued in accounts payable	—	—

The notes to the financial statements are an integral part of this statement.

Business-type Activities – Enterprise Funds					Governmental Activities
Public Building Construction	**State Lottery**	**Unemployment Programs**	**Nonmajor Enterprise**	**Total**	**Internal Service Funds**
$ 62,118	$ 1,152,431	$ (402,365)	$ (300,326)	**$ 691,323**	$ 51,182
—	—	—	99,598	**99,598**	734
—	9,100	716	87,837	**175,718**	39,926
1,958	—	—	2,020	**3,978**	—
242	(1,795)	—	(1,421)	**(2,974)**	—
(11,796)	—	—	—	**(11,796)**	—
—	—	—	369	**369**	—
37,854	7,408	—	7,388	**41,695**	—
—	1,219	—	(11,277)	**(78,095)**	—
(622)	5,362	7,975	13,805	**(14,537)**	29,976
16,650	3	74	2,974	**19,701**	(55,857)
—	—	39,002	(2,572)	**28,644**	(2,368)
—	(2,887)	—	(521)	**(3,408)**	(19,166)
—	2,689	—	283	**3,817**	(7,065)
290,925	—	—	14,228	**305,153**	—
—	—	—	—	**223,000**	—
—	(1,357)	—	1,044	**(313)**	(173)
—	—	—	(219,310)	**(219,310)**	—
—	—	—	(4,032)	**(4,032)**	—
(804)	(11,499)	(11)	37,288	**4,013**	61,548
468	45	28,031	(16,766)	**4,614**	166,937
—	—	—	—	**—**	113
(48)	—	3,845	—	**21,724**	(158)
—	—	—	567	**567**	5,582
—	—	—	—	**—**	2,321
(47)	(364)	—	93	**(318)**	6,499
(6,662)	—	—	3,287	**(3,375)**	—
—	—	16,236	1,994	**18,230**	(38)
—	—	—	3,171	**3,171**	—
—	(291)	59,210	(3,954)	**54,965**	—
—	(297,724)	—	—	**(297,724)**	—
—	—	7,119	(4,353)	**4,243**	(1,533)
—	—	—	—	**—**	603
—	—	(2)	(5,748)	**(10,750)**	458
328,118	(290,091)	162,195	5,992	**366,568**	228,339
$ 390,236	**$ 862,340**	**$ (240,170)**	**$ (294,334)**	**$ 1,057,891**	**$ 279,521**
					(concluded)
$ —	$ 118,856	$ —	$ —	**$ 118,856**	$ —
—	29,218	—	—	**29,218**	—
—	(8,916)	—	—	**(8,916)**	—
—	14,064	—	—	—	—

The notes to the financial statements are an integral part of this statement.

Statement of Fiduciary Net Assets

Fiduciary Funds and Similar Component Units

June 30, 2007
(amounts in thousands)

	Private Purpose Trust	Pension and Other Employee Benefit Trust	Investment Trust Local Agency Investment	Agency
ASSETS				
Cash and pooled investments	$ 41,724	$ 1,343,353	$ 19,990,748	$ 2,907,569
Investments, at fair value:				
Short-term	—	4,867,991	—	—
Equity securities	—	256,590,799	—	—
Debt securities	—	96,949,065	—	—
Real estate	—	38,113,015	—	—
Other	2,729,123	36,749,553	—	—
Securities lending collateral	—	78,404,152	—	—
Total investments	2,729,123	511,674,575	—	—
Receivables (net)	5,272	9,362,751	—	1,315,298
Due from other funds	49,097	412,656	—	7,972,528
Due from other governments	—	12	—	61,943
Prepaid Items	—	—	—	30,910
Interfund receivables	925,855	—	—	—
Loans receivable	—	—	—	78,468
Other assets	107,725	399,195	—	388
Total assets	**3,858,796**	**523,192,542**	**19,990,748**	**$ 12,367,104**
LIABILITIES				
Accounts payable	2,231	5,769,412	48	$ 4,720,253
Due to other funds	78	14,471	520	—
Due to other governments	—	59,830	253,922	5,914,184
Tax overpayments	—	—	—	2,354
Benefits payable	—	266,187	—	224,916
Deposits	107,725	—	—	832,637
Advance collections	—	—	—	65,291
Securities lending obligations	—	78,404,152	—	—
Interfund payables	—	—	—	66,936
Other liabilities	1,013,966	6,331,978	—	540,533
Total liabilities	**1,124,000**	**90,846,030**	**254,490**	**$ 12,367,104**
NET ASSETS				
Held in trust for pension benefits, pool participants, and other purposes	**$ 2,734,796**	**$ 432,346,512**	**$ 19,736,258**	

The notes to the financial statements are an integral part of this statement.

Statement of Changes in Fiduciary Net Assets

Fiduciary Funds and Similar Component Units

Year Ended June 30, 2007
(amounts in thousands)

	Private Purpose Trust	Pension and Other Employee Benefit Trust	Investment Trust Local Agency Investment
ADDITIONS			
Contributions:			
Employer	$ —	$ 10,066,858	$ —
Plan member	—	6,266,946	—
Total contributions	—	16,333,804	—
Investment income:			
Net appreciation in fair value of investments	—	35,862,523	—
Interest, dividends, and other investment income	63,531	42,084,553	870,419
Less: investment expense	—	(6,278,580)	—
Net investment income	63,531	71,668,496	870,419
Receipts from depositors	741,619	—	27,239,487
Other	223,456	24,777	—
Total additions	**1,028,606**	**88,027,077**	**28,109,906**
DEDUCTIONS			
Distributions paid and payable to participants	—	17,472,982	868,661
Refunds of contributions	—	288,800	—
Administrative expense	8,235	397,167	1,753
Payments to and for depositors	386,279	385,681	23,895,119
Total deductions	**394,514**	**18,544,630**	**24,765,533**
Change in net assets	634,092	69,482,447	3,344,373
Net assets, July 1, 2006	**2,100,704**	**362,864,065**	**16,391,885**
Net assets, June 30, 2007	**$ 2,734,796**	**$ 432,346,512**	**$ 19,736,258**

The notes to the financial statements are an integral part of this statement.

Discretely Presented Component Units Financial Statements

Statement of Net Assets

Discretely Presented Component Units – Enterprise Activity

June 30, 2007
(amounts in thousands)

	University of California	State Compensation Insurance	California Housing Finance Agency	Public Employees' Benefits	Nonmajor Component Units	Total
ASSETS						
Current assets:						
Cash and pooled investments	$ 308,752	$ 65,613	$ 793,300	$ 344,470	$ 642,917	$ 2,155,052
Investments	6,296,969	5,214,231	872,193	11,066	246,847	12,641,306
Restricted assets:						
Cash and pooled investments	—	—	—	—	8,316	8,316
Investments	—	—	—	—	45,981	45,981
Receivables (net)	1,682,520	1,182,618	398,418	1,631	345,445	3,610,632
Due from primary government	251,374	—	—	5,786	1,135	258,295
Due from other governments	538,461	—	—	47,633	44,309	630,403
Prepaid items	—	—	718	—	2,750	3,468
Inventories	143,254	—	—	—	313	143,567
Other current assets	138,808	—	100	—	58,435	197,343
Total current assets	9,360,138	6,462,462	2,064,729	410,586	1,396,448	19,694,363
Noncurrent assets:						
Restricted assets:						
Cash and pooled investments	—	—	—	—	128,334	128,334
Investments	—	—	—	—	63,184	63,184
Investments	17,664,282	16,207,430	52,187	2,556,570	1,051,652	37,532,121
Receivables (net)	724,128	—	—	—	243,944	968,072
Loans receivable	—	—	7,192,125	—	295,414	7,487,539
Deferred charges	—	20,189	37,344	—	1,550	59,083
Capital assets:						
Land	615,015	53,526	—	—	93,688	762,229
Collections – nondepreciable	266,153	—	—	—	3,944	270,097
Buildings and other depreciable property	25,100,258	456,624	1,424	—	1,513,581	27,071,887
Less: accumulated depreciation	(11,712,172)	(210,943)	(558)	—	(615,011)	(12,538,684)
Construction in progress	3,836,078	73,373	—	—	56,791	3,966,242
Other noncurrent assets	267,613	—	4,509	—	82,629	354,751
Total noncurrent assets	36,761,355	16,600,199	7,287,031	2,556,570	2,919,700	66,124,855
Total assets	**$ 46,121,493**	**$ 23,062,661**	**$ 9,351,760**	**$ 2,967,156**	**$ 4,316,148**	**$ 85,819,218**

The notes to the financial statements are an integral part of this statement.

	University of California	State Compensation Insurance	California Housing Finance Agency	Public Employees' Benefits	Nonmajor Component Units	Total
LIABILITIES						
Current liabilities:						
Accounts payable	$ 1,445,046	$ 98,545	$ 12,883	$ 298,259	$ 113,288	$ 1,968,021
Due to other governments	—	—	5	—	33	38
Dividends payable	—	3,100	—	—	—	3,100
Deferred revenue	755,709	—	—	—	56,316	812,025
Deposits	357,504	—	167,240	—	1,494	526,238
Contracts and notes payable	—	—	—	—	10,598	10,598
Advance collections	—	139,851	—	—	609	140,460
Interest payable	—	—	147,850	—	1,952	149,802
Securities lending obligations	4,921,107	1,799,480	—	—	—	6,720,587
Benefits payable	—	2,236,720	—	—	—	2,236,720
Current portion of long-term obligations	1,429,427	62,108	81,759	21,230	110,047	1,704,571
Other current liabilities	1,078,692	121,166	1,055	109,951	181,169	1,492,033
Total current liabilities	9,987,485	4,460,970	410,792	429,440	475,506	15,764,193
Noncurrent liabilities:						
Benefits payable	—	14,088,574	—	2,916,015	—	17,004,589
Compensated absences payable	202,606	—	—	—	10,277	212,883
Certificates of participation, commercial paper, and other borrowings	76,592	—	—	—	52,333	128,925
Capital lease obligations	1,884,177	—	—	—	231,375	2,115,552
Revenue bonds payable	6,223,248	—	7,499,692	—	448,990	14,171,930
Other noncurrent liabilities	971,710	331,562	48,363	—	314,071	1,665,706
Total noncurrent liabilities	9,358,333	14,420,136	7,548,055	2,916,015	1,057,046	35,299,585
Total liabilities	**19,345,818**	**18,881,106**	**7,958,847**	**3,345,455**	**1,532,552**	51,063,778
NET ASSETS						
Investment in capital assets, net of related debt	9,101,981	372,580	866	—	497,581	9,973,008
Restricted:						
Nonexpendable	2,647,931	—	—	—	647,564	3,295,495
Expendable:						
Endowments and gifts	7,665,687	—	—	—	9,793	7,675,480
Education	818,016	—	—	—	652,756	1,470,772
Indenture	—	—	731,330	—	—	731,330
Employee benefits	—	—	—	463,958	—	463,958
Workers' compensation liability	—	3,808,975	—	—	—	3,808,975
Statute	—	—	660,717	—	250,449	911,166
Other purposes	—	—	—	—	258,675	258,675
Total expendable	8,483,703	3,808,975	1,392,047	463,958	1,171,673	15,320,356
Unrestricted	6,542,060	—	—	(842,257)	466,778	6,166,581
Total net assets	**26,775,675**	**4,181,555**	**1,392,913**	**(378,299)**	**2,783,596**	34,755,440
Total liabilities and net assets	**$ 46,121,493**	**$ 23,062,661**	**$ 9,351,760**	**$ 2,967,156**	**$ 4,316,148**	$ 85,819,218

The notes to the financial statements are an integral part of this statement.

Statement of Activities

Discretely Presented Component Units – Enterprise Activity

Year Ended June 30, 2007
(amounts in thousands)

	University of California	State Compensation Insurance Fund	California Housing Finance Agency	Public Employees' Benefits	Nonmajor Component Units	Total
OPERATING EXPENSES						
Personal services	$ 10,313,242	$ 654,073	$ 21,836	$ —	$ 508,576	$ 11,497,727
Scholarships and fellowships	401,153	—	—	—	43,921	445,074
Supplies	1,909,814	—	—	—	7,060	1,916,874
Services and charges	371,661	69,881	61,996	1,903,139	1,229,963	3,636,640
Department of Energy laboratories	2,169,750	—	—	—	—	2,169,750
Depreciation	1,049,008	34,268	189	—	60,844	1,144,309
Distributions to beneficiaries	—	2,386,717	—	—	—	2,386,717
Interest expense and fiscal charges	385,201	—	368,382	—	36,723	790,306
Amortization of deferred charges	—	370,418	9,249	—	89	379,756
Grants provided	451,290	—	74,505	—	—	525,795
Other	2,521,130	275,934	—	—	74,411	2,871,475
Total operating expenses	**19,572,249**	**3,791,291**	**536,157**	**1,903,139**	**1,961,587**	**27,764,423**
PROGRAM REVENUES						
Charges for services	10,714,361	3,477,665	516,398	1,649,056	1,187,287	17,544,767
Operating grants and contributions	7,475,951	—	114,235	—	518,346	8,108,532
Capital grants and contributions	216,783	—	—	—	14,780	231,563
Total program revenues	**18,407,095**	**3,477,665**	**630,633**	**1,649,056**	**1,720,413**	**25,884,862**
Net (expense) revenue	(1,165,154)	(313,626)	94,476	(254,083)	(241,174)	(1,879,561)
GENERAL REVENUES						
Investment and interest income	1,986,685	835,349	—	310,596	177,974	3,310,604
Other	1,879,252	116,323	30,230	362	263,341	2,289,508
Total general revenues	**3,865,937**	**951,672**	**30,230**	**310,958**	**441,315**	**5,600,112**
Change in net assets	2,700,783	638,046	124,706	56,875	200,141	3,720,551
Net assets (deficit), July 1, 2006	**24,074,892**	**3,543,509**	**1,268,207**	**(435,174)**	**2,583,455 ***	**31,034,889**
Net assets (deficit), June 30, 2007	**$ 26,775,675**	**$ 4,181,555**	**$ 1,392,913**	**$ (378,299)**	**$ 2,783,596**	**$ 34,755,440**

* Restated

The notes to the financial statements are an integral part of this statement.

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Notes to the Financial Statements

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements present information on the financial activities of the State of California over which the Governor, the Legislature, and other elected officials have direct or indirect governing and fiscal control. These financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). During the year ended June 30, 2007, provisions of Governmental Accounting Standards Board Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, were implemented.

A. Reporting Entity

These financial statements present the primary government of the State and its component units. The **primary government** consists of all funds, organizations, institutions, agencies, departments, and offices that are not legally separate from the State. **Component units** are organizations that are legally separate from the State but for which the State is financially accountable or organizations whose relationship with the State is such that exclusion would cause the State's financial statements to be misleading or incomplete. The decision to include a component unit in the State's reporting entity is based on several criteria, including legal standing, fiscal dependency, and financial accountability. Following is information on the blended, fiduciary, and discretely presented component units of the State.

1. Blended Component Units

Blended component units, although legally separate entities, are in substance part of the primary government's operations. Therefore, data from these blended component units are integrated into the appropriate funds for reporting purposes.

Building authorities are blended component units because they have been created through the use of joint exercise-of-powers agreements with various cities to finance the construction of state buildings. The building authorities are reported as capital projects funds. As a result, capital lease arrangements between the building authorities and the State in the amount of $568 million have been eliminated from the financial statements. Instead, only the underlying capital assets and the debt used to acquire them are reported in the government-wide financial statements. For information on how to obtain copies of the financial statements of the building authorities, contact the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250.

The *Golden State Tobacco Securitization Corporation (GSTSC)* is a not-for-profit corporation established through legislation in September 2002 solely for the purpose of purchasing Tobacco Settlement Revenues from the State. The five voting members of the State Public Works Board serve ex officio as the directors of the corporation. GSTSC is authorized to issue bonds necessary to provide sufficient funds for carrying out its purpose. GSTSC is reported in the combining statements in the Nonmajor Governmental Funds section as a special revenue fund. For information on how to obtain copies of the financial statements of GSTSC, contact the Department of Finance, Capital Outlay/Resources Section, 915 L Street, 9th Floor, Sacramento, California 94814.

The *California State University, Channel Islands Site Authority (Site Authority)* was formed in 1998 to convert the property previously known as the Camarillo State Hospital from its former use to a California State University campus and other compatible uses. The Site Authority is governed by a board of seven members comprised of four representatives of the Trustees of the California State University and three representatives from Ventura County. The *California State University, Channel Islands Financing Authority (Financing Authority)* was formed in 2000 to provide financing through revenue bonds for the construction and other improvements conducted by the Site Authority. The Site Authority and the Financing Authority are included in the California State University Programs special revenue fund in the combining statements in the Nonmajor Governmental Funds section. The loan and other transactions of $46 million between the two authorities have been eliminated from the financial statements. Instead, only the underlying capital assets and the debt used to acquire them are reported in the government-wide financial statements. For information on how to obtain copies of the financial statements of the Site Authority and the Financing Authority, contact the California State University, Channel Islands, One University Drive, Camarillo, California 93012.

2. Fiduciary Component Units

The State has two fiduciary component units that administer pension and other employee benefit trust funds. These entities are legally separate from the State and meet the definition of a component unit because they are fiscally dependent on the State; however, due to their fiduciary nature, they are presented in the Fiduciary Fund Statements as pension and other employee benefit trust funds, along with other primary government fiduciary funds.

The *California Public Employees' Retirement System (CalPERS)* administers pension and health benefit plans for state employees, non-teaching school employees, and employees of California public agencies. Its Board of Administration has plenary authority and fiduciary responsibility for the investment of monies and the administration of the plans. CalPERS administers the following eight pension and other employee benefit trust funds: the Public Employees' Retirement Fund, the Judges' Retirement Fund, the Judges' Retirement Fund II, the Legislators' Retirement Fund, the Volunteer Firefighters' Length of Service Award Fund, the State Peace Officers' and Firefighters' Defined Contribution Plan Fund, the Replacement Benefits Fund, and the Supplemental Contributions Program Fund. Copies of CalPERS' separately issued financial statements may be obtained in writing from the California Public Employees' Retirement System, Fiscal Services Division, P.O. Box 942703, Sacramento, California 94229.

The *California State Teachers' Retirement System (CalSTRS)* administers pension benefit plans for California public school teachers and certain other employees of the public school system. CalSTRS administers two pension and other employee benefit trust funds: the State Teachers' Retirement Fund, the Teachers' Health Benefits Fund and the Voluntary Investment Program. Copies of CalSTRS' separately issued financial statements may be obtained from the California State Teachers' Retirement System, P.O. Box 15275, Sacramento, California 95851.

3. Discretely Presented Component Units

Enterprise activity of discretely presented component units is reported in a separate column in the government-wide financial statements. Discretely presented component units are legally separate from the primary government and mostly provide services to entities and individuals outside the primary government. Discretely presented component units that report enterprise activity include the University of California, the State Compensation Insurance Fund, the California Housing Finance Agency, the Public Employees' Benefits Fund, and nonmajor component units.

The *University of California* was founded in 1868 as a public, state-supported, land grant institution. It was written into the State Constitution of 1879 as a public trust to be administered by a governing board, the Regents of the University of California. The University of California is a component unit of the State because the State appoints a voting majority of the regents and because expenditures for the support of various university programs and capital outlay are appropriated by the annual Budget Act. The University of California offers defined benefit pension plans and defined contribution pension plans to its employees through the University of California Retirement System (UCRS). The UCRS is a discretely presented fiduciary unit of the university; and as such, the financial information of the UCRS is not included in the financial statements of this report. Copies of the University of California's and the UCRS' separately issued financial statements may be obtained from the University of California, Financial Management, 1111 Franklin Street, Oakland, California 94607.

The *State Compensation Insurance Fund (SCIF)* is a self-supporting enterprise created to offer insurance protection to employers at the lowest possible cost. It operates in competition with other insurance carriers to provide services to the State, counties, cities, school districts, and other public corporations. It is a component unit of the State because the State appoints all five voting members of SCIF's governing board and has the authority to approve or modify SCIF's budget. Copies of SCIF's financial statements for the year ended December 31, 2006, may be obtained from the State Compensation Insurance Fund, 1275 Market Street, San Francisco, California 94103.

The *California Housing Finance Agency (CalHFA)* was created by the Zenovich-Moscone-Chacon Housing and Home Finance Act, as amended. CalHFA's purpose is to meet the housing needs of persons and families of low and moderate income. It is a component unit of the State because the State appoints a voting majority of CalHFA's governing board and has the authority to approve or modify its budget. Copies of CalHFA's financial statements may be obtained from the California Housing Finance Agency, P.O. Box 4034, Sacramento, California 95812.

The *Public Employees' Benefits Fund*, which is administered by the California Public Employees' Retirement System and accounts for contributions and premiums for public employee long-term care plans and for administration of a deferred compensation program. Copies of CalPERS' separately issued financial statements may be obtained in writing from the California Public Employees' Retirement System, Fiscal Services Division, P.O. Box 942703, Sacramento, California 94229.

State legislation created various *nonmajor component units* to provide certain services outside the primary government and to provide certain private and public entities with a low-cost source of financing for programs deemed to be in the public interest. The California Pollution Control Financing Authority, the San Joaquin River Conservancy, and the district agricultural associations are considered component units because they have a fiscal dependency on the primary government. The California Educational Facilities Authority is considered a component unit because its exclusion from the statements would be misleading because of its relationship to the primary government. California State University auxiliary organizations are considered component units because they exist entirely or almost entirely for the direct benefit of the universities. The remaining nonmajor component units are considered component units because the majority of members of their governing boards are appointed by or are members of the primary government, because the primary government can impose its will on the entity, or because the entity provides a specific financial benefit to the primary government. For information on how to obtain copies of the financial statements of these component units, contact the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250.

The nonmajor component units are:

The *California Alternative Energy and Advanced Transportation Financing Authority*, which provides financing for alternative energy and advanced transportation technologies;

The *California Infrastructure and Economic Development Bank*, which provides financing for business development and public improvements;

The *California Pollution Control Financing Authority*, which provides financing for pollution control facilities;

The *California Health Facilities Financing Authority*, which provides financing for the construction, equipping, and acquisition of health facilities;

The *California Educational Facilities Authority*, which issues revenue bonds to finance loans for students attending public and private colleges and universities and to assist private educational institutions of higher learning in financing the expansion and construction of educational facilities (the EdFund financial report included in this entity is as of and for the year ended September 30, 2006);

The *California School Finance Authority,* which provides loans to school and community college districts to assist them in obtaining equipment and facilities;

California State University auxiliary organizations, which provide services primarily to university students through foundations, associated student organizations, student unions, food service entities, book stores, and similar organizations;

District agricultural associations, which exhibit all of the industries, industrial enterprises, resources, and products of the state (the district agricultural association's financial report is as of and for the year ended December 31, 2006);

The *University of California Hastings College of the Law*, which was established as the law department of the University of California to provide legal education programs and operates independently under its own board of directors. The college has a discretely presented component unit, the Foundation, that provides private sources of funds for academic programs, scholarships, and faculty research;

The *San Joaquin River Conservancy*, which was created to acquire and manage public lands within the San Joaquin River Parkway;

The *California Urban Waterfront Area Restoration Financing Authority*, which provides financing for coastal and inland urban waterfront restoration projects; and

The *California Consumer Power and Conservation Financing Authority*, which provides financing for projects to increase power supplies, reduce demand for energy, and improve the efficiency and environmental performance of power plants.

4. Joint Venture

A joint venture is an entity resulting from a contractual arrangement; it is owned, operated, or governed by two or more participants as a separate and specific activity subject to joint control. In such an arrangement, the participants retain an ongoing financial interest or an ongoing financial responsibility in the entity. These entities are not part of the primary government or a component unit.

The State participates in a joint venture called the *Capitol Area Development Authority (CADA)*. CADA was created in 1978 by the joint exercise of powers agreement between the primary government and the City of Sacramento for the location of state buildings and other improvements. CADA is a public entity, separate from the primary government and the city, and is administered by a board of five members: two appointed by the primary government, two appointed by the city, and one appointed by the affirmative vote of at least three of the other four members of the board. The primary government designates the chairperson of the board. Although the primary government does not have an equity interest in CADA, it does have an ongoing financial interest. Based upon the appointment authority, the primary government has the ability to indirectly influence CADA to undertake special projects for the citizenry of the participants. The primary government subsidizes CADA's operations by leasing land to CADA without consideration; however, the primary government is not obligated to do so. At June 30, 2007, CADA had total assets of $27.9 million, total liabilities of $18.2 million, and total net assets of $9.7 million. Total revenues for the fiscal year were $9.9 million and expenses were $8.4 million, resulting in a change in net assets of $1.5 million. Because the primary government does not have an equity interest in CADA, CADA's financial information is not included in the financial statements of this report. Separately issued financial statements may be obtained from the Capitol Area Development Authority, 1522 14th Street, Sacramento, California 95814.

5. Related Organizations

A related organization is an organization for which a primary government is accountable because that government appoints a voting majority of the organization's governing board, but for which it is not financially accountable.

Chapter 854 of the Statutes of 1996 created an *Independent System Operator*, a state-chartered, nonprofit market institution. The Independent System Operator provides centralized control of the statewide electrical transmission grid to ensure the efficient use and reliable operation of the transmission system. A five-member oversight board, comprised of three appointees of the Governor, an appointee of the Senate Committee on Rules, and an appointee of the Speaker of the Assembly, oversees the Independent System Operator. In addition, the Governor appoints the five members of a separate governing board. The State's accountability for this institution does not extend beyond making the initial oversight board appointments. Because the primary government is not financially accountable for the Independent System Operator, the financial information of this institution is not included in the financial statements of this report. For information on how to obtain copies of the financial statements of the Independent System Operator, contact the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, CA 94250.

The *California Earthquake Authority (CEA)*, a legally separate organization, offers basic earthquake insurance for California homeowners, renters, condominium owners, and mobile home owners. A three-member board of state-elected officials governs the CEA. The State's accountablility for this institution does not extend beyond making the appointments. Because the primary government is not financially accountable for the CEA, the financial information of this institution is not included in the financial statements of this report. For information on how to obtain copies of the financial statements of the CEA, contact the California Earthquake Authority, 801 K Street, Suite 1000, Sacramento, CA 95814.

The *Bay Area Toll Authority (BATA)*, which is not part of the State's reporting entity, was created by the California Legislature in 1997 to administer a portion of the toll revenues collected from the San Francisco Bay Area's seven state-owned toll bridges and to have program oversight related to certain bridge construction projects. In 2005, the California Legislature transferred toll-bridge administration responsibility from the California Department of Transportation (Caltrans) to BATA. This responsibility includes consolidation of all toll-bridge revenue under BATA's administration. BATA is a blended component unit of the Metropolitan

Transportation Commission. Additional information may be obtained from the Metropolitan Transportation Commission, 101 Eighth Street, Oakland, California 94607.

B. Government-wide and Fund Financial Statements

Government-wide financial statements (the Statement of Net Assets and the Statement of Activities) give information on all the nonfiduciary activities of the primary government and its component units. The primary government is reported separately from legally separate component units for which the State is financially accountable. Within the primary government, the State's governmental activities, which are normally supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. The effect of interfund activity has been removed from the statements, with the exception of amounts between governmental and business-type activities, which are presented as internal balances and transfers. Centralized services provided by the General Fund for other funds are charged as direct costs to the funds that received those services. Also, the General Fund recovers the cost of centralized services provided to federal programs from the federal government.

The Statement of Net Assets reports all of the financial and capital resources of the government as a whole in a format where assets equal liabilities plus net assets. The statement of activities demonstrates the degree to which the expenses of a given function are offset by program revenues. Program revenues include charges to customers who purchase, use, or directly benefit from goods, services, or privileges provided by a given function. Program revenues also include grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Taxes and other items that are not program-related are reported as general revenues.

Fund financial statements are provided for governmental funds, proprietary funds, fiduciary funds and similar component units, and discretely presented component units. A fund is a fiscal and accounting entity with a self-balancing set of accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with finance-related legal and contractual provisions. The State maintains the minimum number of funds consistent with legal and managerial requirements. Fiduciary funds, although excluded from the government-wide statements, are included in the fund financial statements. Major governmental and enterprise funds are reported in separate columns in the fund financial statements. Nonmajor governmental and proprietary funds are grouped into separate columns. Discretely presented component unit statements, which follow the fiduciary fund statements, also separately report the enterprise activity of the major discretely presented component units. In this report, the enterprise activity of nonmajor discretely presented component units is grouped in a separate column.

Governmental fund types are used primarily to account for services provided to the general public without direct charge.

The State reports the following major governmental funds.

The *General Fund* is the main operating fund of the State. It accounts for transactions related to resources obtained and used for those services that do not need to be accounted for in another fund.

The *Federal Fund* accounts for the receipt and use of grants, entitlements, and shared revenues received from the federal government.

The *Transportation Construction Fund* accounts for fuel taxes, including the State's diesel, motor vehicle, and fuel use taxes; bond proceeds; and other revenues that are used for highway and passenger rail construction.

Proprietary fund types focus on the determination of operating income, changes in net assets, financial position, and cash flows.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

For its proprietary funds, the State applies all applicable GASB pronouncements. In addition, the State applies all applicable Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Committee on Accounting Procedure (CAP) Accounting Research Bulletins issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements. The State has elected not to apply FASB pronouncements issued after November 30, 1989, for its enterprise funds.

The State has two proprietary fund types: enterprise funds and internal service funds.

Enterprise funds record business-type activity for which a fee is charged to external users for goods and services. In addition, the State is required to report activities as enterprise funds in the context of the activity's principal revenue sources when any of the following criteria are met:

1. The activity's debt is secured solely by fees and charges of the activity;
2. There is a legal requirement to recover costs; or
3. The pricing policies of fees and charges are designed to recover costs.

The State reports the following *major enterprise funds*.

The *Electric Power Fund* accounts for the acquisition and resale of electric power to retail end-use customers.

The *Water Resources Fund* accounts for charges to local water districts and the sale of excess power to public utilities.

The *Public Building Construction Fund* accounts for rental charges from the lease of public assets.

The *State Lottery Fund* accounts for the sale of California State Lottery (Lottery) tickets and the Lottery's payments for education.

The *Unemployment Programs Fund* accounts for employer and worker contributions used for payments of unemployment insurance and disability benefits.

Nonmajor enterprise funds account for additional operations that are financed and operated in a manner similar to private business enterprises.

Additionally, the State reports *internal service funds* as a proprietary fund type with governmental activity. Internal service funds account for goods or services provided to other agencies, departments, or governments on a cost-reimbursement basis. The goods and services provided include: architectural services, construction and improvements, printing and procurement services, goods produced by inmates of state prisons, data processing services, administrative services related to water delivery, and equipment used by the California Department of Transportation. Internal service funds are included in the governmental activities at the government-wide level.

Fiduciary fund types are used to account for assets held by the State. The State acts as a trustee or as an agent for individuals, private organizations, other governments, or other funds. Fiduciary funds, including fiduciary component units, are not included in the government-wide financial statements.

The State has the following four fiduciary fund types.

Private purpose trust funds account for all trust arrangements, other than those properly reported in pension or investment trust funds, whereby principal and income benefit individuals, private organizations, or other governments.

Pension and other employee benefit trust funds of the primary government and fiduciary component units account for transactions, assets, liabilities, and net assets available for plan benefits of the retirement systems and for other employee benefit programs.

An *investment trust fund* accounts for the deposits, withdrawals, and earnings of the Local Agency Investment Fund, an external investment pool for local governments and public agencies.

Agency funds account for assets held by the State, which acts as an agent for individuals, private organizations, or other governments.

Discretely presented component units consist of certain organizations that have enterprise activity. The enterprise activity component units are the University of California, the State Compensation Insurance Fund, the California Housing Finance Agency, the Public Employees' Benefits Fund, and nonmajor component units. In this report, all of the enterprise activity of the discretely presented component units is reported in a separate column in the government-wide financial statements and on separate pages following the fund financial statements.

C. Measurement Focus and Basis of Accounting

1. Government-wide Financial Statements

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when they are earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar transactions are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

2. Fund Financial Statements

The measurement focus and basis of accounting for the fund financial statements vary with the type of fund. **Governmental fund types** are presented using the current financial resources measurement focus. With this

measurement focus, operating statements present increases and decreases in net current assets; the unreserved fund balance is a measure of available spendable resources.

The accounts of the governmental fund types are reported using the modified accrual basis of accounting. Under the modified accrual basis, revenues are recorded as they become measurable and available, and expenditures are recorded at the time the liabilities are incurred. The State records revenue sources when they are earned or when they are due, provided they are measurable and available within the ensuing 12 months. Principal tax revenues susceptible to accrual are recorded as taxpayers earn income (personal income and corporation taxes), as sales are made (consumption and use taxes), and as the taxable event occurs (miscellaneous taxes), net of estimated tax overpayments.

Proprietary fund types, the **investment trust fund, private purpose trust funds,** and **pension and other employee benefit trust funds** are accounted for using the economic resources measurement focus. **Agency funds** are custodial in nature and do not measure the results of operations.

The accounts of the proprietary fund types, the investment trust fund, private purpose trust funds, pension and other employee benefit trust funds, and agency funds are reported using the accrual basis of accounting. Under the accrual basis, most transactions are recorded when they occur, regardless of when cash is received or disbursed.

Lottery revenue and the related prize expenses are recognized when sales are made. Certain prizes are payable in deferred installments. Such liabilities are recorded at the present value of amounts payable in the future.

For purposes of the Statement of Cash Flows, all cash and pooled investments in the State Treasurer's pooled investment program are considered to be cash and cash equivalents.

Discretely presented component units are accounted for using the economic resources measurement focus and the accrual basis of accounting.

D. Inventories

Inventories of supplies are reported at cost and inventories held for resale are stated at the lower of average cost or market. In the government-wide financial statements, inventories for both governmental and business-type activities are expensed when they are consumed and unused inventories are reported as an asset on the Statement of Net Assets. In the fund financial statements, governmental funds report inventories as expenditures when purchased, and proprietary funds report inventories as expenditures when consumed. The discretely presented component units have inventory policies similar to those of the primary government.

E. Deposits and Investments

The State reports investments at fair value, as prescribed by GAAP. Additional information on the State's investments can be found in Note 3, Deposits and Investments.

F. Net Investment in Direct Financing Leases

The State Public Works Board, an agency that accounts for its activities as an enterprise fund, has entered into lease-purchase agreements with various other primary government agencies, the University of California, and certain local agencies. The payments from these leases are used to satisfy the principal and interest

requirements of revenue bonds issued by the State Public Works Board to finance the cost of projects such as acquisition and construction of facilities and equipment. Upon expiration of these leases, title to the facilities and projects transfers to the primary government agency, the University of California, or the local agency. The State Public Works Board records the net investment in direct financing leases at the net present value of the minimum lease payments.

G. Deferred Charges

The deferred charges account primarily represents operating and maintenance costs and unrecovered capital costs in the enterprise fund type that will be recognized as expenses over the remaining life of long-term state water supply contracts in the Water Resources Fund. These costs are billable in future years. In addition, the account includes unbilled interest earnings on unrecovered capital costs that are recorded as deferred charges. These charges are recognized when billed in future years under the terms of water supply contracts. The deferred charges for the Public Buildings Construction Fund include bond counsel fees, trustee fees, rating agency fees, underwriting costs, insurance costs, and miscellaneous expenses. Bond issuance costs are amortized using the straight-line method over the term of the bonds. Amortization of bond issue costs during the facility construction period is capitalized and included in the construction costs. Deferred charges are also included in the State Lottery Fund and nonmajor enterprise funds. Bond issuance costs recorded as expenditures in certain capital projects and special revenue funds are reclassified as deferred charges in the governmental activities column of the Statement of Net Assets.

H. Capital Assets

Capital assets are categorized into land, state highway infrastructure, collections, buildings and other depreciable property, and construction in progress. The buildings and other depreciable property account includes buildings, improvements other than buildings, equipment, personal property, intangible assets, certain infrastructure assets, certain books, and other capitalized and depreciable property. The value of the capital assets, including the related accumulated depreciation, is reported in the applicable governmental, business-type, or component unit activities columns in the government-wide Statement of Net Assets.

The primary government has a large collection of historical and contemporary treasures that have important documentary and artistic value. These assets are not capitalized or depreciated because they are cultural resources and cannot reasonably be valued and/or the assets have inexhaustible useful lives. These treasures and works of art include furnishings, portraits and other paintings, books, statues, photographs, and miscellaneous artifacts. These collections meet the conditions for exemption from capitalization because the collections are: held for public exhibition, education, or research in furtherance of public service, rather than financial gain; protected, kept unencumbered, cared for, and preserved; and are subject to an organizational policy that requires the proceeds from sales of collection items to be used to acquire other items for collections.

In general, capital assets of the primary government are defined as assets that have a normal useful life of at least one year and a unit acquisition cost of at least $5,000. These assets are recorded at historical cost or estimated historical cost, including all costs related to the acquisition. Donated capital assets are recoded at the fair market value on the date the gift was received. Major capital asset outlays are capitalized as projects are constructed.

Buildings and other depreciable property are depreciated using the straight-line method with no salvage value for governmental activities. Generally, buildings and other improvements are depreciated over 40 years and

equipment is depreciated over five years. Depreciable assets of business-type activities are depreciated using the straight-line method over their estimated useful or service lives, ranging from three to 100 years.

California has elected to use the modified approach for capitalizing the infrastructure assets of the state highway system. The state highway system consists of 49,477 lane-miles and 12,155 bridges that are maintained by the California Department of Transportation. By using the modified approach, the infrastructure assets of the state highway system are not depreciated and all expenditures made for those assets, except for additions and improvements, are expensed in the period incurred. All additions and improvements made after June 30, 2001, are capitalized. All infrastructure assets that are related to projects completed prior to July 1, 2001, are recorded at the historical costs contained in annual reports of the American Association of State Highway and Transportation Officials (AASHTO) and the Federal Highway Administration.

The capital assets of the discretely presented component units are reported at cost at the date of acquisition or at fair market value at the date of donation, in the case of gifts. They are depreciated over their estimated useful service lives.

I. Long-term Obligations

Long-term obligations consist of certain unmatured general obligation bonds, certain unmatured revenue bonds, capital lease obligations, certificates of participation, commercial paper, the net pension obligation of the pension and other employee benefit trust funds, the liability for employees' compensated absences and workers' compensation claims, amounts owed for lawsuits, reimbursement for costs mandated by the State, the outstanding Proposition 98 funding guarantee owed to schools, the liability for Lottery prizes and annuities, and the primary government's share of the University of California pension liability that is due in more than one year. In the government-wide financial statements, current and noncurrent obligations are reported as liabilities in the applicable governmental activities, business-type activities, and component units columns of the Statement of Net Assets.

Bond premiums and discounts for business-type activities and component units are generally deferred and amortized over the life of the bonds. In these instances, bonds payable are reported net of the applicable premium or discount. Bond premiums and discounts for governmental activities are expensed in the year incurred in the fund financial statements. In the government-wide financial statements, the revenue bonds payable for governmental activities is reported net of the applicable premium or discount.

With approval in advance from the Legislature, certain authorities and state agencies may issue revenue bonds. Principal and interest on revenue bonds are payable from the pledged revenues of the respective funds, building authorities, and agencies. The General Fund has no legal liability for payment of principal and interest on revenue bonds. With the exception of certain special revenue funds (Transportation Construction, California State University Programs, and the Golden State Tobacco Securitization Corporation) and the building authorities' capital projects funds, the liability for revenue bonds is recorded in the respective fund.

J. Compensated Absences

The government-wide financial statements report both the current and the noncurrent liabilities for compensated absences, which are vested unpaid vacation and annual leave. However, unused sick-leave balances are not included in the compensated absences because they do not vest to employees. In the fund financial statements for governmental funds, only the compensated absences for employees that have left state service and have unused reimbursable leave at year-end would be included. The amounts of vested unpaid vacation and annual leave accumulated by state employees are accrued in proprietary funds when

incurred. In the discretely presented component units, the compensated absences are accounted for in the same manner as in the proprietary funds of the primary government.

K. Net Assets and Fund Balance

The difference between fund assets and liabilities is called "net assets" on the government-wide financial statements, the proprietary and fiduciary fund statements, and the component unit statements; it is called "fund balance" on the governmental fund statements. The government-wide financial statements have the following categories of net assets.

Investment in capital assets, net of related debt, represents capital assets, net of accumulated depreciation, reduced by the outstanding principal balances of debt attributable to the acquisition, construction, or improvement of those assets.

Restricted net assets result from transactions with purpose restrictions and are designated as either *nonexpendable* or *expendable*. *Nonexpendable restricted net assets* are subject to externally imposed restrictions that must be retained in perpetuity. *Expendable restricted net assets* are subject to externally imposed restrictions that can be fulfilled by actions of the State. As of June 30, 2007, the government-wide financial statements show restricted net assets for the primary government of $19.1 billion, of which $10.0 billion is due to enabling legislation.

Unrestricted net assets are neither restricted nor invested in capital assets, net of related debt.

In the fund financial statements, proprietary funds have categories of net assets similar to those in the government-wide statements. Governmental funds have two fund balance sections: *reserved and unreserved*. Part or all of the total fund balance may be reserved as a result of law or generally accepted accounting principles. Reserves represent those portions of the fund balances that are segregated for specific uses. The reserves of the fund balance for governmental funds are as follows.

Reserved for encumbrances represents goods and services that are ordered, but not received, by the end of the fiscal year.

Reserved for interfund receivables represents the noncurrent portion of advances to other funds that do not represent expendable available financial resources.

Reserved for loans receivable represents the noncurrent portion of loans receivable that does not represent expendable available financial resources.

Reserved for continuing appropriations represents the unencumbered balance of all appropriations for which the period of availability extends beyond the period covered in the report. These appropriations are legally segregated for a specific future use.

Reserved for debt service represents the amount legally reserved for the payment of bonded indebtedness that is not available for other purposes until the bonded indebtedness is liquidated.

The *unreserved* amounts represent the net of total fund balance, less reserves.

Fiduciary fund net assets are "amounts held in trust for benefits and other purposes."

L. Restatement of Beginning Fund Balances and Net Assets

1. Fund Financial Statements

The beginning fund balance of the **governmental funds** increased by a net total of $188 million. This increase is comprised of an increase of $228 million in loans receivable that were previously omitted and a decrease of $40 million as a result of prior-period adjustments to correct errors in **nonmajor governmental funds**. Due to a reclassification of funds, there was also a beginning fund balance increase in the Transportation Construction Fund and an offsetting decrease in the **nonmajor governmental funds**.

The beginning net assets of the **internal service funds** decreased by $2 million for a prior-period adjustment of revenue for the Department of Technology.

The beginning net assets of the **nonmajor enterprise funds** increased by a net total of $12 million as a result of a prior-period adjustment for the previous ommission of capital assets.

Beginning net assets of the **discretely presented component units – enterprise activity** increased by a total of $22 million. This increase was the result of prior-period adjustments to correct errors, including the ommision of $21 million in loans receivable.

2. Government-wide Financial Statements

The beginning net assets of the **governmental activities**, the **business-type activities**, and the **component units** were restated as described in the previous section for governmental funds, nonmajor enterprise funds, and discretely presented component units – enterprise activity, respectively. In addition, the beginning net assets of the governmental activities decreased by $458 million as a result of prior-period adjustments to correct for overstated capital assets and by $477 million as a result of a change in the methodology for calculating the net pension obligation, a noncurrent liability.

M. Guaranty Deposits

The State is custodian of guaranty deposits held to protect consumers, to secure the State's deposits in financial institutions, and to ensure payment of taxes and fulfillment of obligations to the State. Guaranty deposits of securities and other properties are not shown on the financial statements.

NOTE 2: BUDGETARY AND LEGAL COMPLIANCE

A. Budgeting and Budgetary Control

The State's annual budget is prepared primarily on a modified accrual basis for governmental funds. The Governor recommends a budget for approval by the Legislature each year. This recommended budget includes estimated revenues; however, revenues are not included in the annual budget bill adopted by the Legislature. Under state law, the State cannot adopt a spending plan that exceeds estimated revenues.

Under the State Constitution, money may be drawn from the treasury only through a legal appropriation. The appropriations contained in the Budget Act, as approved by the Legislature and signed by the Governor, are the primary sources of annual expenditure authorizations and establish the legal level of control for the annual

operating budget. The budget can be amended throughout the year by special legislative action, budget revisions by the Department of Finance, or executive orders of the Governor.

Amendments to the original budget for the year ended June 30, 2007, were legally made, and they had the effect of increasing spending authority for the General Fund and decreasing spending authority for the Transportation Construction Fund.

Appropriations are generally available for expenditure or encumbrance either in the year appropriated or for a period of three years if the legislation does not specify a period of availability. At the end of the availability period, the encumbering authority for the unencumbered balance lapses. Some appropriations continue indefinitely, while others are available until fully spent. Generally, encumbrances must be liquidated within two years from the end of the period in which the appropriation is available. If the encumbrances are not liquidated within this additional two-year period, the spending authority for these encumbrances lapses.

B. Legal Compliance

State agencies are responsible for exercising basic budgetary control and ensuring that appropriations are not overspent. The State Controller's Office is responsible for overall appropriation control and does not allow expenditures in excess of authorized appropriations.

Financial activities are mainly controlled at the appropriation level but can vary, depending on the presentation and wording contained in the Budget Act. Certain items that are established at the category, program, component, or element level can be adjusted by the Department of Finance. For example, an appropriation for support may have detail accounts for personal services, operating expenses and equipment, and reimbursements. The Department of Finance can authorize adjustments between the detail accounts but cannot increase the amount of the overall support appropriation. While the financial activities are controlled at various levels, the legal level of budgetary control, or the extent to which management may amend the budget without seeking approval of the governing body, has been established in the Budget Act for the annual operating budget.

NOTE 3: DEPOSITS AND INVESTMENTS

The State Treasurer administers a single pooled investment program comprising both an internal investment pool and an external investment pool (the Local Agency Investment Fund). A single portfolio of investments exists, with all participants having an undivided interest in the portfolio. Both pools are administered in the same manner, as described below.

As required by generally accepted accounting principles, certain risk disclosures are included in this note to the extent that the risks exist at the date of the statement of net assets. Disclosure of the following risks are included:

Interest Rate Risk is the risk that the value of fixed-income securities will decline because of changing interest rates. The prices of fixed-income securities with longer time to maturity tend to be more sensitive to changes in interest rates than those with shorter durations.

Credit Risk is the risk that a debt issuer will fail to pay interest or principal in a timely manner, or that negative perceptions of the issuer's ability to make these payments will cause security prices to decline.

Custodial Credit Risk is the risk that, in the event a financial institution or counterparty fails, the investor will not be able to recover the value of deposits, investments, or collateral.

Concentration of Credit Risk is the risk of loss attributed to the magnitude of an investor's holdings in a single issuer.

Foreign Currency Risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit.

A. Primary Government

The State's pooled investment program and certain funds of the primary government are allowed by state statutes, bond resolutions, and investment policy resolutions to invest in United States government securities, Federal agency securities, negotiable certificates of deposit, bankers' acceptances, commercial paper, corporate bonds, bank notes, other debt securities, repurchase agreements, reverse repurchase agreements, and other investments.

Certain discretely presented component units participate in the State Treasurer's Office pooled investment program. As of June 30, 2007, the discretely presented component units accounted for approximately 3.2% of the State Treasurer's pooled investment portfolio. This program enables the State Treasurer's Office to combine available cash from all funds and to invest cash that exceeds current needs.

Both deposits and investments are included in the State's investment program. For certain banks, the State Treasurer's Office maintains cash deposits that cover uncleared checks deposited in the State's accounts and that earn income which compensates the banks for their services.

Demand and time deposits held by financial institutions as of June 30, 2007, totaling approximately $9.0 billion, were insured by federal depository insurance or by collateral held by the State Treasurer's Office or an agent of the State Treasurer's Office in the State's name. The California Government Code requires that collateral pledged for demand and time deposits be deposited with the State Treasurer.

As of June 30, 2007, the State Treasurer's Office had amounts on deposit with a fiscal agent totaling $29 million related to principal and interest payments to bondholders. Additionally, $6 million was in a compensating balance account with a custodial agent to provide sufficient earnings to cover fees for custodial services. These deposits were also insured by federal depository insurance or by collateral held by an agent of the State Treasurer's Office in the State's name.

The State Treasurer's Office reports its investments at fair value. The fair value of securities in the State Treasurer's pooled investment program generally is based on quoted market prices. As of June 30, 2007, the weighted average maturity of the securities in the pooled investment program administered by the State Treasurer's Office was approximately 138 days. Weighted average maturity is the average number of days, given a dollar-weighted value of individual investments, that the securities in the portfolio have remaining from evaluation date to stated maturity.

The Pooled Money Investment Board provides oversight of the State Treasurer's pooled investment program. The purpose of the board is to design an effective cash management and investment program, using all moneys flowing through the State Treasurer's Office bank accounts and keeping all available funds invested in a manner consistent with the goals of safety, liquidity, and yield. The Pooled Money Investment Board is comprised of the State Treasurer as chair, the State Controller, and the Director of Finance. This board designates the amounts of money available for investment. The State Treasurer is charged with making the

actual investment transactions for this program. This investment program is not registered with the Securities and Exchange Commission as an investment company.

The value of the deposits in the State Treasurer's pooled investment program, including the Local Agency Investment Fund, is equal to the dollars deposited in the program. The fair value of the position in the program may be greater or less than the value of the deposits, with the difference representing the unrealized gain or loss. As of June 30, 2007, this difference was immaterial to the valuation of the program. The pool is run with "dollar-in, dollar-out" participation. There are no share-value adjustments to reflect changes in fair value.

Certain funds have elected to participate in the pooled investment program, even though they have the authority to make their own investments. Others may be required by legislation to participate in the program. As a result, the deposits of these funds or accounts may be considered involuntary. However, these funds or accounts are part of the State's reporting entity. The remaining participation in the pool, the Local Agency Investment Fund, is voluntary.

Certain funds that have deposits in the State Treasurer's pooled investment program do not receive the interest earnings on their deposits. Instead, by law, the earnings are to be assigned to the State's General Fund. Some of the $537 million in interest revenue received by the General Fund from the pooled investment program in the 2006-07 fiscal year was earned on balances in these funds.

The State Treasurer's pooled investment program values participants' shares on an amortized cost basis. Specifically, the program distributes income to participants quarterly, based on their relative participation during the quarter. This participation is calculated based on (1) realized investment gains and losses calculated on an amortized cost basis, (2) interest income based on stated rates (both paid and accrued), (3) amortization of discounts and premiums on a straight-line basis, and (4) investment and administrative expenses. This amortized cost method differs from the fair value method used to value investments in these financial statements; the amortized cost method is not designed to distribute to participants all unrealized gains and losses in the fair value of the pool's investments. Because the total difference between the fair value of the investments in the pool and the value distributed to pool participants using the amortized cost method described above is not material, no adjustment was made to the financial statements.

The State Treasurer's Office also reports participant fair value as a ratio of amortized cost on a quarterly basis. The State Treasurer's Office has not provided or obtained a legally binding guarantee to support the principal invested in the investment program.

As of June 30, 2007, structured notes and asset-backed securities comprised slightly less than 3.5% of the pooled investments. A significant portion of the asset-backed securities consists of small-business loans and mortgage-backed securities. The small-business loans held in the portfolio are guaranteed by the Small Business Administration, an agency of the federal government. The mortgage-backed securities, which are called real estate mortgage investment conduits (REMICs), are securities backed by pools of mortgages. The REMICs in the State's portfolio have a fixed principal payment schedule. A portion of the asset-backed securities consisted of floating-rate notes. For floating-rate notes held in the portfolio during the fiscal year, the interest received by the State Treasurer's pooled investment program rose or fell as the underlying index rate rose or fell. The structure of the floating-rate notes in the State Treasurer's pooled investment program portfolio provided a hedge against the risk of increasing interest rates.

Enterprise funds and special revenue funds also make separate investments, which are presented at fair value.

Table 1 identifies the investment types that are authorized by the California Government Code and the State Treasurer's Office investment policy for the pooled investment program.

Table 1

Authorized Investments

Authorized Investment Type	Maximum Maturity	Maximum Percentage of Portfolio	Maximum Investment in One Issuer	Credit Rating
U.S. Treasury Securities	5 years*	N/A**	N/A**	N/A**
Federal Agency Securities	5 years*	N/A**	N/A**	N/A**
Certificates of Deposit	5 years*	N/A**	N/A**	N/A**
Bankers Acceptances	180 days*	N/A**	N/A**	N/A**
Commercial Paper	180 days	30%	10% of issuer's outstanding Commercial Paper	A-2/P-2/F-2***
Corporate Bonds/Notes	5 years*	N/A**	N/A**	A/A/A****
Repurchase Agreements	1 year*	N/A**	N/A**	N/A**
Reverse Repurchase Agreements	1 year*	10%*	N/A**	N/A**

* Limitations are pursuant to the State Treasurer's Office Investment Policy for the Pooled Money Investment Account. The Government Code does not establish limits for investments of surplus moneys in this investment type.

** N/A = Neither the Government Code nor the State Treasurer's Office Investment Policy for the Pooled Money Investment Account sets limits for the investment of surplus moneys in this investment type.

*** The State Treasurer's Office Investment Policy for the Pooled Money Investment account is more restrictive than the Government Code, which allows investments rated A-3/P-3/F-3.

**** The Government Code requires that a security fall within the top three ratings of a nationally recognized rating service.

1. Interest Rate Risk

Table 2 presents the interest rate risk of the primary government's investments.

Table 2

Schedule of Investments – Primary Government – Interest Rate Risk
June 30, 2007
(amounts in thousands)

	Interest Rates*	Maturity	Fair Value at Year End	Weighted Average Maturity (in years)
Pooled investments				
U.S. Treasury bills and notes	4.77 - 4.97	12 days - 180 days	$ 3,362,656	0.24
U.S. agency bonds and discount notes	3.01 - 5.64	6 days - 2.45 years	13,227,874	0.71
Small Business Administration loans	5.55 - 6.38	0.25 year	629,834	0.25 **
Mortgage-backed securities #	3.92 - 14.25	124 days - 8.13 years	840,984	3.88
Certificates of deposit	5.27 - 5.34	2 days - 180 days	15,594,616	0.18
Commercial paper	5.17 - 5.39	2 days - 121 days	14,471,657	0.11
Corporate bonds and notes	4.30 - 5.50	20 days - 2.33 years	1,683,796	0.40
Total pooled investments			**49,811,417** @	
Other primary government investments				
U.S. Treasuries and agencies			1,996,805	4.71 ***
Commercial paper			868,963	N/A ****
Guaranteed investment contracts			602,683	14.14
Corporate debt securities			583,619	1.42
Other			996,057	0.57
Total other primary government investments ^			**5,048,127**	
Funds outside primary government included in pooled investments				
Less: investment trust funds			19,990,748	
Less: other trust and agency funds			2,331,496	
Less: discretely presented component units			2,081,871	
Total primary government investments			**$ 30,455,429**	

* These numbers represent high and low interest rates for each investment type.

** In calculating SBA holdings' weighted average maturity, the State Treasurer's Office assumes stated maturity is the quarterly reset date.

*** This amount includes $495,000 of U.S. Treasuries and agencies securities held by the Golden State Tobacco Securitization Corporation that mature in less than one year.

**** These commercial paper holdings of the California State University and the Golden State Tobacco Securitization Corporation mature in less than one year.

These securities are issued by U. S. government agencies such as the Federal National Mortgage Association.

@ Total pooled investments does not include certain assets of the State's pooled investment program. The other assets include $8.7 billion of time deposits and $7.2 billion of loans to State funds, which are reported as cash in the respective funds.

^ Total other primary government investments include approximately $22 million of cash equivalents that are included in Cash and Pooled Investments.

Table 3 identifies the debt securities that are highly sensitive to interest rate fluctuations (to a greater degree than already indicated in the information provided previously).

Table 3

Schedule of Highly Sensitive Investments in Debt Securities – Primary Government – Interest Rate Risk
June 30, 2007
(amounts in thousands)

Pooled investments	Fair Value at Year End	% of Total Pooled Investments
Mortgage-backed		
Federal National Mortgage Association Collateralized Mortgage Obligations	$ 840,265	1.686 %
Government National Mortgage Association Pools	231	0.000
Federal Home Loan Mortgage Corporation Participation Certificate Pools	488	0.001

These mortgage-backed securities entitle the purchaser to receive a share of the cash flows, such as principal and interest payments, from a pool of mortgages. Mortgage securities are sensitive to interest rate changes because principal prepayments either increase (in a low interest rate environment) or decrease (in a high interest rate environment). A change, up or down, in the payment rate will result in a change in the security yield.

2. Credit Risk

Table 4 presents the credit risk of the primary government's debt securities.

Table 4

Schedule of Investments in Debt Securities – Primary Government – Credit Risk
June 30, 2007
(amounts in thousands)

Credit Rating as of Year End			
Short-term	**Long-term**	**Fair Value**	
Pooled investments*			
A-1+/P-1/F-1+	AAA/Aaa/AAA	$ 35,274,735	**
A-1/P-1/F-1	AA/Aa/AA	8,026,780	
A-2/P-2/F-2	A/A/A	1,676,428	
Not rated		840,753	
Not applicable		3,992,721	
Total pooled investments		$ **49,811,417**	***
Other primary government investments			
A-1+/P-1/F-1+	AAA/Aaa/AAA	$ 1,101,388	
A-1/P-1/F-1	AA/Aa/AA	772,659	
A-2/P-2/F-2	A/A/A	769,220	
Not rated		549,548	
Not applicable		1,855,312	
Total other primary government investments		**$ 5,048,127**	

* The State Treasurer's Office utilizes Standard & Poor's, Moody's, and Fitch ratings services. Securities are classified by the lowest rating of the three agencies.

** This amount includes $6.6 billion in Freddie Mac-issued debt. Freddie Mac has not requested that all of its debt be rated, but all debt that has been rated received S&P's and Moody's top ratings.

*** Total pooled investments does not include certain assets of the State's pooled investment program. The other assets include time deposits of $8.7 billion, for which credit risk is mitigated by collateral that the State holds for them—as discussed earlier in this note—and loans to State funds of $7.2 billion, for which external credit risk is not applicable because they are internal loans.

3. Concentration of Credit Risk

The investment policy of the State Treasurer's Office contains no limitations on the amount that can be invested in any one issuer beyond those limitations stipulated in the California Government Code. Table 5 identifies debt securities in any one issuer (other than U.S. Treasury securities) that represent 5% or more of the State Treasurer's investments, or of the separate investments of other primary government funds.

Table 5

Schedule of Investments – Primary Government – Concentration of Credit Risk
June 30, 2007
(amounts in thousands)

POOLED INVESTMENTS

Issuer	Investment Type	Reported Amount	% of Total Pooled Investments
Federal Home Loan Mortgage Corp.	U.S. agency securities	$ 6,553,214	13.16 %
Federal Home Loan Bank	U.S. agency securities	5,831,586	11.71
Citigroup, Inc	Corporate Bonds/Commercial Paper	2,743,368	5.51
General Electric Capital/GE Company	Corporate Bonds/Commercial Paper	2,649,884	5.32

OTHER PRIMARY GOVERNMENT INVESTMENTS

Issuer	Investment Type	Reported Amount	% of Total Agency Investments
Golden State Tobacco Securitization Corporation			
Coral	Commercial paper	$ 58,378	12.39 %
Briarwood	Commercial paper	63,514	13.48
Morgan Stanley	Commercial paper	74,633	15.84
Security Benefit Life Insurance	Commercial paper	65,021	13.80
Curzon	Commercial paper	63,985	13.58
Chesham	Commercial paper	74,633	15.84
Natexis Banques Populaires	Commercial paper	65,870	13.98
Department of Water Resources			
Federal Home Loan Mortgage Corp.	U.S. agency securities	$ 50,722	41.61 %

4. Custodial Credit Risk

The State of California has a deposit policy for custodial credit risk that requires deposits held by financial institutions to be insured by federal depository insurance or secured by collateral. As of June 30, 2007, $24 million in deposits of the Electric Power Fund were uninsured and uncollateralized.

B. Fiduciary Funds

The fiduciary funds include pension and other employee benefit trust funds of the following fiduciary funds and component units: the California Public Employees' Retirement System (CalPERS), the California State Teachers' Retirement System (CalSTRS), the fund for the California Scholarshare program, and various other funds. CalPERS and CalSTRS account for 98% of these separately invested funds.

CalPERS and CalSTRS exercise their authority under the State Constitution and invest in stocks, bonds, mortgages, real estate, and other investments.

CalPERS reports investments in securities at fair value, generally based on published market prices and quotations from major investment firms. Many factors are considered in arriving at fair value. In general, however, corporate bonds are valued based on yields currently available on comparable securities of issuers with similar credit ratings. Investments in certain restricted common stocks are valued at the quoted market price of the issuer's unrestricted common stock, less an appropriate discount.

CalPERS' mortgages are valued on the basis of their future principal and interest payments, discounted at prevailing interest rates for similar instruments. The fair value of real estate investments, principally rental property subject to long-term net leases, is estimated based on independent appraisals. Short-term investments are reported at market value, when available, or, when market value is not available, at cost plus accrued interest, which approximates market value. For investments where no readily ascertainable market value exists, management, in consultation with its investment advisors, determines the fair values for the individual investments.

Under the State Constitution and statutory provisions governing CalPERS' investment authority, CalPERS, through its outside investment managers, holds investments in futures and options and enters into forward foreign currency exchange contracts. CalPERS held for investment purposes futures and options with a fair value of approximately $30 million as of June 30, 2007. Gains and losses on futures and options are determined based upon quoted market values and recorded in the statement of changes in fiduciary net assets.

Due to the level of risk associated with certain derivative investment securities, it is reasonably possible that investment securities values will change in the near term; such changes could materially affect the amounts reported in the financial statements.

CalPERS uses forward foreign currency exchange contracts primarily to hedge against changes in exchange rates related to foreign securities. As of June 30, 2007, CalPERS had an approximately $30 million net exposure to loss from forward foreign currency exchange transactions related to the approximately $54.8 billion international debt and equity portfolios. CalPERS could be exposed to risk if the counterparties to the contracts are unable to meet the terms of the contracts. CalPERS investment managers seek to control this risk through counterparty credit evaluations and approvals, counterparty credit limits, and exposure monitoring procedures. CalPERS anticipates that the counterparties will be able to satisfy their obligations under the contracts.

CalSTRS also reports investments at fair value, generally based on published market prices and quotations from major investment firms for securities. Mortgages are valued based on future principal and interest payments, and are discounted at prevailing interest rates for similar instruments. Real estate equity investment fair values are based on either recent estimates provided by CalSTRS' contract real estate advisors or by independent appraisers. Short-term investments are reported at cost or amortized cost, which approximates

fair value. Fair value for commingled funds (other than those funds traded on a national or international exchange) is based on information provided by the applicable fund managers. Alternative investments represent interests in private equity partnerships that CalSTRS enters into under a limited partnership agreement. For alternative investments and other investments for which no readily ascertainable market value exists, CalSTRS management, in consultation with its investment advisors, has determined the fair value for the individual investments. Purchases and sales are recorded on the trade date.

The State Constitution, state statutes, and board policies permit CalPERS and CalSTRS to lend their securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. Third-party securities lending agents are under contract to lend domestic and international equity and debt securities. For both CalPERS and CalSTRS, collateral, in the form of cash or other securities, is required at 102% and 105% of the fair value of domestic and international securities loaned, respectively. CalPERS' management believes that CalPERS has minimized its credit risk exposure by requiring the borrowers to provide collateral greater than 100% of the market value of the securities loaned. The securities loaned are priced daily. Securities on loan can be recalled on demand by CalPERS and loans of securities may be terminated by CalPERS or the borrower.

For CalPERS, the weighted average maturities of the collateral invested by two externally managed portfolios and two internally managed portfolios were 46 days, 158 days, 547 days, and 410 days. In accordance with CalPERS' investment guidelines, the cash collateral was invested in short-term investment funds that, at June 30, 2007, had durations of 1 day, 18 days, 36 days, and 40 days, for two externally managed portfolios and two internally managed portfolios.

For CalSTRS, collateral received on each security loan was placed in investments that, at June 30, 2007, had a 25-day difference in weighted average maturity between the investments and loans. Most of CalSTRS' security loans can be terminated on demand by CalSTRS or the borrower. As of June 30, 2007, CalSTRS has no credit risk exposure to borrowers because the amounts it owes the borrowers exceed the amounts the borrowers owe it. CalSTRS is not permitted to pledge or sell collateral securities received unless the borrower defaults. The contracts with the security lending agents require them to indemnify CalSTRS if the borrowers fail to return the securities (or if the collateral is not sufficient to replace the securities lent) or if the borrowers fail to pay CalSTRS for income distributions by the securities' issuers while the securities are on loan.

Table 6 presents the investments of the fiduciary funds by investment type.

Table 6

Schedule of Investments - Fiduciary Funds
June 30, 2007
(amounts in thousands)

Investment Type	Fair Value
Equity securities	$ 256,590,799
Debt securities*	101,817,056
Investment contracts	735,404
Mutual funds	7,761,185
Real estate	38,113,015
Insurance contracts	322,606
Private equity	29,456,424
Securities lending collateral	78,404,152
Other	1,203,057
Total investments	**$ 514,403,698**

* Debt securities include short-term investments not included in Cash and Pooled Investments.

1. Interest Rate Risk

CalPERS and CalSTRS manage the interest rate risk inherent in their investment portfolios by measuring the effective or option-adjusted duration of the portfolio. In using the duration method, these agencies may make assumptions regarding the timing of cash flows or other factors that affect interest rate risk information. The CalPERS investment policies require the option-adjusted duration of the total fixed-income portfolio to stay within 20% of the option adjusted duration of its benchmark (Lehman Brothers Long Liabilities). All individual portfolios are required to maintain a specific level of risk relative to their benchmark. Risk exposures are monitored daily. The CalSTRS investment guidelines allow the internally managed long-term investment grade portfolios the discretion to deviate within plus or minus .50 years from the effective duration of the relevant Lehman Brothers benchmark. The permissible range of deviation for the effective duration within the high yield portfolios is negotiated with each of the high yield managers and detailed in the investment guidelines. The CalSTRS investment guidelines state that 50% of the portfolio shall reflect an expected-maturity, first-call date or first-reset date to fall within a 0-30 day range and/or be invested in U.S. government and agency obligations.

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Table 7 presents the interest rate risk of the fixed-income securities of these fiduciary funds.

Table 7

Schedule of Investments in Fixed-Income Securities - Fiduciary Funds - Interest Rate Risk
June 30, 2007
(amounts in thousands)

	Fair Value at Year End	Effective Duration**
California Public Employees' Retirement Fund *		
U.S. Treasuries and agencies	$ 16,650,258	9.01
Mortgages	25,256,693	6.39
Corporate	13,447,274	8.69
Asset-backed	1,322,684	3.65
Private placement	9,161	2.06
International	6,778,416	6.96
Not rated ***	3,323,270	N/A
Total	**$ 66,787,756**	
Deferred Compensation Plan Fund		
Investment contracts	$ 735,404	5.49
Scholarshare Program Trust Fund		
Investment contracts	$ 322,606	3.38
California State Teachers' Retirement System		
Long-term fixed-income investments		
U.S. Government and agency obligations	$ 6,985,280	4.44
Corporate	7,362,539	5.89
High yield	2,439,546	3.76
Debt core plus	5,289,592	4.81
Asset-backed securities	621,379	2.76
Commercial mortgage-backed securities	1,651,684	4.80
Mortgage-backed securities	10,904,463	4.17
Total	**$ 35,254,483**	

	0-30 days	31-90 days	91-120 days
Short-term fixed-income investments			
Money market securities	$ 615,022	$ 242,909	$ 79,608
Corporate bonds	—	15,000	14,997
Corporate floating-rate notes	101,601	179,545	17,000
U.S. Government and agency obligations			
Noncallables	40,000	10,000	—
Discount notes	24,957	124,138	49,254
Callable	49,235	166,652	10,000
U.S. Treasury	—	24,712	49,244
Asset-backed securities	22,832	26,444	—
Total	**$ 853,647**	**$ 789,400**	**$ 220,103**

* Includes investments of fiduciary funds and certain discretely presented component units that CalPERS administers.
** Effective duration is described in the paragraph preceding this table.
*** Securities held in externally managed investment pools or in default.

121-180 days	181-365 days	366+ days	Fair Value at Year End
$ —	$ —	$ —	$ 937,539
—	—	—	29,997
—	25,000	—	323,146
—	—	—	50,000
24,571	62,704	—	285,624
13,984	—	—	239,871
98,285	48,804	4,976	226,021
—	—	—	49,276
$ 136,840	**$ 136,508**	**$ 4,976**	**$ 2,141,474**

2. Credit Risk

The CalPERS investment policies require that 90% of the total fixed-income portfolio be invested in investment-grade securities. Investment-grade securities are those fixed-income securities with a Moody's rating of AAA to BAA or a Standard and Poor's rating of AAA to BBB. Each portfolio is required to maintain a specified risk level. Portfolio exposures are monitored daily. The CalSTRS investment guidelines require that the lowest long-term credit rating of securities eligible for purchase by the internally managed fixed-income assets be Baa3 by Moody's Investor Services or BBB- by Standard and Poor's Corporation (i.e., investment grade by at least one major rating agency). Furthermore, the total position of the outstanding debt of any one issuer shall be limited to 10% of the market value of the portfolio. The investment guidelines also include an allocation to high yield assets that are managed externally and allow for the purchase of bonds rated below investment grade. Limitations on the amount of debt of any one issuer a manager may hold are negotiated on a manager-by-manager basis.

Table 8 presents the credit risk of the fixed-income securities of these fiduciary funds.

Table 8

Schedule of Investments in Fixed-Income Securities – Fiduciary Funds – Credit Risk
June 30, 2007
(amounts in thousands)

Credit Rating as of Year End		
Short-term	**Long-term**	**Fair Value**
A-1+/P-1/F-1+	AAA/Aaa/AAA	$ 52,703,294
A-1/P-1/F-1	AA/Aa/AA	17,876,011
A-2/P-2/F-2	A/A/A	12,640,373
A-3/P-3/F-3	BBB/Baa/BBB	11,492,807
B/NP/B	BB/Ba/BB	1,472,108
B/NP/B	B/B/B	1,710,671
C/NP/C	CCC/Caa/CCC	580,115
C/NP/C	CC/Ca/CC	63
D/NP/D	D/D/D	19,079
Not rated		18,384,152
Not applicable		20,080,413
Total fixed-income securities		**$ 136,959,086**

3. Concentration of Credit Risk

The Deferred Compensation Plan Fund held $735 million in investment contracts of Dwight Asset Management Company, which represented 10.3% of the fund's total investments as of June 30, 2007. The Scholarshare Program Trust Fund held $323 million in investment contracts of TIAA-CREF Life Insurance Company, which represented 11.82% of the fund's total investments as of June 20, 2007.

CalPERS and CalSTRS did not have investments in a single issuer that represented 5% or more of total fair value of all investments.

4. Custodial Credit Risk

CalPERS and CalSTRS have policies or practices to minimize custodial risk, and their investments at June 30, 2007, were not exposed to custodial risk.

5. Foreign Currency Risk

At June 30, 2007, CalPERS and CalSTRS held $22.3 billion and $34.5 billion, respectively, in investments subject to foreign currency risk. CalPERS' asset allocation and investment policies allow for active and passive investments in international securities. CalPERS' target allocation is to have 33% of total global equity assets invested in international equities and 11.5% of total fixed-income invested in international securities. Real estate and alternative investments do not have a target allocation for international investment. CalPERS uses a currency overlay program to reduce risk by hedging approximately 25% of the developed market international equity portfolio. Its currency exposures are monitored daily. CalSTRS believes that its Currency Management Program should emphasize the protection of the value of its non-dollar public and private equity assets against a strengthening U.S. dollar first, yet recognizes that opportunities also exist for alpha generation (the ability to derive a return in excess of a market return) within the currency markets. CalSTRS' fixed-income staff has management responsibilities for the Currency Management Program. The hedging range has been designed to allow for some degree of symmetry around the unhedged program benchmark in order to enable the Currency Management Program to both protect the translation value fo the assets against a strengthening U.S. dollar and to enhance returns in a declining U.S. dollar environment. As a result, the hedging range is -25% to 50% of the total market value of the non-dollar public and private equity portfolios.

Table 9 identifies the investments of the fiduciary funds that are subject to foreign currency risk.

Table 9

Schedule of Investments - Fiduciary Funds - Foreign Currency Risk
June 30, 2007
(amounts in thousands of U.S. dollars at fair value)

Currency	Cash	Equity	Alternative	Fixed Income	Real Estate	Currency Overlay	Total
Argentine Peso	$ 1,472	$ —	$ —	$ —	$ —	$ —	$ 1,472
Australian Dollar	15,648	2,206,914	35,355	168,733	262	(174,691)	2,252,221
Brazilian Real	4,113	1,029,241	—	25,543	—	(14,107)	1,044,790
British Pound Sterling	70,256	8,339,621	479,827	487,097	14,727	(479,744)	8,911,784
Canadian Dollar	22,173	1,710,414	81,431	100,606	—	(85,247)	1,829,377
Chilean Peso	2,759	55,571	—	—	—	—	58,330
Columbian Peso	—	—	—	867	—	—	867
Czech Koruna	609	32,809	—	—	—	(428)	32,990
Danish Krone	7,382	299,071	804	179,296	—	—	486,553
Egyptian Pound	293	110,532	—	—	—	—	110,825
Euro	233,949	17,872,122	1,208,531	1,559,306	—	(961,676)	19,912,232
Hong Kong Dollar	13,941	1,675,095	—	—	481	(8,192)	1,681,325
Hungarian Forint	992	177,127	—	1,944	—	(12,805)	167,258
Indian Rupee	2,730	751,406	—	—	—	—	754,136
Indonesian Rupiah	918	232,142	—	—	—	—	233,060
Israeli Shekel	1,061	219,021	—	1	—	—	220,083
Japanese Yen	70,352	7,531,594	24,426	587,825	812	(41,317)	8,173,692
Malaysian Ringgit	188	308,151	—	—	—	—	308,339
Mexican Peso	1,157	619,465	—	13,652	—	(67,730)	566,544
Moroccan Dirham	—	104	—	—	—	—	104
New Russian Ruble	—	—	—	—	—	(25,491)	(25,491)
New Zealand Dollar	198	57,377	—	35,747	—	(22,330)	70,992
Norwegian Krone	4,906	551,051	—	33,658	—	(40,788)	548,827
Philippine Peso	18,757	84,672	—	—	—	—	103,429
Polish Zloty	303	99,260	—	61,262	—	(80,832)	79,993
Singapore Dollar	6,038	581,364	—	—	713	(121)	587,994
South African Rand	9,697	958,743	—	—	—	—	968,440
South Korean Won	1,545	2,111,092	—	32,215	—	—	2,144,852
Sri Lanka Rupee	—	724	—	—	—	—	724
Swedish Krona	12,772	1,074,035	—	51,698	—	(711)	1,137,794
Swiss Franc	14,562	2,607,003	394	—	—	(39,261)	2,582,698
Taiwan Dollar	18,221	1,601,068	—	—	—	—	1,619,289
Thailand Baht	3,321	320,697	—	—	—	—	324,018
Turkish New Lira	5,298	371,311	—	2,536	—	(6,133)	373,012
Total exposure to foreign currency risk	**$ 545,611**	**$ 53,588,797**	**$ 1,830,768**	**$ 3,341,986**	**$ 16,995**	**$ (2,061,604)**	**$ 57,262,553**

C. Discretely Presented Component Units

The discretely presented component units consist of the University of California and its foundations, the State Compensation Insurance Fund (SCIF), the California Housing Finance Agency (CalHFA), the Public Employees' Benefits Fund administered by CalPERS, and various funds that constitute less than 3% of the total investments of discretely presented component units. State law, bond resolutions, and investment policy resolutions allow component units to invest in U.S. government securities, state and municipal securities, commercial paper, corporate bonds, investment agreements, real estate, and other investments. Additionally, a portion of the cash and pooled investments of SCIF, CalHFA, and other component units is invested in the State Treasurer's pooled investment program.

The investments of the University of California, a discretely presented component unit, are primarily stated at fair value. Investments authorized by the regents include equity securities, fixed-income securities, and certain other asset classes. The equity portion of the investment portfolio includes domestic and foreign common and preferred stocks, which may be included in actively or passively managed strategies, along with a modest exposure to private equities. Private equities include venture capital partnerships, buy-outs, and international funds. The fixed-income portion of the investment portfolio may include both domestic and foreign securities, as well as certain securitized investments including mortgage-backed and asset-backed securities. Absolute return strategies, incorporating short sales, plus derivative positions to implement or hedge an investment position, are also authorized. Where donor agreements have placed constraints on allowable investments, assets associated with endowments are invested in accordance with the terms of the agreements.

The University of California participates in a securities lending program as a means to augment income. Campus foundations' cash, cash equivalents, and investments that are invested with the University of California and managed by the university's treasurer are included in the university's investment pools that participate in a securities lending program. The campus foundations' allocated share of the program's cash collateral received, investment of cash collateral, and collateral held for securities lending is determined based upon the foundations' equity in the investment pools. The Board of Trustees for each campus foundation may also authorize participation in a direct securities lending program. The university loans securities to selected brokerage firms and receives collateral that equals or exceeds the fair value of such investments during the period of the loan. Collateral may be cash or securities issued by the U.S. government or its agencies, or the sovereign or provincial debt of foreign countries. Collateral securities cannot be pledged or sold by the university unless the borrower defaults. Loans of domestic equities and all fixed-income securities are initially collateralized at 102% of the fair value of the securities loaned. Loans of foreign equities are initially collateralized at 105%. All borrowers are required to provide additional collateral by the next business day if the value falls to less than 100% of the fair value of the securities loaned. The university earns interest and dividends on the collateral held during the loan period, as well as a fee from the brokerage firm, and is obligated to pay a fee and a rebate to the borrower. The university receives the net investment income. As of June 30, 2007, the university had no exposure to borrowers because the amounts the it owed the borrowers exceeded the amounts the borrowers owed the university. The university is fully indemnified by its lending agents against any losses incurred as a result of borrower default.

Securities loans immediately terminate upon notice by either the university or the borrower. Cash collateral is invested by the university's lending agents in short-term investment pools in the university's name, with guidelines approved by the university. As of June 30, 2007, the securities in these pools had a weighted average maturity of 62 days.

The State Department of Insurance permits SCIF to lend a certain portion of its securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. A

third-party lending agent has been contracted to lend U.S. Treasury notes and bonds. Collateral, in the form of cash and other securities, is adjusted daily and is required at all times to equal at least 100% of the fair value of securities loaned. Collateral securities received cannot be pledged or sold unless the borrower defaults. The maximum loan term is one year. In accordance with SCIF's investment guidelines, cash collateral is invested in short-term investments, with maturities matching the related loans. Interest income on these investments is shared by the borrower, the third-party lending agent, and SCIF. As of December 31, 2006, the aggregate fair value of the loaned securities and the cash collateral received in respect to these loans was $1.77 billion and $1.80 billion, respectively.

Table 10 presents the investments of the discretely presented component units by investment type.

Table 10

Schedule of Investments – Discretely Presented Component Units
June 30, 2007
(amounts in thousands)

Investment Type	Fair Value
Equity securities	$ 5,172,660
Debt securities*	32,276,453
Investment contracts	857,981
Mutual funds	4,692,124
Real estate	487,251
Money market securities	453,824
Private equity	586,929
Mortgage loans	403,684
Externally held irrevocable trusts	302,374
Securities lending collateral	4,920,992
Invested for others	(1,354,776)
Other	1,483,096
Total investments	**$ 50,282,592**

* Debt securities include short-term investments not included in Cash and Pooled Investments.

1. Interest Rate Risk

Interest rate risk for the University of California's short-term investment pool is managed by constraining the maturity of all individual securities to be less than five and one-half years. There is no restriction on weighted average maturity of the portfolio, as it is managed relative to the liquidity demands of the investors. Portfolio guidelines for the fixed-income portion of the university's general endowment pool limit weighted average effective duration to the effective duration of the Lehman Aggregate Index, plus or minus 20%.

SCIF guidelines provide that not less than 15% of its total assets shall be maintained in cash or in securities maturing in five years or less. For information about CalPERS' policies related to interest rate risk, refer to Section B, Fiduciary Funds.

Table 11 presents the interest rate risk of the fixed-income or variable-income securities of the major discretely presented component units.

Table 11

Schedule of Investments in Fixed-Income or Variable-Income Securities - Discretely Presented Component Units - Interest Rate Risk
June 30, 2007
(amounts in thousands)

	University of California		University of California Foundations	
Investment Type	**Fair Value at Year End**	**Effective Duration**	**Fair Value at Year End**	**Effective Duration**
U.S. Treasury bills, notes, and bonds	$ 1,379,320	1.60	$ 132,579	4.40
U.S. Treasury strips	16,916	13.60	—	—
U.S. TIPS	404,913	5.40	—	—
U.S. government-backed securities	3,577	6.30	5,529	3.60
U.S. government-backed asset-backed securities	—	—	15	3.30
Corporate bonds	2,620,866	2.30	47,703	4.40
Commercial paper	1,245,777	0.00	—	—
U.S. agencies	2,335,213	1.30	84,693	2.60
U.S. agencies asset-backed securities	170,956	5.30	2,450	3.90
Corporate asset-backed securities	92,603	1.70	10,868	0.60
Supranational/foreign	917,248	2.50	622	1.00
Other	205	0.90	815	3.00
Government/Sovereign(foreign currency denominated)	165,557	6.30	—	—
Corporate (foreign currency denominated)	6,405	12.40	—	—
U.S. bond funds	36,887	4.70	207,542	4.90
Non-U.S. bond funds	—	—	7,879	5.70
Money market funds	25,187	0.00	395,711	1.20
Mortgage loans	395,791	0.00	7,893	0.00
Total	**$ 9,817,421**		**$ 904,299**	

	State Compensation Insurance Fund		California Housing Finance Agency	
Investment Type	**Fair Value at Year End**	**Weighted Average Maturity**	**Fair Value at Year End**	**Effective Duration**
U.S. Treasury and agency securities	$ 5,747,006	2.05	$ 54,966	9.38
Municipal securities	413,499	6.52	—	—
Public utilities	412,624	6.70	—	—
Corporate bonds	6,288,330	4.29	—	—
Commercial paper	994,561	0.07	59,679	0.10
Certificate of deposit	234,521	0.49	—	—
Special revenue	908,582	11.01	—	—
Other government	48,491	1.92	—	—
Mortgage-backed securities	6,062,612	22.02	—	—
Mutual funds	311,435	0.06	—	—
Total	**$ 21,421,661**		**$ 114,645**	

Table 12 identifies the debt securities that are highly sensitive to interest rate fluctuations (to a greater degree than already indicated in the information provided previously) because of the existence of prepayment or conversion features, although the effective duration of these securities may be low.

Table 12

Schedule of Highly Sensitive Investments in Debt Securities – University of California and its Foundations – Interest Rate Risk
June 30, 2007
(amounts in thousands)

	University of California		University of California Foundations	
	Fair Value at Year End	Effective Duration	Fair Value at Year End	Effective Duration
Mortgage-Backed Securities These securities are primarily issued by the Federal National Mortgage Association (Fannie Mae), Government National Mortgage Association (Ginnie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac) and include short embedded prepayment options. Unanticipated prepayments by the obligees of the underlying asset reduce the total expected rate of return.	$ 263,559	4.00	$ 69,504	2.70
Collateralized Mortgage Obligations Collateralized mortgage obligations (CMOs) generate a return based upon either the payment of interest or principal on mortgages in an underlying pool. The relationship between interest rates and prepayments makes the fair value highly sensitive to changes in interest rates. In falling interest rate environments, the underlying mortgages are subject to a higher propensity of prepayments. In a rising interest rate environment, the underlying mortgages are subject to a lower propensity of prepayments.			12,185	1.90
Other Asset-Backed Securities Other asset-backed securities also generate a return based upon either the payment of interest or principal on obligations in an underlying pool, generally associated with auto loans or credit cards. As with CMOs, the relationship between interest rates and prepayments makes the fair value highly sensitive to changes in interest rates.			10,868	0.70
Variable-Rate Securities These securities are investments with terms that provide for the adjustment of their interest rates on set dates and are expected to have fair values that will be relatively unaffected by interest rate changes. Variable-rate securities may have limits on how high or low the interest may change. These constraints may affect the market value of the security.	566,833	0.50		
Callable Bonds Although bonds are issued with clearly defined maturities, an issuer may be able to redeem, or call, a bond earlier than its maturity date. The university must then replace the called bond with a bond that may have a lower yield than the original. The call feature causes the fair value to be highly sensitive to changes in interest rates.	1,992,692	1.70	798	4.60

2. Credit Risk

The investment guidelines for the University of California's short-term investment pool provide that no more than 5% of the total market value of the pool's portfolio may be invested in securities rated below investment grade (BB, Ba, or lower). The average credit quality of the pool must be A or better and commercial paper must be rated at least A-1, P-1 or F-1. For its general endowment pool, the university uses a fixed-income benchmark, the Lehman Aggregate Index, which is comprised of approximately 30% high grade corporate bonds and 30% to 35% mortgage/asset-backed securities, all of which carry some degree of credit risk. The remaining 35% to 40% are government-issued bonds. Credit risk in this pool is managed primarily by diversifying across issuers, and portfolio guidelines mandate that no more than 10% of the market value of fixed-income securities may be invested in issues with credit ratings below investment grade. Further, the weighted average credit rating must be A or higher.

SCIF investment guidelines provide that securities issued and/or guaranteed by the government of Canada and its political subdivisions must be rated AA or equivalent by a nationally recognized rating service, provided the rating of the other service, if it has a rating, is not less than AA. Securities issued and/or guaranteed by a state or its political subdivision must be rated A or equivalent by a nationally recognized rating service, provided the rating of the other service, if it has a rating, is not less than A. Securities issued by a qualifying corporation must be rated A or equivalent by a nationally recognized rating service, provided the rating of the other service, if it has a rating, is not less than A.

Table 13 presents the credit risk of the fixed-income or variable-income securities of the major discretely presented component units.

Table 13

Schedule of Investments in Fixed-Income or Variable-Income Securities – Major Discretely Presented Component Units – Credit Risk
June 30, 2007
(amounts in thousands)

Credit Rating as of Year End		
Short-term	**Long-term**	**Fair Value**
A-1+/P-1/F-1+	AAA/Aaa/AAA	$ 16,341,291
A-1/P-1/F-1	AA/Aa/AA	6,721,259
A-2/P-2/F-2	A/A/A	5,443,963
A-3/P-3/F-3	BBB/Baa/BBB	1,181,210
B/NP/B	BB/Ba/BB	152,765
B/NP/B	B/B/B	131,579
C/NP/C	CCC/Caa/CCC	559
Not rated		1,097,320
Total fixed-income securities		**$ 31,069,946**

3. Concentration of Credit Risk

Investment guidelines addressing concentration of credit risk related to the investment-grade fixed-income portion of the University of California's portfolio include a limit of no more than 3% of the portfolio's market value to be invested in any single issuer (except for securities issued by the U.S. government or its agencies). These same guidelines apply to the university's short-term investment pool. Each campus foundation may

have its own individual investment policy designed to limit exposure to a concentration of credit risk. The University of California held $1.3 billion in federal agency securities of the Federal National Mortgage Association and $1.2 billion in Federal agency securities of the Federal Home Loan Mortgage Corporation, which represented 9.10% and 8.63%, respectively, of the university's total investments as of June 30, 2007.

4. Custodial Credit Risk

The University of California's securities are registered in the university's name by the custodial bank as an agent for the university. Other types of investments represent ownership interests that do not exist in physical or book-entry form. As a result, custodial credit risk is remote. Some of the investments of certain University of California campus foundations are exposed to custodial credit risk. These investments may be uninsured or not registered in the name of the campus foundation and held by a custodian.

Table 14 presents the investments of the major discretely presented component units subject to custodial credit risk.

Table 14

Schedule of Investments – University of California Foundations – Custodial Credit Risk
June 30, 2007
(amounts in thousands)

	Fair Value
Investment Type	
Domestic equity securities	$ 173,916
Foreign equity securities	20,397
U.S. Treasury bills, notes, and bonds	98,041
U.S. agencies	3,625
Total exposure to custodial credit risk	**$ 295,979**

5. Foreign Currency Risk

The University of California's portfolio guidelines for U.S. investment-grade fixed-income securities allow exposure to non-U.S. dollar denominated bonds up to 10% of the total portfolio market value. Exposure to foreign currency risk from these securities may be fully or partially hedged using forward foreign currency exchange contracts. Under the university's investment policies, such instruments are not permitted for speculative use or to create leverage.

Table 15 identifies the investments of the University of California – including its campus foundations – that are subject to foreign currency risk.

Table 15

Schedule of Investments – University of California – Foreign Currency Risk
June 30, 2007
(amounts in thousands of U.S. dollars at fair value)

Currency	Equity	Fixed-Income	Total
Australian Dollar	$ 66,169	$ 713	$ 66,882
British Pound Sterling	308,192	12,609	320,801
Canadian Dollar	73,153	6,759	79,912
Danish Krone	9,509	1,528	11,037
Euro	493,453	88,094	581,547
Hong Kong Dollar	34,413	—	34,413
Japanese Yen	271,048	56,438	327,486
New Zealand Dollar	2,637	—	2,637
Norwegian Krone	12,125	545	12,670
Polish Zloty	—	1,683	1,683
Singapore Dollar	16,106	627	16,733
South African Rand	1,677	—	1,677
South Korean Won	6,260	—	6,260
Swedish Krona	28,604	1,467	30,071
Swiss Franc	106,197	1,499	107,696
Thailand Baht	2,550	—	2,550
Other	23,283	—	23,283
Commingled currencies	1,226,993	2,999	1,229,992
Total exposure to foreign currency risk	**$ 2,682,369**	**$ 174,961**	**$ 2,857,330**

NOTE 4: ACCOUNTS RECEIVABLE

Table 16 presents the disaggregation of accounts receivable attributable to taxes, interest expense reimbursements, Lottery retailer collections, and unemployment program receipts. Other receivables are for interest, gifts, grants, various fees, penalties, and other charges. The adjustment for the fiduciary funds represents amounts due from fiduciary funds that were reclassified as external receivables on the government-wide Statement of Net Assets.

Table 16

Schedule of Accounts Receivable
June 30, 2007
(amounts in thousands)

	Taxes	Reimbursement of Accrued Interest Expense	Lottery Retailers	Unemployment Programs	Other	Total
Current governmental activities						
General Fund	$ 7,910,704	$ —	$ —	$ —	$ 531,357	$ 8,442,061
Federal Fund	—	—	—	—	1,854	1,854
Transportation Construction Fund	343,375	—	—	—	58,065	401,440
Nonmajor governmental funds	99,605	142	—	—	1,164,390	1,264,137
Internal service funds	—	—	—	—	117,209	117,209
Adjustment:						
Fiduciary funds	—	—	—	—	14,547	14,547
Total current governmental activities	**$ 8,353,684**	**$ 142**	**$ —**	**$ —**	**$ 1,887,422**	**$ 10,241,248**
Amounts not scheduled for collection during the subsequent year	**$ 1,227,511**	**$ —**	**$ —**	**$ —**	**$ 281,337**	**$ 1,508,848**
Current business-type activities						
Water Resources Fund	$ —	$ —	$ —	$ —	$ 151,009	$ 151,009
Public Buildings Construction Fund	—	133,157	—	—	—	133,157
State Lottery Fund	—	—	225,278	—	—	225,278
Unemployment Programs Fund	—	—	—	152,488	—	152,488
Nonmajor enterprise funds	—	—	—	—	31,079	31,079
Adjustment:						
Account reclassification	—	(132,535)	—	—	(1,993)	(134,528)
Total current business-type activities	**$ —**	**$ 622**	**$ 225,278**	**$ 152,488**	**$ 180,095**	**$ 558,483**
Amounts not scheduled for collection during the subsequent year	**$ —**	**$ —**	**$ —**	**$ 26,854**	**$ —**	**$ 26,854**

NOTE 5: RESTRICTED ASSETS

Table 17 presents a summary of the legal restrictions placed on assets in the enterprise funds of the primary government and the discretely presented component units.

Table 17

Schedule of Restricted Assets
June 30, 2007
(amounts in thousands)

	Cash and Pooled Investments	Investments	Due From Other Governments	Loans Receivable	Total
Primary government					
Debt service	$ 1,071,211	$ 711,197	$ 55,965	$ 512,173	$ 2,350,546
Construction	140,212	—	—	—	140,212
Operations	1,784,305	—	—	—	1,784,305
Other	17,712	23,551	—	—	41,263
Total primary government	**3,013,440**	**734,748**	**55,965**	**512,173**	**4,316,326**
Discretely presented component units					
Nonmajor component units – debt service	136,650	109,165	—	—	245,815
Total discretely presented component units	**136,650**	**109,165**	**—**	**—**	**245,815**
Total restricted assets	**$ 3,150,090**	**$ 843,913**	**$ 55,965**	**$ 512,173**	**$ 4,562,141**

NOTE 6: NET INVESTMENT IN DIRECT FINANCING LEASES

The State Public Works Board, an agency that accounts for its activities as an enterprise fund, has entered into lease-purchase agreements with various other primary government agencies, the University of California, and certain local agencies. Payments from these leases will be used to satisfy the principal and interest requirements of revenue bonds issued by the State Public Works Board.

Table 18 summarizes the minimum lease payments to be received by the State Public Works Board for the primary government.

Table 18

Schedule of Minimum Lease Payments to be received by the State Public Works Board for the Primary Government

(amounts in thousands)

Year Ending June 30	Primary Government Agencies	University of California	Local Agencies	Total
2008	$ 471,116	$ 167,477	$ 69,674	$ 708,267
2009	464,313	165,138	69,408	698,859
2010	448,077	157,749	68,627	674,453
2011	422,061	157,622	67,297	646,980
2012	411,902	157,704	63,235	632,841
2013-2017	1,994,875	688,423	276,499	2,959,797
2018-2022	1,401,006	591,927	90,747	2,083,680
2023-2027	833,018	301,381	56,472	1,190,871
2028-2032	277,702	165,499	43,317	486,518
Total minimum lease payments	**6,724,070**	**2,552,920**	**805,276**	**10,082,266**
Less: unearned income	2,456,355	910,619	245,452	3,612,426
Net investment in direct financing leases	**$ 4,267,715**	**$ 1,642,301**	**$ 559,824**	**$ 6,469,840**

NOTE 7: CAPITAL ASSETS

Table 19 summarizes the capital activity for the primary government, which includes $5.8 billion in capital assets related to capital leases.

Table 19

Schedule of Changes in Capital Assets – Primary Government
June 30, 2007
(amounts in thousands)

	Beginning Balance (Restated)	Additions	Deductions	Ending Balance
Governmental activities				
Capital assets not being depreciated				
Land	$ 15,238,079	$ 342,810	$ 70,457	$ 15,510,432
State highway infrastructure	55,725,491	354,887	89,161	55,991,217
Collections	20,442	346	106	20,682
Construction in progress	6,441,427	2,357,698	922,229	7,876,896
Total capital assets not being depreciated	**77,425,439**	**3,055,741**	**1,081,953**	**79,399,227**
Capital assets being depreciated				
Buildings and improvements	15,522,036	876,632	75,390	16,323,278
Infrastructure	516,608	50,741	719	566,630
Equipment and other assets	3,946,955	388,099	216,282	4,118,772
Total capital assets being depreciated	**19,985,599**	**1,315,472**	**292,391**	**21,008,680**
Less accumulated depreciation for:				
Buildings and improvements	5,019,972	433,662	37,692	5,415,942
Infrastructure	149,312	24,345	107	173,550
Equipment and other assets	2,936,628	278,103	214,478	3,000,253
Total accumulated depreciation	**8,105,912**	**736,110**	**252,277**	**8,589,745**
Total capital assets being depreciated, net	**11,879,687**	**579,362**	**40,114**	**12,418,935**
Governmental activities, capital assets, net	**$ 89,305,126**	**$ 3,635,103**	**$ 1,122,067**	**$ 91,818,162**
Business-type activities				
Capital assets not being depreciated				
Land	$ 46,766	$ —	$ —	$ 46,766
Collections	39	—	10	29
Construction in progress	891,503	623,380	338,233	1,176,650
Total capital assets not being depreciated	**938,308**	**623,380**	**338,243**	**1,223,445**
Capital assets being depreciated				
Buildings and improvements	7,049,754	278,629	955	7,327,428
Infrastructure	1,223,097	491	—	1,223,588
Equipment and other assets	95,706	18,875	3,951	110,630
Total capital assets being depreciated	**8,368,557**	**297,995**	**4,906**	**8,661,646**
Less accumulated depreciation for:				
Buildings and improvements	2,685,408	146,741	626	2,831,523
Infrastructure	697,180	18,584	—	715,764
Equipment and other assets	63,692	10,393	3,718	70,367
Total accumulated depreciation	**3,446,280**	**175,718**	**4,344**	**3,617,654**
Total capital assets being depreciated, net	**4,922,277**	**122,277**	**562**	**5,043,992**
Business-type activities, capital assets, net	**$ 5,860,585**	**$ 745,657**	**$ 338,805**	**$ 6,267,437**

Table 20 summarizes the depreciation expense charged to the activities of the primary government.

Table 20

Schedule of Depreciation Expense – Primary Government
June 30, 2007
(amounts in thousands)

	Amount
Governmental activities	
General government	$ 67,680
Education	215,432
Health and human services	45,598
Resources	48,170
State and consumer services	41,565
Business and transportation	114,095
Correctional programs	163,644
Internal service funds (charged to the activities that utilize the fund)	39,926
Total depreciation expense – governmental activities	**736,110**
Business-type activities	
Enterprise	**175,718**
Total primary government	**$ 911,828**

Table 21 summarizes the capital activity for discretely presented component units.

Table 21

Schedule of Changes in Capital Assets – Discretely Presented Component Units
June 30, 2007
(amounts in thousands)

	Beginning Balance	Additions	Deductions	Ending Balance
Capital assets not being depreciated				
Land	$ 666,904	$ 98,793	$ 3,468	$ 762,229
Collections	258,378	12,082	363	270,097
Construction in progress	3,234,846	805,247	73,851	3,966,242
Total capital assets not being depreciated	**4,160,128**	**916,122**	**77,682**	**4,998,568**
Capital assets being depreciated				
Buildings and improvements	17,352,629	1,272,301	115,869	18,509,061
Equipment and other depreciable assets	7,839,256	646,603	356,278	8,129,581
Infrastructure	398,481	34,844	80	433,245
Total capital assets being depreciated	**25,590,366**	**1,953,748**	**472,227**	**27,071,887**
Less accumulated depreciation for:				
Buildings and improvements	6,341,997	574,845	39,300	6,877,542
Equipment and other depreciable assets	5,238,283	550,600	313,971	5,474,912
Infrastructure	171,166	15,068	4	186,230
Total accumulated depreciation	**11,751,446**	**1,140,513**	**353,275**	**12,538,684**
Total capital assets being depreciated, net	**13,838,920**	**813,235**	**118,952**	**14,533,203**
Capital assets, net	**$ 17,999,048**	**$ 1,729,357**	**$ 196,634**	**$ 19,531,771**

NOTE 8: ACCOUNTS PAYABLE

Accounts payable are amounts due to taxpayers, vendors, customers, beneficiaries, and employees related to different programs. Table 22 presents details related to the accounts payable.

The adjustment for the fiduciary funds represents amounts due to fiduciary funds that were reclassified as external payables on the government-wide Statement of Net Assets.

Table 22

Schedule of Accounts Payable
June 30, 2007
(amounts in thousands)

	Education	Health and Human Services	Resources	Business and Transportation	General Government and Others	Total
Governmental activities						
General Fund	$ 161,844	$ 354,716	$ 165,836	$ 951	$ 409,673	$ 1,093,020
Federal Fund	180,074	571,502	81,677	293,216	197,028	1,323,497
Transportation Construction Fund	141	—	—	105,236	1,141	106,518
Nonmajor governmental funds	697,191	543,938	299,072	1,067,756	532,844	3,140,801
Internal service funds	—	—	11,297	—	188,971	200,268
Adjustment:						
Fiduciary funds	3,894,081	3,846,065	—	47,630	620,164	8,407,940
Total governmental activities	**$ 4,933,331**	**$ 5,316,221**	**$ 557,882**	**$ 1,514,789**	**$ 1,949,821**	**$ 14,272,044**
Business-type activities						
Electric Power Fund	$ —	$ —	$ 453,000	$ —	$ —	$ 453,000
Water Resources Fund	—	—	107,968	—	—	107,968
Public Building Construction Fund	—	—	—	—	18,005	18,005
State Lottery Fund	—	—	—	—	38,347	38,347
Unemployment Program Fund	—	—	—	—	5	5
Nonmajor enterprise funds	52,361	352	77	2,990	3,035	58,815
Adjustment:						
Fiduciary funds	—	—	—	—	25,819	25,819
Total business-type activities	**$ 52,361**	**$ 352**	**$ 561,045**	**$ 2,990**	**$ 85,211**	**$ 701,959**

NOTE 9: SHORT-TERM FINANCING

As part of its cash management program, the State regularly issues short-term obligations to meet cash flow needs. The State issues revenue anticipation notes (RANs) to partially fund timing differences between revenues and expenditures. A significant portion of the General Fund revenues are received in the latter half of the fiscal year, while disbursements are paid more evenly throughout the fiscal year. If additional external cash flow borrowing is required, the State issues revenue anticipation warrants (RAWs). On October 3, 2006, the State issued $1.5 billion of RANs to fund cash flow needs for the 2006-07 fiscal year. The RANs were repaid on June 29, 2007.

The California Housing Finance Agency, a discretely presented component unit, entered into an agreement with a financial institution to provide a line of credit for short-term borrowings of up to $100 million, which may increase up to $150 million. At June 30, 2007, draws totaling $5 million were outstanding.

NOTE 10: LONG-TERM OBLIGATIONS

As of June 30, 2007, the primary government had long-term obligations totaling $105.2 billion. Of that amount, $6.4 billion is due within one year. The $6.4 billion includes $1.2 billion in outstanding commercial paper that had been scheduled to be refunded by general obligation bonds issued during the fiscal year. This commercial paper was refunded in July 2007. The largest change in governmental activities long-term obligations is an increase of $3.3 billion in general obligation bonds payable. General obligation bonds payable increased because bond sales exceeded redemptions during the year.

The other long-term obligations for governmental activities consist of $1.9 billion for net pension obligations, $342 million owed for lawsuits, and the University of California unfunded pension liability of $69 million. The compensated absences will be liquidated by the General Fund, special revenue funds, capital projects funds, and internal service funds. Workers' compensation and capital leases will be liquidated by the General Fund, special revenue funds, and internal service funds. The General Fund will liquidate loans payable, net pension obligations, the Proposition 98 funding guarantee, lawsuits, reimbursement of costs incurred by local agencies and school districts for costs mandated by the State, and the University of California pension liability. The $547 million in other long-term obligations for business-type activities is mainly for advance collections. These other long-term obligations do not have required payment schedules or they will be paid when funds are appropriated. Table 23 summarizes the changes in the long-term obligations during the year ended June 30, 2007.

Table 23

Schedule of Changes in Long-term Obligations
(amounts in thousands)

	Balance July 1, 2006	Additions	Deductions	Balance June 30, 2007	Due Within One Year	Noncurrent Liabilities
Governmental activities						
Loans payable	$ 1,054,674	$ —	$ 128,819	$ 925,855	$ —	$ 925,855
Compensated absences payable	1,774,664	910,100	685,571	1,999,193	99,079	1,900,114
Certificates of participation and commercial paper	923,890	3,512,366	3,078,205	1,358,051	1,251,932	106,119
Capital lease obligations	4,466,828	177,698	298,347	4,346,179	298,993	4,047,186
General obligation bonds payable	47,003,817	10,227,060	6,961,435	50,269,442	2,045,103	48,224,339
Revenue bonds payable	7,300,638	4,471,717	3,762,571	8,009,784	127,191	7,882,593
Proposition 98 funding guarantee	4,247,600	—	283,000	3,964,600	300,000	3,664,600
Workers compensation	2,574,699	97,228	351,449	2,320,478	325,801	1,994,677
Mandated costs	2,845,568	425,330	1,204,020	2,066,878	78,931	1,987,947
Other long-term obligations	2,141,200 *	192,053	47,978	2,285,275	48,359	2,236,916
Total	**$ 74,333,578**	**$ 20,013,552**	**$ 16,801,395**	**$ 77,545,735**	**$ 4,575,389**	**$ 72,970,346**
Business-type activities						
Benefits payable	$ 14,008	$ —	$ 3,954	$ 10,054	$ 1,173	$ 8,881
Lottery prizes and annuities	2,221,064	1,940,954	2,149,041	2,012,977	630,374	1,382,603
Compensated absences payable	49,115	25,188	20,604	53,699	26,121	27,578
Certificates of participation and commercial paper	231,121	129,723	181,062	179,782	—	179,782
General obligation bonds payable	1,963,305	359,160	368,245	1,954,220	136,430	1,817,790
Revenue bonds payable	22,812,509	1,743,761	1,622,176	22,934,094	1,042,722	21,891,372
Other long-term obligations	565,967	59	19,459	546,567	5,745	540,822
Total	**$ 27,857,089**	**$ 4,198,845**	**$ 4,364,541**	**$ 27,691,393**	**$ 1,842,565**	**$ 25,848,828**

* Restated

NOTE 11: CERTIFICATES OF PARTICIPATION

Table 24 shows debt service requirements for certificates of participation, which are financed by lease payments from governmental activities. The certificates of participation were used to finance the acquisition and construction of a state office building.

Table 24

Schedule of Debt Service Requirements for Certificates of Participation – Primary Government
(amounts in thousands)

Year Ending June 30	Principal	Interest	Total
2008	$ 7,039	$ 2,604	$ 9,643
2009	6,743	2,895	9,638
2010	6,584	3,057	9,641
2011	6,654	2,986	9,640
2012	6,715	2,926	9,641
2013-2017	35,235	6,232	41,467
Total	**$ 68,970**	**$ 20,700**	**$ 89,670**

Table 25 shows debt service requirements for certificates of participation for the University of California, a discretely presented component unit.

Table 25

Schedule of Debt Service Requirements for Certificates of Participation – University of California – Discretely Presented Component Unit

(amounts in thousands)

Year Ending June 30	Principal	Interest	Total
2008	$ 4,020	$ 290	$ 4,310
2009	2,175	158	2,333
2010	2,270	67	2,337
Total	**$ 8,465**	**$ 515**	**$ 8,980**

NOTE 12: COMMERCIAL PAPER AND OTHER LONG-TERM BORROWINGS

The primary government has two commercial-paper-borrowing programs: a general obligation commercial paper program and an enterprise fund commercial paper program for the Department of Water Resources. Under the general obligation and enterprise fund programs, commercial paper may be issued at the prevailing market rate, not to exceed 11%, for periods not to exceed 270 days from the date of issuance. The proceeds from the issuance of commercial paper are restricted primarily for construction costs of general obligation bond program projects and certain state water projects. For both commercial-paper-borrowing programs, the commercial paper is retired by the issuance of long-term debt, so commercial paper is considered a noncurrent liability.

To provide liquidity for the programs, the State has entered into revolving credit agreements with commercial banks. The current agreement for the general obligation commercial paper program, effective December 1, 2004, authorizes the issuance of notes in an aggregate principal amount not to exceed $1.5 billion. The current agreement for the enterprise fund commercial paper program authorizes the issuance of notes in an aggregate principal amount not to exceed $142 million. As of June 30, 2007, the enterprise fund commercial paper program had $133 million in outstanding notes.

During the year ended June 30, 2007, the primary government issued $3.5 billion in general obligation commercial paper and $3.8 billion in long-term general obligation bonds to refund outstanding commercial paper. However, by June 30, 2007, only $2.6 billion of the $3.8 billion had been used to repay outstanding commercial paper. The remaining $1.2 billion was used to repay commercial paper in July 2007. As of June 30, 2007, the general obligation commercial paper program had $1.3 billion in outstanding commercial paper notes, of which $1.2 billion is considered a current liability for governmental activities and $16 million is considered a noncurrent liability for business-type activities.

The primary government has a revenue bond anticipation note (BAN) program that consists of borrowing for capital improvements on certain California State University campuses. As of June 30, 2007, $30 million in outstanding BANs existed in anticipation of issuing revenue bonds to the public. In addition, the primary government issued Stem Cell Research and Cures Bond Anticipation Notes to private individuals and philanthropic foundations to finance stem cell research. As of June 30, 2007, the primary government had $45 million in outstanding BANs in anticipation of issuing general obligation bonds to the public.

The University of California has established a $550 million commercial paper program with tax-exempt and taxable components. The program is supported by the legally available unrestricted investments balance in the University of California's short-term investment pool. Commercial paper has been issued by the University to provide for interim financing of the construction, renovation, and acquisition of certain facilities and equipment. Commercial paper is secured by a pledge of the net revenues generated by the enterprise financed—not by any encumbrance, mortgage, or other pledge of property—and does not constitute a general obligation of the University of California. At June 30, 2007, outstanding tax-exempt and taxable commercial paper totaled $430 million and $120 million, respectively.

The University of California, a discretely presented component unit, has other borrowings consisting of contractual obligations resulting from the acquisition of land or buildings and the construction and renovation of certain facilities. Included in other borrowings, which total approximately $411 million as of June 30, 2007, are various unsecured financing agreements, totaling approximately $147 million, with commercial banks.

NOTE 13: LEASES

The aggregate amount of lease commitments for facilities and equipment of the primary government in effect as of June 30, 2007, was approximately $7.5 billion. Primary government leases that are classified as operating leases, in accordance with the applicable standards, contain clauses providing for termination. Operating lease expenditures are recognized as being incurred over the lease term. It is expected that, in the normal course of business, most of these operating leases will be replaced by similar leases.

The total present value of minimum capital lease payments for the primary government comprises $11 million from internal service funds and $4.3 billion from other governmental activities. Note 10, Long-term Obligations, reports the additions and deductions of capital lease obligations. Also reported in Note 10 are the current and noncurrent portions of the capital lease obligations. Lease expenditures for the year ended June 30, 2007, amounted to approximately $756 million.

Included in the capital lease commitments are lease-purchase agreements that certain state agencies have entered into with the State Public Works Board, an enterprise fund agency, amounting to a present value of net minimum lease payments of $4.3 billion. This amount represents 98.2% of the total present value of minimum lease payments of the primary government. Also included in the capital lease commitments are some lease-purchase agreements to acquire equipment.

The capital lease commitments do not include $568 million of lease-purchase agreements with building authorities that are blended component units. These building authorities acquire or develop office buildings and then lease the facilities to state agencies. Upon expiration of the lease, title passes to the primary government. The costs of the buildings and the related outstanding revenue bonds and certificates of participation are reported in the government-wide financial statements. Accordingly, the lease receivables or capital lease obligations associated with these buildings are not included in the financial statements.

Table 26 summarizes future minimum lease commitments of the primary government.

Table 26

Schedule of Future Minimum Lease Commitments – Primary Government
(amounts in thousands)

Year Ending June 30	Operating Leases	Capital Leases: Internal Service Funds	Capital Leases: Other Governmental Activities	Total
2008	$ 221,260	$ 2,003	$ 498,657	$ 721,920
2009	162,998	2,006	484,539	649,543
2010	98,700	2,046	459,512	560,258
2011	56,017	2,055	427,197	485,269
2012	32,813	2,085	414,859	449,757
2013-2017	108,088	1,870	2,001,769	2,111,727
2018-2022	7,990	—	1,401,006	1,408,996
2023-2027	927	—	833,019	833,946
2028-2032	645	—	277,702	278,347
2033-2037	695	—	—	695
2038-2042	95	—	—	95
2043-2047	95	—	—	95
2048-2052	95	—	—	95
2053-2057	84	—	—	84
2058-2062	32	—	—	32
Total minimum lease payments	**$ 690,534**	**12,065**	**6,798,260**	**$ 7,500,859**
Less: amount representing interest		1,447	2,462,699	
Present value of net minimum lease payments		**$ 10,618**	**$ 4,335,561**	

The aggregate amount of the major discretely presented component units' lease commitments for land, facilities, and equipment in effect as of June 30, 2007, was approximately $3.5 billion. Table 27 presents the future minimum lease commitments for the University of California and the State Compensation Insurance Fund. Operating lease expenditures for the year ended June 30, 2007, amounted to approximately $238 million for major discretely presented component units.

Table 27

Schedule of Future Minimum Lease Commitments – Major Discretely Presented Component Units
(amounts in thousands)

Year Ending June 30	University of California Capital	University of California Operating	State Compensation Insurance Fund Operating	Total
2008	$ 221,359	$ 101,382	$ 48,325	$ 371,066
2009	221,114	83,919	42,423	347,456
2010	186,705	60,730	28,450	275,885
2011	181,414	42,788	19,527	243,729
2012	176,114	24,605	4,863	205,582
2013-2017	818,463	35,899	17,717	872,079
2018-2022	629,520	4,021	—	633,541
2023-2027	371,203	3,694	—	374,897
2028-2032	204,610	4,195	—	208,805
2033-2037	—	4,745	—	4,745
2038-2042	—	2,694	—	2,694
Total minimum lease payments	**3,010,502**	$ **368,672**	$ **161,305**	**$ 3,540,479**
Less: amount representing interest	1,001,004			
Present value of net minimum lease payments	**$ 2,009,498**			

NOTE 14: COMMITMENTS

As of June 30, 2007, the primary government had commitments of $6.2 billion for certain highway construction projects. These commitments are not included as a reserve for encumbrances in the Federal Fund or the Transportation Construction Fund because the future expenditures related to these commitments will be reimbursed with $2.5 billion from local governments and $3.7 billion from proceeds of approved federal grants. The ultimate liability will not accrue to the State. In addition, the primary government had commitments of $445 million for various education programs and $3 million for services provided under the welfare program that are not included as a reserve for encumbrances in the Federal Fund and will be reimbursed by the proceeds of approved federal grants.

The primary government had other commitments, totaling $24.7 billion, that are not included as a liability on the Balance Sheet or the Statement of Net Assets. These commitments included $8.1 billion in long-term contracts to purchase power; these contracts are considered to be derivatives and are not included as a liability on the Statement of Net Assets of the Electric Power Fund. In addition, variable costs, estimated by management at $7.9 billion, are associated with these power purchase contracts. Purchases will take place in the future, and the commitments will be met with future receipts from charges to residential and commercial energy users. Some of these derivatives do not qualify as normal purchases or normal sales. These contracts had a negative fair value of $251 million as of June 30, 2007. Also, the Department of Water Resources entered into bilateral arrangements, with a fair value of $42 million, to hedge the price of natural gas. The $24.7 billion in commitments also included grant agreements, totaling approximately $7.1 billion, to reimburse other entities for construction projects for school building aid, parks, and other improvements, and to reimburse counties and cities for costs associated with various programs. Any constructed buildings will not

belong to the primary government, whose payments are contingent upon the other entities entering into construction contracts.

In addition to the power purchase contracts and grant commitments, the primary government had commitments of approximately $936 million for the construction of water projects and the purchase of power. Included in this amount were certain power purchase, sale, and exchange contracts which are considered to be derivatives. These contracts had a fair value of $277 million as of June 30, 2007. The primary government also had commitments of $454 million for California State University construction projects, $111 million for the California State Lottery's gaming and telecommunication systems and services, and $75 million to veterans for the purchase of properties under contracts of sale. These are long-term projects, and all of the contracts' needs may not have been defined. The projects will be funded with existing and future program resources or with the proceeds of revenue and general obligation bonds. In addition, the Department of Technology Services had commitments of $56 million for software, hardware and copiers, purchase of commodities, consulting services, and the purchase of a generator system. These commitments are not included as a liability on the Statement of Net Assets because payments towards these contracts are contingent on the Department's maintenance needs.

As of June 30, 2007, the discretely presented component units had other commitments that are not included as liabilities on the Statement of Net Assets. The University of California had authorized construction projects totaling $2.4 billion. The university also made commitments to make investments in certain investment partnerships pursuant to provisions in the partnership agreements. These commitments totaled $493 million as of June 30, 2007. Other component units had outstanding commitments to provide $135 million for loans under various housing programs and $20 million to other governments for infrastructure improvements. The California Public Employees' Retirement System had capital commitments to private equity funds and commitments to purchase real estate equity totaling $14.0 billion and $996 million, respectively, that remained unfunded and not recorded as liabilities on the Statement of Net Assets of either the fiduciary or discretely presented component units.

NOTE 15: GENERAL OBLIGATION BONDS

The State Constitution permits the primary government to issue general obligation bonds for specific purposes and in such amounts as approved by a two-thirds majority of both houses of the Legislature and by a majority of voters in a general or direct primary election. The debt service for general obligation bonds is appropriated from the General Fund. Under the State Constitution, the General Fund is used first to support the public school system and public institutions of higher education; the General Fund can then be used to service the debt on outstanding general obligation bonds. Enterprise funds and certain other funds reimburse the General Fund for any debt service it provides on their behalf. General obligation bonds that are directly related to, and are expected to be paid from, the resources of enterprise funds are included as a liability of such funds in the financial statements. However, the General Fund may be liable for the payment of any principal and interest on these bonds that is not met from the resources of such funds.

As of June 30, 2007, the State had $50.3 billion in outstanding general obligation bonds related to governmental activities and $2.0 billion related to business-type activities. In addition, $68.0 billion of general obligation bonds had been authorized but not issued. This amount includes $21.9 billion authorized by the applicable finance committees for issuance in the form of commercial paper notes. Of this amount, $1.3 billion in general obligation indebtedness was issued in the form of commercial paper notes but was not yet retired by long-term bonds.

Note 10, Long-term Obligations, discusses the change to general obligation bonds payable.

A. Variable-rate General Obligation Bonds

The State issues both fixed and variable-rate general obligation bonds. As of June 30, 2007, the State had $3.4 billion of variable-rate general obligation bonds outstanding, consisting of $987 million in daily rate, $1.9 billion in weekly rate, and $500 million in auction rate.

The interest rates associated with the daily rates and weekly rates are determined by the remarketing agents to be the lowest rate that would allow the bonds to sell on the effective date of such rate at a price (without regard to accrued interest) equal to 100% of the principal amount. The interest is paid on the first business day of each calendar month. The interest rates on the auction-rate bonds are determined by the auction agent through an auction process and the interest is paid on the business day immediately following each auction rate period.

Letters of credit were issued to secure payment of principal and interest on the daily and weekly variable-rate bonds. Under these letters of credit, the credit providers pay all principal and interest payments to the bondholders; the State is then required to reimburse the credit providers for the amounts paid. Different credit providers exist for each series of variable-rate bonds issued. For the variable-rate bonds issued during the 2002-03 fiscal year, expiration dates of the letters of credit for the daily and weekly variable-rate bonds have been amended to December 11, 2009 and December 31, 2015. For the variable-rate bonds issued during the 2004-05 and 2005-06 fiscal years, the initial expiration dates of the letters of credit are October 20, 2009 and November 17, 2010, respectively.

Based on the schedules provided in the Official Statements, sinking fund deposits for the variable-rate general obligation bonds will be set aside in a mandatory sinking fund at the beginning of each of the following fiscal years: the 2006-07 fiscal year, the 2015-16 through 2033-34 fiscal years, and the 2039-40 fiscal year. The deposits set aside in any fiscal year may be applied, with approval of the State Treasurer and the appropriate bond finance committees, to the redemption of any other general obligation bonds then outstanding. To the extent that the deposit is not applied by January 31 of each fiscal year, the variable-rate general obligation bonds will be redeemed in whole or in part on an interest payment date in that fiscal year.

B. Economic Recovery Bonds

On March 2, 2004, voters approved the one-time issuance of up to $15 billion in Economic Recovery Bonds; during the 2003-04 fiscal year, the State sold a total of $10.9 billion of these bonds. The debt service for these bonds is payable from and secured by amounts available in the Economic Recovery Bond Sinking Fund, a debt service fund that consists primarily of revenues from a dedicated sales tax. However, the General Fund may be liable for the payment of any principal and interest on the bonds that cannot be paid from the Economic Recovery Bond Sinking Fund.

As of June 30, 2007, the State had $9.0 billion of Economic Recovery Bonds outstanding. Of the $9.0 billion outstanding, bonds totaling $2.4 billion are variable rate bonds, consisting of $635 million in daily rates and $1.7 billion in weekly rates. The interest rates associated with the daily rates and weekly rates are determined by the remarketing agents to be the lowest rates that would enable them to sell the bonds for delivery on the effective date of such rate at a price (without regard to accrued interest) equal to 100% of the principal amount. The interest is paid on the first business day of each calendar month. As described in the Official Statement, payment of principal, interest, and purchase price upon tender, for a portion of these bonds, is secured by a direct-pay letter of credit. Payment of principal and interest for another portion of these bonds is secured by a bond insurance policy, together with an insured standby bond purchase agreement upon tender. A separate uninsured standby bond purchase agreement supports the purchase upon tender for the final

portion of these bonds, without credit enhancement in the form of an insurance policy or letter of credit related to the payment of principal or interest. The State reimburses its credit providers for any amounts paid, plus interest. Different credit providers exist for each series of variable-rate bonds issued. The expiration dates for these letters of credit, bond insurance policies, and standby bond purchase agreements fall between June 15, 2009, and December 31, 2015.

Another $1.0 billion of the outstanding $9.0 billion in Economic Recovery Bonds have interest-reset dates of either July 1, 2007, or July 1, 2008. At that time, the bonds are subject to mandatory tender for purchase at a price equal to 100% of the principal amount, plus accrued interest, without premium. Upon mandatory tender, the State will seek to remarket these bonds. The debt service requirements published in the Official Statement differ from the calculation included in Table 28 because the statement presumes a successful remarketing at an interest rate of 3.33% per year, along with the creation of a mandatory sinking fund. The debt service calculation in Table 28 uses the interest rates in effect at year-end, which are the same interest rates in effect until the applicable reset date, and does not assume the future establishment of a sinking fund. In the event of a failed remarketing, the State is required to return all tendered bonds to their initial purchasers and pay an annual interest rate of 11% until the bonds are successfully remarketed.

C. Debt Service Requirements

Table 28 shows the debt service requirements for all general obligation bonds as of June 30, 2007. The estimated debt service requirements for the $3.4 billion variable-rate general obligation bonds and the $2.4 billion variable-rate Economic Recovery Bonds are calculated using the actual interest rates in effect on June 30, 2007.

Table 28

Schedule of Debt Service Requirements for General Obligation Bonds
(amounts in thousands)

Year Ending	Governmental Activities			Business-type Activities		
June 30	Principal	Interest	Total	Principal	Interest	Total
2008	$ 2,045,103	$ 2,382,271	$ 4,427,374	$ 136,430	$ 99,697	$ 236,127
2009	2,211,335	2,300,610	4,511,945	135,340	89,909	225,249
2010	2,360,375	2,184,119	4,544,494	118,190	80,636	198,826
2011	2,423,244	2,059,188	4,482,432	86,480	73,307	159,787
2012	1,973,295	1,929,693	3,902,988	100,895	68,674	169,569
2013-2017	9,406,475	8,172,962	17,579,437	526,280	275,814	802,094
2018-2022	9,373,745	5,943,409	15,317,154	298,350	166,664	465,014
2023-2027	8,713,400	3,904,807	12,618,207	143,990	116,717	260,707
2028-2032	7,733,510	1,961,505	9,695,015	204,465	74,957	279,422
2033-2037	4,027,960	401,440	4,429,400	138,095	29,020	167,115
2038-2041	1,000	108	1,108	65,705	6,213	71,918
Total	**$ 50,269,442**	**$ 31,240,112**	**$ 81,509,554**	**$ 1,954,220**	**$ 1,081,608**	**$ 3,035,828**

D. General Obligation Bond Defeasances

1. Current Year

On November 9, 2006 , the primary government issued $239 million in veterans general obligation refunding bonds to immediately refund $239 million in outstanding veterans general obligation bonds maturing in years 2012 through 2032. This refunding reduced debt service payments by $3 million and resulted in an economic gain of $22 million, using a discount rate of 3.0%.

On December 6, 2006, the primary government issued $423 million in various-purpose general obligation refunding bonds to advance-refund $398 million in general obligation bonds maturing in 2016 through 2018, 2022 through 2023, 2027 through 2028, and 2030. The primary government placed the net proceeds into an irrevocable trust to pay the debt service on the refunded bonds. As a result, the refunded bonds are considered defeased and the liability for those bonds has been removed from the financial statements. This advance refunding decreased overall debt service payments by $49 million and resulted in an economic gain of $30 million. The economic gain is the difference between the present value of the old debt service requirements and the present value of the new debt service requirements, discounted at 4.3% per year over the life of the new bonds.

On February 28, 2007, the primary government issued $132 million in various-purpose general obligation refunding bonds to immediately refund $134 million in general obligation bonds maturing in 2014 through 2019. The refunding decreased overall debt service payments by $14 million and resulted in an economic gain of $12 million, using a discount rate of 4.4%.

On April 11, 2007, the primary government issued $4.1 billion in various-purpose general obligation refunding bonds to current-refund and advance-refund $4 billion in general obligation bonds maturing in 2010 through 2034. The primary government placed the net proceeds into an irrevocable trust to pay the debt service on the refunded bonds. As a result, the refunded bonds are considered defeased and the liability for those bonds has been removed from the financial statements. The refunding decreased overall debt service payments by $410 million and resulted in an economic gain of $205 million, using a discount rate of 4.4%.

2. Prior Years

In prior years, the primary government placed the proceeds of the refunding bonds in a special irrevocable escrow trust account with the State Treasury to provide for all future debt service payments on defeased bonds. The assets of the trust accounts and the liability for defeased bonds are not included in the State's financial statements. As of June 30, 2007, the outstanding balance of general obligation bonds defeased in prior years was approximately $3.3 billion.

NOTE 16: REVENUE BONDS

A. Governmental Activities

The State Treasurer is authorized by state law to issue Federal Highway Grant Anticipation Revenue Vehicles (GARVEE bonds). The purpose of these bonds is to accelerate the funding and construction of critical transportation infrastructure projects in order to provide congestion relief benefits to the public significantly sooner than with traditional funding mechanisms. These bonds are secured and payable from the annual federal appropriation for the State's federal-aid transportation projects. The primary government has no legal

liability for the payment of principal and interest on these revenue bonds. This bond funds activity in the Transportation Construction Fund and is included in the governmental activities column of the government-wide Statement of Net Assets.

The California State University, Channel Islands Financing Authority, a blended component unit in the California State University Programs Fund, issues revenue bonds to provide funding for public capital improvements serving the California State University, Channel Islands. These bonds are secured and payable from special taxes, tax increment revenues, and pledged rental housing revenues of the California State University, Channel Islands Site Authority, which is also a blended component unit in the California State University Programs Fund. The primary government has no legal liability for the payment of principal and interest on these revenue bonds. The bonds are included in the governmental activities column of the government-wide Statement of Net Assets.

The Golden State Tobacco Securitization Corporation (GSTSC), a blended component unit, is authorized by state law to issue asset-backed bonds to purchase the State's rights to future revenues from the Master Settlement Agreement with participating tobacco companies. These bonds are secured by and payable solely from future Tobacco Settlement Revenue. The primary government has no legal liability for the payment of principal and interest on these bonds. These bonds are included in the governmental activities column of the government-wide Statement of Net Assets.

Under state law, certain building authorities may issue revenue bonds. These bonds are issued for the purpose of acquiring and constructing buildings for public education purposes and for the purpose of constructing state office buildings. Leases with state agencies pay the principal and interest on the revenue bonds issued by the building authorities. The primary government has no legal liability for the payment of principal and interest on these revenue bonds. These revenue bonds are included in the governmental activities column of the government-wide Statement of Net Assets.

B. Business-type Activities

Revenue bonds that are directly related to, and are expected to be paid from, the resources of enterprise funds are included in the accounts of such funds. Principal and interest on revenue bonds are payable from the pledged revenues of the respective funds of agencies that issued the bonds. The General Fund has no legal liability for payment of principal and interest on revenue bonds.

Revenue bonds to acquire, construct, or renovate state facilities or to refund outstanding revenue bonds in advance of maturity are issued for water resources, public building construction, financing of electric power purchases for resale to utility customers, and certain nonmajor enterprise funds.

C. Discretely Presented Component Units

The University of California issues revenue bonds to finance the construction, renovation, and acquisition of certain facilities and equipment.

Under state law, the California Housing Finance Agency (CalHFA) issues fixed- and variable-rate revenue bonds to make loans to finance housing developments and to finance the acquisition of homes by low- and moderate-income families. Variable-rate debt is typically tied to a common index, such as the Securities Industry and Financial Markets Association (SIFMA) or the London Interbank Offered Rate (LIBOR) and is reset periodically.

Table 29 shows outstanding revenue bonds of the primary government and the discretely presented component units.

Table 29

Schedule of Revenue Bonds Outstanding
June 30, 2007
(amounts in thousands)

Primary government		
Governmental activities		
Transportation Construction Fund	$	518,719
Nonmajor governmental funds		
California State University Programs Fund		44,500
Golden State Tobacco Securitization Corporation Fund		6,922,503
Building authorities		524,062
Total governmental activities		**8,009,784**
Business-type activities		
Electric Power Fund		9,995,000
Water Resources Fund		2,568,083
Public Building Construction Fund		6,916,267
Nonmajor enterprise funds		3,454,744
Total business-type activities		**22,934,094**
Total primary government		**30,943,878**
Discretely presented component units		
University of California		6,384,409
California Housing Finance Agency		7,579,228
Nonmajor component units		463,012
Total discretely presented component units		**14,426,649**
Total	**$**	**45,370,527**

Table 30 shows the debt service requirements for fixed- and variable-rate bonds. It excludes certain unamortized refunding costs, premiums, discounts, and other costs that are included in Table 29.

Table 30

Schedule of Debt Service Requirements for Revenue Bonds
(amounts in thousands)

Year Ending June 30	Primary Government				Discretely Presented Component Units	
	Governmental Activities		Business-type Activities			
	Principal	Interest	Principal	Interest*	Principal	Interest*
2008	$ 187,545	$ 376,056	$ 1,023,136	$ 1,047,923	$ 250,364	$ 646,085
2009	151,580	369,062	1,280,614	1,003,355	354,192	643,931
2010	159,120	362,234	1,048,943	942,028	408,221	627,733
2011	162,210	361,755	1,089,755	890,121	391,723	609,844
2012	154,715	354,024	1,130,460	837,256	416,050	592,122
2013-2017	591,660	1,791,788	6,262,345	3,314,290	2,340,740	2,652,075
2018-2022	478,431	1,685,015	6,950,858	1,843,889	2,331,393	2,084,335
2023-2027	972,701	1,778,771	2,289,735	761,888	2,422,167	1,532,217
2028-2032	198,086	1,443,155	1,417,360	262,439	2,596,072	964,162
2033-2037	1,534,216	1,326,197	379,915	69,962	1,969,215	427,076
2038-2042	401,055	867,633	99,000	12,047	719,035	96,744
2043-2047	3,543,936	4,031,759	18,475	1,015	123,580	15,687
Total	**$ 8,535,255**	**$ 14,747,449**	**$ 22,990,596**	**$ 10,986,213**	**$ 14,322,752**	**$ 10,892,011**

* Includes interest on variable-rate bonds based on rates in effect on June 30, 2007.

Table 31 shows debt service requirements as of June 30, 2007, for variable-rate debt included in Table 30, as well as net swap payments, assuming that current interest rates remain the same for their term. As interest rates vary, variable-rate bond interest payments and net swap payments will vary.

Table 31

Schedule of Debt Service and Swap Requirements for Variable-rate Revenue Bonds
(amounts in thousands)

	Primary Government				Discretely Presented Component Units			
	Business-type Activities							
Year Ending June 30	Principal	Interest*	Interest Rate* Swap Net	Total	Principal	Interest*	Interest Rate* Swap Net	Total
2008	$ 21,000	$ 148,000	$ (10,000)	$ 159,000	$ 42,230	$ 202,954	$ 19,818	$ 265,002
2009	127,000	146,000	(9,000)	264,000	91,092	202,352	18,389	311,833
2010	80,000	142,000	(9,000)	213,000	104,304	197,881	17,603	319,788
2011	241,000	138,000	(9,000)	370,000	111,224	192,942	16,746	320,912
2012	258,000	129,000	(7,000)	380,000	130,474	187,672	16,094	334,240
2013-2017	1,959,000	508,000	(26,000)	2,441,000	729,904	852,557	63,733	1,646,194
2018-2022	1,274,000	118,000	(4,000)	1,388,000	904,265	684,882	46,368	1,635,515
2023-2027	—	—	—	—	996,862	490,691	30,894	1,518,447
2028-2032	—	—	—	—	1,159,984	277,252	16,931	1,454,167
2033-2037	—	—	—	—	697,068	79,558	4,853	781,479
2038-2042	—	—	—	—	81,788	4,976	452	87,216
Total	**$ 3,960,000**	**$ 1,329,000**	**$ (74,000)**	**$ 5,215,000**	**$ 5,049,195**	**$ 3,373,717**	**$ 251,881**	**$ 8,674,793**

* Based on rates in effect on June 30, 2007.

D. Primary Government Variable Rate/Swap Disclosure

Objective: The Department of Water Resources (DWR) entered into interest-rate swap agreements with various counterparties to reduce variable-interest-rate risk for the Electric Power Fund. The swaps create a synthetic fixed rate. The DWR agreed to make fixed-rate payments and receive floating-rate payments on notional amounts equal to a portion of the principal amount of this variable-rate debt.

Terms and Fair Value: The terms and fair value of the swap agreements entered into by DWR, which became effective February 13, 2003, and December 1, 2005, are summarized in Table 32. The notional amounts of the swaps match the principal amounts of the associated debt. The swap agreements contain scheduled reductions to outstanding notional amounts that follow scheduled amortization of the associated debt. The fair values were determined based on quoted market prices for similar financial instruments.

Credit Risk: The DWR has a total of 20 swap agreements with 10 different counterparties. Approximating 22% of the total notional value is held with a counterparty that has Moody's Investors Service, Fitch Ratings, and Standard & Poor's (S&P) credit ratings of Aa1, AA, and AA+, respectively. Of the remaining swaps, two are held with a single counterparty and approximate 20% of the outstanding notional value; that counterparty has Moody's, Fitch's, and S&P's credit ratings of Aa1, AA-, and AA-, respectively. The remaining swaps are with separate counterparties, all having Moody's, Fitch's, and S&P's credit ratings of Aa3, A+, and A+, respectively, or better. Table 32 summarizes the credit ratings of the counterparties for the swap agreements.

Table 32

Schedule of Terms, Fair Values, and Credit Ratings of Swap Agreements
(amounts in thousands)

Swap Termination Date	Outstanding Notional Amount at June 30, 2007	Fair Values at June 30, 2007	Fixed Rate Paid by Electric Power Fund	Variable Rate Received by Electric Power Fund	Counterparty Credit Ratings (Moody's, Fitch's, S&P's)
5/1/2011	$ 94,000	$ 2,000	2.914 %	67% of LIBOR	Aaa, AAA, AAA
5/1/2012	234,000	6,000	3.024	67% of LIBOR	Aaa, AAA, AAA
5/1/2013	190,000	1,000	3.405	BMA	Aaa, AA-, AA
5/1/2013	95,000	1,000	3.405	BMA	Aa3, AA-, A+
5/1/2013	28,000	—	3.405	BMA	Aa3, AA-, AA-
5/1/2014	194,000	5,000	3.204	67% of LIBOR	Aaa, AA, AA+
5/1/2015	308,000	7,000	3.184	66.5% of LIBOR	Aa3, AA-, A+
5/1/2015	174,000	5,000	3.280	67% of LIBOR	Aaa, AAA, AAA
5/1/2016	202,000	6,000	3.342	67% of LIBOR	Aa1, AA, AA+
5/1/2016	485,000	16,000	3.228	66.5% of LIBOR	Aa1, AA, AA+
5/1/2017	202,000	6,000	3.389	67% of LIBOR	Aa3, AA-, A+
5/1/2017	480,000	17,000	3.282	66.5% of LIBOR	Aa1, AA-, AA
5/1/2018	515,000	19,000	3.331	66.5% of LIBOR	Aa1, AA-, AA-
5/1/2020	306,000	12,000	3.256	64% of LIBOR	Aa1, AA-, AA-
5/1/2022	453,000	19,000	3.325	64% of LIBOR	Aaa, AA, AA-
Total	**$ 3,960,000**	**$ 122,000**			

Basis Risk: The DWR is exposed to basis risk on the swaps that have payments calculated on the basis of a percentage of LIBOR. The basis risk results from the fact that DWR's floating interest payments payable on the underlying debt are determined in the tax-exempt market, while the DWR floating receipts on the swaps are based on LIBOR, which is determined in the taxable market. Should the relationship between LIBOR and the tax-exempt market change and move to convergence, or should DWR's bonds trade at levels higher in rate in relation to the tax-exempt market, DWR's cost would increase.

Effective July 1, 2006, DWR entered into the basis swaps, shown in Table 33, to mitigate this risk and optimize debt service by changing the variable rate received by the Electric Power Fund to a five-year Constant Maturity Swap Index (CMS). The fair values were provided by the counterparties, using the par value or marked-to-market method.

Table 33

Schedule of Terms, Fair Values, and Credit Ratings of Swap Agreements
(amounts in thousands)

Swap Termination Date	Outstanding Notional Amount at June 30, 2007	Fair Values at June 30, 2007	Variable Rate Paid by Electric Power Fund	Variable Rate Received by Electric Power Fund	Counterparty Credit Ratings (Moody's, Fitch's, S&P's)
5/1/2012	$ 234,000	$ —	67% of LIBOR	62.83% of CMS	Aa1, AA, AA+
5/1/2014	194,000	—	67% of LIBOR	62.70% of CMS	Aa1, AA-, AA-
5/1/2015	174,000	—	67% of LIBOR	62.60% of CMS	Aaa, AA-, AA
5/1/2016	202,000	—	67% of LIBOR	62.80% of CMS	Aa1, AA, AA+
5/1/2017	202,000	—	67% of LIBOR	62.66% of CMS	Aaa, AA-, AA
Total	**$ 1,006,000**	**$ —**			

As of June 30, 2007, 67% of LIBOR paid on the basis swaps was equal to 3.56%, while the variable rates received based on the five-year CMS Index varied from 3.45 to 3.47%.

Termination Risk: The DWR's swap agreements do not contain any out-of-the-ordinary termination provisions that would expose it to significant termination risk. In keeping with market standards, DWR or the counterparty may terminate a swap agreement if the other party fails to perform under the terms of the contract or significantly loses creditworthiness. The DWR views the likelihood of either event to be remote at this time. If a termination were to occur, DWR would, at the time of the termination, be liable for payment equal to the swap's fair value, if it had a negative fair value at that time. A termination would mean that DWR's underlying floating-rate bonds would no longer be hedged, and DWR would be exposed to floating rate risk unless it entered into a new hedge.

Rollover Risk: Other than termination, no rollover risk is associated with the swap agreements because the agreements have termination dates and notional amounts that are tied to equivalent maturity dates and principal amounts of amortizing debt.

E. Discretely Presented Component Unit Variable Rate/Swap Disclosure—University of California

Table 31 includes debt service requirements and net swap payments as of June 30, 2007, of the University of California (UC), a discretely presented component unit. Total principal, variable interest, and interest rate net swap payments are $432 million, $178 million, and negative $15 million, respectively.

Objective: UC has entered into interest rate swap agreements as a means to lower borrowing costs, rather than using fixed-rate bonds at the time of issuance, and to effectively change the variable interest rate bonds to synthetic fixed rate bonds. UC entered into two separate interest rate swaps in connection with certain variable-rate Medical Center Revenue Bonds and Medical Center Pooled Revenue Bonds.

Terms: The notional amount of the swaps matches the principal amounts of the associated bond issuance. The UC's swap agreements contain scheduled reductions to outstanding notional amounts that match scheduled reductions in the associated bond issuance. UC pays the swap counterparties a fixed interest rate payment and receives a variable interest rate payment. UC believes that over time the variable interest rates it

pays to the bondholders will approximate the variable payments it receives on the interest rate swaps, leaving the fixed interest rate payment to the swap counterparty as the net payment obligation for the transaction.

Fair Value: The swaps have an estimated positive fair value of $18 million as of June 30, 2007. The fair value of the interest rate swaps is the estimated amount the UC would have either received or (paid) if the swap agreements had been terminated on June 30, 2007. The fair value was estimated by the financial institutions using available quoted market prices or a forecast of expected discounted net future cash flows. The terms and fair value of the swap agreements are summarized in Table 34.

Table 34

Schedule of Terms and Fair Values of Swap Agreements
(amounts in thousands)

Swap Termination Date	Outstanding Notional Amounts at June 30, 2007	Fair Values at June 30, 2007	Fixed Rate Paid by University of California	Variable Rate Received by University of California
09/01/2026	$ 336,225	$ 16,460	3.1385 %	67% of LIBOR
05/15/2032	96,155	1,734	3.5897	58% of LIBOR + 0.48%
Total	**$ 432,380**	**$ 18,194**		

Basis Risk: UC is exposed to basis risk whenever the interest rates on the bonds are reset. The interest rates on the bonds are tax-exempt interest rates, while the variable receipt rate on the interest rate swaps is taxable.

Termination and Credit Risk: UC is exposed to losses in the event of nonperformance by counterparties or unfavorable interest rate movements. The swap contracts with positive fair values are exposed to credit risk. UC faces a maximum possible loss equivalent to the amount of the derivative's fair value. Swaps with negative fair values are not exposed to credit risk. Depending on the agreement, certain swaps may be terminated if the insurer's credit quality rating, as issued by Fitch Ratings or Standard & Poor's, falls below A-, or if the Medical Center Pooled Revenue Bonds or swap counterparty's bond ratings falls below Baa2 or BBB, thereby canceling the synthetic interest rate and returning the interest rate payments to the variable interest rates on the bonds. At termination, UC may also owe a termination payment if there is a realized loss based on the fair value of the swap.

F. Discretely Presented Component Unit Variable Rate/Swap Disclosure—California Housing Finance Agency

Table 31 includes debt service requirements and net swap payments as of June 30, 2007, for the California Housing Finance Agency (CalHFA), a discretely presented component unit. Total principal, variable interest, and interest rate net swap payments are $4.6 billion, $3.2 billion, and $267 million, respectively.

Objective: CalHFA has entered into interest rate swap agreements with various counterparties to protect itself against rising rates by providing a synthetic fixed rate for a like amount of variable-rate bond obligations. The majority of CalHFA's interest rate swap transactions are structured to pay a fixed rate of interest while receiving a variable rate of interest, with some exceptions. CalHFA previously entered into swaps at a ratio of

65% of LIBOR. Its current formula (60% of LIBOR plus a spread, currently .26%) results in comparable fixed-rate economics but performs better when short-term rates are low and the SIFMA/LIBOR percentage is high. CalHFA has used this new formula since December 2002, and the agency expects to continue to use this formula for LIBOR-based swaps exclusively. In addition, CalHFA entered into 13 basis swaps as a means to change the variable-rate formula received from counterparties for $631 million outstanding notional amount from 65% of LIBOR to varying floating rates.

Terms, Fair Value, and Credit Risk: Most of CalHFA's notional amounts of the fixed-payer swaps match the principal amounts of the associated debt. CalHFA has created a synthetic fixed rate by swapping a portion of its variable-rate debt. CalHFA did not pay or receive any cash when the swap transactions were initiated. CalHFA utilizes 11 counterparties for its interest-rate swap transactions. Counterparties are required to collateralize their exposure to CalHFA when their credit ratings fall from AA to the highest single-A category, A1/A+. CalHFA is not required to provide collateralization until its ratings fall to the mid-single-A category, A2/A. CalHFA's swap portfolio has an aggregate negative fair value, due to a decline in interest rates, of $35 million as of June 30, 2007. Fair values are as reported by CalHFA's counterparties and are estimated using the zero-coupon method. As CalHFA's swap portfolio has an aggregate negative fair value, CalHFA is not exposed to credit risk. However, if interest rates rise, the negative fair value of the swap portfolio would be reduced and could eventually become positive. At that point, CalHFA would become exposed to the counterparties' credit because the counterparties would be obligated to make payments to CalHFA in the event of termination. CalHFA has 132 swap transactions, with outstanding notional amounts of $4.7 billion. Standard & Poor's credit ratings for these counterparties range from A+ to AAA; Moody's credit ratings range from Aa3 to Aaa.

Basis Risk: CalHFA's swaps contain the risk that the floating-rate component of the swap will not match the floating rate of the underlying bonds. This risk arises because floating rates paid by swap counterparties are based on indices that consist of market-wide averages, while interest paid on CalHFA's variable-rate bonds is specific to individual bond issues. CalHFA's variable-rate tax-exempt bonds trade at a slight discount to the SIFMA index. Swaps associated with tax-exempt bonds, for which CalHFA receives a variable-rate payment, are based on a percentage of LIBOR; thus, CalHFA is exposed to basis risk if the relationship between SIFMA and LIBOR converges. As of June 30, 2007, the SIFMA rate was 3.73%, 65% of the one-month LIBOR was 3.46%, and 60% of the one-month LIBOR plus 26 basis points was 3.45%.

Termination Risk: Counterparties to CalHFA's interest rate swaps have termination rights that require settlement payments by either CalHFA or the counterparties, based on the fair value of the swap.

Rollover Risk: CalHFA's swap agreements have limited rollover risk because the agreements contain scheduled reductions to outstanding notional amounts that are expected to follow scheduled and anticipated reductions in the associated bonds payable.

G. Revenue Bond Defeasances

1. Current Year—Governmental Activities

In March 2007, the GSTSC issued Enhanced Tobacco Settlement Asset-Backed Bonds to advance-refund $2.9 billion in outstanding bonds. A portion of the proceeds was deposited into an escrow account to provide for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability for those bonds has been removed from the financial statements. According to the State Department of Finance (Finance) no economic gain or loss was calculated or disclosed because the 2007 issuance was not undertaken solely to refund the 2003 bonds and $1.3 billion of the bond proceeds

above what was needed to advance refund the 2003 bonds were deposited in the General Fund. Finance asserts that had the economic gain calculation been made and disclosed, it would have given the impression that the refunding transaction had resulted in far greater debt and cash flows than the debt defeased, when in fact a substantial portion of the new debt was not intended for advance refunding at all.

In March 2007, the primary government issued California State University systemwide revenue bonds to advance-refund $151 million of the Channel Island Financing Authority revenue bonds. As a result, the refunded bonds are considered defeased and the liability for these bonds has been removed from the financing authority's financial statements. The liability for the new bonds is included in the nonmajor enterprise fund financial statements. For a complete description of the refunding bonds issued, refer to the Current Year–Business-type Activities section below.

2. Current Year—Business-type Activities

During the year ended June 30, 2007, the primary government issued $637 million in lease revenue refunding bonds to advance-refund $669 million in outstanding bonds. The proceeds were deposited into an escrow account to provide for all future debt service payments on the refunded bonds. As a result, the bonds are considered defeased and the liability for those bonds has been removed from the financial statements. The refunding will reduce debt service payments by $79 million over the next 11 to 16 years and will result in an economic gain of $55 million. These lease revenue bonds are reported in the Public Buildings Construction Fund.

In November 2006, the primary government issued $144 million in veterans home purchase revenue refunding bonds, the proceeds of which were used to immediately refund $112 million in outstanding veterans home purchase revenue bonds maturing in years 2014 through 2028. This refunding reduced debt service payments by $7 million, and resulted in an economic gain of $2 million, using a discount rate of 3.0%. The veterans home purchase revenue bonds are reported in the Housing Loan Fund, a nonmajor enterprise fund.

In March 2007, the primary government issued California State University systemwide revenue refunding bonds to defease the outstanding Channel Island Financing Authority revenue bonds discussed in the Current Year–Governmental Activities section above. A portion of the proceeds was deposited into an escrow account to provide for all future debt service payments on the refunded bonds. As a result, the bonds are considered to be defeased and the liability for those bonds has been removed from the financial statements. The refunding will reduce debt service payments by $10 million over the life of the bonds and will result in an economic gain of $11 million. The California State University systemwide revenue bonds are reported in the State Dormitory Building Maintenance and Equipment Fund, a nonmajor enterprise fund.

3. Current Year—Discretely Presented Component Units

In January 2007, the University of California, a discretely presented component unit, issued $1.7 billion in revenue bonds; a portion of the proceeds from these bonds was used to refund $1.2 billion in outstanding revenue bonds. This refunding will reduce debt service payments by $49 million through 2035 and will result in an economic gain of $62 million. In June 2007, the university issued $242 million in revenue bonds to refund $247 million in outstanding revenue bonds. This refunding will reduce debt service payments by $13 million through 2025 and will result in an economic gain of $15 million.

4. Prior Years

In prior years, the primary government defeased certain bonds by placing the proceeds of new bonds in irrevocable trust accounts to provide for all future debt service requirements. Accordingly, the assets and liabilities for these defeased bonds are not included in the financial statements. As of June 30, 2007, the outstanding balance of revenue bonds defeased in prior years was $2.4 billion for governmental activities and $2.8 billion for business-type activities.

In prior years, the University of California, a discretely presented component unit, defeased certain bonds. Investments that have maturities and interest rates sufficient to fund retirement of defeased liabilities are being held in irrevocable trusts for the debt service payments. Accordingly, the assets of the trust accounts and the liabilities for the defeased bonds are not included in the State's financial statements. As of June 30, 2007, the outstanding balance of University of California revenue bonds defeased in prior years was $1.3 billion.

NOTE 17: INTERFUND BALANCES AND TRANSFERS

A. Interfund Balances

Due from other funds and due to other funds represent short-term interfund receivables and payables resulting from the time lag between the dates on which goods and services are provided and received and the dates on which payments between entities are made. Table 35 presents the amounts due from and due to other funds.

Table 35

Schedule of Due From Other Funds and Due To Other Funds
June 30, 2007
(amounts in thousands)

	Due To					
Due From	**General Fund**	**Federal Fund**	**Transportation Construction Fund**	**Nonmajor Governmental Fund**	**Electric Power Fund**	**Water Resources Fund**
Governmental funds						
General Fund	$ —	$ —	$ 167,928	$ 171,882	$ —	$ —
Federal Fund	793,342	—	1,268,612	416,857	—	—
Transportation Construction Fund	—	—	—	9,324	—	—
Nonmajor governmental funds	235,799	—	5,511	874,447	—	—
Total governmental funds	**1,029,141**	**—**	**1,442,051**	**1,472,510**	**—**	**—**
Enterprise funds						
Water Resources Fund	195	—	—	—	—	—
Public Building Construction Fund	23,075	—	—	—	—	—
State Lottery Fund	406	—	—	292,060	—	—
Unemployment Programs Fund	43,423	591	—	7,054	—	—
Nonmajor enterprise funds	6,124	—	—	28,296	—	—
Total enterprise funds	**73,223**	**591**	**—**	**327,410**	**—**	**—**
Internal service funds	**53,028**	**128**	**37,991**	**224,196**	**41,000**	**8,230**
Fiduciary funds	**14,448**	**—**	**—**	**99**	**—**	**—**
Total primary government	**$ 1,169,840**	**$ 719**	**$ 1,480,042**	**$ 2,024,215**	**$ 41,000**	**$ 8,230**

Due To						
Public Building Construction Fund	State Lottery Fund	Unemployment Programs Fund	Nonmajor Enterprise Funds	Internal Service Funds	Fiduciary Funds	Total
$ —	$ —	$ —	$ —	$ 181,564	$ 4,355,862	$ 4,877,236
—	—	—	2,976	12,365	3,850,817	6,344,969
—	—	—	—	2,938	196	12,458
256	—	—	31	26,426	179,328	1,321,798
256	**—**	**—**	**3,007**	**223,293**	**8,386,203**	**12,556,461**
—	—	—	—	—	—	195
—	—	—	—	67,864	25,819	116,758
—	—	—	—	—	—	292,466
—	—	—	—	—	—	51,068
—	—	—	58	129	—	34,607
—	**—**	**—**	**58**	**67,993**	**25,819**	**495,094**
28,558	**6,298**	**36,853**	**27,944**	**37,520**	**21,737**	**523,483**
—	**—**	**—**	**—**	**—**	**522**	**15,069**
$ 28,814	**$ 6,298**	**$ 36,853**	**$ 31,009**	**$ 328,806**	**$ 8,434,281**	**$ 13,590,107**

Interfund receivables and payables are the result of interfund loans that are not expected to be repaid within one year. The $1.7 billion in Transportation Construction Fund loans payable from the General Fund is primarily the result of deferred Proposition 42 transfers for traffic congestion relief and other direct loans from the traffic congestion relief program. Table 36 presents the interfund receivables and payables.

Table 36

Schedule of Interfund Receivables and Payables
June 30, 2007
(amounts in thousands)

	Interfund Payables						
Interfund Receivables	**General Fund**	**Transportation Construction Fund**	**Nonmajor Governmental Funds**	**Water Resources Fund**	**Nonmajor Enterprise Funds**	**Fiduciary Funds**	**Total**
Governmental funds							
General Fund	$ —	$ 1,699,747	$ 725,329	$ —	$ —	$ 925,855	$ 3,350,931
Nonmajor governmental funds	13,849	—	—	—	—	—	13,849
Total governmental funds	**13,849**	**1,699,747**	**725,329**	**—**	**—**	**925,855**	**3,364,780**
Enterprise funds	—	—	—	—	**2,188**	—	**2,188**
Internal service funds	**3,000**	—	**1,220**	**91,517**	—	—	**95,737**
Fiduciary funds	**66,936**	—	—	—	—	—	**66,936**
Total primary government	**$ 83,785**	**$ 1,699,747**	**$ 726,549**	**$ 91,517**	**$ 2,188**	**$ 925,855**	**$ 3,529,641**

Due from primary government and due to component units represent short-term receivables and payables between the primary government and component units resulting from the time lag between the dates on which goods and services are provided and received and the dates on which payments between entities are made. Table 37 presents the due from primary government and due to component units.

Table 37

Schedule of Due From Primary Government and Due to Component Units
June 30, 2007
(amounts in thousands)

	Due To			
Due From	**University of California**	**Public Employees' Benefits**	**Nonmajor Component Units**	**Total**
Governmental funds				
General Fund	$ 185,327	$ —	$ —	$ 185,327
Nonmajor governmental funds	60,484	—	—	60,484
Total governmental funds	**245,811**	**—**	**—**	**245,811**
Enterprise funds	**5,563**	**—**	**—**	**5,563**
Internal service funds	**—**	**5,786**	**1,135**	**6,921**
Total primary government	**$ 251,374**	**$ 5,786**	**$ 1,135**	**$ 258,295**

B. Interfund Transfers

As required by law, transfers move money collected by one fund to another fund, which disburses it. The General Fund and certain other funds transfer money to support various programs accounted for in other funds. The largest transfers from the General Fund were $3.3 billion to the Transportation Construction Fund for traffic congestion relief and $1.7 billion to nonmajor governmental funds for support of trial courts. The $1.6 billion transfer from the nonmajor governmental funds to the General Fund includes a $1.3 billion transfer of bond proceeds from the Golden State Tobacco Securitization Corporation. Table 38 presents interfund transfers of the primary government.

Table 38

Schedule of Interfund Transfers
June 30, 2007
(amounts in thousands)

	Transferred To		
Transferred From	**General Fund**	**Transportation Construction Fund**	**Nonmajor Governmental Funds**
Governmental funds			
General Fund	$ —	$ 3,340,445	$ 3,131,931
Federal Fund	—	—	903,571
Transportation Construction Fund	9,287	—	19,400
Nonmajor governmental funds	1,573,325	9,734	254,954
Total governmental funds	**1,582,612**	**3,350,179**	**4,309,856**
Nonmajor enterprise funds	**6,148**	**—**	**23,831**
Internal service funds	**1,413**	**35,651**	**1,772**
Total primary government	**$ 1,590,173**	**$ 3,385,830**	**$ 4,335,459**

Transferred To		
Public Building Construction Fund	Nonmajor Enterprise Funds	Total
$ —	$ —	$ 6,472,376
—	—	903,571
—	—	28,687
—	124	1,838,137
—	**124**	**9,242,771**
66,601	**1,447**	**98,027**
—	**—**	**38,836**
$ 66,601	**$ 1,571**	**$ 9,379,634**

NOTE 18: FUND DEFICITS AND ENDOWMENTS

A. Fund Deficits

Table 39 shows the funds that had deficits.

Table 39

Schedule of Fund Deficits
June 30, 2007
(amounts in thousands)

	Governmental Funds	Internal Service Funds	Component Units
General Fund	$ 1,907,538	$ —	$ —
Local Revenue and Public Safety Fund	4,526	—	—
Prison Construction Fund	406	—	—
Higher Education Construction Fund	1,128,229	—	—
Other capital projects funds	13,975	—	—
Architecture Revolving Fund	—	20,124	—
Public Employees' Benefits Fund	—	—	378,299
Total	**$ 3,054,674**	**$ 20,124**	**$ 378,299**

B. Discretely Presented Component Unit Endowments and Gifts

The University of California, a discretely presented component unit, administers certain restricted nonexpendable, restricted expendable, and unrestricted endowments that are included in the related net asset categories of the government-wide and fund financial statements. As of June 30, 2007, the total value of restricted and unrestricted endowments and gifts was $10.3 billion and $1.4 billion, respectively. The university's policy is to retain appreciation on investments with the endowment after an annual income distribution. The net appreciation available to meet future spending needs upon approval by the board of regents amounted to $1.9 billion at June 30, 2007. The portion of investment returns earned on endowments and distributed each year to support current operations is based on a rate approved by the board of regents.

NOTE 19: RISK MANAGEMENT

The primary government has elected, with a few exceptions, to be self-insured against loss or liability. Generally, the exceptions are when a bond resolution or a contract requires the primary government to purchase commercial insurance for coverage against property loss or liability. There have been no significant reductions in insurance coverage from the prior year. In addition, no insurance settlement in the last three years has exceeded insurance coverage. The primary government generally does not maintain reserves. Losses are covered by appropriations from each fund responsible for payment in the year in which the payment occurs. All claim payments are on a "pay as you go" basis, with workers' compensation benefits for self-insured agencies being initially paid by the State Compensation Insurance Fund. The potential amount of loss arising from risks other than workers' compensation benefits is not considered material in relation to the primary government's financial position.

The discounted liability for unpaid self-insured workers' compensation losses is estimated to be $2.3 billion as of June 30, 2007. This estimate is based on actuarial reviews of the State's employee workers' compensation program and includes indemnity payments to claimants, as well as all other costs of providing workers' compensation benefits, such as medical care and rehabilitation. The estimate also includes the liability for unpaid services fees, industrial disability leave benefits, and incurred-but-not-reported amounts. The estimated total liability of approximately $3.5 billion is discounted to $2.3 billion using a 5% interest rate. Of the total, $326 million is a current liability, of which $203 million is included in the General Fund, $122 million in the special revenue funds, and $1 million in the internal service funds. The remaining $2.0 billion is reported as other noncurrent liabilities in the government-wide Statement of Net Assets.

The University of California, a discretely presented component unit, is self-insured for medical malpractice, workers' compensation, employee health care, and general liability claims. These risks are subject to various claim and aggregate limits, with excess liability coverage provided by an independent insurer. Liabilities are recorded when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. These losses include an estimate for claims that have been incurred but not reported. The estimated liabilities are based on an independent actuarial determination of the anticipated future payments, discounted at rates ranging from 4.5% to 5.5%. The other major discretely presented component units do not have significant liabilities related to self-insurance.

Changes in the self-insurance claims liability for the primary government and the University of California are shown in Table 40.

Table 40

Schedule of Changes in Self-Insurance Claims
Years Ended June 30
(amounts in thousands)

	Primary Government		University of California – Discretely Presented Component Unit	
	2007	**2006**	**2007**	**2006**
Unpaid claims, beginning	$ 2,576,741	$ 2,807,718	$ 524,220	$ 561,827
Incurred claims	97,287	111,023	224,926	213,604
Claim payments	(352,141)	(342,000)	(189,565)	(251,211)
Unpaid claims, ending	**$ 2,321,887**	**$ 2,576,741**	**$ 559,581**	**$ 524,220**

NOTE 20: NONMAJOR ENTERPRISE SEGMENT INFORMATION

A segment is an identifiable activity reported as or within an enterprise fund or another stand-alone entity for which debt is outstanding and a revenue stream has been pledged in support of that debt. In addition, to qualify as a segment, an activity must be subject to an external requirement to separately account for revenues, expenses, gains and losses, assets, and liabilities of the activity. All of the activities reported in the following condensed financial information meet these requirements.

Table 41 presents the Condensed Statement of Net Assets; the Condensed Statement of Revenues, Expenses, and Changes in Fund Net Assets; and the Condensed Statement of Cash Flows for nonmajor enterprise funds that meet the definition of a segment. The primary sources of revenues for these funds follow.

High Technology Education Fund: Rental payments on public buildings that are used for educational and research purposes related to specific fields of high technology.

State University Dormitory Building Maintenance and Equipment Fund: Charges to students for housing and parking, and student fees for campus unions.

State Water Pollution Control Revolving Fund: Interest charged on loans to communities for construction of water pollution control facilities and projects.

Housing Loan Fund: Interest payments from low-interest, long-term farm and home mortgage loan contracts to eligible veterans living in California.

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Table 41

Nonmajor Enterprise Segments

(amounts in thousands)

Condensed Statement of Net Assets

June 30, 2007

	High Technology Education	State University Dormitory Building Maintenance and Equipment
Assets		
Due from other funds	$ 674	$ 9,477
Due from other governments	—	—
Other current assets	48,343	916,155
Capital assets	—	1,993,981
Other noncurrent assets	128,449	20,963
Total assets	**$ 177,466**	**$ 2,940,576**
Liabilities		
Due to other funds	$ 3,490	$ 12,318
Due to other governments	—	17
Other current liabilities	26,005	176,738
Noncurrent liabilities	117,132	2,411,068
Total liabilities	**146,627**	**2,600,141**
Net assets		
Investment in capital assets, net of related debt	—	(449,373)
Restricted	30,839	290,549
Unrestricted	—	499,259
Total net assets	**30,839**	**340,435**
Total liabilities and net assets	**$ 177,466**	**$ 2,940,576**

Condensed Statement of Revenues, Expenses, and Changes in Fund Net Assets

Year Ended June 30, 2007

Operating revenues	$ 22,966	$ 506,794
Depreciation expense	—	(63,084)
Other operating expenses	(22,704)	(774,962)
Operating income (loss)	262	(331,252)
Nonoperating revenues	—	41,305
Capital contributions	—	—
Transfers in	—	—
Transfers out	(66,601)	(22,372)
Change in net assets	(66,339)	(312,319)
Total net assets, July 1, 2006	**97,178**	**652,754** *
Total net assets, June 30, 2007	**$ 30,839**	**$ 340,435**

Condensed Statement of Cash Flows

Year Ended June 30, 2007

Net cash provided (used) by:		
Operating activities	$ 26,503	$ (130,416)
Noncapital financing activities	(22,270)	(22,372)
Capital and related financing activities	(29,426)	28,336
Investing activities	18,960	(206,903)
Net increase (decrease)	**(6,233)**	**(331,355)**
Cash and pooled investments at July 1, 2006	**53,046**	**975,060**
Cash and pooled investments at June 30, 2007	**$ 46,813**	**$ 643,705**

* Restated

State Water Pollution Control	Housing Loan	Total
$ 9,467	$ 6,999	$ 26,617
112,798	—	112,798
474,595	665,532	2,104,625
—	1,085	1,995,066
2,190,256	1,603,449	3,943,117
$ 2,787,116	**$ 2,277,065**	**$ 8,182,223**
$ 385	$ —	$ 16,193
—	1,272	1,289
27,344	164,423	394,510
215,727	1,876,352	4,620,279
243,456	**2,042,047**	**5,032,271**
—	1,084	(448,289)
591,214	233,934	1,146,536
1,952,446	—	2,451,705
2,543,660	**235,018**	**3,149,952**
$ 2,787,116	**$ 2,277,065**	**$ 8,182,223**
$ 55,045	$ 128,415	$ 713,220
—	(756)	(63,840)
(3,387)	(126,450)	(927,503)
51,658	1,209	(278,123)
14,204	1,878	57,387
182,989	—	182,989
—	—	—
—	—	(88,973)
248,851	3,087	(126,720)
2,294,809	**231,931**	**3,276,672**
$ 2,543,660	**$ 235,018**	**$ 3,149,952**
$ (158,618)	$ (29,324)	$ (291,855)
150,685	127,434	233,477
—	—	(1,090)
21,588	91,852	(74,503)
13,655	**189,962**	**(133,971)**
404,883	**467,440**	**1,900,429**
$ 418,538	**$ 657,402**	**$ 1,766,458**

NOTE 21: NO COMMITMENT DEBT

Certain debt of the nonmajor component units is issued to finance activities such as construction of new facilities, remodeling of existing facilities, and acquisition of equipment. This debt is secured solely by the credit of private and public entities and is administered by trustees independent of the State. As of June 30, 2007, these component units had $19.6 billion of debt outstanding, which is not debt of the State.

The State has also entered into transactions that involve debt issued by four special-purpose trusts that were created by one of its nonmajor component units, the California Infrastructure and Economic Development Bank. The special-purpose trusts are legally separate entities that issued long-term debt for the primary purpose of financing certain costs of assets and obligations that are recoverable by utilities through electric rate charges. These costs may prevent the utilities from offering electricity at lower rates in a competitive market. As of June 30, 2007, the special-purpose trusts had approximately $314 million of debt outstanding. Like the debt of nonmajor component units, the debt of the special purpose trusts is not debt of the State.

NOTE 22: CONTINGENT LIABILITIES

A. Litigation

The primary government is a party to numerous legal proceedings, many of which normally occur in governmental operations. To the extent they existed, the following were accrued as a liability in the government-wide financial statements: legal proceedings that were decided against the primary government before June 30, 2007; legal proceedings that were in progress as of June 30, 2007, and were settled or decided against the primary government as of March 3, 2008; and legal proceedings having a high probability of resulting in a decision against the primary government as of March 3, 2008, and for which amounts could be estimated. In the governmental fund financial statements, the portion of the liability that is expected to be paid within the next 12 months is recorded as a liability of the fund from which payment will be made. In the proprietary fund financial statements, the entire liability is recorded in the fund from which payment will be made.

In addition, the primary government is involved in certain other legal proceedings that, if decided against the primary government, may impair its revenue sources or require it to make significant expenditures. Because of the prospective nature of these proceedings, no provision for the potential liability has been made in the financial statements.

Following are the more significant lawsuits pending against the primary government.

A test claim was filed on behalf of all California counties with the Commission on State Mandates, based on a precedential County of San Diego case, regarding certain unreimbursed costs for the care of medically indigent adults (MIAs). Although certain estimates of the annual cost of services rendered by all counties to MIAs exceed $4.0 billion, the test claim was withdrawn by the claimant and subsequently dismissed by the Commission in May 2007.

The primary government is a defendant in three cases regarding the constitutionality of a fee imposed on limited liability companies (LLC). In the *Northwest Energetic Services, LLC v. Franchise Tax Board*, the Court of Appeal found the fee unconstitutional only as applied to the plaintiff, and in *Ventas Finance I, LLC v. Franchise Tax Board*, the trial court found the fee also to be unconstitutional as applied to the plaintiff in that case. The

Ventas case is currently on appeal. The trial for the third case, *Bakersfield Mall, LLC v. Franchise Tax Board*, has been postponed and a new trial date has not been set. If the courts were to rule against the State in all three cases, the potential refunds would be $1.3 billion. However, because a recently enacted Revenue and Taxation code section implements a statutory remedy in the event the fee is finally adjudged to be unconstitutional, the State Department of Finance believes the refunds would be limited to approximately $300 million.

The University of California (UC), the State Compensation Insurance Fund (SCIF), the California Housing Finance Agency (CalHFA) and nonmajor discretely presented component units are contingently liable in connection with claims and contracts, including those currently in litigation, arising in the normal course of their activities. Although there are inherent uncertainties in any litigation, the management and the general counsel of UC, SCIF, and CalHFA are of the opinion that the outcome of such matters either will not have a material effect on the financial statements or cannot be estimated at this time.

B. Federal Audit Exceptions

The primary government receives substantial funding from the federal government in the form of grants and other federal assistance. The primary government, UC, and CalHFA are entitled to these resources only if they comply with the terms and conditions of the grants and contracts and with the applicable federal laws and regulations; they may spend these resources only for eligible purposes. If audits disclose exceptions, the primary government, UC, and CalHFA may incur a liability to the federal government.

NOTE 23: PENSION TRUSTS

Two retirement systems, the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS), which are fiduciary component units, are included in the pension and other employee benefit trust funds column of the fiduciary funds and similar component units' financial statements. The pension liability for all pension and other employee benefit trust funds was determined in accordance with GASB Statement No. 27, *Accounting for Pensions by State and Local Government Employers*. The amounts of the pension liability for all pension and other employee benefit trust funds are presented in Table 42 as the net pension obligation (NPO) as of June 30, 2007. The investments of these fiduciary component units are presented in Table 6 in Note 3, Deposits and Investments.

CalPERS administers five defined benefit retirement plans: the Public Employees' Retirement Fund (PERF), the Judges' Retirement Fund (JRF), the Judges' Retirement Fund II (JRF II), the Legislators' Retirement Fund (LRF), and the Volunteer Firefighters' Length of Service Award Fund (VFF). CalPERS also administers three defined contribution plans: the State Peace Officers' and Firefighters' Defined Contribution Plan Fund (SPOFF), the public employee Replacement Benefit Fund (RBF), and the public employee Supplemental Contributions Program Fund (SCPF). CalPERS issues a publicly available financial report that includes financial statements and required supplementary information for these plans. This report may be obtained by writing to the California Public Employees' Retirement System, Fiscal Services Division, P.O. Box 942703, Sacramento, California 94229 or by visiting the CalPERS Web site at www.CalPERS.ca.gov.

CalPERS uses the accrual basis of accounting. Member contributions are recognized in the period in which the contributions are due. Employer contributions are recorded when due and the employer has made a formal commitment to provide the contributions. Benefits under the defined benefit plans and refunds are recognized when due and payable in accordance with the terms of each plan.

CalSTRS administers three defined benefit retirement plans within the State Teachers' Retirement Plan: the Defined Benefit Program (DB Program), the Defined Benefit Supplement Program, and the Cash Balance Benefit Program. CalSTRS also offers the Voluntary Investment Program, through a third-party administrator, that is a tax-deferred defined contribution plan meeting the requirements of Internal Revenue Code Section 403(b). The Teachers' Health Benefits Fund provides post-employment health benefits to retired members of the DB Program. CalSTRS issues a publicly available financial report that includes financial statements and required supplementary information for these plans. This report may be obtained from the California State Teachers' Retirement System, P.O. Box 15275, Sacramento, California 95851.

CalSTRS uses the accrual basis of accounting. Member contributions are recognized in the period in which the contributions are due. Employer and primary government contributions are recognized when due and when the employer or the primary government has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable, in accordance with the retirement and benefits programs.

A. Public Employees' Retirement Fund

1. Fund Information

Plan Description: CalPERS administers the PERF, which is an agent multiple-employer defined benefit retirement plan. Employers participating in the PERF include the primary government and certain discretely presented component units, 61 school employers, and 1,499 public agencies as of June 30, 2007. For reporting purposes, the financial information of the RBF is combined with that of the PERF.

The amount by which the actuarial accrued liability exceeded the actuarial value of assets in the PERF for the primary government and other participating agencies was $29.1 billion at June 30, 2006. This is a result of the difference between the actuarial value of assets of $199.0 billion and the actuarial accrued liability of $228.1 billion. Contributions are actuarially determined.

2. Employer's Information

Plan Description: The primary government and certain discretely presented component units contribute to the PERF. CalPERS acts as a common investment and administrative agent of the primary government and the other member agencies. The discretely presented component units' participation in the PERF is not a material portion of the program. The primary government employees served by the PERF include: first-tier and second-tier miscellaneous and industrial employees, California Highway Patrol employees, peace officers and firefighters, and other safety members. The payroll for primary government employees covered by the PERF in the year ended June 30, 2007, was approximately $14.8 billion.

All employees in a covered class of employment who work half-time or more are eligible to participate in the PERF. The PERF provides benefits based on members' years of service, age, final compensation, and benefit formula. Vesting occurs after five years, or after ten years for second-tier employees. The PERF provides death, disability, and survivor benefits. The benefit provisions are established by statute.

Funding Policy: Benefits are funded by contributions from members and the primary government and earnings from investments. Member and primary government contributions are a percentage of applicable member compensation. Member rates are defined by law and based on the primary government's benefit formula. The primary government contribution rates are determined by periodic actuarial valuations.

Employees, with the exception of employees in the second-tier plans and the State's Alternative Retirement Program, contribute to the fund based on the required contribution rates. The contribution rates of active plan members are based on a percentage of salary over a monthly base compensation amount of $133 to $863. Employees' required contributions vary from 5.0% to 8.0% of their salary over the base compensation amount.

All of the primary government employees served by the PERF are now covered by group term life insurance. The required employer contribution rates for the primary government are shown in Table 42.

Table 42

Schedule of Required Employer Contribution Rates for the Primary Government by Member Category

Year Ended June 30, 2007

	Normal Cost	Unfunded Liability	Group Term Life Benefit	Total Rate
Miscellaneous members				
First tier	10.093 %	6.819 %	0.085 %	16.997 %
Second tier	9.874	6.819	0.085	16.778
Industrial (first and second tier)	13.844	3.967	0.050	17.861
California Highway Patrol	16.652	14.718	0.093	31.463
Peace officers and firefighters	17.389	7.116	0.000	24.505
Other safety members	15.903	3.389	0.002	19.294

For the year ended June 30, 2007, the annual pension cost (APC) and the amount of contributions made by the primary government were each $2.8 billion. The APC and the percentage of APC contributed for the last three years are shown in Table 43. Actuarial valuations of the PERF are performed annually. Information from the last valuation, which was performed as of June 30, 2006, is also shown in Table 43 for the primary government.

B. Judges' Retirement Fund

Plan Description: CalPERS administers the JRF, which is an agent multiple-employer defined benefit retirement plan. The JRF membership includes justices of the Supreme Court and courts of appeal, as well as judges of superior courts, appointed or elected prior to November 9, 1994. There are 59 employers participating in the JRF for the year ended June 30, 2007. The payroll for employees covered by the JRF for the year ended June 30, 2007, was approximately $120 million. The primary government pays the employer contributions for all employees covered by the JRF.

The JRF provides benefits based on a member's years of service, age, final compensation, and benefit formula. Vesting occurs after five years. The JRF provides death, disability, and survivor benefits. Benefits for the JRF are established by the Judges' Retirement Law.

Funding Policy: The contribution rate of active plan members is defined by law and is based on a percentage of salary over a base compensation amount. For the year ended June 30, 2007, the required member rate for the JRF was 8.0%.

The contributions of the primary government to the JRF are made pursuant to state statute and are not actuarially determined. As of June 30, 2007, employer contributions are required to be 8.0% of applicable member compensation. Other funding to meet benefit payment requirements of the JRF is currently provided by: filing fees, which require varying amounts, depending on fee rate and number of filings; investments, which earn the current yield on short-term investments; and the primary government's balancing contributions, as required by the Judges' Retirement Law. The balancing contributions are an amount at least equal to the estimated benefits payable during the ensuing fiscal year, less the sum of the estimated member contributions during the ensuing fiscal year and net assets available for benefits at the beginning of the fiscal year ("pay as you go" basis).

The annual pension cost (APC) and the amount of employer contributions made to the JRF for the year ended June 30, 2007, were $324 million and $131 million, respectively. The net pension obligation (NPO) of the JRF at June 30, 2007, was $1.9 billion, an increase of $192 million over last year's balance of $1.7 billion. The APC is comprised of $561 million for the annual required contribution (ARC), $117 million for interest on the NPO, and a negative $354 million adjustment to the ARC. An actuarial valuation of the JRF's assets and liabilities is made annually. The APC, the percentage of APC contributed, and the NPO for the last three years are shown in Table 43. Information on the last valuation, which was performed as of June 30, 2006, is shown in Table 43. The aggregate cost method that was used for the June 30, 2006, valuation does not identify or separately amortize the unfunded actuarial accrued liability; therefore, this liability is not shown in Table 43.

C. Judges' Retirement Fund II

Plan Description: CalPERS administers the JRF II, which is an agent multiple-employer defined benefit retirement plan. The membership of the JRF II includes justices of the same courts covered by the JRF who were appointed or elected on or subsequent to November 9, 1994. There are 59 employers participating in the JRF II. The payroll for employees covered by the JRF II for the year ended June 30, 2007, was approximately $146 million. The primary government pays the employer contributions for all employees covered by the JRF II.

The JRF II provides benefits based on a member's years of service, age, final compensation, and benefit formula. Vesting occurs after five years. The JRF II provides death, disability, and survivor benefits. Benefits for the JRF II are established by the Judges' Retirement System II Law.

Funding Policy: The required contribution rate of active plan members is defined by law and is based on a percentage of salary over a base compensation amount. For the year ended June 30, 2007, the required member rate for the JRF II was 8.0%, and the primary government's contribution rate for the JRF II was 19.92% of applicable member compensation.

Actuarial valuations for the JRF II are required to be carried out annually. The legislated primary government contribution rate is adjusted periodically as part of the annual Budget Act, in order to maintain or restore the actuarial soundness of the fund.

For the year ended June 30, 2007, the annual pension cost (APC) and the amount of contributions made for the JRF II were approximately $27.1 million, which is slightly less than the actuarially determined required contribution of $28.5 million. The APC and the percentage of APC contributed for the year ended June 30, 2007, are shown in Table 43. Information on the last valuation, which was performed as of June 30, 2006, is also shown in Table 43.

D. Legislators' Retirement Fund

Plan Description: CalPERS administers the LRF, which is a single-employer defined benefit retirement plan. The eligible membership of the LRF includes state legislators serving in the legislature prior to November 1, 1990, constitutional officers, and legislative statutory officers. For the fiscal year ending June 30, 2007, no statutory contribution was required, based on the June 30, 2005 valuation.

The LRF provides benefits based on a member's years of service, age, final compensation, and benefit formula. Vesting occurs after five years. The plan provides death, disability, and survivor benefits. Benefits for the LRF are established by the Legislators' Retirement Law.

No current legislators are eligible to participate in the LRF. The only active members in the LRF are 13 constitutional officers (including the Insurance Commissioner and members of the Board of Equalization) and legislative statutory officers.

Funding Policy: The employer contribution requirements of the LRF are based on actuarially determined rates. An actuarial valuation of the LRF's assets and liabilities is required at least every two years. Member contribution rates are defined by law. For the year ended June 30, 2007, employee contributions were not required because the plan was superfunded. By definition, "superfunded" means that the plan's actuarial value of assets exceeds the present value of future benefits for current members. However, some members made contributions towards military service and prior service.

The net pension obligation (NPO) of the LRF on June 30, 2007, was approximately $10 million. There was no annual pension cost (APC) because the annual required contribution (ARC) equaled zero and the interest on the NPO closely approximated the adjustment to the ARC. The APC, the percentage of APC contributed, and the NPO for the last three years are shown in Table 43. An actuarial valuation of the LRF's assets and liabilities is required at least every two years. Information on the last valuation, which was performed as of June 30, 2006, is also shown in Table 43. The aggregate cost method that was used for the June 30, 2006, valuation does not identify or separately amortize the unfunded actuarial accrued liability; therefore, this liability is not shown in Table 43.

E. Volunteer Firefighters' Length of Service Award Fund

Plan Description: CalPERS administers the VFF, which is an agent multiple-employer defined benefit retirement plan. The VFF membership includes volunteer firefighters. There were 47 fire departments participating in the VFF for the year ended June 30, 2007.

The actuarial accrued liability of the VFF exceeded the actuarial value of assets by $531,000 at June 30, 2006. This is a result of the difference between the actuarial accrued liability of $4.1 million and the actuarial value of assets of $3.6 million. Contributions are actuarially determined.

F. State Peace Officers' and Firefighters' Defined Contribution Plan Fund

Plan Description: CalPERS administers the SPOFF, which is a defined contribution pension plan. The plan is a qualified money purchase pension plan under Section 401(a) of Title 26 of the Internal Revenue Code. It is intended to supplement the retirement benefits provided by the Public Employees' Retirement Fund to eligible correctional employees employed by the State of California.

Funding Policy: Contributions to the plan are funded entirely by the primary government with a contribution rate of 2% of the employee's base pay, not to exceed contribution limits established by the Internal Revenue Code. Contribution requirements are established and may be amended through a memorandum of understanding from the State of California Department of Personnel Administration. As a result of negotiation provisions in the bargaining unit contract, the State resumed monthly contributions for rank and file employees in addition to contributions for managers and supervisors. These contributions, as well as the participant's share of the net earnings of the fund, are credited to the participant's account. For the year ended June 30, 2007, contributions by the primary government to the SPOFF were approximately $49 million.

The net earnings of the fund are allocated to the participant's account as of each valuation date, in the ratio that the participant's account balance bears to the aggregate of all participants' account balances. The benefit paid to a participant will depend only on the amount contributed to the participant's account and earnings on the value of the participant's account. Plan provisions are established by and may be amended by statute. At June 30, 2007, there were 37,760 participants in the SPOFF.

G. Teachers' Retirement Fund

Plan Description: CalSTRS administers the Teachers' Retirement Fund, which is an employee benefit trust fund created to administer the State Teachers' Retirement Plan (STRP). The STRP is a defined benefit pension plan that provides for retirement, disability, and survivor benefits. The STRP is comprised of three programs: the Defined Benefit (DB) Program, the Defined Benefit Supplement (DBS) Program, and the Cash Balance (CB) Benefit Program. The STRP is a cost-sharing, multiple-employer, defined-benefit retirement plan that provides pension benefits to teachers and certain other employees of the California public school system.

Membership in the DB Program is mandatory for all employees meeting the eligibility requirements. The DB Program provides benefits based on a member's age, final compensation, and years of service. Vesting occurs after five years. In addition, the retirement program provides benefits to members upon disability and to survivors upon the death of eligible members. The Teachers' Retirement Law establishes the benefits for the DB Program. At June 30, 2007, the DB Program had approximately 1,600 contributing employers and as of June 30, 2006, had 586,966 active and inactive program members and 207,846 benefit recipients. The primary government is a nonemployer contributor to the DB Program. The payroll for employees covered by the DB Program for the year ended June 30, 2007, was approximately $26.6 billion.

Membership in the DBS Program is automatic for all members of the DB Program. The DBS Program provides benefits based on the balance of member accounts. Vesting occurs immediately. The Teachers' Retirement Law establishes the benefits for the DBS Program. The primary government does not contribute to the DBS Program.

The CB Benefit Program is designed for employees of California public schools who are hired to perform creditable service for less than 50% of the full-time equivalent for the position. Employer participation in the CB Benefit Program is optional. However, if the employer elects to offer the CB Benefit Program, each eligible employee will automatically be covered by the CB Benefit Program unless the member elects to participate in the DB Program or an alternative plan provided by the employer within 60 days of hire. At June 30, 2007, the CB Benefit Program had 30 contributing school districts and 23,941 contributing participants.

Funding Policy: DB Program benefits are funded by contributions from members, employers, the primary government, and earnings from investments. Members and employers contribute a percentage of applicable member earnings. The Teachers' Retirement Law governs member rates, employer contribution rates, and primary government contributions.

The DB Program contribution rate of members is 6% of creditable compensation through December 31, 2010, increasing to 8% thereafter for service less than or equal to one year of creditable service per fiscal year. The employer contribution rate is 8.25% of creditable compensation for service less than or equal to one year of creditable service per fiscal year. For service in excess of one year within one fiscal year, the employer contribution rate is 0.25%. In fiscal year 2006-07, the General Fund contribution was 2.017% of total creditable compensation of the fiscal year ending in the prior calendar year. Education Code section 22955(b) states that the General Fund will contribute additional quarterly payments at a contribution rate of 0.524% of creditable earnings of the fiscal year ending in the immediately preceding calendar year when there is an unfunded obligation or a normal cost deficit. The percentage is adjusted up to 0.25% per year to reflect the contributions required to fund the unfunded obligation or the normal cost deficit. However, the transfer may not exceed 1.505% of creditable compensation from the immediately preceding calendar year. The normal cost deficit is the difference between the normal cost rate and the member and employer contributions, which equal 16.00% of creditable compensation. Based on the most recent actuarial valuation, as of June 30, 2006, no normal cost deficit or an unfunded obligation exists for benefits in place as of July 1, 1990. Therefore, the General Fund is not required to contribute the additional quarterly payments at a contribution rate of 0.524% starting October 1, 2007.

The DBS Program member contribution rate is 2% of creditable compensation for service less than or equal to one year of creditable service per fiscal year. For service in excess of one year within one fiscal year, the member contribution rate is 8% and the employer rate is 8%.

For the year ended June 30, 2007, the annual pension cost (APC) for the DB Program was approximately $4 billion; the employer and primary government contributions were approximately $2.2 billion and $481 million, respectively. The APC and the percentage of APC contributed for the last three years are shown in Table 43. Actuarial valuations of the DB Program are performed at least biennially. Information from the last valuation is shown in Table 43.

H. CalSTRS Voluntary Investment Program

Plan Description: CalSTRS administers the Voluntary Investment Program (VIP), a 403(b) program, through a third-party administrator. The VIP is a defined contribution plan and is open to any employee who is eligible to participate. Contributions to the program are voluntary; however, the Internal Revenue Code does impose a maximum amount that can be contributed annually. At June 30, 2007, the VIP had 400 participating employers (school districts) and 3,878 plan members.

I. Teachers' Health Benefits Fund

Plan Description: CalSTRS administers the Teachers' Health Benefits Fund (THBF), which was established pursuant to Chapter 1032, Statutes of 2000 (SB 1435), to provide the Medicare Premium Payment Program for eligible retired members of the DB Program. At June 30, 2007, there were 6,225 benefit recipients.

Funding Policy: The THBF is funded as needed from the monthly DB Program statutory employer contribution that exceeds the amount needed to finance the liabilities of the DB Program based on the June 30, 2000, valuation of the DB Program.

Table 43

Actuarial Information – Pension Trusts – Primary Government
Valuation Date As Indicated

	Public Employees' Retirement Fund	Judges' Retirement Fund	Judges' Retirement II Fund
Last actuarial valuation	June 30, 2006	June 30, 2006	June 30, 2006
Actuarial cost method	Individual Entry Age Normal	Aggregate Cost	Aggregate Entry Age Normal
Amortization method	Level % of Payroll, Closed	None	Level % of Payroll, Closed
Remaining amortization period	23 to 28 years	None	Average of 30 Years
Asset valuation method	Smoothed Market Value	Market Value	Smoothed Market Value
Actuarial assumption			
Investment rate of return	7.75 %	7.00 %	7.25 %
Projected salary increase	3.25 - 19.95	3.25	3.25
Includes inflation at	3.00	3.00	3.00
Post-retirement benefit increases	2 - 3	3.25	3.00
Annual pension costs (in millions)			
Year ended 6/30/05	$ 2,480	$ 184	$ 21
Year ended 6/30/06	2,419	315	24
Year ended 6/30/07	2,782	324	27
Percent contribution			
Year ended 6/30/05	100 %	67 %	93 %
Year ended 6/30/06	100	62	95
Year ended 6/30/07[2]	100	23	95
Net pension obligation (NPO) (in millions)			
Year ended 6/30/05	—	$ 1,477	—
Year ended 6/30/06	—	1,672	—
Year ended 6/30/07	—	1,864	—
Funding as of last valuation (in millions)			
Actuarial value – assets	$ 81,968	N/A	$ 213
Actuarial accrued liabilities (AAL) – entry age	92,557	N/A	220
Excess of actuarial value of assets over AAL (EAV) (unfunded actuarial accrued liability (UAAL))	(10,589)	N/A	(7)
Covered payroll	14,790	N/A	125
Funded ratio	88.6 %	N/A	96.7 %
EAV (UAAL) as percent of covered payroll	(71.6) %	N/A	(5.8) %

1 The State is a non-employer contributor to the State Teacher's Retirement Defined Benefit Program Fund, a cost-sharing multiple-employer plan. The annual pension cost includes the amount related to both the State and the local government employers. The notion of NPO does not apply to cost-sharing employer plans. According to the provisions of the Education Code, the State and local government employers contributed $481 million and $2.2 billion, respectively, for the year ending June 30, 2007. Based on the most recent actuarial valuation, dated June 30, 2006, current statutory contributions are sufficient to fund normal costs but are not expected to be sufficient to amortize the unfunded actuarial obligation. However, future estimates of the actuarial unfunded obligation may change due to market performance, legislative actions, and other experience that may differ from the actuarial assumptions.

2 Prior to fiscal year 2007, a variation of the Aggregate Cost Method was used to determine the ARC for the Judges' Retirement Fund. Effective fiscal year 2007, the Traditional Aggregate Cost Method was used to determine the ARC.

Legislators' Retirement Fund	State Teachers' Retirement Defined Benefit Program Fund[1]
June 30, 2006	June 30, 2006
Aggregate Cost	Entry Age Normal
None	Level % of Payroll, Open
None	Not amortizable
Smoothed Market Value	Expected Value, With 33% Adjustment to Market Value
7.00 %	8.00 %
3.25	4.25
3.00	3.25
3.00	2.00
—	$ 3,709
—	3,821
—	3,980
—	70 %
—	64
—	67
$ 10	—
10	—
10	—
N/A	$ 131,237
N/A	150,872
N/A	(19,635)
N/A	24,240
N/A	87.0 %
N/A	(81.0) %

NOTE 24: POST-RETIREMENT HEALTH CARE BENEFITS

The primary government and certain discretely presented component units provide health care and dental benefits to annuitants of retirement systems to which the primary government contributes as an employer. The discretely presented component units' participation in these plans is not a material portion of the program. To be eligible for these benefits, first-tier plan annuitants must retire on or after age 50 with at least five years of service, and second-tier plan annuitants must retire on or after attaining age 55 with at least 10 years of service. In addition, annuitants must retire within 120 days of separation from employment to be eligible to receive these benefits. As of June 30, 2007, approximately 134,600 annuitants were enrolled to receive health benefits and approximately 109,300 annuitants were enrolled to receive dental benefits. In accordance with the California Government Code, the primary government generally pays 100% of the health insurance cost for annuitants, plus 90% of the additional premium required for the enrollment of family members of annuitants. Although the California Government Code does not specify the primary government's contribution toward dental insurance costs, the primary government generally pays all or a portion of the dental insurance cost for annuitants, depending upon the completed years of credited state service at retirement and the dental coverage selected by the annuitant. The primary government recognizes the cost of providing health and dental insurance to annuitants on a pay-as-you-go basis. The cost of these benefits for the year ended June 30, 2007, was approximately $1.0 billion.

Also, the University of California, a discretely presented component unit, provides to retired employees certain health plan benefits in addition to pension benefits. Employees who meet specific requirements may continue their medical and dental benefits into retirement and continue to receive University of California contributions for those benefits. Approximately 37,800 retirees are eligible to receive such benefits. The cost of retiree medical and dental coverage is recognized when paid. The cost of providing medical and dental benefits for retirees and their families and survivors for the year ended June 30, 2007, was $216 million.

NOTE 25: SUBSEQUENT EVENTS

The following information describes significant events that occurred subsequent to June 30, 2007, but prior to the date of the auditor's report.

The primary government issued $3.7 billion in general obligation bonds to retire previously issued commercial paper, to repay internal state loans, to repay bond anticipation notes, and to finance various school, water, park, library, seismic, transportation, housing, prisons, children's hospital projects, and stem cell research projects. The primary government issued $91 million in veterans' general obligation bonds to retire previously issued commercial paper and to finance and refinance homes and farms for California military veterans. The primary government issued revenue anticipation notes of $7 billion that are due to be redeemed in June 2008.

In February 2008, the primary government issued $3.2 billion in Economic Recovery Bonds to finance a portion of the State's accumulated budget deficit. However, by February 2008, the primary government redeemed $1.7 billion of Economic Recovery Bonds that were outstanding at June 30, 2007, prior to their required redemption.

The Regents of the University of California issued Medical Center Pooled Revenue Bonds totaling $197 million to refinance certain improvements to one of the medical centers and to refund certain Medical Center Revenue Bonds. The university also issued Limited Project Revenue Bonds totaling $415 million to finance and refinance certain auxiliary enterprises of the university. In addition, General Revenue Bonds totaling $249 million were issued to finance and refinance certain facilities and projects of the university.

The California State University issued Systemwide Revenue Bonds in the amount of $63 million for refunding existing senior student union bonds. The university issued Revenue Bond Anticipation Notes in the amount of $91 million for construction projects and $45 million to refinance housing at the Channel Islands campus. The California State University Auxiliary Organizations, a discretely presented component unit, issued $14 million of commercial paper for capital financing to specific campuses and purchased land for $11 million to expand student housing.

The Department of Veterans Affairs issued $100 million in Home Purchase Revenue Bonds to finance the purchase of homes and farms for California military veterans.

The State Public Works Board, an agency whose activities are accounted for as an enterprise fund, issued lease revenue bonds totaling $124 million for the benefit of the Department of Corrections and Rehabilitiation, the Department of Food and Agriculture, the Department of Forestry and Fire Protection, and the Judicial Council.

In the primary election held on February 5, 2008, voters approved four tribal casino measures with the passage of Propositions 94, 95, 96, and 97, Referendum on Amendment to Indian Gaming Compact. The impact of the passage of these propositions will be an increase to annual state revenues in the low to mid hundreds of millions of dollars, lasting until 2030.

Required Supplementary Information

Schedule of Funding Progress [1]

Public Employees' Retirement Fund - Primary Government

(amounts in millions)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Excess of Actuarial Value of Assets Over AAL (Unfunded Actuarial Accrued Liability (UAAL)) (a - b)	Funded Ratio (a / b)	Covered Payroll (c)	Excess (UAAL) as a Percentage of Covered Payroll ((a - b) / c)
June 30, 2004	$ 67,081	$ 79,800	$ (12,719)	84.1 %	$ 12,624	(100.8) %
June 30, 2005	71,830	86,595	(14,765)	82.9	13,790	(107.1)
June 30, 2006	81,968	92,557	(10,589)	88.6	14,790	(71.6)

Judges' Retirement Fund II

(amounts in thousands)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Excess of Actuarial Value of Assets Over AAL (Unfunded Actuarial Accrued Liability (UAAL)) (a - b)	Funded Ratio (a / b)	Covered Payroll (c)	Excess (UAAL) as a Percentage of Covered Payroll ((a - b) / c)
June 30, 2004	$ 129,153	$ 137,704	$ (8,551)	93.8 %	$ 99,005	(8.6) %
June 30, 2005	167,556	177,761	(10,205)	94.3	111,767	(9.1)
June 30, 2006	212,904	220,135	(7,231)	96.7	125,300	(5.8)

State Teachers' Retirement Defined Benefit Program

(amounts in millions)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL)[2] (b)	Excess of Actuarial Value of Assets Over AAL (Unfunded Actuarial Accrued Liability (UAAL)) (a - b)	Funded Ratio (a / b)	Covered Payroll[2] (c)	Excess (UAAL) as a Percentage of Covered Payroll ((a - b) / c)
June 30, 2004	$ 114,094	$ 134,677	$ (20,583)	84.7 %	$ 22,591	(91.1) %
June 30, 2005	121,882	142,193	(20,311)	85.7	23,257	(87.3)
June 30, 2006	131,237	150,872	(19,635)	87.0	24,240	(81.0)

[1]Actuarial valuations for the Judges' Retirement Fund and the Legislators' Retirement Fund are performed using the aggregate actuarial cost valuation method. The schedule of funding progress is not required if this method is used.

[2]Actuarial Accrued Liability and Covered Payroll figures for 2004 were revised on an estimated basis in 2006 to reflect data corrections.

Infrastructure Assets Using the Modified Approach

Pursuant to Governmental Accounting Standards Board (GASB), Statement No. 34, the State has adopted the Modified Approach as an alternative method to depreciating the cost of its infrastructure (state roadways and bridges). Under the Modified Approach, the State will not report depreciation expense for roads and bridges but will capitalize all costs that add to the capacity and efficiency of State-owned roads and bridges. All maintenance and preservation costs will be expensed and not capitalized.

A. Infrastructure Asset Reporting Categories

The infrastructure assets reported in the State's financial statements for the fiscal year ending June 30, 2007, are in the following categories and amounts: state highway infrastructure (completed highway projects), totaling $56.0 billion; land purchased for highway projects, totaling $11.4 billion; and infrastructure construction-in-progress (uncompleted highway projects), totaling $5.8 billion.

Donation and Relinquishment: Donation and relinquishment activity affects the inventory of statewide lane miles, land, and/or bridges as adjustments to the infrastructure assets and/or land balance in the State's financial statements. There were no donations for the fiscal year ending June 30, 2007. Relinquishments for the fiscal year ending June 30, 2007, are $89 million of state highway infrastructure and $18 million of infrastructure land.

B. Condition Baselines and Assessments

The State is providing the most recent and two previous condition assessments, as required by GASB Statement No. 34.

1. Bridges

The State uses the Bridge Health Index — a numerical rating scale from 0% to 100% that utilizes element-level inspection data — to determine the aggregate condition of its bridges. The inspection data is based on the American Association of State Highway Transportation Officials' (AASHTO) "Commonly Recognized Structural Elements Standard."

From a deterioration standpoint, the Bridge Health Index (BHI) represents the remaining asset value of the bridge. A new bridge that has 100% of its asset value will have a BHI of 100%. As a bridge deteriorates over time, it loses asset value as represented by a decline in its BHI. When a deteriorated bridge is repaired, it will regain some (or all) of its asset value and its BHI will increase.

The State's established condition baseline and actual BHI for fiscal years 2004-05 through 2006-07 are as follows:

Fiscal Year Ending June 30	Established BHI Condition Baseline*	Actual BHI Condition
2005	80.0 %	94.3 %
2006	80.0	94.5
2007	80.0	94.3

* The actual statewide Bridge Health Index (BHI) should not be lower than the minimum BHI established by the State.

The following table provides details on the State's actual BHI and condition baseline as of June 30, 2007.

BHI Description	Bridge Count	Percent	Network BHI
Excellent	6,401	52.66 %	99.9 %
Good	4,576	37.65	96.2
Acceptable	831	6.84	87.0
Fair	197	1.62	75.8
Poor	150	1.23	60.8
Total	**12,155**	**100.00 %**	

2. Roadways

The State uses AASHTO "Pavement Performance Data Collection Protocols" in its annual pavement condition survey, which evaluates ride quality and structural integrity and identifies the number of distressed lane miles. The State classifies its roadways' pavement condition by the following descriptions:

1. Excellent/good condition – minor or no potholes or cracks.
2. Fair condition – moderate potholes and cracks.
3. Poor condition – significant or extensive potholes or cracks.

Statewide lane miles are considered "distressed lane miles" if they are in either fair or poor condition. The actual distressed lane miles are compared to the established condition baseline to ensure that the baseline is not exceeded.

The State's established condition baseline and actual distressed lane miles for fiscal years 2004-05 through 2006-07 are as follows:

Fiscal Year Ending June 30	Established Condition Baseline Distressed Lane Miles (maximum)*	Actual Distressed Lane Miles	Actual Distressed Lane Miles as Percent of Total Lane Miles
2005	18,000	12,624	25.5 %
2006	18,000	13,845	27.9
2007	18,000	12,905	26.0

* The actual statewide distressed lane miles should not exceed the maximum distressed lane miles established by the State.

The following table provides details on the pavement condition of the State's roadways as of June 30, 2007.

Pavement Condition	Lane Miles	Distressed Lane Miles
Excellent/Good	36,572	—
Fair	571	571
Poor	12,334	12,334
Total	**49,477**	**12,905**

C. Budgeted and Actual Preservation Costs

The State provides only budgeted and actual preservation costs starting with the fiscal year ending June 30, 2004, instead of the last five fiscal years, because the information was not previously required by GASB. In succeeding years, the State will add the previous fiscal years' budgeted and actual preservation cost information until the number of fiscal years being reported reaches five, as required by GASB Statement No. 34.

The estimated budgeted preservation costs represents the preservation projects approved by the California Transportation Commission and the State's scheduled preservation work for each fiscal year. The actual preservation costs represents the cumulative cost to date for the projects approved and work scheduled in each fiscal year.

Fiscal Year Ending June 30	Estimated Budgeted Preservation Costs (in millions)	Actual Preservation Costs (in millions)
2004	$ 975	$ 916
2005	1,049	994
2006	2,025	1,836
2007	2,313	1,713

Budgetary Comparison Schedule

General Fund and Major Special Revenue Funds

Year Ended June 30, 2007
(amounts in thousands)

	General			
	Budgeted Amounts		Actual	Variance With
	Original	Final	Amounts	Final Budget
REVENUES				
Corporation tax	$ —	$ —	$ 11,157,897	$ —
Intergovernmental	—	—	—	—
Cigarette and tobacco taxes	—	—	115,368	—
Inheritance, estate, and gift taxes	—	—	6,348	—
Insurance gross premiums tax	—	—	2,178,336	—
Vehicle license fees	—	—	26,981	—
Motor vehicle fuel tax	—	—	—	—
Personal income tax	—	—	52,409,766	—
Retail sales and use taxes	—	—	27,444,661	—
Other major taxes and licenses	—	—	336,059	—
Other revenues	—	—	2,257,517	—
Total revenues	**—**	**—**	**95,932,933**	**—**
EXPENDITURES				
State and consumer services	655,559	612,817	605,222	7,595
Business and transportation	2,648,715	2,648,931	2,648,664	267
Resources	1,824,566	1,720,355	1,668,148	52,207
Health and human services	29,526,323	29,865,632	29,112,987	752,645
Correctional programs	8,785,783	9,288,959	8,993,306	295,653
Education	49,250,882	49,321,232	49,074,900	246,332
General government:				
Tax relief	976,956	981,204	958,463	22,741
Debt service	3,387,674	3,401,691	3,397,681	4,010
Other general government	5,083,624	5,164,526	5,036,946	127,580
Total expenditures	**102,140,082**	**103,005,347**	**101,496,317**	**1,509,030**
OTHER FINANCING SOURCES (USES)				
Transfers from other funds	—	—	1,466,082	—
Transfers to other funds	—	—	(1,568,898)	—
Other additions and deductions	—	—	1,342,170	—
Total other financing sources (uses)	**—**	**—**	**1,239,354**	**—**
Excess (deficency) of revenues and other sources over (under) expenditures and other uses	—	—	(4,324,030)	—
Fund balances, July 1, 2006 (restated)	**—**	**—**	**11,447,742**	**—**
Fund balances, June 30, 2007	**$ —**	**$ —**	**$ 7,123,712**	**$ —**

Federal				Transportation Construction			
Budgeted Amounts		Actual	Variance With	Budgeted Amounts		Actual	Variance With
Original	Final	Amounts	Final Budget	Original	Final	Amounts	Final Budget
$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —
—	—	41,596,613	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	3,399,694	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	997,283	—
—	—	534	—	—	—	340,494	—
—	**—**	**41,597,147**	**—**	**—**	**—**	**4,737,471**	**—**
31,045	31,045	31,045	—	—	—	—	—
3,077,185	3,077,185	3,077,185	—	5,794,293	5,737,862	4,813,019	924,843
342,836	342,836	342,836	—	12	12	12	—
28,467,197	28,467,197	28,467,197	—	—	—	—	—
199,461	199,461	199,461	—	—	—	—	—
6,676,932	6,676,932	6,676,932	—	980	980	980	—
—	—	—	—	—	—	—	—
—	—	—	—	700	700	624	76
1,107,490	1,107,490	1,107,490	—	1,255,219	849,925	848,727	1,198
39,902,146	**39,902,146**	**39,902,146**	**—**	**7,051,204**	**6,589,479**	**5,663,362**	**926,117**
—	—	5,070,481	—	—	—	6,724,856	—
—	—	(6,761,913)	—	—	—	(5,893,462)	—
—	—	(3,426)	—	—	—	1,157,520	—
—	**—**	**(1,694,858)**	**—**	**—**	**—**	**1,988,914**	**—**
—	—	143	—	—	—	1,063,023	—
—	**—**	**11,326**	**—**	**—**	**—**	**3,269,360**	**—**
$ —	**$ —**	**$ 11,469**	**$ —**	**$ —**	**$ —**	**$ 4,332,383**	**$ —**

Reconciliation of Budgetary Basis Fund Balances of the General Fund and the Major Special Revenue Funds to GAAP Basis Fund Balances

June 30, 2007
(amounts in thousands)

		Special Revenue Funds	
	General	Federal	Transportation Construction
Budgetary fund balance reclassified into GAAP statement fund structure	**$ 7,123,712**	**$ 11,469**	**$ 4,332,383**
Basis difference:			
Interfund receivables	83,785	—	1,699,747
Loans receivable	99,768	43,465	—
Interfund payables	(2,425,076)	—	—
Escheat property	(925,855)	—	—
Other	1,468	—	(81,812)
Timing difference:			
Liabilities budgeted in subsequent years	(5,865,340)	(17,210)	(70,709)
GAAP fund balance (deficit), June 30, 2007	**$ (1,907,538)**	**$ 37,724**	**$ 5,879,609**

Notes to the Required Supplementary Information

Budgetary Comparison Schedule

The State annually reports its financial condition based on a Generally Accepted Accounting Principles (GAAP) basis and on the State's budgetary provisions (budgetary basis). The Budgetary Comparison Schedule, General Fund and Major Special Revenue Funds reports the original budget, the final budget, the actual expenditures, and the variance between the final budget and the actual expenditures, using the budgetary basis of accounting.

On a budgetary basis, individual appropriations are charged as expenditures when commitments for goods and services are incurred. However, for financial reporting purposes, the State reports expenditures based on the year in which goods and services are received. The Budgetary Comparison Schedule includes all of the current-year expenditures for the General Fund and major special revenue funds as well as their related appropriations that are legislatively authorized annually, continually, or by project. On a budgetary basis, adjustments for encumbrances are budgeted under other general government, while the encumbrances relate to all programs' expenditures.

The Budgetary Comparison Schedule is not presented in this document at the legal level of budgetary control because such a presentation would be extremely lengthy and cumbersome. The State of California prepares a separate report, the *Budgetary/Legal Basis Annual Report Supplement*, which includes statements that demonstrate compliance with the legal level of budgetary control in accordance with GASB's *Codification of Governmental Accounting and Financial Reporting Standards*, Section 2400.121. The Statement of Appropriations, Expenditures, and Balances and the Comparative Statement of Actual and Budgeted Expenditures include the comparison of the annual appropriated budget with expenditures at the legal level of control. The Federal Fund, which is a major special revenue fund, and certain programs of the Transportation Construction Fund are not included in the *Budgetary/Legal Basis Annual Report Supplement* statements

because they are considered fiduciary fund activities on the budgetary basis. A copy of the *Budgetary/Legal Basis Annual Report Supplement* is available from the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250.

Reconciliaton of Budgetary Basis With GAAP Basis

The reconciliation of Budgetary Basis fund balances of the General Fund and the major special revenue funds to GAAP Basis fund balances are presented on the previous page and are explained in the following paragraphs.

The beginning fund balances for the General Fund, Federal Fund, and Transportation Construction Fund on the budgetary basis are restated for prior-year revenue adjustments and prior-year expenditure adjustments. A prior-year revenue adjustment occurs when the actual amount received in the current year differs from the amount of revenue accrued in the prior year. A prior-year expenditure adjustment results when the actual amount paid in the current year differs from the prior-year accrual for appropriations whose ability to encumber funds has lapsed in previous periods. The beginning fund balance on a GAAP basis is not affected by these adjustments.

Basis Difference

Interfund Receivables and Loans Receivable: Loans made to other funds or to other governments are normally recorded as expenditures on the budgetary basis. However, in accordance with GAAP, these loans are recorded as assets. The adjustments related to interfund receivables caused a $84 million increase to the fund balance in the General Fund and a $1.7 billion increase to the fund balance in the Transportation Construction Fund. The adjustments related to loans receivable caused increases of $100 million in the General Fund and $43 million in the Federal Fund.

Interfund Payables: Loans received from other funds are normally recorded as revenues on a budgetary basis. However, in accordance with GAAP, these loans are recorded as liabilities. The adjustments related to interfund payables caused a $2.4 billion decrease to the budgetary fund balance in the General Fund.

Escheat Property: A liability for the estimated amount of escheat property expected to ultimately be reclaimed and paid is not reported on a budgetary basis. The liability is required to be reported in the interfund payables on a GAAP basis. This adjustment caused a $926 million decrease to the General Fund balance.

Other: Certain other adjustments and reclassifications are necessary in order to present the financial statements in accordance with GAAP. The other adjustments caused a fund balance increase of $1 million in the General Fund and a fund balance decrease of $82 million in the Transportation Construction Fund.

Timing Difference

Liabilities Budgeted in Subsequent Years: On a budgetary basis, the primary government does not accrue liabilities for which there is no existing appropriation or no currently available appropriation. The adjustments made to account for these liabilities in accordance with GAAP caused fund balance decreases of $5.9 billion in the General Fund, $17 million in the Federal Fund, and $71 million in the Transportation Construction Fund. The large decrease in the General Fund primarily consists of $2.0 billion for deferred apportionment payments to K-12 schools and community colleges, $622 million of tax amnesty program overpayments, and $1.8 billion for medical assistance.

We conducted this audit to comply with Section 8546 of the California Government Code. The Independent Auditor's Report provides the opinions we expressed on the State of California's basic financial statements.

Respectfully submitted,

ELAINE M. HOWLE
State Auditor

Date: March 28, 2008

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Part Two

State of California Internal Control and State and Federal Compliance Audit Report for the Year Ended June 30, 2007

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AUDITOR'S SECTION

Independent Auditor's Reports on Internal Control and on Compliance and Other Matters

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Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With Government Auditing Standards

The Governor and the Legislature of the State of California

We have audited the basic financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of California as of and for the year ended June 30, 2007, which collectively comprise the State of California's basic financial statements, and have issued our report thereon dated March 3, 2008. Our report was modified to include a reference to other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America. As described in our report on the State of California's financial statements, other auditors audited the financial statements of the following:

Government-wide Financial Statements

- Certain enterprise funds that, in the aggregate, represent 82 percent, 42 percent, and 56 percent, respectively, of the assets, net assets, and revenues of the business-type activities.

- The University of California, State Compensation Insurance Fund, California Housing Finance Agency, Public Employees' Benefits, and certain other funds that, in the aggregate, represent over 99 percent of the assets, net assets, and revenues of the discretely presented component units.

Fund Financial Statements

- The following major enterprise funds: Electric Power fund, Water Resources fund, Public Building Construction fund, and State Lottery fund.

- Certain nonmajor enterprise funds that represent 89 percent, 79 percent, and 88 percent, respectively, of the assets, net assets, and revenues of the nonmajor enterprise funds.

- The funds of the Public Employees' Retirement System and the State Teachers' Retirement System that, in the aggregate, represent 93 percent, 94 percent, and 75 percent, respectively, of the assets, net assets, and additions of the fiduciary funds and similar component units.

- The discretely presented component units noted above.

This report does not include the results of the other auditors' testing of internal control over financial reporting and compliance and other matters that are reported on separately by those auditors.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the State of California's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State of California's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State of California's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies with item numbers 2007-15-2, 2007-15-3, 2007-15-4, and 2007-15-5 described in the accompanying schedule of findings and questioned costs to be significant deficiencies in internal control over financial reporting.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described above is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of California's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as item 2007-15-1.

The State of California's response to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the State of California's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the governor and Legislature of the State of California, the management of the executive branch, and the federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

BUREAU OF STATE AUDITS

Philip Jelicich

PHILIP J. JELICICH, CPA
Deputy State Auditor

March 3, 2008

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Independent Auditor's Report on Compliance With Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133

The Governor and the Legislature of the State of California

Compliance

We have audited the compliance of the State of California with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2007. The State of California's major federal programs are identified in the summary of the auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the State of California's management. Our responsibility is to express an opinion on the State of California's compliance based on our audit. We did not audit the State of California's compliance with the requirements of the U.S. Environmental Protection Agency's Capitalization Grants for Clean Water State Revolving Funds (CFDA Number 66.458). This program, which accounts for less than 1 percent of the total of federal assistance received by the State of California, is included in the accompanying schedule of federal assistance. Other auditors have audited the State of California's compliance with this program's requirements and their report thereon has been furnished to us. Our opinion, insofar as it relates to this program, is based solely on the report of the other auditors.

The State of California's basic financial statements include the operations of the University of California and the California State University systems, as well as the California Housing Finance Agency, a component unit authority of the State. However, these entities are not included in the accompanying schedule of findings and questioned costs or schedule of federal assistance for the year ended June 30, 2007. The University of California and the California State University systems, and the California Housing Finance Agency, which reported expenditures of federal awards totaling $3.2 billion and $1.3 billion, and $74.5 million, respectively, engaged other auditors to perform an audit in accordance with OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (OMB Circular A-133).

Except as discussed in the following paragraph, we conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the State of California's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit and the reports of the other auditors provide a reasonable basis for our opinion. Our audit does not provide a legal determination of the State of California's compliance with those requirements.

We were unable to obtain sufficient documentation supporting the State of California's compliance with the requirements for 10 of the 11 programs described in Table 1 on the following page, nor were we able to satisfy ourselves as to the State of California's compliance with those requirements by other

auditing procedures. For one program—the Capitalization Grants for Drinking Water State Revolving Funds—circumstances related to the timing of the work posed a restriction on our ability to audit the State of California's compliance.

Table 1

MAJOR FEDERAL PROGRAM	CATALOG OF FEDERAL DOMESTIC ASSISTANCE NUMBER	COMPLIANCE REQUIREMENT(S)
Federal Transit Metropolitan Planning Grants/ Consolidated Planning Grants	20.505	Matching
Capitalization Grants for Drinking Water State Revolving Funds	66.468	Activities allowed/allowable costs, cash management, earmarking, matching, period of availability, suspension and debarment, reporting, subrecipient monitoring, and special tests and provisions
Title I Grants to Local Educational Agencies	84.010	Special tests and provisions—comparability
Special Education—Grants for Infants and Families With Disabilities	84.181	Activities allowed/allowable costs and level of effort—maintenance of effort
Promoting Safe and Stable Families	93.556	Level of effort—maintenance of effort
Temporary Assistance for Needy Families	93.558	Activities allowed/allowable costs
Child Support Enforcement	93.563	Eligibility
Low-Income Home Energy Assistance	93.568	Eligibility and earmarking
Block Grants for Community Mental Health Services	93.958	Activities allowed/allowable costs and level of effort—maintenance of effort
Maternal and Child Health Services Block Grant	93.994	Earmarking
AmeriCorps	94.006	Activities allowed/allowable costs, earmarking, and matching

As described in Table 2 and in the accompanying schedule of findings and questioned costs, the State of California did not comply with requirements that are applicable to the following programs indicated in the table.

Table 2

FINDING NUMBER	FEDERAL DEPARTMENT	PROGRAM	CATALOG OF FEDERAL DOMESTIC ASSISTANCE NUMBER	COMPLIANCE REQUIREMENT(S)
2007-1-9	Education	Safe and Drug-Free Schools and Communities—State Grants	84.186	Activities allowed/ allowable costs/ subrecipient monitoring
2007-1-10	Health and Human Services	Medicaid Cluster: State Medicaid Fraud Control units, Hurricane Katrina Relief, State Survey and Certification of Health Care Providers and Suppliers, Medical Assistance Program	93.775 93.776 93.777 93.778	Activities allowed
2007-2-1	Labor	Occupational Safety and Health—State Program	17.503	Allowable costs/ cost principles
2007-2-5	Health and Human Services	Medical Assistance Program	93.778	Allowable costs/ cost principles
2007-2-8	Health and Human Services	HIV Care Formula Grants	93.917	Allowable costs/ cost principles
2007-2-10	Health and Human Services	Medicaid Cluster: State Medicaid Fraud Control units, Hurricane Katrina Relief, State Survey and Certification of Health Care Providers and Suppliers, Medical Assistance Program	93.775 93.776 93.777 93.778	Allowable costs/ cost principles

FINDING NUMBER	FEDERAL DEPARTMENT	PROGRAM	CATALOG OF FEDERAL DOMESTIC ASSISTANCE NUMBER	COMPLIANCE REQUIREMENT(S)
2007-2-12	Health and Human Services	Reimbursement of State Costs for Provision of Part D Drugs	93.794	Allowable costs/ cost principles/eligibility
2007-3-2	Health and Human Services	Block Grants for Community Mental Health Services	93.958	Cash management
2007-3-3	Health and Human Services	Child Support Enforcement	93.563	Cash management
2007-3-7 and 2007-3-10	Education	Title I Grants to Local Educational Agencies, Special Education Cluster: Special Education Grants to States and Special Education Preschool Grants, Safe and Drug-Free Schools and Communities-State Grants, Charter Schools, Education Technology State Grants, English Language Acquisition Grants, Improving Teacher Quality State Grants	84.010 84.027 84.173 84.186 84.282 84.318 84.365 84.367	Cash management
2007-3-16	Homeland Security	State Domestic Preparedness Equipment Support Program, Urban Areas Security Initiative, Hazard Mitigation Grant	97.004 97.008 97.039	Cash management
2007-5-2	Health and Human Services	HIV Care Formula Grants	93.917	Eligibility
2007-5-3	Health and Human Services	Refugee Entrant Assistance—State Administered Programs	93.566	Eligibility
2007-5-4 and 2007-5-5	Health and Human Services	Medicaid Cluster: State Medicaid Fraud Control units, Hurricane Katrina Relief, State Survey and Certification of Health Care Providers and Suppliers, Medical Assistance Program	93.775 93.776 93.777 93.778	Eligibility
2007-7-3	Election Assistance Commission	Help America Vote Act Requirements Payments	90.401	Level of effort—maintenance of effort
2007-7-11	Justice	Crime Victim Assistance	16.575	Earmarking
2007-7-12	Education	Title I Grants to Local Educational Agencies, Safe and Drug-Free Schools and Communities-State Grants, Education Technology State Grants, English Language Acquisition Grants, Improving Teacher Quality State Grants	84.010 84.186 84.318 84.365 84.367	Level of effort—maintenance of effort
2007-7-13	Education	Charter Schools	84.282	Level of effort—supplement not supplant
2007-8-1	Corporation for National and Community Service	AmeriCorps	94.006	Period of availability
2007-8-2	Labor	Occupational Safety and Health—State Program	17.503	Period of availability
2007-8-3	Health and Human Services	Block Grants for Community Mental Health Services	93.958	Period of availability
2007-8-4	Health and Human Services	Special Programs for Aging—Title III, Part B—Grants for Supportive Services and Senior Citizens	93.044	Period of availability
2007-8-9 and 2007-8-10	Health and Human Services	Child Care Development Fund Cluster: Child Care and Development Block Grant and Child Care Mandatory and Matching Funds of the Child Care and Development Fund	93.575 93.596	Period of availability
2007-9-1	Health and Human Services	Block Grants for Community Mental Health Services	93.958	Procurement, suspension and debarment
2007-9-2	Education	Special Education—Grants for Infants and Families With Disabilities	84.181	Procurement, suspension and debarment
2007-9-3	Health and Human Services	Temporary Assistance for Needy Families, Refugee and Entrant Assistance—State Administered Programs, Promoting Safe and Stable Families, and Child Welfare Services—State Grants	93.558 93.566 93.556 93.645	Procurement, suspension and debarment

continued on next page . . .

FINDING NUMBER	FEDERAL DEPARTMENT	PROGRAM	CATALOG OF FEDERAL DOMESTIC ASSISTANCE NUMBER	COMPLIANCE REQUIREMENT(S)
2007-9-4	Education	Charter Schools	84.282	Procurement, suspension and debarment
2007-9-5	Homeland Security	Disaster Grants—Public Assistance Grants (Presidentially Declared Disasters), Hazard Mitigation Grant	97.036 97.039	Procurement, suspension and debarment
2007-12-1 and 2007-12-2	Veterans Affairs	Veterans Housing—Guaranteed and Insured Loans	64.114	Reporting
2007-12-6	Health and Human Services	Block Grants for Community Mental Health Services	93.958	Reporting
2007-12-15 and 2007-12-16	Justice	Crime Victim Assistance	16.575	Reporting
2007-12-18 and 2007-12-19	Education	Charter Schools	84.282	Reporting
2007-12-25	Health and Human Services	Child Care Development Fund Cluster: Child Care and Development Block Grant and Child Care Mandatory and Matching Funds of the Child Care and Development Fund	93.575 93.596	Reporting
2007-12-27	Homeland Security	State Domestic Preparedness Equipment Support Program	97.004	Reporting
2007-13-1	Corporation for National and Community Service	AmeriCorps	94.006	Subrecipient monitoring
2007-13-2	Election Assistance Commission	Help America Vote Act Requirements Payments	90.401	Subrecipient monitoring
2007-13-3	Health and Human Services	Block Grants for Community Mental Health Services	93.958	Subrecipient monitoring
2007-13-4	Health and Human Services	Child Support Enforcement	93.563	Subrecipient monitoring
2007-13-5	Health and Human Services	Low-Income Home Energy Assistance	93.568	Subrecipient monitoring
2007-13-6	Education	Special Education—Grants for Infants and Families With Disabilities	84.181	Subrecipient monitoring
2007-13-7	Health and Human Services	Promoting Safe and Stable Families	93.556	Subrecipient monitoring
2007-13-9	Health and Human Services	Promoting Safe and Stable Families, Temporary Assistance for Needy Families	93.556 93.558	Subrecipient monitoring
2007-13-10	Education	Safe and Drug-Free Schools and Communities—State Grants	84.186	Subrecipient monitoring
2007-13-11	Justice	Crime Victim Assistance	16.575	Subrecipient monitoring
2007-13-15 and 2007-13-16	Education	Charter Schools	84.282	Subrecipient monitoring
2007-13-20 and 2007-13-21	Health and Human Services	Medicaid Cluster: State Medicaid Fraud Control units, Hurricane Katrina Relief, State Survey and Certification of Health Care Providers and Suppliers, Medical Assistance Program	93.775 93.776 93.777 93.778	Subrecipient monitoring
2007-13-23	Homeland Security	Disaster Grants—Public Assistance Grants (Presidentially Declared Disasters), Hazard Mitigation Grant	97.036 97.039	Subrecipient monitoring
2007-14-1	Health and Human Services	Block Grants for Community Mental Health Services	93.958	Special tests and provisions—independent peer reviews
2007-14-3	Education	Federal Family Education Loans	84.032	Special tests and provisions—conditions of reinsurance coverage

FINDING NUMBER	FEDERAL DEPARTMENT	PROGRAM	CATALOG OF FEDERAL DOMESTIC ASSISTANCE NUMBER	COMPLIANCE REQUIREMENT(S)
2007-14-5	Health and Human Services	Child Support Enforcement	93.563	Special tests and provisions—provisions of child support services for interstate cases—state programs
2007-14-6	Agriculture	Special Supplemental Nutrition Program for Women, Infants, and Children	10.557	Special tests and provisions—review of food instruments to enforce price limitations and detect errors
2007-14-12 and 2007-14-13	Health and Human Services	Medicaid Cluster: State Medicaid Fraud Control Units, Hurricane Katrina Relief, State Survey and Certification of Health Care Providers and Suppliers, Medical Assistance Program	93.775 93.776 93.777 93.778	Special tests and provisions—provider eligibility

Compliance with such requirements is necessary, in our opinion, for the State of California to comply with the requirements applicable to those programs.

In our opinion, because of the effects of the noncompliance described in Table 2, the State of California did not comply in all material respects with the requirements applicable to the Charter Schools program. Also, except for the effects of such noncompliance, if any, as might have been determined had we been able to examine sufficient evidence regarding the State of California's compliance with the requirements described in Table 1 and except for the remaining noncompliance described in Table 2, the State of California complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2007. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items:

2007-1-3, 2007-1-5, 2007-2-3, 2007-2-4, 2007-2-6, 2007-3-1, 2007-3-8, 2007-3-9, 2007-3-12, 2007-3-13, 2007-3-15, 2007-5-1, 2007-5-6, 2007-8-6, 2007-8-7, 2007-8-8, 2007-12-3, 2007-12-4, 2007-12-5, 2007-12-8, 2007-12-9, 2007-12-10, 2007-12-12, 2007-12-13, 2007-12-16, 2007-12-17, 2007-12-21, 2007-12-22, 2007-13-8, 2007-13-12, 2007-13-13, 2007-13-14, 2007-13-17, 2007-13-18, 2007-13-19, 2007-13-22, 2007-14-7, 2007-14-9, 2007-14-10, 2007-14-11, and 2007-14-14.

Internal Control Over Compliance

The management of the State of California is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the State of California's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the State of California's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the State of California's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies and others that we consider to be material weaknesses.

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 2007-1-1, 2007-1-2, 2007-1-3, 2007-1-4, 2007-1-5, 2007-1-6, 2007-1-7, 2007-1-8, 2007-1-9, 2007-1-10, 2007-1-11, 2007-2-1, 2007-2-2, 2007-2-3, 2007-2-4, 2007-2-6, 2007-2-7, 2007-2-8, 2007-2-9, 2007-2-10, 2007-2-11, 2007-2-12, 2007-3-2, 2007-3-3, 2007-3-4, 2007-3-5, 2007-3-6, 2007-3-7, 2007-3-8, 2007-3-9, 2007-3-10, 2007-3-11, 2007-3-12, 2007-3-13, 2007-3-14, 2007-3-16, 2007-5-1, 2007-5-2, 2007-5-3, 2007-5-4, 2007-5-5, 2007-5-6, 2007-7-1, 2007-7-2, 2007-7-3, 2007-7-4, 2007-7-5, 2007-7-6, 2007-7-7, 2007-7-8, 2007-7-9, 2007-7-10, 2007-7-11, 2007-7-12, 2007-7-13, 2007-7-14, 2007-7-15, 2007-7-16, 2007-7-17, 2007-8-2, 2007-8-3, 2007-8-4, 2007-8-5, 2007-8-6, 2007-8-7, 2007-8-8, 2007-8-9, 2007-8-10, 2007-9-1, 2007-9-2, 2007-9-3, 2007-9-4, 2007-9-5, 2007-12-1, 2007-12-2, 2007-12-3, 2007-12-5, 2007-12-6, 2007-12-7, 2007-12-9, 2007-12-11, 2007-12-12, 2007-12-15, 2007-12-16, 2007-12-17, 2007-12-18, 2007-12-19, 2007-12-20, 2007-12-21, 2007-12-22, 2007-12-23, 2007-12-24, 2007-12-25, 2007-12-26, 2007-12-27, 2007-13-1, 2007-13-2, 2007-13-3, 2007-13-5, 2007-13-6, 2007-13-7, 2007-13-9, 2007-13-11, 2007-13-12, 2007-13-13, 2007-13-14, 2007-13-15, 2007-13-16, 2007-13-17, 2007-13-18, 2007-13-19, 2007-13-20, 2007-13-21, 2007-13-22, 2007-13-23, 2007-14-1, 2007-14-2, 2007-14-4, 2007-14-5, 2007-14-6, 2007-14-7, 2007-14-8, 2007-14-9, 2007-14-10, 2007-14-11, 2007-14-12, 2007-14-13, and 2007-14-14 to be significant deficiencies.

A *material weakness* is a significant deficiency or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. Of the significant deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs, we consider items 2007-1-1, 2007-1-2, 2007-1-3, 2007-1-6, 2007-1-7, 2007-1-8, 2007-1-9, 2007-1-10, 2007-2-1, 2007-2-2, 2007-2-3, 2007-2-8, 2007-2-10, 2007-2-12, 2007-3-2, 2007-3-3, 2007-3-7, 2007-3-10, 2007-3-12, 2007-3-13, 2007-3-16, 2007-5-2, 2007-5-3, 2007-5-4, 2007-5-5, 2007-7-1, 2007-7-2, 2007-7-3, 2007-7-4, 2007-7-5, 2007-7-7, 2007-7-8, 2007-7-9, 2007-7-10, 2007-7-11, 2007-7-12, 2007-7-13, 2007-7-17, 2007-8-2, 2007-8-3, 2007-8-4, 2007-8-5, 2007-8-6, 2007-8-9, 2007-8-10, 2007-9-1, 2007-9-2, 2007-9-3, 2007-9-4, 2007-9-5, 2007-12-1, 2007-12-2, 2007-12-3, 2007-12-6, 2007-12-9, 2007-12-11, 2007-12-15, 2007-12-16, 2007-12-18, 2007-12-19, 2007-12-25, 2007-12-27, 2007-13-1, 2007-13-2, 2007-13-3, 2007-13-5, 2007-13-6, 2007-13-7, 2007-13-9, 2007-13-11, 2007-13-15, 2007-13-16, 2007-13-20, 2007-13-21, 2007-13-23, 2007-14-1, 2007-14-4, 2007-14-5, 2007-14-6, 2007-14-12, and 2007-14-13 to be material weaknesses.

Schedule of Federal Assistance

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of California, as of and for the year ended June 30, 2007, and have issued our report thereon dated March 3, 2008. We did not audit the following significant amounts in the financial statements of:

Government-wide Financial Statements

- Certain enterprise funds that, in the aggregate, represent 82 percent, 42 percent, and 56 percent, respectively, of the assets, net assets, and revenues of the business-type activities.

- The University of California, State Compensation Insurance Fund, California Housing Finance Agency, Public Employees' Benefits, and certain other funds that, in the aggregate, represent over 99 percent of the assets, net assets, and revenues of the discretely presented component units.

Fund Financial Statements

- The following major enterprise funds: Electric Power fund, Water Resources fund, Public Building Construction fund, and State Lottery fund.

- Certain nonmajor enterprise funds that represent 89 percent, 79 percent, and 88 percent, respectively, of the assets, net assets, and revenues of the nonmajor enterprise funds.

- The funds of the Public Employees' Retirement System and the State Teachers' Retirement System that, in the aggregate, represent 93 percent, 94 percent, and 75 percent, respectively, of the assets, net assets, and additions of the fiduciary funds and similar component units.

- The discretely presented component units noted above.

Those financial statements were audited by other auditors whose reports have been furnished to us, and our opinions, insofar as they relate to the amounts included for those funds and entities, is based on the reports of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America.

Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise the State of California's basic financial statements. The accompanying schedule of federal assistance is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. OMB Circular A-133 requires the schedule of federal assistance to present total expenditures for each federal assistance program. However, although the State's automated accounting system separately identifies receipts for each federal assistance program, it does not separately identify expenditures for each program. As a result, the State presents the schedule of federal assistance on a cash receipts basis. In addition, the schedule of federal assistance does not include expenditures of federal awards received by the University of California and the California State University systems, or the California Housing Finance Agency. These expenditures are audited by other independent auditors in accordance with OMB Circular A-133. The information in the accompanying schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of the governor and Legislature of the State of California, the management of the executive branch, and the federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

BUREAU OF STATE AUDITS

Philip Jelicich

PHILIP J. JELICICH, CPA
Deputy State Auditor

May 12, 2008, except for the Schedule of Federal Assistance, as to which the date is March 3, 2008.

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Schedule of Findings and Questioned Costs

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STATE OF CALIFORNIA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS FOR THE FISCAL YEAR ENDED JUNE 30, 2007

Summary of Auditor's Results

Financial Statements

Type of auditor's report issued	Unqualified
Internal control over financial reporting:	
Material weakness(es) identified?	No
Significant deficiency(ies) identified that are not considered to be material weaknesses?	Yes
Noncompliance material to financial statements noted?	No

Federal Awards

Internal control over major programs:	
Material weaknesses identified?	Yes
Significant deficiency(ies) identified that are not considered to be material weaknesses?	Yes
Type of auditor's reports issued on compliance for major programs:	
Special Supplemental Nutrition Program for Women, Infants, and Children (10.557)	Qualified
Crime Victim Assistance (16.575)	Qualified
Occupational Safety and Health—State Program (17.503)	Qualified
Capitalization Grants for Drinking Water State Revolving Funds (66.468)	Disclaimer
Title I Grants to Local Educational Agencies (84.010)	Qualified
Migrant Education—State Grant Program (84.011)	Qualified
Special Education Cluster: Special Education Grants to States, Special Education Preschool Grants (84.027 and 84.173)	Qualified
Safe and Drug-Free Schools and Communities—State Grants (84.186)	Qualified
Charter Schools (84.282)	Adverse
Education Technology State Grants (84.318)	Qualified
English Language Acquisition Grants (84.365)	Qualified
Improving Teacher Quality State Grants (84.367)	Qualified

Help America Vote Act Requirements Payments (90.401)	Qualified
Promoting Safe and Stable Families (93.556)	Qualified
Temporary Assistance for Needy Families (93.558)	Qualified
Child Support Enforcement (93.563)	Qualified
Refugee and Entrant Assistance—State Administered Programs (93.566)	Qualified
Low-Income Home Energy Assistance (93.568)	Qualified
Child Care Development Fund Cluster: Child Care and Development Block Grant, Child Care Mandatory and Matching Funds of the Child Care and Development Fund (93.575 and 93.596)	Qualified
Medicaid Cluster: State Medicaid Fraud Control units, Hurricane Katrina Relief, State Survey and Certification of Health Care Providers and Suppliers, Medical Assistance Program (93.775, 93.776, 93.777, and 93.778)	Qualified
Reimbursement of State Costs for Provision of Part D Drugs (93.794)	Qualified
National Bioterrorism Hospital Preparedness Program (93.889)	Qualified
HIV Care Formula Grants (93.917)	Qualified
Block Grants for Community Mental Health Services (93.958)	Qualified
Maternal and Child Health Services Block Grant to States (93.994)	Qualified
AmeriCorps (94.006)	Qualified
State Domestic Preparedness Equipment Support Program (97.004)	Qualified
Urban Areas Security Initiative (97.008)	Qualified
Disaster Grants—Public Assistance Grants (Presidentially Declared Disasters) (97.036)	Qualified
Hazard Mitigation Grant (97.039)	Qualified
All other major programs	Unqualified
Any audit findings disclosed that are required to be reported in accordance with Section .510(a) of Circular A-133?	Yes
Dollar threshold used to distinguish between Type A and Type B programs	$73.8 million
Auditee qualified as low-risk auditee?	No

Identification of Major Programs:

CFDA Number	*Name of Federal Program or Cluster of Programs*
	Aging Cluster
	Child Care Development Fund Cluster
	Employment Services Cluster
	Medicaid Cluster
	Special Education Cluster
10.557	Special Supplemental Nutrition Program for Women, Infants, and Children
16.575	Crime Victim Assistance
17.245	Trade Adjustment Assistance
17.503	Occupational Safety and Health—State Program
20.505	Federal Transit Metropolitan Planning Grants/Consolidated Planning Grants
64.114	Veterans Housing—Guaranteed and Insured Loans
66.458	Capitalization Grants for Clean Water State Revolving Funds
66.468	Capitalization Grants for Drinking Water State Revolving Funds
84.010	Title I Grants to Local Educational Agencies
84.011	Migrant Education—State Grant Program
84.032	Federal Family Education Loans
84.181	Special Education—Grants for Infants and Families With Disabilities
84.186	Safe and Drug-Free Schools and Communities—State Grants
84.282	Charter Schools
84.318	Education Technology State Grants
84.365	English Language Acquisition Grants
84.367	Improving Teacher Quality State Grants
84.369	Grants for State Assessments and Related Activities
90.401	Help America Vote Act Requirements Payments*
93.268	Immunization Grants
93.283	Centers for Disease Control and Prevention—Investigations and Technical Assistance†
93.556	Promoting Safe and Stable Families
93.558	Temporary Assistance for Needy Families
93.563	Child Support Enforcement
93.566	Refugee and Entrant Assistance—State Administered Programs
93.568	Low-Income Home Energy Assistance
93.645	Child Welfare Services—State Grants
93.767	State Children's Insurance Program
93.794	Reimbursement of State Costs for Provision of Part D Drugs
93.889	National Bioterrorism Hospital Preparedness Program
93.917	HIV Care Formula Grants
93.958	Block Grants for Community Mental Health Services
93.994	Maternal and Child Health Services Block Grant to the States
94.006	AmeriCorps
97.004	State Domestic Preparedness Equipment Support Program
97.008	Urban Areas Security Initiative
97.036	Disaster Grants—Public Assistance Grants (Presidentially Declared Disasters)
97.039	Hazard Mitigation Grant

* As described on page 337 in Note 2 to the Schedule of Federal Assistance, the State prepares its schedule on a cash receipts basis. The Help America Vote Act Requirements Payments (HAVA) funds are not shown on the schedule because they were received by the State in prior fiscal years and maintained in a Special Deposit Fund. The State transfers HAVA funds from the Special Deposit Fund to the Federal Trust Fund as it incurs expenditures. For fiscal year 2006–07, the HAVA expenditures exceeded the Type A program threshold of $73.8 million and the program was deemed a major program.

† The Notice of Cooperative Agreement (agreement) between the federal Department of Health and Human Services and the State of California refers to this program as the Centers for Disease Control and Prevention—Public Health Preparedness and Response for Bioterrorism. For reporting purposes, we use the program name stated in the agreement.

Internal Control and Compliance Issues Applicable to the Financial Statements and State Requirements

VARIOUS STATE DEPARTMENTS

Reference Number: 2007-15-1

Condition

State departments do not always report their employees' taxable fringe benefits and business expense reimbursements. Federal and state tax laws require that employers report income and related tax amounts for payments other than regular wages, including fringe benefits and business expense reimbursements. Fringe benefits—cash, property, or services received in addition to regular pay—are reportable as taxable income unless specifically excluded or deferred in Internal Revenue Service (IRS) regulations. Examples of such taxable reimbursements include mileage compensation for commuting or personal travel between home and office when employees must work overtime (overtime or callback mileage), payment for employees' meals when they must work overtime or travel for 24 hours or less without lodging, and the value of personal use of state vehicles.

The State Controller's Office (Controller's Office) informs state departments through its payroll procedures manual and its Payroll Letters about the IRS and state requirements for reporting taxable fringe benefits and taxable business expenses. State departments must report employees' taxable fringe benefits and business expense reimbursements to the Controller's Office by the 10th of the month following the month in which the payments were made. The Controller's Office then calculates and deducts the required taxes.

Despite these requirements, some state departments did not consistently ensure that all employees' taxable benefits or taxable business expense reimbursements were being reported to the Controller's Office. We followed up on concerns we reported for five departments for fiscal years 2004–05 and 2005–06. We summarize the results of this review in Table 3 on the following page.

We reported concerns for fiscal year 2005–06 at five departments—the Department of Housing and Community Development (Housing), the Department of Fish and Game (Fish and Game), the Department of Health Services (Health Services), the Department of Industrial Relations (Industrial Relations), and the State Personnel Board (Personnel Board). We performed a follow-up review of the reporting of employee taxable benefits and reimbursements at these state departments for April 2007 through June 2007, the period since our last review. Our review found that three of the five departments continued to have reporting problems. Specifically, we reviewed 75 travel expense claims at Fish and Game and found that it again did not always report to the Controller's Office the taxable fringe benefits arising from employees' travel and overtime expense reimbursements. We also found that Fish and Game, Industrial Relations, and the Personnel Board still did not always ensure that they reported the personal use of state vehicles to the Controller's Office.

When state departments do not properly report their employees' taxable benefits and business expense reimbursements, the Controller's Office cannot calculate and withhold the related tax, as required by federal and state laws and regulations.

Table 3
Reportable Items Reviewed That Were Not Reported to the Controller's Office in Fiscal Year 2006–07

STATE AGENCY	TOTAL NUMBER OF TRAVEL EXPENSE CLAIMS WITH REPORTABLE ITEMS REVIEWED	ITEMS NOT REPORTED		
		OVERTIME/ CALLBACK MILEAGE	MEALS FOR TRAVEL OF 24 HOURS OR LESS/ OVERTIME MEALS	EMPLOYEES WITH PERSONAL USE OF STATE VEHICLE*
Department of Fish and Game	12	NA	5	1
Department of Industrial Relations	NA	NA	NA	5
State Personnel Board	NA	NA	0	2
Totals	**12**	**NA**	**5**	**8**

Note: Some travel expense claims contained more than one type of reportable item.
NA: We did not review this area because, in our prior year audit, we did not report noncompliance.
* Personal use of state vehicles is reported on documents separate from travel expense claims.

Criteria

The Controller's Office payroll procedures manual, sections 120 through 176, provides procedures for reporting to the Controller's Office taxable fringe benefits and business expense reimbursements provided to state employees. These procedures are based on federal and state tax laws. The following benefits and payments included in this manual relate to our testing of agency compliance:

- Section 129.1 states that the use of state-owned or -leased vehicles for personal commutes between home and office is reportable taxable income.
- Section 129.1.3 describes an IRS exemption for unmarked law-enforcement vehicles if the use of the vehicle is authorized by the department owning the vehicle and employing the officer and is incident to law enforcement functions and the actual facts and circumstances are documented.
- Section 129.1.3 also states that for the value of personal use of a state-owned or -leased vehicle to be excluded from income for an employee whose home is designated as his/her headquarters, certain criteria, including documentation of vehicle mileage logs, must be met.
- Section 130.1.2 states that reimbursements to employees for commuting expenses, such as expenses from commuting or personal travel between home and office, are considered taxable income. This includes callback and overtime mileage.
- Section 143.3 states that overtime meal compensation is reportable and constitutes taxable income.
- Section 145.1.2 states that meal reimbursements for travel of 24 hours or less without lodging are taxable income. Simply stated, if an employee receives reimbursement for meals during travel in which there was no overnight stay, this reimbursement is taxable income.

Recommendation

All state departments should ensure that they properly report taxable fringe benefits and taxable employee business expense reimbursements.

Departments' Views and Corrective Action Plans

Fish and Game concurs with our finding and states that it has provided training to its staff to accurately and promptly report taxable benefits. Fish and Game also states that it issued a department-wide bulletin in August 2007, as well as e-mail reminders, specifying the requirements of the personal use of state-owned vehicles.

Industrial Relations concurs with our finding and states that it will take appropriate steps to ensure compliance with reporting requirements by the end of fiscal year 2007–08. Specifically, Industrial Relations indicates that it will develop, distribute, and enforce a policy listing the roles and responsibilities of its employees, supervisors, and managers in complying with the state and federal mandates regarding taxable fringe benefits and business expense reimbursements.

The Personnel Board concurs with our finding and states that it will revise its policy relating to the personal use of state vehicles.

DEPARTMENT OF FISH AND GAME

Reference Number: 2007-15-2

Condition

For the fiscal year ending June 30, 2006, we reported that the Department of Fish and Game (Fish and Game) had inadequate procedures for accounting and reporting its real property. We noted that Fish and Game's Land and Facilities Branch is responsible for reporting information on land to the Department of General Services (General Services) to be included in the Statewide Property Inventory and for reconciling with the Statewide Property Inventory. Its Fiscal and Administrative Services Branch, Property Unit, had the same responsibilities for buildings and improvements. Its accounting unit reported real property information to the State Controller's Office (Controller's Office) for inclusion in the State's financial statements. Fish and Game also accounted for and reported real property information for the Wildlife Conservation Board (Wildlife Conservation), using the same agency number for both agencies in the Statewide Property Inventory.

For fiscal year 2001–02, the two branches did not reconcile their data with the Statewide Property Inventory. Further, the two branches and the accounting unit did not reconcile the property listings and Statement of Changes in General Fixed Assets. Also, the accounting unit reported incorrect information to the Controller's Office. Specifically, we determined the following:

- For the fiscal year ending June 30, 2002, Fish and Game's property listings for itself and Wildlife Conservation had land of $490.1 million, while the Statewide Property Inventory recorded $97.6 million more.

- As of June 30, 2002, the Statements of Changes in General Fixed Assets reported land, buildings, and improvements $105.3 million greater than the property listings showed. For the fiscal year ending June 30, 2002, the accounting unit reported real property of $164.3 million that may not have represented completed asset purchases.

- The accounting unit overstated land additions in Wildlife Conservation's Statement of General Fixed Assets by at least $2.5 million by including cash grants given to a nonstate entity. For fiscal year 2002–03, Fish and Game inappropriately reported $65.9 million in cash grants as land additions and understated the gift value of land by $46.1 million.

In October 2007 we followed up with Fish and Game to determine whether it has implemented our prior-year recommendations. We found that Fish and Game has made progress in ensuring that it reports only real property acquired for the State in its Statement of Changes in General Fixed Assets. However, our review also found that Fish and Game has not yet fully implemented our recommendations concerning reconciliation with Statewide Property Inventory and reporting real property in the period acquired. For example, 22 land acquisitions completed in fiscal year 2006–07 were capitalized subsequent to June 30, 2007.

Unless Fish and Game reconciles its property listings to the Statewide Property Inventory, reconciles its property listings to its Statement of General Fixed Assets, and reports complete and accurate information to the Controller's Office and General Services, the State's financial statements will be misstated and the Statewide Property Inventory will be incomplete and inaccurate.

Criteria

The California Government Code, Section 11011.15, requires each agency to furnish General Services with a record of each parcel of real property that it possesses and to update its real property holdings by July 1 each fiscal year. It also requires General Services to maintain a complete and accurate inventory of all real property held by the State. General Services includes Fish and Game's information in the Statewide Property Inventory with the Statement of Changes in General Fixed Assets. In addition, the *State Administrative Manual*, Section 7924, requires agencies to annually reconcile the amounts reported in the Statewide Property Inventory with the Statement of Changes in General Fixed Assets.

Additionally, the *State Administrative Manual*, sections 7463, 7977, and 8660, requires agencies to report to the Controller's Office in a Statement of Changes in General Fixed Assets all additions and deductions to real property funded by governmental funds. The Controller's Office includes this information in the State's financial statements.

Recommendations

To ensure that it reports complete and accurate information for the State's financial statements and the Statewide Property Inventory, Fish and Game should do the following:

- Annually reconcile amounts it reports for the Statewide Property Inventory with its and Wildlife Conservation's Statements of Changes in General Fixed Assets.

- Report in the Statement of Changes in General Fixed Assets any real property that has been acquired on or before the end of the fiscal year.

Department's View and Corrective Action Plan

Fish and Game concurs with our finding and indicates that it has made progress in addressing the recommendations, but additional time is necessary for full implementation.

Fish and Game indicates that it has implemented procedures to perform monthly comparisons of its Statement of Changes in General Fixed Assets with the Statewide Property Inventory, and has reconciled over 1,600 land transactions, and continues to reconcile structures and improvements other than structures. Fish and Game expects that it will be able to reconcile its capital asset records by June 2008.

Fish and Game also states that it has implemented procedures to help ensure that the real property reported in the Statement of Changes in Fixed Assets is accurate and up to date at the end of each fiscal year, and that it no longer includes works in progress or non-State expenditures in its Statement of Changes in Fixed Assets.

DEPARTMENT OF PARKS AND RECREATION

Reference Number: 2007-15-3

Condition

For the fiscal year ending June 30, 2004, we reported that the Department of Parks and Recreation (Parks and Recreation) continued to have inadequate procedures to account for and report its real property. Specifically, its acquisition unit had not reported $3.4 million in ancillary costs for the real property acquired between July 2001 and June 2002, and it did not report ancillary costs to the Department of General Services (General Services) in a format that allows input into the Statewide Property Inventory system. In addition, Parks and Recreation did not reconcile the amounts reported in the Statewide Property Inventory with its records. In December 2004, in an attempt to reconcile the two sources, Parks and Recreation acknowledged an unexplained difference of $167 million between its and General Services' Statewide Property Inventory account balances for land. In its corrective action plan, Parks and Recreation had stated that it would work with General Services to develop a process to include ancillary costs to the Statewide Property Inventory and that it had initiated a process to reconcile the amounts reported in the Statewide Property Inventory with its Statement of Changes in General Fixed Assets.

In November 2007 we followed up with Parks and Recreation to determine whether it reports ancillary costs to General Services for inclusion in the Statewide Property Inventory. Parks and Recreation informed us it has reported all ancillary costs of real property to General Services in a format that allows input into the Statewide Property Inventory, and as a result, its records agree with those of General Services. In November 2007 Parks and Recreation also informed us that it has not fully implemented our prior-year recommendation to reconcile the amounts reported in the Statewide Property Inventory with its Statement of Changes in General Fixed Assets and that the difference between the two sources is $21.8 million. Because Parks and Recreation has not fully implemented our recommendation to reconcile the amounts reported, we did not review its progress in reporting ancillary costs.

Unless Parks and Recreation reports complete and accurate ancillary cost information to General Services and periodically reconciles its Statement of Changes in General Fixed Assets with the Statewide Property Inventory, the State's financial statements may be misstated, and the Statewide Property Inventory may be incomplete and inaccurate.

Criteria

The *State Administrative Manual*, Section 8611, requires that all costs related to purchasing land be included in the capitalized amount. This includes ancillary costs such as legal and title fees, title search costs, and costs of grading, surveying, draining, or other related items.

The California Government Code, Section 11011.15, requires each department to furnish General Services with a record of each parcel of real property that it possesses and to update its real property holdings by July 1 each year. It also requires General Services to maintain a complete and accurate inventory of all real property held by the State. General Services includes Parks and Recreation's information in the Statewide Property Inventory.

The *State Administrative Manual*, Section 7924, requires agencies to annually reconcile the amounts reported in the Statewide Property Inventory with the Statement of Changes in General Fixed Assets.

The *State Administrative Manual*, sections 7463, 7977, and 8660, requires agencies to report to the State Controller's Office (Controller's Office) in a Statement of Changes in General Fixed Assets all additions and deductions to real property funded by governmental funds. The Controller's Office includes this information in the State's financial statements.

Recommendation

We recommend that Parks and Recreation reconcile the amounts reported in the Statewide Property Inventory with its Statement of Changes in General Fixed Assets.

Department's View and Corrective Action Plan

Parks and Recreation concurs with our findings and indicates that it has made significant progress in addressing the recommendation, but additional time is necessary for full implementation.

DEPARTMENT OF HEALTH CARE SERVICES[1]

Reference Number: 2007-15-4

Condition

In completing its generally accepted accounting principles (GAAP) adjustments for fiscal year 2006–07, the Department of Health Care Services (Health Care Services) overstated reported expenditures for its Medical Assistance Program (Medi-Cal) by a total of $263 million. This error related to accrued expenditures of the Federal Trust Fund and was caused by two problems. First, Health Care Services did not report to the State Controller's Office (Controller's Office) an adjustment of $135 million to its original accrual. Second, Health Care Services instituted a new methodology that broadened its accrual of administrative expenditures. This methodology used outdated information and had the effect of overstating these expenditures by $128 million.

When departments do not report revisions to their GAAP entries or use flawed methodologies to calculate accruals, the Controller's Office does not have accurate data for preparing the State's GAAP-based financial statements included in the Comprehensive Annual Financial Report.

Criteria

Under California Government Code, sections 12460 and 12461, the Controller's Office is required to issue a report prepared strictly in accordance with GAAP. To assist it in this responsibility, the Controller's Office annually requests that departments provide adjustments to conform their financial statements to GAAP. Further, the Controller's Office provides instructions to help departments prepare their GAAP adjustments.

Recommendation

Health Care Services should make improvements to its financial reporting process to ensure that it prepares and submits accurate and complete GAAP entries to the Controller's Office.

Department's View and Corrective Action Plan

Health Care Services works to continually improve the GAAP basis financial statements and the reporting process. For the past several years, we have met with the Bureau of State Audits (BSA) prior to each year's audit period to review the accrual method and receive guidance from BSA as to how exactly it would like us to determine the GAAP adjustments to meet its requirements. We will continue to work closely with BSA to make improvements.

A revised GAAP statement for fiscal year 2006–07 was prepared for the Health Care Deposit Fund for an adjustment of $135 million. The revision was prepared in a timely manner. However, it was later determined that, through an oversight, the revised statement was not forwarded to the Controller's Office.

[1] Effective July 1, 2007, the Department of Health Services was reorganized. The Department of Health Care Services was formerly the Department of Health Services.

Corrective Action #1:

For future GAAP statement revisions for the Health Care Deposit Fund, staff preparing the revision will confirm by e-mail that the Controller's Office has received the revised version.

The BSA states, ". . . the Department of Health Care Services has overstated reported expenditures for Medi-Cal by a total of $263 million. This includes the $135 million adjustment described above and $128 million because DHCS instituted a new methodology that broadened its accrual of administrative expenditures . . . and used outdated information."

Corrective Action #2:

Health Care Services has had further discussions with BSA on its methodology and calculation regarding the excess accrual of the $128 million of administrative expenditures and agrees with this finding. In the future, Health Care Services will use this methodology to accrue the administrative costs.

DEPARTMENT OF PARKS AND RECREATION

Reference Number: 2007-15-5

Condition

In preparing its adjustments for fiscal year 2006–07, the Department of Parks and Recreation (Parks and Recreation) overstated its liabilities and expenditures by $504 million for the California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Fund and $211 million for the Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Bond Fund. On a budgetary/legal basis, local assistance contracts or grants are recorded as encumbrances when the grant commitment or contract is executed. However, in accordance with the Accounting Principles Generally Accepted in the United States of America, these commitments are not reported as encumbrances because the future expenditures related to these commitments are either reimbursed or funded from other sources, or the State will not own the resulting asset. The overstatement errors were caused by Parks and Recreation recording commitments as a liability.

When departments make errors in their generally accepted accounting principles (GAAP) adjustments, the State Controller's Office (Controller's Office) will not have accurate data when preparing the State's GAAP-based financial statements that it includes in the Comprehensive Annual Financial Report.

Criteria

Under California Government Code, sections 12460 and 12461, the Controller's Office is required to issue a report prepared strictly in accordance with GAAP. To assist it in this responsibility, the Controller's Office annually requests departments to provide adjustments to conform their financial statements to GAAP. Further, the Controller's Office provides instructions to help departments prepare their GAAP adjustments.

Recommendation

Parks and Recreation should make improvements to its financial reporting process to ensure that it prepares and submits accurate GAAP adjustments to the Controller's Office. In particular, Parks and Recreation should properly distinguish between commitments and encumbrances in preparing its GAAP adjustments.

Department's View and Corrective Action Plan

Parks and Recreation concurs with our finding and indicates, after several discussions with us, it has made progress addressing the reporting process for GAAP adjustments. However, Parks and Recreation asks for us to direct the Controller's Office to more clearly articulate the guidelines for

reporting GAAP adjustments. Further, it states for the past three fiscal years, it has received conflicting information regarding the GAAP adjustment requirements from the Controller's Office and us. Parks and Recreation also feels the Controller's Office year-end training manual is unclear and inconsistent as to the distinction between commitments and encumbrances on a GAAP basis, and it does not coincide with our determination of what is a commitment versus what is a liability. Nonetheless, Parks and Recreation indicates it will continue to strive for a methodology that follows the recommendations of the Controller's Office and the Bureau of State Audits.

Auditor's Comments on Department's View

We acknowledge the Controller's Office has revised its guidance over the past two fiscal years. However, we found errors in Parks and Recreation's GAAP adjustments over the past two fiscal years and, notwithstanding revisions to the Controller's Office guidance, we have explained these errors to Parks and Recreation staff as well as directed them to appropriate Controller's Office and Governmental Accounting Standards Board guidance.

Compliance Issues Related to All Federal Grants

IDENTIFYING PROGRAM EXPENDITURES

Reference Number:	2007-12-14
Federal Program:	All Programs
Category of Finding:	Reporting
State Administering Department:	Department of Finance (Finance)

Criteria

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133. *AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS* (OMB CIRCULAR A-133), Subpart C—Auditees, Section .310, Financial Statements

(b) Schedule of expenditures of Federal awards. The auditee shall also prepare a schedule of expenditures of Federal awards for the period covered by the auditee's financial statements. At a minimum, the schedule shall:

(3) Provide total Federal awards expended for each individual Federal program and the CFDA number or other identifying number when the CFDA information is not available.

OMB CIRCULAR A-133, Subpart D—Auditors, Section .520 Major Program Determination

(a) General. The auditor shall use a risk-based approach to determine which Federal programs are major programs. The risk-based approach shall include consideration of: current and prior audit experience, oversight by Federal agencies and pass-through entities, and the inherent risk of the Federal program. The process in paragraphs (b) through (i) of this section shall be followed.

(b) Step 1.

(1) The auditor shall identify the larger Federal programs, which shall be labeled Type A programs. Type A programs are defined as Federal programs with Federal awards expended during the audit period exceeding the larger of:

(i) $300,000 or three percent (.03) of total Federal awards expended in the case of an auditee for which total Federal awards expended equal or exceed $300,00 but are less than or equal to $100 million.

(ii) $3 million or three-tenths of one percent (.003) of total Federal awards expended in the case of an auditee for which total Federal awards expended exceed $100 million but are less than or equal to $10 billion.

(iii) $30 million or 15 hundredths of one-percent (.0015) of total Federal awards expended in the case of an auditee for which total Federal awards expended exceed $10 billion.

Condition

State law requires Finance to maintain a complete accounting system to ensure that all revenues, expenditures, receipts, disbursements, resources, obligations, and property of the State are accounted for properly and accurately. Because of limitations in its automated accounting systems, the State has not complied with the provision of OMB Circular A-133 requiring auditees to prepare a schedule of expenditures of federal awards that includes the total federal awards expended for each individual federal program. As a result, the schedule (beginning on page 319) shows total cash receipts, rather than expenditures, by program. Further, without the expenditure information, we are unable to comply with the provision of OMB Circular A-133 for determining which federal programs are major programs. Instead, we use the cash receipts information to make our determination for

Type A programs. We also review expenditure information for those federal programs that have cash receipts within 10 percent of the Type A program threshold to ensure that they are classified correctly as Type A programs.

Recommendation

As priorities and resources permit, Finance should modify the State's accounting system to allow it to prepare a schedule of expenditures of federal awards that includes the total federal awards expended for each individual federal program.

Department's View and Corrective Action Plan

Finance stated that the state's accounting system will require substantial modification to comply with federal and state requirements. Finance received approval for a new integrated statewide financial management system, the Financial Information System for California (FI$Cal). At the Legislature's direction, Finance has developed additional governance structure and other project infrastructure tasks. Finance has returned to the Legislature for project funding. It is anticipated that the new system will have the capability to provide total expenditures for each federal program.

U.S. DEPARTMENT OF THE TREASURY

Reference Number:	2007-3-5
Federal Program:	All programs subject to the Treasury-State Agreement
Category of Finding:	Cash Management
State Administering Department:	Department of Finance (Finance)

Criteria

TITLE 31—MONEY AND FINANCE, SUBTITLE V—GENERAL ASSISTANCE ADMINISTRATION, CHAPTER 65—INTERGOVERNMENTAL COOPERATION, Section 6503, Intergovernmental Financing

(b)(1) The Secretary shall enter into an agreement with each State to which transfers of funds are made, which establishes procedures and requirements for implementing this section.

(2) An agreement under this subsection shall—

(A) specify procedures chosen by the State for carrying out transfers of funds under the agreement;

(B) describe the process by which the Federal Government shall review and approve the implementation of the procedures specified under subparagraph (A);

(C) establish the methods to be used for calculating and documenting payments of interest pursuant to this section; and

(D) specify those types of costs directly incurred by the State for interest calculations required under this section, and require the Secretary to consider those costs in computing payments under this section.

TITLE 31—MONEY AND FINANCE: TREASURY, Part 205—RULES AND PROCEDURES FOR EFFICIENT FEDERAL-STATE FUNDS TRANSFERS, Subpart A—Rules Applicable to Federal Assistance Programs Included in a Treasury-State Agreement, Section 205.29, What Are the State Oversight and Compliance Responsibilities?

(b) A State must maintain records supporting interest calculations, clearance patterns, Interest Calculation Costs, and other functions directly pertinent to the implementation and administration of this subpart A for audit purposes. A State must retain the records for each fiscal year for three years from the date the State submits its Annual Report, or until any pending dispute or action involving the records and documents is completed, whichever is later. We, the Comptroller General, and the Inspector General or other representative of a Federal Program Agency must have the right of access to, and may require submission of, all records for the purpose of verifying interest calculations, clearance patterns, interest calculation cost claims, and the State's accounting for Federal funds.

STATE ADMINISTRATIVE MANUAL, Section 8013—Principal Responsibilities

1. The principal responsibilities of DOF:
   a. Identify annually the State agencies and federal assistance programs that will be impacted by CMIA.
   b. Negotiate with the U.S. Department of the Treasury, Financial Management Service (FMS) on new agreements and amendments to the existing Agreement.
   c. With the assistance of the SCO, develop patterns by programs for the average number of days from warrant issuance to redemption.
   d. Calculate the state and federal interest liabilities by programs and direct costs for DOF's interest calculation costs.
   e. Prepare annual interest reports and interest calculation cost claims for submittal to FMS.
   f. Budget funds from the General Fund and special funds for the payment of the state interest liability to the federal government

Condition

Finance and the U.S. Department of the Treasury (Treasury) executed a Cash Management Improvement Act Treasury-State Agreement (TSA) for fiscal year 2006–07 on July 10, 2006. Our review of Finance's implementation of the TSA found that it lacks adequate written policies and procedures instructing staff on how to calculate the state and federal interest liabilities by program. Periodically, Finance conducts meetings with the departments responsible for administering programs subject to the TSA to instruct them on how to prepare accurately the worksheets it uses to calculate the state and federal interest liability. The departments prepare worksheets quarterly and include information on federal drawdowns and the related payments for the programs they administer that are subject to the TSA. Currently, one staff person compiles the worksheets.

Our review of the interest calculations for the fiscal year 2006–07 annual report found that Finance incorrectly calculated the federal interest liability, interest liability related to disbursements without warrants, and the Medi-Cal refund interest liability. Specifically, according to the TSA, to calculate federal interest liability, Finance should calculate the number of days between when the State pays out its own funds for program purposes and when it receives federal reimbursement. However, Finance is incorrectly using the methodology outlined in the TSA for the state interest liability, which adds the number of days between when the State receives federal funds and when it issues warrants to the clearance pattern for the program.

Similarly, according to the TSA, to calculate the interest liability for disbursements without warrants, Finance should calculate the number of days between when the State receives the federal funds and the date of the journal entry transferring the funds between state departments. However, Finance is again incorrectly using the methodology outlined in the TSA for calculating the state interest liability. Finally, the TSA requires Finance to calculate interest liability on Medi-Cal refunds by using a pre-disbursement period and the clearance pattern period. The pre-disbursement period is from the midpoint date for the deposit of refunds to the issuance of warrants. The TSA then requires Finance to calculate the total

weighted average days for the two periods and apply it to the total refunds to arrive at the state interest liability. However, Finance calculates the pre-disbursement period from the midpoint for the deposit of refunds to the remittance advice date, which is the date the departments request the funds prior to the issuance of the warrants. Without written policies and procedures, those responsible for reviewing the compilation of the worksheets and the annual report cannot ensure that the methodology used complies with the TSA.

Additionally, Finance does not review the methodology used by the State Controller's Office (Controller's Office) to develop clearance patterns to ensure that it is consistent with the TSA. Specifically, despite certifying in the fiscal year 2006–07 TSA that an authorized state official has certified the clearance patterns at least every five years Finance was unable to provide us with documentation demonstrating that it reviewed the clearance patterns. Finance staff felt that the policies and procedures they had in place were sufficient. Because Finance is responsible for the development of the clearance patterns, it has the responsibility to ensure that the Controller's Office's methodology is consistent with the TSA.

Questioned Costs

Unknown

Recommendations

Finance should prepare written policies and procedures instructing staff on how to calculate the state and federal interest liabilities by program.

Additionally, Finance should recalculate the federal interest liability and liability for disbursements without warrants and revise its fiscal year 2006–07 annual report.

Finally, Finance should review the methodology used by the Controller's Office to develop the clearance patterns by program and retain evidence of its review for audit purposes.

Department's View and Corrective Action Plan

1. Lack of Written Procedures
   BSA Finding: Our review of Finance's implementation of the TSA found that it lacks written policies and procedures instructing staff on how to calculate the state and federal interest liabilities by program.

   Finance Response: The Department of Finance (Finance) does not agree with the finding "… that it lacks written policies and procedures on how to calculate the state and federal interest liabilities." Finance has a comprehensive procedures manual, which was provided to the auditor. The procedures manual includes procedures on how to calculate state and federal interest liabilities for a program administered by the Department of Rehabilitation. Although the procedures appear to pertain to only one program, these procedures apply to all programs.

2. Federal Interest Liability
   BSA Finding: Finance incorrectly calculated the federal interest liability, interest liability related to disbursements without warrants and Medi-Cal refund interest liability. Specifically, according to the TSA, to calculate federal interest liability, Finance should calculate the number of days between when the State pays out its own funds for program purposes and when it receives federal reimbursement. However, Finance is incorrectly using the methodology outlined in the TSA for the state interest liability, which adds the number of days between when the state receives federal funds and when it issues warrants to the clearance pattern for the program.

   Finance Response: Finance disagrees with the finding that it is incorrectly calculating federal interest liabilities. TSA Section 8.2.2 requires federal interest liabilities to be calculated from the date the state pays out its own funds to the date federal funds are deposited to a state account to cover the outlay. In accordance with this requirement, Finance correctly calculates federal

interest liabilities between the State's warrant issue date and the date the federal funds are deposited in the State Treasurer's demand account. The calculations are based on spreadsheets CMIA departments are required to complete which are thoroughly reviewed by Finance for accuracy.

3. Disbursements Without Warrants
BSA Finding: Finance should calculate the number of days between when the State receives the federal funds and the date of the journal entry transferring the funds between state departments. However, Finance is again incorrectly using the methodology outlined in the TSA for calculating the state interest liability.

   Finance Response: Finance disagrees with the finding that it is incorrectly calculating state interest liabilities for disbursements without warrants. TSA Section 8.7.11 requires state interest liabilities to be calculated from the date federal funds are deposited in the state's account to the journal entry date. As required by this section, Finance correctly calculates state interest liabilities based on the number of days between the date federal funds are deposited in the State Treasurer's demand account and the date of the journal entry. The calculations are based on spreadsheets CMIA departments are required to complete which are thoroughly reviewed by Finance for accuracy.

4. Medi-Cal Refund Interest Liability
BSA Finding: Finally, the TSA requires Finance to calculate interest liability on Medi-Cal refunds by using a pre-disbursement period and the clearance pattern period. The pre-disbursement period is from the mid-point date for the deposit of refunds to the issuance of warrants. The TSA then requires Finance to calculate the total weighted average days for the two periods and apply it to the total refunds to arrive at the state interest liability. However, Finance calculates the pre-disbursement period from the mid-point for the deposit of refunds to the remittance advice date, which is the date the departments request the funds prior to the issuance of the warrants.

   Finance Response: Finance does not agree with the finding that it ". . . calculates the pre-disbursement period from the mid-point for the deposit of refunds to the remittance advice date." TSA Section 8.4.7 (b) defines the pre-disbursement period as the period between the mid-point date for the deposit of refunds and the issuance of warrants. In accordance with this section, Finance correctly calculates the pre-disbursement period from the mid-point for the deposit of refunds to the issuance of warrants, not the remittance advice date. The calculations are based on a spreadsheet the Department of Health Care Services is required to complete which is thoroughly reviewed by Finance for accuracy.

5. Clearance Patterns
BSA Finding: Finance does not review the methodology used by the State Controller's Office (SCO) to develop clearance patterns to ensure that it is consistent with the TSA.

   Finance Response: Finance disagrees with the finding that it does not review the methodology used by the SCO to develop clearance patterns. Each year, the SCO provides clearance pattern reports to Finance. These are automated reports that are generated based on specific programming requirements, which have remained constant. Finance performs a thorough examination of these reports prior to using them to verify the reasonableness of the data and ensure that the reports were generated correctly.

Auditor's Comments on Department's View

Because certain assertions made by Finance were inconsistent with our audit evidence, we met with its staff to discuss its response. Staff were unable to provide documentation to support certain assertions made in the response. The following are our specific concerns with Finance's response.

Lack of Written Procedures

The policies and procedures manual Finance provided to us includes instructions, using one program as an example, on how to format documents but does not include substantive matters such as how to calculate state and federal interest liabilities. Therefore, we modified our text to state Finance lacks adequate written policies and procedures on how to calculate the state and federal interest liabilities by program.

Federal Interest Liability, Disbursements Without Warrants, and Medi-Cal Refund Interest Liability

Finance's summarization of the TSA is accurate. Finance also correctly states that it uses the CMIA spreadsheets prepared by those departments covered under the TSA to capture the data it uses for its calculations. However, Finance fails to recognize that the spreadsheets it uses to calculate interest liabilities for federal interest and disbursement without warrants categories have incorrect formulas. Additionally, it fails to recognize that the instructions it gave to Health Care Services to capture the data for the Medi-Cal refund liability are incorrect.

Clearance Patterns

During our review, Finance had to request the methodology used by the Controller's Office. If Finance does not have the Controller's Office's methodology or an agreement with the Controller's Office regarding the methodology, then it cannot review the methodology as required by the TSA.

Additionally, during our follow-up meeting with Finance staff, it became clear that management did not understand the requirements of the TSA. Adequate policies and procedures, if prepared, should enable management to have a better understanding of the actions of their staff.

Compliance and Internal Control Issues Related to Specific Grants Administered by Federal Departments

Bureau of State Audits

U.S. DEPARTMENT EDUCATION

Reference Number:	2007-1-6
Federal Catalog Number:	84.181
Federal Program Title:	Special Education—Grants for Infants and Families With Disabilities
Federal Award Numbers and Years:	H181A050037;2005 H181A060037;2006
Category of Finding:	Activities Allowed/Allowable Costs
State Administering Department:	Department of Developmental Services (Developmental Services)

Criteria

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements—Financial Administration, Section 80.20, Standards for Financial Management Systems

(a) A State must expend and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contractors, must be sufficient to:

(2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

Condition

Developmental Services does not have an adequate internal control process in place to assure that expenses incurred by regional centers are only for allowable activities and costs. Specifically, the regional centers' reimbursement claims do not include the detail necessary for Developmental Services staff who approve the claims to determine whether the claims include only allowable activities and costs covered under the program. Regional centers submit summary-level claims that include only two amounts—a total for operations and a total for purchase of services. However, the regional centers did not submit additional source documentation to support the $31.6 million they were paid during fiscal year 2006–07.

The regional centers use data generated from their Uniform Fiscal System (UFS) to create the claims they submit for reimbursement. Additionally, according to the chief of the Customer Application and Program Support Section, she believes the UFS system is reliable because it links eligible children with the specific services they receive from certain vendors, and it has built-in checks to prevent duplicate billing, billing over hours, and billing for noneligible consumers. However, Developmental Services staff who approve regional center claims do not reconcile the claim amounts to the expenses recorded in UFS when approving claims. Moreover, its program staff who conduct site visits to each regional center triennially do not review financial information such as their claims submitted for payment and the related source documentation.

Finally, although Developmental Services' auditors review a sample of claims and salary allocations charged to the program during their biennial fiscal audits of the regional centers, these reviews are not sufficient for the prevention and early detection of unallowable activities and costs. For example, its auditors completed fiscal audits of nine regional centers during fiscal year 2006–07, and these audits covered payments made between fiscal year 2000–01 and fiscal year 2004–05.

Without an adequate internal control process in place, there is the possibility that program funds could be spent on unallowable activities and costs.

Questioned Costs

Unknown

Recommendation

Developmental Services should establish procedures to assure that regional centers charge only allowable activities and costs to the grant.

Department's View and Corrective Action Plan

Developmental Services disagrees with this finding as there is a statutory and contractual structure in place that provides for good internal control. The historic and unique role of regional centers in implementing California's developmental disabilities program is one that the California Legislature carefully contemplated. The system in place is one that under Section 4620(b) of the Welfare and Institutions Code states: "The Legislature finds that the service provided to individuals and their families by regional centers is of such a special and unique nature that it cannot be satisfactorily provided by state agencies. Therefore, private nonprofit community agencies shall be utilized by the state for the purpose of operating regional centers." In subsequent sections of the Code, the Legislature put into place a governance structure to minimize conflicts of interest and to enhance accountability for services to people with developmental disabilities. Specifically, Section 4631 of the Welfare and Institutions Code prescribes how costs shall be budgeted for, accounted for, and reported. Explicit in this is the establishment of a Uniform Fiscal System (UFS) that establishes the relationship between the services provided and the costs claimed for those services. This system is reinforced by Article IV of the regional center contracts that prescribe the data collection responsibilities in Subsection 3 as follows:

a. . . . The Contractor shall maintain books, records, documents, case files, and other evidence pertaining to the budget, revenues, expenditures, and consumers served under this contract (hereinafter collectively called the "records") to the extent and in such detail as will properly reflect net costs (direct and indirect) of labor, materials, equipment, supplies and services, overhead and other costs and expenses of whatever nature for which reimbursement is claimed under the provisions of this contract in accordance with mutually agreed to procedures and generally accepted accounting principles.

Regional centers thus act as fiscal intermediaries, systematically capturing expenditure information with ample supporting documentation that they maintain to validate the payment of claims. To ensure that the regional centers maintain the required supporting documentation, as cited in the condition for this finding, Developmental Services' auditors review a sample of the claims and salary allocations to ensure that unallowable activities and costs to the grant have not been billed by the regional centers.

Developmental Services recognizes that for the period of this review, its auditors have not been reviewing a sample of claims and salary allocations on a timely basis to allow for the early detection of unallowable activities and costs to the grant. However, Developmental Services has made aggressive efforts to hire auditors to perform the audits upon the regional centers on a timely basis. For example, the biannual fiscal audits upon the regional centers that are currently in progress cover fiscal years 2005–06 and 2006–07. More timely completion of these audits provides Developmental Services with the ability to promptly detect and identify unallowable activities and costs to the grant.

We recognize, however, that there is always room for improvement and appreciate the Bureau of State Audits' recommendation. To address the concerns expressed in this finding, Developmental Services will develop additional procedures for the program staff who review and approve regional center claims so that the claim amounts are reconciled to the expenses recorded in UFS prior to approving the claims for payment. As discussed with the auditors, Developmental Services will extract all program

claims by regional center on a monthly basis and compare each invoice submitted against the total claim for purchase of services before approving the invoice for payment. If the claim does not exceed the total amount of the invoice submitted for the same period, the invoice will be considered valid for payment. This procedure, along with the review of supporting documentation for the regional centers invoices in the biannual audits performed by Developmental Services' auditors, will provide for timely detection and identification of unallowable activities and costs in the regional center billing invoices.

Reference Number:	2007-1-7
Federal Catalog Number:	84.181
Federal Program Title:	Special Education—Grants for Infants and Families With Disabilities
Federal Award Numbers and Years:	H181A050037;2005 H181A060037;2006
Category of Finding:	Activities Allowed/Allowable Costs
State Administering Department:	Department of Developmental Services (Developmental Services)

Criteria

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements—Financial Administration, Section 80.36, Procurement

(a) States. When procuring property and services under a grant, a State will follow the same policies and procedures it uses for procurements from its non-Federal funds. The State will ensure that every purchase order or other contract includes any clauses required by Federal statutes and executive orders and their implementing regulations.

CALIFORNIA STATE CONTRACT MANUAL, CHAPTER 9—CONTRACT MANAGEMENT, Section 9.04, Responsibilities of the Contract Manager

(A) Typical responsibilities of the contract manager are as follows:

(9) Review and approve invoices for payment to substantiate expenditures for work performed and to prevent penalties being assessed under GC § 926.17.

Condition

Developmental Services does not have an adequate internal control process in place to assure that expenses incurred by one of its vendors, WestEd, are only for allowable activities and costs.

Specifically, WestEd, a nonprofit vendor that provides program support, submits monthly invoices to Developmental Services that contain summary-level expenses for personnel, consultants, operating costs, and administrative management. These invoices, while categorizing expenses, do not include supporting documentation necessary for Developmental Services staff who approve the invoices to substantiate the expenses and determine whether the costs claimed are for allowable activities and costs.

According to one of its supervisors, the additional supporting documentation is not necessary because Developmental Services' contract requires WestEd to submit a detailed breakdown of its expenses at the end of each fiscal year. However, this approach does not allow for the prevention or early detection of unallowable activities and costs from being funded during the year payment is made. Furthermore, Developmental Services had not received the supporting documentation for the invoices paid in fiscal year 2006–07 as of December 2007. Consequently, Developmental Services has paid WestEd $2.7 million during fiscal year 2006–07 without any assurance that the activities and costs were allowable.

In prior years Developmental Services required WestEd to submit more detailed supporting documentation with its invoices, such as the breakdown of specific employees' hours. One of its supervisors stated that starting in fiscal year 2006–07, Developmental Services allowed WestEd to submit less-detailed monthly invoices so that WestEd could focus more on its programmatic support and deliverables instead of spending time on this administrative task. However, Developmental Services' decision is inconsistent with the State's contracting procedures and reduces its ability to assure that federal funds are spent on only allowable activities and costs.

Questioned Costs

Unknown

Recommendation

Developmental Services should require WestEd to submit detailed supporting documentation with its invoices so that the department can assure that only activities and costs allowed will be funded by the grant.

Department's View and Corrective Action Plan

Developmental Services audit and program staff will work with WestEd to renegotiate and amend the current contract in order to assure that only activities and costs allowed are reimbursed by Developmental Services. Specifically, Developmental Services audit and program staff will review previous invoice procedures and current invoice procedures, will identify the appropriate level of detail required for determining allowable activities and costs, and will initiate a new invoicing process per a contract amendment.

Reference Number:	2007-1-9
Federal Catalog Number:	84.186
Federal Program Title:	Safe and Drug-Free Schools and Communities—State Grants (SDFSC)
Federal Award Numbers and Years:	Q186B050005;2005 Q186B060005;2006
Category of Finding:	Activities Allowed/Allowable Costs Subrecipient Monitoring
State Administering Department:	Department of Alcohol and Drug Programs (ADP)

Criteria

TITLE 20—EDUCATION, CHAPTER 70—STRENGTHENING AND IMPROVEMENT OF ELEMENTARY AND SECONDARY SCHOOLS, SUBCHAPTER IV—21ST CENTURY SCHOOLS, Part A—Safe and Drug-Free Schools and Communities, Subpart 1—State Grants, Section 7112—Reservation of State Funds for Safe and Drug-Free Schools

(a) State reservation for the chief executive officer of a State

(5) Use of Funds
Grants and contracts under this section shall be used to implement drug and violence prevention activities, including—

(A) activities that complement and support local educational agency activities under section 7115 of this title, including developing and implementing activities to prevent and reduce violence associated with prejudice and tolerance;

(B) dissemination of information about drug and violence prevention; and

(C) development and implementation of community-wide drug and violence prevention planning and organizing.

TITLE 20—EDUCATION, CHAPTER 70—STRENGTHENING AND IMPROVEMENT OF ELEMENTARY AND SECONDARY SCHOOLS, SUBCHAPTER IV—21ST CENTURY SCHOOLS, Part A—Safe and Drug-Free Schools and Communities, Subpart 4—General Provisions, Section 7164—Prohibited Uses of Funds

No funds under this part may be used for—

(1) construction (except for minor remodeling needed to accomplish the purpose of this part); or

(2) medical services, drug treatment or rehabilitation, except for pupil services or referral to treatment for students who are victims of, or witnesses to, crime or who illegally use drugs.

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements—Financial Administration, Section 20—Standards for Financial Management Systems

(a) A State must expend and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contractors, must be sufficient to:

(2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

Condition

ADP does not ensure that SDFSC expenditures are made only for allowable activities and costs. ADP requires its county grantees to submit a claim form and a progress report with copies of invoices for their subrecipients or vendors. ADP also requires its noncounty grantees to submit invoices and progress reports.

In its grant administrative manual, ADP states that its analysts may choose to review grantee purchase records for large budget items, but should not review lengthy records of routine expenditures such as payroll, local mileage logs or minor office supplies. In fact, one of ADP's supervisors stated that ADP has never required its grantees to submit receipts. Consequently, our review of 45 claims and invoices found only 16 that had adequate documentation to support either all or a portion of the grantees' expenditures.

Moreover, although ADP's policy is to conduct site visits for grantees once within the grant period, the primary outcome of the site visit is not for ADP to monitor program compliance, but for it to identify opportunities to provide technical assistance to the grantee. Thus, ADP does not use its site visits to ensure that the claims and invoices submitted by the grantees include only allowable activities and costs. Finally, ADP's Audit Services Branch does not perform audits of grantees unless requested by management. According to the manager of ADP's Audit Services Branch, it has been more than 12 years since the branch conducted an audit of a SDFSC grantee, and that audit was only of the SDFSC costs associated with a separate non-SDFSC contract.

Until ADP establishes policies and procedures to periodically review detailed supporting documentation, it cannot ensure that activities and costs reported on invoices or claim forms are only for allowable activities and costs.

Questioned Costs

$1,139,832 of the $1,342,281 sampled

Recommendation

ADP should establish policies and procedures to ensure that federal awards are expended for only allowable costs and activities.

Department's View and Corrective Action Plan

ADP disagrees with this finding and requests that it be removed.

In its Condition, Bureau of State Audits (BSA) asserts that until ADP establishes polices and procedures to periodically review detailed supporting documentation it cannot ensure that activities and costs reported on invoices or claim forms are only for allowable activities and costs.

BSA uses a criterion that does not apply to the State, its subgrantees, or cost-type contractors.
(1) Specifically, BSA cites Title 34, CFR, 80.20—Standards for financial management systems (b) (2) and (6).

Title 34, CFR, Part 80.20 (b) (2) and (6) applies to other grantees and subgrantees, i.e., grantees that are not the State, its subgrantees, or cost-type contractors.

Title 34, CFR, Part 80.20 (a) (2) applies to the State, its subgrantees, and cost-type contractors, and requires that a State must expend and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. ADP expends and accounts for SDFSC grant funds in accordance with the same State laws and procedures it uses for accounting for State funds.

The regulation cited requires that the State and its subgrantees and cost-type contractors maintain records sufficient to permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

ADP requires its subgrantees and cost-type contractors to maintain all fiscal records, (General Terms and Conditions IXA), which would permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

(2) The condition states that "ADP also requires its non-county grantees to submit invoices and progress reports." ADP has no non-county grantees; all of ADP's SDFSC grant agreements are with counties.

BSA did not include monitoring requirements in its criteria; however, it included subrecipient monitoring in the Category of Finding.

The condition implies that the only acceptable way to assure that funds are expended only for allowable costs and activities is to either require subrecipients to submit detailed supporting documentation for ADP review, or for ADP to review supporting documentation during site visits. The Department of Health and Human Services, Office of Inspector General, *Protocol for Assessing State's Monitoring of Subgrantees* (December 2004, OEI-05-03-00062), notes that the monitoring requirements established by OMB Circular A-133) and Title 45 CFR 92.40 (a), which is identical to 34 CFR 80.40(a), can be met through a variety of mechanisms, including progress reports, site visits, financial reports, and independent (third party) financial audits and/or internal (State-conducted) financial audits (p. 2). The Protocol established criteria for meeting federal monitoring requirements: the State must have one fiscal monitoring mechanism, and one program monitoring mechanism. ADP meets this criteria. (3)

The following information is provided to demonstrate the fiscal and programmatic monitoring activities ADP undertakes to meet the requirements of Title 34, CFR, 80.40 and OMB Circular A-133 §___.400(d), and to clarify inaccuracies in the Condition.

The condition states: ADP . . . cannot ensure that activities and costs reported on invoices or claim forms are only for allowable activities and costs. This statement is inaccurate: Allowable activities are not reported on invoices and claim forms; activities are reported in quarterly progress reports and annual reports. (4)

ADP has in place an extensive and integrated fiscal and program monitoring system to ensure that funds are expended appropriately: (5)

- ADP's SDFSC subrecipient agreements are with the counties. ADP has ongoing relationships with the counties through a federal block grant, Drug Medi-Cal, various federal discretionary grants, and state programs administered by the Department. This ongoing relationship provides ADP with a reasonable assurance that the counties have adequate financial management systems (34 CFR 80.20 (c)).

ADP also: (6)

- Structures its SDFSC Requests for Applications to be responsive to the requirements the authorizing statute (Title 20, USC, §7112 et sec.).

- Evaluates and makes SDFSC grant awards based on the applicants proposal to implement programs/ activities that meet these requirements.

- Includes references to applicable statute, regulations, guidance, and cost principles (A-87 [2 CFR 225], or A-122 [2 CFR 230]) in the Request for Application (RFA) and the General Terms and Conditions of the award.

- Includes the funding restrictions cited above in the RFA and the General Terms and Conditions of the award.

- Requires each applicant for SDFSC grants to submit a detailed budget and a budget justification that supports the costs of proposed grant programs/ activities under the guidelines of the applicable statute, regulations, and costs principles. Requires justification for budget revisions.

- Program analysts review budgets and justifications during the award finalization process, discuss questions and resolve issues related to costs, including but not limited to allowability and reasonableness, with potential grantees. The ADP Office of Grants Management also reviews budgets and justifications; questions are brought back to the program analyst, who works with the grantee to resolve issues. If necessary, OGM discusses the issue with the Office of Legal Services to resolve issues. These processes are undertaken before ADP enters into a grant agreement.

- Reviews and answers questions regarding costs throughout the term of the grant.
- Requires subrecipients to submit quarterly progress reports. Program analysts review these reports for evidence that:
  - The subrecipient is making adequate progress toward goals and objectives,
  - Milestones and outcomes are supported by data, if applicable,
  - Information in the report relates to costs included in the claim (see claim information below), and
  - Grant funds are being used to support grant program activities, not activities that are outside the scope of the approved grant.
- Requires subrecipients to submit claims quarterly, in conjunction with quarterly progress reports. Requires certification that the costs being claimed are true and correct and in accordance with the grant provisions. Requires copies of signed and approved subrecipient and vendor invoices to accompany claims.
- Program analysts compare claim forms with the approved budget estimate to assure expenditures claimed are included on the budget and adequately defined. Claims are also compared to the quarterly progress reports to ensure that costs claimed correspond to allowable activities.
- Program analysts maintain frequent contact with subrecipients via telephone and e-mail.
- Requires eligible subrecipients (those expending more than $500,000 in federal financial assistance in the fiscal year) to comply with A-133 Audit requirements. As discussed below, ADP has a process in place to follow-up on any A-133 Audit findings related to funds it administers.

7 The BSA Condition also states: "the primary outcome of the site visit is not for ADP to monitor program compliance, but for it to identify opportunities to provide technical assistance to the grantee." This is incorrect.

ADP's SDFSC Site Visit Interview Protocol states that the site visit: "is intended to help . . . gain

- a thorough understanding of the organization and management of the project,
- provide a baseline description of the intended target population and core services, and
- identify the extent to which the programs are in alignment with the 'Principles of Effectiveness'"

The ADP SDFSC Site Visit Construct lists key areas to investigate during a site visit to ensure compliance with Title 20, USC, 7115, Authorized Activities. These areas include but are not limited to:

> Program management and support; staffing structure and management; relevant staff training that has been/will be provided; level of resources and support; roles/responsibilities/agreement mechanism of partner agencies (including LEAs); planning process; needs assessment procedures and data sources; parental involvement; methods for soliciting feedback; risk characteristics of the target population; description of major service components; who provides/facilitates the services; types of curriculum; curriculum adherence; modifications/adaptations to meet the needs of participants; types of retention strategies utilized; evaluation design; ensuring that service are in alignment with the program objectives; and evaluation feedback and distribution mechanisms.

Technical assistance is identified during site visits and recommended and/or required when grantees are not in compliance with the grant requirements and statutes.

Finally, The Single Audit Act of 1984 states that its basic purposes are to: 8

1. Improve financial management of government with respect to Federal financial assistance programs.

2. Establish uniform requirements for audits of such programs.

3. Promote the efficient and effective use of audit resources.

4. Ensure that Federal agencies to the maximum extent practicable rely upon and use audit work pursuant to the Act.

The Condition states that ADP's Audit Services Branch (ASB) does not perform audits of SDFSC grantees unless requested by management; this statement is correct only in part. The role and responsibility of ASB is to audit any Alcohol and Other Drug (AOD) funding administered by ADP at the request of its management. However, ASB does not audit SDFSC funding simply because they fall under the OMB Circular A-133 issued pursuant to the Single Audit Act of 1984, P.L. 98-502 and Single Audit Act Amendments of 1996, P.L. 104.-156.

It is ADP's perspective that in keeping with the basic purposes of the Single Audit Act of 1984, the SDFSC funds are already being addressed under the A-133 audit. This BSA audit has concluded that ADP's ASB has an A-133 audit review process in place to address any deficiencies noted in the A-133 audit reports received through the State's Auditor Controller's Office. To commit additional resources to audit funding such as SDFSC would conflict with the basic purposes of the Single Audit Act of 1984.

Auditor's Comments on Department's View

To address ADP's concern, the reference to Title 34, CFR, 80.20—Standards for Financial Management Systems, (b) (2) and (6), has been removed. 1

ADP's statement that all of its SDFSC grant agreements are with counties is incorrect. OMB Circular A-133, Subpart B, Section .210, Subrecipient and Vendor Determinations, provides guidance to consider in determining whether payments constitute a federal award or a payment for goods and services. This determination is essential because subrecipients are subject to an OMB Circular A-133 audit while vendors providing goods and services are not. We asked the chief of ADP's Office of Grants Management to provide us with ADP's analysis to support its determination that contracts with three noncounty entities were vendors. However, we were provided with a table outlining general criteria, without specific analysis related to these contracts. Consequently, we reviewed the relationship between ADP and these three contracts and concluded that ADP has subrecipient relationships with two of these contractors. 2

ADP fails to understand the OMB Circular A-133 compliance requirements that govern activities allowed or unallowed and allowable costs/cost principles. Throughout the audit process we informed ADP that our audit would be conducted in accordance with OMB Circular A-133 and the *Compliance Supplement* issued by the U.S. Office of Management and Budget. The *Compliance Supplement* states that the audit objective for activities allowed or unallowed is to determine whether federal awards were expended only for allowable activities. Further, it suggests that when allowability is determined based upon individual transactions, such as the reimbursement claims and invoices ADP requires its subgrantees and vendors to submit, the auditor is to select a sample of transactions and perform procedures to verify that the transaction was for an allowable activity. Similarly, the objective of the allowable costs/cost principles compliance requirement is to determine whether federal awards were expended in accordance with the basic guidelines and the list of selected items of cost contained in OMB Circular A-87—Cost Principles for State, Local, and Indian Tribal Governments. For example, 3

one of the basic guidelines is that costs are to be adequately documented. The *Compliance Supplement* also suggests that the auditor is to test a sample of transactions. Finally, according to Title 34, CFR, 80.20, it is the federal government's expectation that the State will expend and account for grant funds in accordance with state laws and procedures for expending and accounting for its own funds. The *State Administrative Manual*, Chapter 8400, sets forth the requirements for disbursements and essentially requires all disbursements to be adequately supported when expending state funds.

We have found that some state departments incorporate their responsibility for ensuring the allowability of activities and costs into their subrecipient monitoring processes such as annual desk audits and/or site visits. Thus, when we found that ADP does not require its analysts to review the underlying supporting documentation for its subgrantees' reimbursement claims and vendor invoices prior to making payment, we sought to identify whether ADP includes a fiscal component in its annual site visits and found that it does not. We would also like to point out that ADP cites the U.S. Department of Health and Human Services, Office of Inspector General, *Protocol for Assessing State's Monitoring of Subgrantees* (December 2004, OEI-05-03-00062), stating that it meets the requirements established in this document. However, the U.S. Department of Health and Human Services is not ADP's cognizant agency with regard to SDFSC grants, and more importantly the report was not intended to establish criteria for states to follow in subrecipient monitoring. In fact, the document references the OMB Circular A-133 audit requirements.

(4) ADP's statement, ". . . allowable activities are not reported on invoices and claim forms; activities are reported in quarterly progress reports and annual reports . . ." is incorrect. Specifically, reviewing supporting documentation for the costs listed on invoices and claim forms allows ADP to conclude that the activities associated with these costs are allowable.

(5) ADP is missing the point. Although ADP may have reasonable assurance that counties have adequate financial management systems, this does not relieve ADP of its responsibility for assuring that individual transactions are only for allowed activities and costs.

(6) ADP's response outlines a number of processes it undertakes with regard to establishing its relationship with subgrantees. However, none of the processes or procedures listed focus directly on ADP's verification that the underlying documentation demonstrates that costs are allowable. Moreover, it is inappropriate for ADP to rely on counties' certifications that they are accurately submitting costs instead of performing this function itself.

(7) ADP's statement regarding our characterization of the primary outcome of its site visits is incorrect. ADP's procedure manual states, "Site visits are an important component of program monitoring. Visiting the actual physical, geographical location of the grantee and observing program services, are sometimes the best way to learn first hand how a program is progressing. It also provides another opportunity to assess if the program could benefit from technical assistance (TA). In addition to obtaining program specifics and identifying TA needs, these site visits offer an opportunity to further develop the working relationship with the grantee and to provide an occasion to consult with the grantee on any administrative issues they may have." The manual further explains that there are two types of site visits, a technical assistance site visit and a corrective action/monitoring site visit. For technical assistance site visits the manual states, "The grantee should be assured that this site visit is not designed to monitor program compliance, but rather to determine if there are areas where TA could strengthen their program." The manual also states, "The corrective action or monitoring site visit is utilized as part of the corrective action procedures. If a program is experiencing extreme difficulty in meeting the grant requirements or is obviously not in compliance, it will be referred to corrective action."

Further, the SDFSC project director/evaluator interview protocol instructions for site visits states, "The ultimate goal of the interview is to identify areas in which the grantee may need additional technical assistance." Finally, ADP's program prevention manager stated, "The primary outcome of the site visit is to identify areas for technical assistance to improve program success and ensure grant compliance." Therefore, we believe our characterization of ADP's site visits is correct.

ADP's discussion regarding the Single Audit Act of 1984 and the role of its Audit Services Branch is perplexing to us. Specifically, as previously mentioned, when we found that ADP does not require its analysts to review the underlying supporting documentation for its subgrantees' reimbursement claims and vendor invoices prior to making payment, we sought to identify whether or not ADP includes a fiscal component in its annual site visits. We also sought to identify if the branch had conducted any audits of the SDFSC grant during fiscal year 2006–07. We found that the branch did not and added this information to our audit finding for informational purposes. Our recommendation does not state that ADP should commit additional resources for the branch to audit the SDFSC grant. 8

Reference Number:	2007-2-4
Federal Catalog Number:	84.186
Federal Program Title:	Safe and Drug-Free Schools and Communities—State Grants (SDFSC)
Federal Award Numbers and Years:	Q186B050005;2005 Q186B060005;2006
Category of Finding:	Activities Allowed/Allowable Costs
State Administering Department:	Department of Alcohol and Drug Programs (ADP)

Criteria

TITLE 2—GRANTS AND AGREEMENTS, PART 225—COST PRINCIPLES FOR STATE, LOCAL, AND INDIAN TRIBAL GOVERNMENTS (OMB CIRCULAR A-87)

Appendix B to Part 225—Selected Items of Cost

8. Compensation for personal services
   - h. Support of salaries and wages. These standards regarding time distribution are in addition to the standards for payroll documentation.
     - (5) Personnel activity reports or equivalent documentation must meet the following standards:
       - (a) They must reflect an after-the-fact distribution of the actual activity of each employee,
       - (b) They must account for the total activity for which each employee is compensated,
       - (c) They must be prepared at least monthly and must coincide with one or more pay periods, and
       - (d) They must be signed by the employee.

Condition

ADP needs to improve its controls to ensure that its accounting records match the hours recorded on its employees' time sheets.

ADP uses two program cost accounts (PCAs) to charge state operations activities related to the SDFSC grant. Administrative activities are charged to PCA 52021, while program activities are charged to PCA 52020. Because ADP employees may work on more than one program or activity, ADP developed guidelines instructing them on how to record hours on their time sheets. Each month, employees sign and submit their completed time sheets to their supervisor, who approves the hours.

Our review of 10 employee time sheets found one instance where ADP's accounting records showed that the employee had charged 106.5 hours to PCA 52020 and 34.25 hours to PCA 52064, but the time sheet indicated that the employee had charged 103.5 hours to PCA 52020 and 37.25 hours to PCA 52064. ADP uses PCA 52064 to capture costs associated with another program it administers that is funded by the federal Block Grants for Prevention and Treatment of Substance Abuse. Consequently, ADP has overcharged the SDFSC grant and undercharged the other federal grant.

Recommendation

ADP should improve its controls to ensure that it correctly charges payroll costs to the federal program it administers and promptly adjusts any discrepancies that arise.

Questioned Costs

$126.81 of the $31,595.62 sampled

Department's View and Corrective Action Plan

ADP is in the process of reviewing its time sheet processes.

ADP has reviewed the time sheet in question. The error may have occurred because the entry had been over-written by the employee, which made it difficult to read, or it may have been the result of a keying error. Nevertheless, the error has been corrected: the amount of $126.04 has been charged to the Substance Abuse Prevention and Treatment block grant, and removed from charges to the SDFSC grant.

Reference Number:	2007-3-4
Federal Catalog Number:	84.186
Federal Program Title:	Safe and Drug-Free Schools and Communities—State Grants (SDFSC)
Federal Award Numbers and Years:	Q186B050005;2005 Q186B060005;2006
Category of Finding:	Cash Management
State Administering Department:	Department of Alcohol and Drug Programs (ADP)

Criteria

TITLE 31—MONEY AND FINANCE: TREASURY, PART 205—RULES AND PROCEDURES FOR EFFICIENT FEDERAL-STATE FUNDS TRANSFERS, Subpart B—Rules Applicable to Federal Assistance Programs Not Included in a Treasury-State Agreement, Section 205.33—How Are Fund Transfers Processed?

(a) A State must minimize the time between the drawdown of Federal funds from the Federal government and their disbursement for Federal program purposes. A Federal Program Agency must limit a funds transfer to a State to the minimum amounts needed by the State and must time the disbursement to be in accord with the actual, immediate cash requirements of the State in carrying out a Federal assistance program or project. The timing and amount of funds transfers must be as close as is administratively feasible to a State's actual cash outlay for direct program costs and the proportionate share of any allowable indirect costs. States should exercise sound cash management in funds transfers to subgrantees in accordance with OMB Circular A-102 (For availability, see 5 CFR 1310.3.).

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements—Financial Administration, Section 80.20—Standards for Financial Management Systems

(a) A State must expend and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contractors, must be sufficient to:

(1) Permit preparation of reports required by this part and the statutes authorizing the grant, and

(2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

Condition

ADP's accounting procedures related to the drawdown of federal funds require its accounting staff to prepare a remittance advice (RA) form and print three copies. The accounting staff submit the RAs and supporting documentation to the accounting administrator for approval. However, ADP procedures require the accounting administrator to sign only the two copies of the RA that are sent to the California State Treasurer's Office (Treasurer's Office). Because ADP does not sign the copy of the RA it retains for its records, we could not verify that the accounting administrator properly reviews and approves the RAs before sending them to the Treasurer's Office.

Questioned Costs

Not applicable.

Recommendation

ADP should amend its procedures to require the accounting administrator to sign all three copies of the RAs prior to sending them to the Treasurer's Office.

Department's View and Corrective Action Plan

ADP will assure that an accounting administrator signs all three copies of the remittance advice.

Reference Number:	2007-7-9
Federal Catalog Number:	84.181
Federal Program Title:	Special Education—Grants for Infants and Families With Disabilities
Federal Award Numbers and Years:	H181A050037;2005 H181A060037;2006
Category of Finding:	Level of Effort—Maintenance of Effort
State Administering Department:	Department of Developmental Services (Developmental Services)

Criteria

TITLE 34—EDUCATION, PART 303—EARLY INTERVENTION PROGRAM FOR INFANTS AND TODDLERS WITH DISABILITIES, Subpart B—State Application for a Grant, Section 303.124—Prohibition Against Supplanting

(a) The statement must include an assurance satisfactory to the Secretary that Federal funds made available under this part will be used to supplement the level of State and local funds expended for children eligible under this part and their families and in no case to supplant those State and local funds.

(b) To meet the requirement in paragraph (a) of this section, the total amount of State and local funds budgeted for expenditures in the current fiscal year for early intervention services for children eligible under this part and their families must be at least equal to the total amount of State and local funds actually expended for early intervention services for these children and their families in the most recent preceding fiscal year for which the information is available. Allowance may be made for—

(1) Decreases in the number of children who are eligible to receive early intervention services under this part; and

(2) Unusually large amounts of funds expended for such long-term purposes as the acquisition of equipment and the construction of facilities.

Condition

Developmental Services refers to the Special Education—Grants for Infants and Families with Disabilities program as the Early Start program. Developmental Services did not provide sufficient information to demonstrate its compliance with the program's maintenance of effort (MOE) requirement. Specifically, according to the chief of the Estimates Section, Developmental Services does not separately budget the state funds it plans to spend at regional centers for serving eligible children and their families in the program. Instead, state funds are budgeted to the regional centers to serve various clients—those in the Early Start program as well as those who receive assistance through other programs.

Furthermore, Developmental Services cannot determine "the total amount of State and local funds actually expended for early intervention services for these individuals and their families in the most recent preceding fiscal year." Specifically, the regional centers submit monthly claims reimbursement summaries for all of their federal programs, including the Early Start program and one monthly claims reimbursement summary for the services charged to the State's General Fund. The reimbursement claims for the General Fund have a line item for operations and a line item for purchase of services. The General Fund expenditures are coded to program cost account codes that do not specifically

identify charges paid with state funds for the Early Start program. Thus, using its accounting records, Developmental Services is unable to determine how much of the General Fund reimbursement claims amount for fiscal year 2005–06 was spent on the Early Start program.

According to Developmental Services, it has derived the actual amount of state funds spent by the regional centers on the "purchase of services" line item from the regional centers' Uniform Fiscal System records for fiscal year 2005–06. Additionally, Developmental Services uses an estimate to derive the amount of State funds spent for the "operations" line item. Specifically, Developmental Services estimates the regional centers' "operations" expenditures by calculating the Early Start coordinators' salaries and fringe benefits, based on a caseload ratio of 1:45, and adding associated rent and operating expense and equipment expenditures. However, Developmental Services' method used to estimate operations costs is not a substitute for determining the actual amount spent for the regional centers' operations costs. Consequently, without the appropriate budget and expenditure information, Developmental Services cannot demonstrate it is in compliance with the MOE requirement.

Questioned Costs

Unknown

Recommendations

Developmental Services should annually establish a budget that includes the total amount of state and local funds to be spent on the program.

Developmental Services should also require the regional centers to track all funds actually expended for early intervention services under the program for the children and their families and to report these expenditures to it annually.

Department's View and Corrective Action Plan

Developmental Services believes it has a methodology to demonstrate the MOE requirements that is acceptable to the federal cognizant agency, Office of Special Education Programs (OSEP).

For the Purchase of Services (POS) expenses, the Uniform Fiscal System (UFS) captures data on all services provided to regional center consumers. This data allows for Developmental Services to determine the total amount of state funds spent upon the Early Start Program charged to POS. The auditors acknowledged that this was an acceptable method to determine the actual amount of state funds spent for POS on the Early Start Program.

For the Operations expenses, Developmental Services will propose to OSEP that it recognize and allow the allocation of the total regional center Operations expenditures attributable to the Early Start Program on the basis of the caseload ratio. Developmental Services will confirm in writing with OSEP that this is an approved method for determining the actual state funds expended for the regional center Operations costs.

The above demonstrates that Developmental Services has the ability to determine the total amount of actual state funds expended upon the Early Start Program.

For budgeting Early Start Program POS, Developmental Services takes the most recent fiscal year for which complete UFS data is available to determine the percent of the total POS attributable to the Early Start Program. This percentage is applied to the proposed total POS budget to determine the Early Start Program budget.

For budgeting Early Start Program Operations, Developmental Services takes the total regional center Operations budget and allocates the budget attributable to the Early Start Program based upon the caseload ratio. Developmental Services will confirm in writing with the federal cognizant agency (OSEP) that this is an approved method for determining the state funds budgeted for regional center Operations costs.

Based upon the above, Developmental Services will be better able to determine the total actual state funds expended and can demonstrate that the amounts budgeted meet the requirements of MOE for the Early Start Program. As stated, to ensure that the federal cognizant agency is in agreement with the methodology used, Developmental Services will request in writing that OSEP confirm that the methodology has been approved for the Early Start Program.

Auditor's Comments on Department's View

Developmental Services' assertion that "the auditors acknowledged that this [deriving purchase of services expenses from UFS] was an acceptable method to determine the actual amount of state funds spent for POS on the Early Start program" implies that we have audited the accuracy and completeness of the information from this system. This is not the case. Although Developmental Services informed us that UFS captures actual POS expenditures, which might help it track MOE compliance, we have not made a determination through testing on the veracity of this system. Thus, we cannot conclude that UFS is an acceptable method for determining the POS portion of MOE compliance.

Furthermore, as indicated in our audit finding at reference number 2007-1-6, we are concerned that Developmental Services' staff do not reconcile the claim amounts to the expenses recorded in UFS when approving claims. Without this reconciliation, there is no way of knowing whether the expenditures recorded in UFS agree with the program expenditures paid by Developmental Services.

Finally, while we appreciate Developmental Services' efforts to seek federal approval for its method of determining MOE compliance, we fail to understand why Developmental Services is reluctant to pursue a simpler, more direct method to document its compliance. Specifically, Developmental Services could establish a specific budget line item for Early Start state spending related to its MOE requirement similar to the separate line item it has for the State's matching requirement for other federal programs it administers and require regional centers to track program-related expenses associated with that budget line item using program cost account codes.

Reference Number:	2007-8-5
Federal Catalog Number:	84.186
Federal Program Title:	Safe and Drug-Free Schools and Communities—State Grants (SDFSC)
Federal Award Numbers and Years:	Q186B050005;2005 Q186B060005;2006
Category of Finding:	Period of Availability
State Administering Department:	Department of Alcohol and Drug Programs (ADP)

Criteria

TITLE 20—EDUCATION, CHAPTER 31—GENERAL PROVISIONS CONCERNING EDUCATION, SUBCHAPTER II—APPROPRIATIONS AND EVALUATIONS, Part 1—Appropriations, Section 1225. Availability of Appropriations on Academic or School-Year Basis; Additional Period for Obligation of Funds

(b) Succeeding fiscal year

(1) Notwithstanding any other provision of law, unless enacted in specific limitation of the provisions of this subsection, any funds from appropriations to carry out any programs to which this chapter is applicable during any fiscal year, which are not obligated and expended by educational agencies or institutions prior to the beginning of the fiscal year succeeding the fiscal year for which such funds were appropriated shall remain available for obligation and expenditure by such agencies and institutions during such succeeding fiscal year.

(2) Any funds under any applicable program which, pursuant to paragraph (1), are available for obligation and expenditure in the year succeeding the fiscal year for which they were appropriated shall be obligated and expended in accordance with—

(A) the Federal statutory and regulatory provisions relating to such program which are in effect for such succeeding fiscal year, and

(B) any program plan or application submitted by such educational agencies or institutions for such program for such succeeding fiscal year

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements—Financial Administration, Section 80.23, Period of Availability of Funds

(a) General. Where a funding period is specified, a grantee may charge to the award only costs resulting from obligations of the funding period unless carryover of unobligated balances is permitted, in which case the carryover balances may be charged for costs resulting from obligations of the subsequent funding period.

(b) Liquidation of obligations. A grantee must liquidate all obligations incurred under the award not later than 90 days after the end of the funding period (or as specified in a program regulation) to coincide with the submission of the annual Financial Status Report (SF-269). The Federal agency may extend this deadline at the request of the grantee.

Condition

ADP lacks written procedures to ensure that it uses SDFSC funds only during the authorized period of availability. Moreover, ADP did not consistently follow the procedures it described to us for ensuring that the federal funds for the SDFSC grant are in compliance with the period-of-availability requirement.

Specifically, ADP's program analysts initiate payments to its grantees, which are to include, on the county grantees quarterly claim forms, the appropriate federal grant and amount to charge prior to sending the forms to the accounting unit. However, three of the 23 claims we tested indicated that the total amount payable should be split between the 2005 and 2006 federal grants but did not indicate how much to charge to each federal grant. Without this information the risk of charging the incorrect federal grant increases.

Additionally, ADP staff use an "SDFSC proposed expenditure plan" and an "SDFSC tracking log for budgets" to plan funding for county awards each year. The Budget Office creates the SDFSC proposed expenditure plan spreadsheet and uses it to track the total amount of federal funding available from all active SDFSC federal grants and to plan grant spending each state fiscal year. Before finalizing an annual amount to award each county, the Office of Grants Management enters the planned award amount into its SDFSC tracking log for budgets, which includes the planned federal funding source for the award, and then submits the log to the Budget Office for approval. However, we found that the total funding planned for county awards from each federal grant shown in the SDFSC tracking log for budgets did not match the funding amounts shown as available and planned for county awards in the SDFSC proposed expenditure plan. Specifically, for state fiscal year 2006–07, the SDFSC tracking log for budgets identified a planned total of roughly $2.9 million to fund county awards from the 2006 SDFSC federal grant, while the SDFSC proposed expenditure plan showed $1.8 million. From the 2005 SDFSC federal grant, the SDFSC tracking log for budgets showed a planned total of $1.8 million to fund county awards, while the SDFSC proposed expenditure plan showed $2.9 million. This discrepancy occurred because the SDFSC tracking log for budgets showed Round 1 county awards as being funded by only one federal grant, while Round 1 awards were actually funded by two federal grants.

During our review, the chief of ADP's Office of Grants Management provided us with an updated SDFSC tracking log for budgets effective for state fiscal year 2007–08, showing the amount from both federal grants planned to fund each county award in Round 1. Additionally, on February 26, 2008, she presented us with a narrative to describe the process she will implement to ensure that ADP spends SDFSC funds within the appropriate period of availability.

Recommendations

ADP should update its grants administrative manual to include the procedures it uses to ensure compliance with the SDFSC federal period-of-availability requirements.

ADP should also ensure that those individuals responsible for reviewing and approving the grantees' quarterly claim forms identify the correct federal grant and amounts to charge.

Finally, ADP should ensure that individuals responsible for reviewing and approving the SDFSC tracking log for budgets verify the accuracy of the amounts contained in this document.

Questioned Costs

Not applicable.

Department's View and Corrective Action Plan

ADP has 27 months to obligate funds from any given SDFSC award and an additional three months to liquidate obligations. As a result, ADP can be charging expenditures to more than one SDFSC award at any given time. This statutory authority allows ADP the flexibility to maximize expenditures charged to any given award if the obligations were made during the period of availability and liquidated within the following three months. ADP will review its processes for assuring that expenditures are charged within the period of availability and maximizing its use of federal funds.

The various documents to which auditor refers after the first two paragraphs under Condition are not designed to address period of availability issues; therefore, they do not provide such information. Rather, they are designed for a variety of other purposes, including state/federal expenditure authority. ADP does not consider them control documents. The information provided on February 26 was an effort to clarify the use of these documents.

Auditor's Comments on Department's View

Because ADP lacked written procedures to ensure that SDFSC funds were used only during the authorized period of availability, we relied on the information ADP presented to us. The chief of ADP's Office of Grants Management provided SDFSC tracking log for budgets and the Budgets Office provided the SDFSC proposed expenditure plan. These documents may have other purposes; however, they were provided in response to our request to understand ADP's processes over the period-of-availability requirement. As noted in our finding, after we discussed this issue with ADP, the chief of ADP's Office of Grants Management initiated a process to correct the discrepancies.

Reference Number:	2007-9-2
Federal Catalog Number:	84.181
Federal Program Title:	Special Education—Grants for Infants and Families With Disabilities
Federal Award Numbers and Years:	H181A050037;2005 H181A060037;2006
Category of Finding:	Procurement, and Suspension and Debarment
State Administering Department:	Department of Developmental Services (Developmental Services)

Criteria

TITLE 34—EDUCATION, PART 303—EARLY INTERVENTION PROGRAM FOR INFANTS AND TODDLERS WITH DISABILITIES, Subpart F—State Administration, Section 303.523, Interagency Agreements

(a) General. Each lead agency is responsible for entering into formal interagency agreements with other State-level agencies involved in the State's early intervention program. Each agreement must meet the requirements in paragraphs (b) through (d) of this section.

(c) Procedures for resolving disputes. (1) Each agreement must include procedures for achieving a timely resolution of intra-agency and interagency disputes about payments for a given service, or disputes about other matters related to the State's early intervention program. Those procedures must include a mechanism for making a final determination that is binding upon the agencies involved.

(2) The agreement with each agency must—

(i) Permit the agency to resolve its own internal disputes (based on the agency's procedures that are included in the agreement), so long as the agency acts in a timely manner; and

(ii) Include the process that the lead agency will follow in achieving resolution of intra-agency disputes, if a given agency is unable to resolve its own internal disputes in a timely manner.

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 80.35, Subawards to Debarred and Suspended Parties

Grantees and subgrantees must not make any award or permit any award (subgrant or contract) at any tier to any party which is debarred or suspended or is otherwise excluded from or ineligible for participation in Federal assistance programs under Executive Order 12549, "Debarment and Suspension."

Condition

Developmental Services refers to the Special Education—Grants for Infants and Families With Disabilities program as the Early Start program. Developmental Services contracts with three state agencies. These state agencies provide assistance such as services to children with vision, hearing, and severe orthopedic impairments who are not eligible for services under the Lanterman Developmental Disabilities Services Act. We reviewed the contract Developmental Services has with one of the state agencies and found that the contract did not include procedures for resolving disputes between it and the state agency or for the state agency to resolve its own disputes. In addition to the dispute language, the contracts are also missing the required suspension and debarment language.

The assistant section chief of its Customer Support Section, the section that prepares the contracts, stated that she was not aware of the federal requirement regarding the inclusion of dispute resolution or suspension and debarment language in Developmental Services' contracts with other state agencies. Specifically, Customer Support Section staff stated that program staff did not ask for it when requesting the contract, and the State Contracting Manual does not require it. Nevertheless, the omission of the dispute resolution language could prevent Developmental Services from achieving a timely resolution of disputes and the omission of suspension and debarment language increases the likelihood that federal funds could be paid to a suspended or debarred party.

Questioned Costs

Not applicable.

Recommendations

Developmental Services should revise its contracts with other state agencies to include the required dispute resolution and suspension and debarment language. Additionally, Developmental Services should ensure that its staff are knowledgeable of all federal laws and regulations governing the program.

Department's View and Corrective Action Plan

Developmental Services recognizes the need to revise its interagency agreements and has developed the following corrective action plan.

- The Customer Support Section will develop the appropriate dispute resolution language for Interagency Agreements (IA) with other State-level agencies, which will be reviewed and approved by the Developmental Services Office of Legal Affairs. Upon approval by the Office of Legal Affairs, all applicable IAs currently in effect will be amended to add the dispute resolution language. In addition, Developmental Services will forward the federal suspension and debarment form to applicable State-level agencies for signature.

- Customer Support Section staff will be trained to become knowledgeable of all federal laws and regulations pertaining to federal-funded programs and to ensure all applicable IAs have the required contract language.

- Developmental Services anticipates that the corrective action plan will be fully implemented by May 31, 2008.

Reference Number:	2007-12-8
Federal Catalog Number:	84.032
Federal Program Title:	Federal Family Education Loans
Federal Award Number and Year:	None; State fiscal year 2006–07
Category of Finding:	Reporting
State Administering Department:	California Student Aid Commission (Student Aid)

Criteria

U.S. OFFICE OF MANAGEMENT AND BUDGET # 1845-0035, NATIONAL STUDENT LOAN DATA SYSTEM, U.S. DEPARTMENT OF EDUCATION GUARANTY AGENCY DATA PROVIDER INSTRUCTIONS, Chapter 1—Introduction

Guaranty agencies (GAs) participating in the Federal Family Education Loan Program (FFELP) are required to report detailed loan information to the National Student Loan Data System (NSLDS).

U.S. OFFICE OF MANAGEMENT AND BUDGET # 1845-0035, NATIONAL STUDENT LOAN DATA SYSTEM, U.S. DEPARTMENT OF EDUCATION GUARANTY AGENCY DATA PROVIDER INSTRUCTIONS, Appendix A—Data Dictionary

Amount of Claim Paid to Lender: The cumulative amount of principal and interest including any additional principal and interest paid on the claim to a lender by a Guaranty Agency for an insurance claim on loan.

CALIFORNIA CODES, EDUCATION CODE, Section 69522, (A) (1)

The commission may establish an auxiliary organization for the purpose of providing operational and administrative services for the commission's participation in the Federal Family Education Loan Program, or for other activities approved by the commission and determined by the commission to be all of the following:

(A) Related to student financial aid.

(B) Consistent with the general mission of the commission.

(C) Consistent with the purposes of the federal Higher Education.

Condition

Student Aid and EDFUND, its auxiliary organization, are required to submit loan-level detail data to the NSLDS, including the amount of claims paid to lenders. Our review of a sample of 35 loans submitted to NSLDS as of September 30, 2007, found several inaccuracies related to the reporting of the amount of claims paid to lenders. Specifically, EDFUND reimbursed lenders for eight student loans in our sample and, according to its Financial Aid Processing System (FAPS), the amounts reported to NSLDS in the "Amount of Claim Paid to Lender" field for five of the student loans were incorrect.

The reason for the discrepancy is that EDFUND reported total loan balances on defaulted loans to NSLDS rather than the actual amounts paid to lenders for the defaulted loans. EDFUND's actual payments to lenders can be less than the total loan balance because lenders can receive between 97 percent and 100 percent of losses on defaulted loans. Because EDFUND reported total loan balances rather than actual amounts paid to lenders, it misreported the amounts paid to lenders

by roughly $150 for these five loans. However, the September 30, 2007, report included more than 2.3 million loans with default claim payments to lenders, and as such, the total amount of this error could be quite substantial. Further, the NSLDS report is used by the U.S. Department of Education (Federal Education) for various performance reports, and inaccuracies can reduce its usefulness.

Questioned Costs

Not applicable.

Recommendation

Student Aid should ensure that future reports that EDFUND submits to NSLDS contain accurate information.

Department's View and Corrective Action Plan

Because the FFEL Program is administered by EDFUND on behalf of Student Aid, EDFUND management has provided the following response.

The system logic that is used to create the required monthly submission of loan detail to NSLDS is separate from the system logic that is used to create the required monthly and annual federal reporting to the Federal Education. The discrepancy noted by the Bureau of State Audits is not related to the federal reporting detail that is submitted to the Federal Education for payment of reinsurance. The Federal Educations' primary method for verifying the data integrity of federal reporting is through reasonability checks that are performed on a regular basis. These performance reports compare the data residing on NSLDS to the data being submitted through the federal reporting process. The published performance reports have not previously indicated that a notable data integrity issue exists regarding lender claim payment amounts.

The noted discrepancy in the lender claim payments amounts as reported to NSLDS through the required monthly submission of loan detail will be researched. The NSLDS guarantor data provider instructions will be reviewed and compared to the current system logic used to identify the appropriate lender claim payment amounts. Necessary changes to the system logic for this monthly reporting will be implemented by June 30, 2008.

Reference Number:	2007-13-6
Federal Catalog Number:	84.181
Federal Program Title:	Special Education—Grants for Infants and Families With Disabilities
Federal Award Numbers and Years:	H181A050037;2005 H181A060037;2006
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Developmental Services (Developmental Services)

Criteria

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133, *AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS* (OMB CIRCULAR A-133) Subpart D—Federal Agencies and Pass-Through Entities, Section .400, Responsibilities

(d) Pass-through entity responsibilities. A pass-through entity shall perform the following for the Federal awards it makes:

(1) Identify Federal awards made by informing each subrecipient of CFDA title and number, award name and number, award year, if the award is R&D, and name of Federal agency. When some of this information is not available, the pass-through entity shall provide the best information available to describe the Federal award.

Condition

Developmental Services did not adequately fulfill its subrecipient monitoring responsibilities for the program. Although Developmental Services identified the federal laws and regulations that govern the program in its contracts with subrecipients, for five of the six contracts we tested, it did not include information such as the Catalog of Federal Domestic Assistance (CFDA) title, CFDA number, award name and federal agency name. Without the required federal award information, Developmental Services cannot ensure that subrecipients understand and are aware of all the relevant federal requirements governing the program.

According to the assistant section chief of the Customer Support Section, Developmental Services has since worked with its subrecipients to add the required language to their fiscal year 2007–08 contracts.

Questioned Costs

Not applicable.

Recommendation

Developmental Services should ensure that it complies with all of its pass-through entity responsibilities, especially those related to federal awards it makes.

Department's View and Corrective Action Plan

During the fiscal year under audit, Developmental Services was in the process of implementing a corrective action plan to address this finding. The required language was drafted in fiscal year 2006–07 and finalized in fiscal year 2007–08. Upon finalizing the required contract language, all subrecipient contracts were identified and amended to include the required language. As indicated in the condition for this finding, Developmental Services has worked with its subrecipients to add the required language in their contracts for fiscal year 2007–08. This was completed in September 2007.

To ensure that all future subrecipient contracts are properly identified, the Customer Support Section is revising the internal contract request form to include all of the required federal award information. The request form is being revised to require an indication whether the contract is with a subrecipient or with a vendor that provides services. The contract request form is the document used to initiate the contract process. In addition, staff will be trained to return the contract request form if it does not contain the required information and contract process will not begin until the all required federal award information is provided. The initial revisions to the contract request form were drafted in fiscal year 2006–07. Developmental Services anticipates that the revisions to the contract request form will be finalized and implemented by May 31, 2008.

Reference Number:	2007-13-10
Federal Catalog Number:	84.186
Federal Program Title:	Safe and Drug-Free Schools and Communities—State Grants (SDFSC)
Federal Award Numbers and Years:	Q186B050005;2005 Q186B060005;2006
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Alcohol and Drug Programs (ADP)

Criteria

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133, *AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS* (OMB Circular A-133), Subpart D—Federal Agencies and Pass-Through Entities, Section .400, Responsibilities

(d) **Pass-through entity responsibilities.** A pass-through entity shall perform the following for the Federal awards it makes:

(1) Identify Federal awards made by informing each subrecipient of CFDA title and number, award name and number, award year, if the award is R&D, and name of Federal agency. When some of this information is not available, the pass-through entity shall provide the best information available to describe the Federal award.

(2) Advise subrecipients of requirements imposed on them by Federal laws, regulations, and the provisions of contracts or grant agreements as well as any supplemental requirements imposed by the pass-through entity.

(4) Ensure that subrecipients expending $300,000 (*$500,000 for fiscal years ending after December 31, 2003*) or more in Federal awards during the subrecipient's fiscal year have met the audit requirements of this part for that fiscal year.

Condition

Our review of ADP's award documents and contracts for seven of its subrecipients found that ADP used an incorrect Catalog of Federal Domestic Assistance (CFDA) title. Specifically, ADP listed the grant as the "Safe and Drug Free Schools and Communities." Additionally, ADP requires certain subrecipients to complete a Notice of Grant Agreement (NOGA), which serves as the binding contract or legal agreement between ADP and the subrecipients. According to its grant administration manual, ADP updates the NOGA anytime there is a formal revision to the grant, funds are encumbered, or there is a change to the subrecipient's signatory. However, ADP did not include the name of the federal agency and the requirements imposed by federal laws and regulations in the NOGA updates for four of the five counties in our sample. Further, when ADP referenced federal regulations it did not specify that grant funds were for the governor's portion of the grant. ADP recently updated its 2007 Request for Applications to include explicit reference to the governor's portion of the grant.

Finally, ADP did not follow its procedures for initiating written and verbal contact with those counties that had delinquent OMB Circular A-133 audits. The State Controller's Office notifies state agencies of those local governments who are required to submit an OMB Circular A-133 audit but have not done so. The status of the counties' submission of their OMB Circular A-133 audits can also be found on the Federal Audit Clearinghouse database. The manager of ADP's Audit Services Branch stated that the staff member who was responsible for OMB Circular A-133 audit follow up was no longer performing this function as of October 2006 and the position remained vacant until October 2007.

Questioned Costs

Not applicable.

Recommendations

ADP should institute procedures to ensure that it properly informs each subrecipient of the award information and of the requirements imposed on them by federal laws, regulations, and other provisions.

ADP should also ensure that staff follow up with counties that have not submitted their OMB Circular A-133 audits.

Department's View and Corrective Action Plan

ADP provides the following clarification to the Condition. The condition states: ADP requires certain subrecipients to complete a Notice of Grant Agreement (NOGA). This is inaccurate. ADP completes the Notice of Grant Agreement for all SDFSC subrecipients, which are exclusively counties. County officials authorized to do so sign the first page of the NOGA. (1)

Further, the condition states that the NOGA serves as the binding contract or legal agreement between ADP and the subrecipients. This is inaccurate. The NOGA is part of the SDFSC Agreement, not the entire binding agreement in and of itself. According to the General Terms and Conditions of the SDFSC Agreements, the SDFSC Agreement consists of the Notice of Grant Agreement (NOGA); the Request for Application (RFA); the approved application, including the Certifications, Assurances, and General Terms and Conditions. The name of the grant, "Safe and Drug Free Schools and Communities," and the source of funds are included in the RFA. Federal laws and regulations are included and passed down by reference in the Agreement. The CFDA number is included on page 2 of the NOGA. Because all these documents make up the Agreement, it is inaccurate to state that the requirements were not included when the NOGA was revised; the requirements continue to be included in the Agreement. (2)

There are no federal regulations that apply specifically or exclusively to the Governor's portion of the SDFSC grant. ADP includes reference to Safe and Drug Free Schools and Communities Act, including the portions of the Act that apply specifically to the Chief Executive Officer. ADP wrote all the RFAs to be responsive to the requirements of statute to assure that applicants understood and applied requirements of the statute.

Because there are differences between the Catalog of Federal Domestic Assistance title, the SDFSC Notice of Grant Award from the United States Department of Education, and how the program is referenced in statute, ADP will seek clarification from the USDOE about how to reference the grant in ADP's grant agreements.

With regard to the comments about A-133 audits, it has been documented and verified through this audit that the Audit Services Branch has an established process and procedure relating to the A-133 audits. The audit finding indicates that the position designated to perform the A-133 functions was vacant for a period of time and has since been filled. However, it should be noted for the record that all of the appropriate Counties' A-133 audit reports were properly submitted and accounted for in the Fiscal Year audited. (3)

Auditor's Comments on Department's View

ADP's statement that it requires all subrecipients to complete a NOGA is incorrect. OMB Circular A-133, Subpart B, Section .210, Subrecipient and Vendor Determinations, provides guidance to consider in determining whether payments constitute a federal award or a payment for goods and services. This determination is essential because subrecipients are subject to an OMB Circular A-133 audit, while vendors providing goods and services are not. We asked the chief of ADP's Office of Grants Management to provide us with ADP's analysis to support its determination that contracts (1)

with three noncounty entities were vendors. However, we were provided with a table outlining general criteria, without specific analysis related to these contracts. Consequently, we reviewed the relationship between ADP and these three contracts and concluded that ADP has subrecipient relationships with two of these contractors.

Further, according to its grants administration manual, ADP's program analysts do not complete the NOGA, but rather help the subrecipient to develop the documents needed for the NOGA.

(2) ADP's conclusion that a revised NOGA is not the binding contract between ADP and subrecipients is inconsistent with its grants administration manual. Specifically, ADP's grants administration manual states that the NOGA serves as the binding "contract" or legal agreement between ADP and the grantee.

(3) ADP's statement that all of the appropriate counties' OMB Circular A-133 audit reports were properly submitted and accounted for in the fiscal year audited is incorrect. On February 26, 2008, the manager of ADP's Audit Services Branch confirmed that the delinquent OMB Circular A-133 audits had not been followed up in a timely manner during the audit period due to a staff vacancy. ADP's manager also stated that subsequent to our bringing this matter to his attention, he followed up with the counties that had delinquent OMB Circular A-133 audits.

Reference Number:	2007-14-3
Federal Catalog Number:	84.032
Federal Program Title:	Federal Family Education Loans
Federal Award Number and Year:	None; State fiscal year 2006–07
Category of Finding:	Special Tests and Provisions
State Administering Department:	California Student Aid Commission (Student Aid)

Criteria

TITLE 34—EDUCATION, PART 682—FEDERAL FAMILY EDUCATION LOANS (FFEL) PROGRAM, Subpart D—Administration of the Federal Family Education Loan Program by a Guaranty Agency, Section 682.406—Conditions for Claim Payments From the Federal Fund and for Reinsurance Coverage

(a) A guaranty agency may make a claim payment from the Federal Fund and receive a reinsurance payment on a loan if—

(9) The agency submitted a request for the payment on a form required by the Secretary no later than 30 days following payment of a default claim to the lender.

Condition

During our procedures performed over special tests and provisions—conditions of reinsurance coverage, we found that EDFUND, the Student Aid auxiliary organization that administers the FFEL Program, requested a substantial portion of the reinsurance it received one to three days prior to EDFUND paying the corresponding default claim to its lenders. Specifically, in the sample of 35 default claims we reviewed, EDFUND requested reinsurance from the U.S. Department of Education (Federal Education) prior to payment to the lender on six occasions. As result of this discovery, we performed additional analyses and found that from July 2006 to June 2007, EDFUND submitted its monthly

requests for reinsurance one to three days prior to some of its lender payments during five of the 12 months. This condition resulted in requests totaling more than $162 million for reinsurance being made prior to payment of the lenders. This is roughly 27 percent of all default claims paid for the fiscal year ending June 30, 2007.

In a September 2007 e-mail to Federal Education regarding this matter, EDFUND explained that a more timely submission of the monthly EDFUND Form 2000 has resulted in some occasions where the request for reinsurance payment on defaulted claims has been submitted to Federal Education either one or two days prior to the second claims disbursement cycle to lenders. However, EDFUND stated that these lender claim payments are always disbursed prior to Federal Education's Form 2000 Statement of Acceptance notification and receiving the reinsurance payment from Federal Education . In response to this e-mail, a Federal Education representative stated that, based upon a reading of the Higher Education Act, a guaranty agency cannot file a claim until the lender's claim has been paid. Consequently, because its requests for payment from Federal Education did not comply with federal requirements, EDFUND indicates it has changed its practices as described in its corrective action plan.

Questioned Costs

Not applicable.

Recommendation

EDFUND should develop procedures to ensure that it submits reinsurance requests only after default claims from lenders have been paid.

Department's View and Corrective Action Plan

Because the FFEL Program is administered by EDFUND on behalf of Student Aid, EDFUND's management has provided the following response.

EDFUND implemented a new claims processing schedule in January 2008. Under this new schedule, second cycle claim payments will usually be sent to lenders on the first day of the following month and the associated reinsurance requests will not occur any earlier than the next day. In this way, EDFUND eliminates the potential for submitting a request for reinsurance prior to issuing the lender payments. As a secondary control, an additional procedure has been adopted to verify with Accounts Payable that the lender claim payments have been made prior to submitting the reinsurance request to Federal Education.

Reference Number:	2007-14-4
Federal Catalog Number:	84.032
Federal Program Title:	Federal Family Education Loans
Federal Award Number and Year:	None; State fiscal year 2006–07
Category of Finding:	Special Tests and Provisions
State Administering Department:	California Student Aid Commission (Student Aid)

Criteria

TITLE 34—EDUCATION, PART 682—FEDERAL FAMILY EDUCATION LOANS (FFEL) PROGRAM, Subpart D—Administration of the Federal Family Education Loan Program by a Guaranty Agency, Section 682.414—Records, Reports, and Inspection Requirements for Guaranty Agency Programs

(a) Records. (1)(i) The guaranty agency shall maintain current, complete, and accurate records of each loan that it holds, including, but not limited to, the records described in paragraph (a)(1)(ii) of this section. The records must be maintained in a system that allows ready identification of each loan's current status, updated at least once every 10 business days. Any reference to a guaranty agency under this section includes a third-party servicer that administers any aspect of the FFEL programs under a contract with the guaranty agency, if applicable.

CALIFORNIA CODES, EDUCATION CODE, Section 69522, (A) (1)

The commission may establish an auxiliary organization for the purpose of providing operational and administrative services for the commission's participation in the Federal Family Education Loan Program, or for other activities approved by the commission and determined by the commission to be all of the following:

(A) Related to student financial aid.

(B) Consistent with the general mission of the commission.

(C) Consistent with the purposes of the federal Higher Education Act of 1965 and amendments thereto.

Condition

EDFUND, Student Aid's auxiliary organization, administers the FFEL Program and is required by its operating agreement with Student Aid to provide information security over Student Aid's and EDFUND's confidential data. However, in past years we found that EDFUND had not developed adequate internal controls over its information systems to provide reasonable assurance that it keeps current, complete, and accurate records of each loan. Specifically, we found weaknesses in EDFUND's controls over entitywide security planning and management and its restriction of access to data files.

EDFUND has made some progress in addressing its controls over entitywide security planning and management. In June 2005, EDFUND hired a contractor to complete a security risk assessment. Additionally, in June 2007, EDFUND approved six new policies related to its entitywide security program plan. However, EDFUND has yet to address all of the high-risk and moderately high-risk findings identified in its risk assessment and to fully implement the entitywide security program plan. The lack of security planning and management has the potential to result in insufficient protection of sensitive or critical computer records.

In past years we also found weaknesses in EDFUND's electronic access controls designed to restrict access to data files. Specifically, EDFUND continued to allow a limited number of employees access to data that is not related to their assigned responsibilities. Additionally, EDFUND inappropriately allowed these same employees to make changes to sensitive data, even though these changes were not subject to the normal edits of its information system. Finally, EDFUND did not maintain a complete history or audit trail of the changes made to the data. In September 2007, EDFUND initiated a project designed to strengthen its logical security controls by eliminating certain employees' access to data that is not associated with their job functions, creating an audit trail of changes made to the data, and reducing the number of changes made that were not subject to normal edits of its information system. However, implementation of this project did not begin until October 2007 and the estimated completion date is April 2008.

Questioned Costs

Not applicable.

Recommendation

Student Aid should ensure that EDFUND fully implements its entitywide program for security planning and management and that it strengthens its electronic access controls. This will help ensure that it maintains current, complete, and accurate records for each loan that it holds.

Department's View and Corrective Action Plan

Because the FFEL Program is administered by EDFUND on behalf of Student Aid, EDFUND management has provided the following response.

Entity-Wide Security Planning and Management

The majority of the identified findings in the 2005 security risk assessment have been addressed through the creation of EDFUND's Security Office and Security Manual. The remaining items will be addressed by June 30, 2008. The entity-wide security program plan is a living document and will continue to be refined and executed.

Data Maintenance (Electronic Access Controls)

The corrective action plan noted in the June 30, 2006, Annual Compliance Report identified possible modifications which would provide a systematic process for performing data maintenance updates. The project to address the possible modifications was in process prior to September 30, 2007, and the first phase was completed by October 31, 2007. The first phase implemented a systematic audit trail for transactions performed in specific data maintenance files and reduced the menu of files available to perform transactions. Individuals performing data maintenance transactions will now have access only to the two primary data maintenance files that are related to their assigned responsibilities. The second phase of the project will implement an alternative method of performing the updates which will reduce the amount of transactions performed in data maintenance files. The second phase is expected to complete by March 31, 2008. With the completion of this project, EDFUND will sufficiently address the stated weaknesses in our electronic access controls for data maintenance.

U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Reference Number:	2007-1-2
Federal Catalog Number:	93.958
Federal Program Title:	Block Grants for Community Mental Health Services
Federal Award Numbers and Years:	06B1CACMHS-03;2006 05B1CACMHS-01;2005 04B1CACMHS-01;2004
Category of Finding:	Activities Allowed/Allowable Costs
State Administering Department:	Department of Mental Health (Mental Health)

Criteria

TITLE 42—THE PUBLIC HEALTH AND WELFARE, CHAPTER 6A—PUBLIC HEALTH SERVICE, SUBCHAPTER XVII—BLOCK GRANTS, Part B—Block Grants Regarding Mental Health and Substance Abuse, Subpart i—Block Grants for Community Mental Health Services, Section 300x, Formula Grants to States

(b) Purpose of grants

A funding agreement for a grant under subsection (a) of this section is that, subject to section 300x-5 of this title, the State involved will expend the grant only for the purpose of—

(1) carrying out the plan submitted under section 300x-1(a) of this title by the State for the fiscal year involved;

(2) evaluating programs and services carried out under the plan; and

(3) planning, administration, and educational activities related to providing services under the plan.

TITLE 42—THE PUBLIC HEALTH AND WELFARE, CHAPTER 6A—PUBLIC HEALTH SERVICE, SUBCHAPTER XVII—BLOCK GRANTS, Part B—Block Grants Regarding Mental Health and Substance Abuse, Subpart i—Block Grants for Community Mental Health Services, Section 300x-5—Restrictions on Use of Payments

(a) In general

A funding agreement for a grant under section 300x of this title is that the State involved will not expend the grant—

(1) to provide inpatient services;

(2) to make cash payments to intended recipients of health services;

(3) to purchase or improve land, purchase, construct, or permanently improve (other than minor remodeling) any building or other facility, or purchase major medical equipment;

(4) to satisfy any requirement for the expenditure of non-Federal funds as a condition for the receipt of Federal funds; or

(5) to provide financial assistance to any entity other than a public or nonprofit private entity.

Condition

Mental Health does not ensure that subgrantees' expenditures are only for allowable activities and costs. Mental Health requires counties to submit a federal grant detailed provider budget and program narrative for each of its programs as part of its application for Substance Abuse and Mental Health Services Administration's Block Grants for Community Mental Health Services (SAMHSA CMHS) funds. Mental Health distributes SAMHSA CMHS grant funds to counties for community mental health services based on an allocation formula. For state fiscal year 2006–07, Mental Health's balance sheet indicates that it awarded almost $52 million to counties.

Mental Health relies on the counties' budget and program description components of their applications to determine if funds are used for allowable costs and activities. Specifically, the SAMHSA CMHS grant renewal application instructions direct counties to include in their program narrative a program description that specifies what is actually being paid for by the block grant funds. The counties must explain their budget line items. However, we examined 19 program narratives submitted by our sample of six counties and found that the program descriptions provide a general outline of program activities but do not explain each budget item. Program staff stated that they do not penalize counties for failing to explain budget items in the program description. We also found that one program narrative was missing and one narrative did not clearly specify its target population as children with serious emotional disturbance or adults with serious mental illness.

Because Mental Health does not collect sufficient information from counties during the application process, we were unable to determine if 12 of the 19 budget sheets we examined from our sample of six counties contained budget line items that were for allowable costs and activities. For example, seven budget sheets referred to contracts with other entities under the "other expense" budget line item, but the counties did not describe the contract or include a copy of it.

Mental Health also does not require the counties to submit invoices, receipts, or payroll information to verify the amounts they report as expenditures. Additionally, Mental Health does not perform regular site visits to the counties to verify the allowability of their programs' costs and activities. According to Mental Health, it used to perform site visits that included procedures to verify the amounts reported in counties' expenditure reports. However, Mental Health ceased performing site visits for this purpose years ago because of changes in organizational structure and a shift in the focus of its site visits to activities related to the Mental Health Services Act. Until Mental Health establishes processes and procedures, it has no way of knowing if counties are charging unallowable costs and activities to the program.

Questioned Costs

Unknown

Recommendation

Mental Health should establish a process to ensure that only allowable costs and activities are paid for with SAMHSA CMHS grant funds.

Department's View and Corrective Action Plan

This issue has not been raised in recent federal reviews conducted by the Center for Mental Health Services which occurred in April 1996, May 1999, and May 2005, nor was it raised in a state audit conducted by the Bureau of State Audits in 2003. Nonetheless, Mental Health recognizes the need to verify appropriate expenditures and understands the approach identified in this report. As a result Mental Health will increase the level of detail required from counties in reporting expenditures and will begin internal planning to determine the best way to organize county site reviews without creating a burden on counties that experience multiple audits and reviews every year. Although Mental Health

appreciates the suggestion that counties be required to submit invoices for payment as a strategy for ensuring expenditures are for allowable activities and costs, it believes that this is best handled by requiring more detail in county expenditure reports.

Mental Health's administration and its accounting unit acknowledge the recommendation and are conducting a reengineering evaluation of the current process that will provide the opportunity to improve the processes and procedures as it relates to invoice submittals.

Reference Number:	2007-1-5
Federal Catalog Number:	93.568
Federal Program Title:	Low-Income Home Energy Assistance (LIHEAP)
Federal Award Numbers and Years:	G-06B1CALIEA;2006 G-07B1CALIEA;2007
Category of Finding:	Allowed Activities/Allowable Costs; Subrecipient Monitoring
State Administering Department:	Department of Community Services and Development (CSD)

Criteria

TITLE 42—THE PUBLIC HEALTH AND WELFARE, CHAPTER 94—LOW-INCOME ENERGY ASSISTANCE, SUBCHAPTER II—LOW-INCOME HOME ENERGY ASSISTANCE, Section 8624, Applications and Requirements

(b) Certifications required for covered activities.

As part of the annual application required by subsection (a) of this section, the chief executive officer of each State shall certify that the State agrees to—

(1) use the funds available under this title to—

(A) conduct outreach activities and provide assistance to low income households in meeting their home energy costs, particularly those with the lowest incomes that pay a high proportion of household income for home energy, consistent with paragraph (5);

(B) intervene in energy crisis situations;

(C) provide low-cost residential weatherization and other cost-effective energy-related home repair; and

(D) plan, develop, and administer the State's program under this subchapter including leveraging programs, and the State agrees not to use such funds for any purposes other than those specified in this subchapter.

TITLE 45—PUBLIC WELFARE, PART 96—BLOCK GRANTS, Subpart C—Financial Management, Section 96.30, Fiscal and Administrative Requirements

(a) Fiscal control and accounting procedures. Except where otherwise required by Federal law or regulation, a State shall obligate and expend block grant funds in accordance with the laws and procedures applicable to the obligation and expenditure of its own funds. Fiscal control and accounting procedures must be sufficient to (a) permit preparation of reports required by the

statute authorizing the block grant and (b) permit the tracing of funds to a level of expenditure adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of the statute authorizing the block grant.

Condition

CSD's processes do not ensure that subgrantees' expenses are only for allowable activities and costs. Specifically, CSD allows its subgrantees to request reimbursement using a monthly expenditure and activity report. The report includes summary-level expense and program activity data. CSD processes the subgrantee expenditure and activity report without reviewing sufficient supporting documentation to verify the allowability of the activities or costs. Instead, CSD relies on the review of supporting documentation for expenses and program activities that occur during its site visits.

CSD's program manager stated site visits are performed for each subgrantee every two years, or more frequently as needed, based on the annual risk assessment. Although CSD's field operations policy and procedures and its monitoring review guide provide some guidance on how its field representatives should conduct monitoring activities, they provide limited guidance on the types of expenses the field representatives should review and the level of supporting documentation they must obtain.

As a result, our review of the site visit documentation maintained by CSD found mixed results. Six of the 10 site visit files we reviewed did not identify or include any supporting documentation related to the specific expenses that were reviewed. For example, one file had notes that merely stated, "We also tracked the expenditures of the Wood Propane and Oil (WPO) applications and are satisfied with the outcome." The remaining four files had evidence that some expenditures were reviewed. A CSD program manager stated that the field representatives retain documentation to support what was reviewed as well as any issues requiring further attention. Nevertheless, the site visit files we reviewed contained inconsistent documentation to ensure that the subgrantees' expenses were only for allowable activities and allowed costs.

Finally, two of the 20 expenditure and activity reports we reviewed included expenses for floor furnace replacements that exceeded the maximum allowable reimbursement rate. The LIHEAP subgrantee contract states that for emergency Energy Crisis Intervention Program or heating and cooling services provided outside the contractor's normal business hours of operations, the contractor may exceed the maximum cost limits allowed for repair and replacement services. However, CSD was unable to provide documentation demonstrating that it followed up on these two exceptions. A CSD program manager stated that while on site, field representatives will review documentation to verify situations where the subgrantee exceeded the maximum reimbursement rate. Yet, the field operations policy and procedures and monitoring review guide do not specifically address reviewing expenses that exceed the maximum reimbursement rate.

Recommendation

CSD should strengthen its subrecipient monitoring policies and procedures to ensure federal funds awarded are expended only for allowable activities and costs. For example, it could direct its field representatives to document their sampling methodology and to retain documentation for the subgrantees' expenses that they review during the site visit.

Questioned Costs

$1,667 ($12,017 total reported expenditures for the two exceptions—allowable amount of $10,350) of the $1,172,088 sampled

Department's View and Corrective Action Plan

CSD concurs with Bureau of State Audits' recommendations to improve its subrecipient monitoring policies and procedures and subrecipient fiscal and programmatic reporting to ensure federal funds awarded are expended only for allowable activities and costs.

CSD will initiate its corrective action plan with an assessment to identify the most cost feasible and practical methods to improve current field operations monitoring policies and procedures, subrecipient fiscal and programmatic reporting, and field operations procedures.

This assessment should be completed by June 2008. Based on the assessment, a solution will be chosen and a work plan for implementation will be developed.

The questioned costs are based on the difference between the total costs of reported furnaces and the allowable amount.

a. CSD requested that the subrecipient submit the complete client file, which included all related invoices and documentation substantiating the furnace replacement costs reported for the monthly period in question.

b. CSD will continue to investigate the subrecipient's costs of reported furnaces for the monthly period in question. We are compiling all required documentation and expect that all reconciliations and necessary adjustments to reflect the total allowable costs that are substantiated in the client files to be completed by June 30, 2008.

Reference Number:	2007-1-8
Federal Catalog Number:	93.558
Federal Program Title:	Temporary Assistance for Needy Families (TANF)
Federal Award Number and Year:	GA-0602CATANF;2006
Category of Finding:	Activities Allowed/Allowable Costs
State Administering Department:	Department of Social Services (Social Services)

Criteria

TITLE 45—PUBLIC WELFARE, PART 92—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE, LOCAL AND TRIBAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 92.20, Standards for Financial Management Systems

(a) A State must expend and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contractors, must be sufficient to—

(2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

Condition

Social Services' process for reviewing and authorizing county assistance expenditures does not provide reasonable assurance that federal funds were expended only for allowable activities and costs. For fiscal year 2006–07, Social Services reimbursed counties at least $1.38 billion under the TANF program.

Social Services requires counties to submit claims that include a summary report of their assistance expenditures electronically on a monthly basis. Social Services' Contract and County Assistance Section is responsible for auditing the counties' claims. The manager stated that the first step of the audit process is to ensure that the county's welfare director and the county's auditor-controller signatures on

the certification page of the claim match the county's authorizing signature letter that Social Services has on file, the amounts on the signed certification page match the amounts in the claim, and that the county used the most current version of Social Services' electronic claim template. The second part of the audit process consists of staff looking for significant variations of costs between months.

However, without audit procedures such as reviewing the supporting documentation for the counties' expenditure claims, Social Services has no way of assuring that counties are spending federal funds on allowable activities and costs only. Moreover, it is inappropriate for Social Services to rely on certifications from county welfare directors and county auditor-controllers to fulfill its monitoring responsibilities.

Questioned Costs

Unknown

Recommendation

Social Services should strengthen its claim audit process to include, at a minimum, the verification of a sample of county assistance expenditures to ensure they are for allowable activities and costs.

Department's View and Corrective Action Plan

Social Services stated that counties are required to have audits conducted and to send the Employment and Eligibility Branch (EEB) their annual Single County Audit. The EEB reviews the single county audits and follows up with the county to ensure corrective action is taken on all audit findings.

Auditor's Comments on Department's View

Social Services' response does not address the concern we raise. Prior to July 1, 2005, Social Services required counties to submit detailed supporting documentation for specific line items with their claims. However, effective July 1, 2005, Social Services directed counties to no longer submit detailed supporting documentation and to submit only the information contained in its electronic claim template.

Social Services informed the counties that they must retain supporting documentation such as prior-month adjustment reports, payroll summaries, and code transfer reports, and all backup information relevant to these documents for audit purposes. However, in fiscal year 2006–07, neither Social Services' program staff nor audit staff conducted audits of the counties that included a review of their claims. Thus, as stated previously, without procedures such as reviewing the supporting documentation for the counties' claims, Social Services has no way of assuring that counties are spending federal funds on allowable activities and costs only.

Moreover, although Social Services is required to ensure that counties take corrective action on all of their Single Audit findings, these audits do not satisfy its responsibility for performing subrecipient monitoring procedures during the award period to ensure that the amounts counties submit on their assistance claims are only for allowable activities and costs. Finally, as our finding number 2007-13-9 states, Social Services lacked adequate processes and procedures to ensure that it issued timely management decisions for the findings presented in the fiscal year 2005–06 U.S. Office of Management and Budget Circular A-133 audits for 27 of its 58 county subrecipients.

Reference Number:	2007-2-2
Federal Catalog Number:	93.563
Federal Program Title:	Child Support Enforcement (CSE)
Federal Award Numbers and Years:	0604CA4004;2006 0704CA4004;2007
Category of Finding:	Allowable Costs/Cost Principles
State Administering Department:	Department of Child Support Services (Child Support Services)

Criteria

TITLE 45—PUBLIC WELFARE, PART 304—OFFICE OF CHILD SUPPORT ENFORCEMENT (CHILD SUPPORT ENFORCEMENT PROGRAM), ADMINISTRATION FOR CHILDREN AND FAMILIES, U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES—FEDERAL FINANCIAL PARTICIPATION, Section 304.10, General Administrative Requirements

As a condition for Federal financial participation, the provisions of part 74 of this title (with the exception of 45 CFR 74.23, Cost Sharing or Matching and 45 CFR 74.52, Financial Reporting) establishing uniform administrative requirements and cost principles shall apply to grants made to States under this part.

TITLE 45—PUBLIC WELFARE, PART 74—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR AWARDS AND SUBAWARDS TO INSTITUTIONS OF HIGHER EDUCATION, HOSPITALS, OTHER NONPROFIT ORGANIZATIONS, AND COMMERCIAL ORGANIZATIONS, Subpart C—Post-Award Requirements—Financial and Program Management, Section 74.21—Standards for Financial Management Systems

(b)(6) Recipients' financial management systems shall provide for the following: Written procedures for determining the reasonableness, allocability and allowability of costs in accordance with the provisions of the applicable Federal cost principles and the terms and conditions of the award.

TITLE 45—PUBLIC WELFARE, PART 74—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR AWARDS AND SUBAWARDS TO INSTITUTIONS OF HIGHER EDUCATION, HOSPITALS, OTHER NONPROFIT ORGANIZATIONS, AND COMMERCIAL ORGANIZATIONS, Subpart C—Post-Award Requirements—Financial and Program Management, Section 74.27, Allowable Costs

(a) For each kind of recipient, there is a particular set of Federal principles that applies in determining allowable costs. Allowability of costs shall be determined in accordance with the cost principles applicable to the entity incurring the costs. Thus, allowability of costs incurred by the State, local or federally-recognized Indian tribal governments is determined in accordance with the provisions of OMB Circular A-87, "Cost Principles for State and Local Governments."

Condition

Child Support Services lacks adequate written policies and procedures to ensure that its expenditures meet the requirements of U.S. Office of Management and Budget (OMB) Circular A-87, *Cost Principles for State and Local Governments*, and the federal requirements for the CSE program. Specifically, Child Support Services' expenditure approval process includes the review and approval of various analysts and managers. However, Child Support Services has not provided its staff who approve expenditures with a list of allowable or unallowable expenditures. Consequently, we were unable to verify if its staff are comparing the invoices and supporting documentation to a list of allowable and unallowable

expenditures prior to approving the invoice for payment. The list is particularly important because federal regulations for the CSE program and OMB Circular A-87 contain specific instructions on costs that are allowable and unallowable. Without written policies and procedures, Child Support Services cannot ensure that its expenditures are in compliance with the requirements of the program and OMB Circular A-87.

Questioned Costs

Not applicable.

Recommendation

Child Support Services should establish written policies and procedures that include providing staff who review and approve CSE program expenditures prior to payment with a list of allowable or unallowable expenditures so that it can ensure that expenditures are made in conformance with applicable OMB cost principles, program laws and regulations, and the state plan.

Department's View and Corrective Action Plan

Child Support Services concurs with the recommendation and is in the process of providing all staff with OMB Circular A-87 list of allowable/unallowable expenditures that will be updated, as necessary.

Reference Number:	2007-2-3
Federal Catalog Number:	93.566
Federal Program Title:	Refugee and Entrant Assistance— State Administered Programs (Refugee Program)
Federal Award Numbers and Years:	G-06AACA9100;2006 G-06AACA9110;2006
Category of Finding:	Allowable Costs/Cost Principles
State Administering Department:	Department of Social Services (Social Services)

Criteria

Title 2—GRANTS AND AGREEMENTS, PART 225—COST PRINCIPLES FOR STATE, LOCAL, AND INDIAN TRIBAL GOVERNMENTS (OMB CIRCULAR A-87)

Appendix B to Part 225—Selected Items Of Cost

8. Compensation for personal services

   h. Support of salaries and wages. These standards regarding time distribution are in addition to the standards for payroll documentation.

      (4) 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 which meets the standards in subsection 8.h.5 of this appendix unless a statistical sampling system (see subsection (6)) or other substitute system has been approved by the cognizant Federal agency. Such documentary support will be required where employees work on:

         (a) More than one Federal award,

         (b) A Federal award and a non-Federal award,

(c) An indirect cost activity and a direct cost activity,

(d) Two or more indirect activities which are allocated using different allocation bases, or

(e) An unallowable activity and a direct or indirect cost activity.

(5) Personnel activity reports or equivalent documentation must meet the following standards:

(a) They must reflect an after-the-fact distribution of the actual activity of each employee,

(b) They must account for the total activity for which each employee is compensated,

(c) They must be prepared at least monthly and must coincide with one or more pay periods, and

(d) They must be signed by the employee.

(e) Budget estimates or other distribution percentages determined before the services are performed do not qualify as support for charges to Federal awards but may be used for interim accounting purposes, provided that:

(i) The governmental unit's system for establishing the estimates produces reasonable approximations of the activity actually performed;

(ii) At least quarterly, comparisons of actual costs to budgeted distributions based on the monthly activity reports are made. Costs charged to Federal awards to reflect adjustments made as a result of the activity actually performed may be recorded annually if the quarterly comparisons show the differences between budgeted and actual costs are less than ten percent; and

(iii) The budget estimates or other distribution percentages are revised at least quarterly, if necessary, to reflect changed circumstances.

Condition

Social Services cannot substantiate the payroll expenditures it charged to the Refugee Program in fiscal year 2006–07. Social Services uses funds from four federal programs to administer California's Refugee Program. However, Social Services does not require its staff to complete personnel activity reports (for example, time sheets) or equivalent documentation to support the actual amount of time they spend working on activities related to this program. Instead, Social Services uses percentages that were developed a long time ago based on a time study or studies to charge its payroll expenditures. In fact, according to one of its program analysts, the time study or studies used by Social Services is so outdated that staff were unable to provide us a copy.

The program analyst stated that Social Services believes the percentages accurately reflect the percentage of time staff spend on program activities because it periodically makes changes to reflect changes in its workload such as the addition of a new staff member or the addition of a new program component. However, Social Services has no documentation to substantiate its claim because it does not compare the percentages used to distribute its personnel costs to actual costs based on monthly personnel activity reports. Without timely and accurate reporting of the actual time spent on the Refugee Program by its staff, Social Services cannot ensure that only allowable costs are charged to the program.

Questioned Costs

$1,200,087 (payroll expenditures charged in fiscal year 2006–07)

Recommendation

Social Services should require staff who work on the Refugee Program to prepare personnel activity reports or equivalent documentation that meets the requirements of OMB Circular A-87.

Department's View and Corrective Action Plan

On an ongoing basis, the Refugee Program Branch (RPB) will conduct a time study of 100 percent of the RPB staff who work on Office of Refugee Resettlement- (ORR) funded programs during each of the work days of the second month of every quarter of the federal fiscal year and use the results of this study to allocate costs to ORR-funded programs or revise quarterly estimates as necessary based on actual time study data obtained. The RPB will retain the documentation in support of costs allocated to ORR-funded programs.

On March 21, 2008, the ORR gave its approval based on ORR's understanding of the RPB proposal, and "RPB compliance with the process described herein and the ORR requests contained in this e-mail, I (ORR Division Director for Budget, Policy and Data Analysis, Gayle Smith) approve the RPB request to move from monthly to quarterly time studies as the basis for allocating RPB costs to ORR-funded programs."

Reference Number:	2007-2-5
Federal Catalog Number:	93.778
Federal Program Title:	Medical Assistance Program (Medi-Cal)
Federal Award Numbers and Years:	05-0505CA5028;2005 05-0605CA5028;2006
Category of Finding:	Allowable Costs/Cost Principles
State Administering Department:	Department of Health Care Services (Health Care Services)

Criteria

TITLE 42—PUBLIC HEALTH, CHAPTER IV—CENTERS FOR MEDICARE & MEDICAID SERVICES, DEPARTMENT OF HEALTH AND HUMAN SERVICES, Part 433—State Fiscal Administration, Subpart F—Refunding of Federal Share of Medicaid Overpayments to Providers, Section 433.312—Basic Requirements for Refunds

(a) Basic rules.

(1) Except as provided in paragraph (b) of this section, the Medicaid agency has 60 days from the date of discovery of an overpayment to a provider to recover or seek to recover the overpayment before the Federal share must be refunded to CMS.

(2) The agency must refund the Federal share of overpayments at the end of the 60-day period following discovery in accordance with the requirements of this subpart, whether or not the State has recovered the overpayment from the provider.

(b) Exception. The agency is not required to refund the Federal share of an overpayment made to a provider when the State is unable to recover the overpayment amount because the provider has been determined bankrupt or out of business in accordance with §433.318.

(c) Applicability.

(1) The requirements of this subpart apply to overpayments made to Medicaid providers that occur and are discovered in any quarter that begins on or after October 1, 1985.

(2) The date upon which an overpayment occurs is the date upon which a State, using its normal method of reimbursement for a particular class of provider (e.g., check, interfund transfer), makes the payment involving unallowable costs to a provider.

Condition

In our report for fiscal year ended June 30, 2006, we identified that Electronic Data Systems (EDS)—the firm Health Care Services contracts with to authorize Medi-Cal payments—authorized Medi-Cal payments to some skilled nursing facilities (facilities) more than once for the same services. We identified these errors while performing an audit of California's implementation of a new facility-specific reimbursement rate system. Specifically, we identified more than 2,100 duplicate payments to facilities for claims reflecting dates of service between August 1, 2005, and July 31, 2006, totaling $3.3 million. We were also aware of other potential duplicate payments to facilities; however, due to the complexity of these payments, additional research by EDS was necessary. According to EDS, its examiners followed a flawed procedure that instructed them to override a specific type of suspended claim, resulting in duplicate payment authorizations.

Health Care Services and EDS subsequently took measures to resolve this problem. EDS implemented a special processing guideline to discontinue overriding suspended claims, updated its procedures, and started to identify all facilities that received duplicate Medi-Cal payments to begin efforts to recoup those funds. However, subsequent to our audit, we found that the special processing guideline instructs examiners in certain situations to continue to follow the flawed procedure, which could result in EDS continuing to pay duplicate claims related to the skilled nursing facilities. Subsequently, EDS further revised the special processing guidelines to correct this oversight. In response to our finding last year, Health Care Services stated that it would increase its quality control over the claims override function. However, we found that Health Care Services has not yet increased its quality control over the claims override function. In fact, Health Care Services is planning to request a study of this process to determine if any additional quality controls over the claims override function are warranted. This study was scheduled to begin in March 2008.

Because the scope of the audit described above focused only on long-term care payments made to facilities subject to the new reimbursement rates, we reviewed Health Care Services' guidelines for other types of payments and found that those for medical, outpatient, and vision payments included this same flawed procedure. However, because EDS does not document or track the reasons it overrides a suspended claim, we could not identify which claims were paid using the flawed procedure that could result in duplicate payments. Thus, until Health Care Services increases its quality control over the claims override function, it has no way of knowing if duplicate payments are being made to providers for medical, outpatient, and vision services.

Health Care Services stated that it has begun to recoup duplicate payments made to long-term care facilities in those situations where a single facility received more than one payment for the same individual on the same day. Specifically, according to Health Care Services, it identified $5,099,557 in overpayments to 532 long-term care facilities, of which it has recouped all but $184,812 plus interest as of January 31, 2008. However, we could not validate this information because Health Care Services did not retain the supporting documentation used to arrive at these amounts.

Health Care Services also stated that it has begun to identify the amount of duplicate payments that were paid to multiple long-term care providers for the same individual on the same day, but it has not yet begun to recoup overpayments for these claims. Health Care Services estimates that $780,113 was paid to providers as the result of this type of duplicate payment.

Finally, Health Care Services has not yet begun to identify and to recoup overpayments for any duplicate medical and outpatient claims. Health Care Services expects to finish the process of identifying duplicate payments related to these claims by April 30, 2008. Until Health Care Services recoups its overpayments to providers, it is not in compliance with the federal regulations that govern refunding the federal share of overpayments to providers.

Questioned Costs

Unknown

Recommendations

To ensure that EDS authorizes disbursements of Medicaid funds only to facilities and providers entitled to them, Health Care Services should take the following steps:

- Ensure that EDS documents and tracks the reasons for overriding claims that have been suspended in the system.
- Increase its quality control over the claims override function.
- Further investigate the possibility that EDS authorized duplicate payments beyond those we specifically identified during our earlier audit to ensure that the magnitude of the problem is identified and corrected, and duplicate payments are recouped.
- Direct EDS to retain documentation to support all of its recoupment efforts.

Department's View and Corrective Action Plan

In response to the audit's finding of duplicate payments to skilled nursing facilities due to the use of inaccurate claim processing guideline procedures by Medi-Cal Fiscal Intermediary (FI) claim examiners, Health Care Services implemented an interim fix to those procedures on November 17, 2006. This interim fix was accomplished through the issuance of "Special Processing Guidelines" (SPG). On March 28, 2007, the problem with the original claim processing guidelines was more formally fixed by approval of a revision to the original guidelines. These guidelines only applied to suspended claims from skilled nursing facilities. Use of the SPG process was employed to implement a correction to the guidelines and stop the incidence of duplicate payments as soon as possible, and in advance of the timeline needed to more formally approve a revision to the guidelines.

As a result of Health Care Services' additional finding that claim processing guidelines used for suspended Medical and Outpatient claims had the same flaw as those used for processing skilled nursing facility claims, a SPG was issued to implement an interim fix to these guidelines on June 19, 2007. The subsequent formal revision of the Medical and Outpatient claim processing guidelines occurred on September 20, 2007.

Recoupment of funds for the duplicate skilled nursing facility claims began on September 14, 2007. The recoupment process entails the offsetting of each affected provider's weekly Medi-Cal claim payments until the provider's repayment obligation is paid in full. If the payment obligation is not satisfied within 60 days, the account is forwarded to Health Care Services' Third Party Liability and Recovery Division for additional collection action. As of April 4, 2008, $5,003,903 of the $5,099,557 in overpayments to skilled nursing facilities has been recouped.

Health Care Services estimates that there may have been an additional $780,113 of potential overpayments to skilled nursing or other facilities when payments were made to multiple facilities for the same individual on the same day. There are certain circumstances for which such payments are allowed by existing Medi-Cal policy. As a result, to determine the amount of these funds that should be recouped, Health Care Services solicited additional information from affected facilities by letter

on January 24, 2008, with a deadline for response of March 24, 2008. The Medi-Cal FI is currently analyzing this additional information. Recoupment of the portion of funds determined to be paid inappropriately is scheduled to begin on May 30, 2008. Potential duplicate claim cases in which the affected provider has not responded to the information request will be referred to Health Care Services Audits Section for additional action.

The review of the potential duplicate payments for medical and outpatient claims that may have been paid in error due to the flawed processing guidelines was delayed until March 25, 2008, due to other competing departmental priorities for the Medi-Cal FI. However, completion of this review is expected by April 30, 2008, and Health Care Services anticipates initiating recoupment efforts in May 2008.

In regard to the audit's recommendations:

- *Ensure that EDS documents and tracks the reasons for overriding claims that have been suspended in the system.*

Existing processing requirements restrict EDS (Medi-Cal FI) claim examiners to only override the reason a claim has been suspended for review when the claim meets specific criteria documented in the claims processing guidelines for the error code condition that resulted in the claim being suspended. As a result, there is no need to additionally document the reasons a suspended claim's error code has been overridden.

- *Increase its quality control over the claims override function.*

Health Care Services believes the Medi-Cal FI's current level of quality control over the suspense override function is effective. The cause of this audit's finding of duplicate payments was not due to a systemic problem in quality of the override function. Rather, it was caused by an unusual, one-time, breakdown in the process of creating, reviewing and approving new suspense claim processing guidelines, a process that has multiple control points and has a proven track record of ensuring quality. However, in order to identify the potential overpayment of duplicate claims in the future, Health Care Services has directed the Medi-Cal FI to add to its existing Quality Assurance program a routine sampling and review of potential duplicate claims.

- *Further investigate the possibility that EDS authorized duplicate payments beyond those we specifically identified during our earlier audit to ensure that the magnitude of the problem is identified and corrected, and duplicate payments are recouped.*

Health Care Services investigated further the possibility of EDS authorizing duplicate payments beyond those already identified by the audit. Health Care Services determined that processing guidelines containing the same flaw as mentioned above also caused duplicate payments to Medical and Outpatient providers. This problem was corrected in June 2007, and recoupment of these additional overpayments is scheduled to begin in May 2008. Health Care Services has directed EDS to add a routine sampling of potential duplicate claims to its existing Quality Assurance program to identify any future incidence of duplicate payments.

- *Direct EDS to retain documentation to support all of its recoupment efforts.*

The existing recoupment process already documents collection of amounts owed at the individual provider level in weekly financial reports. This information is available for review via on-line query, and a demonstration of access to a sample of this information was provided to the auditors.

Health Care Services plans the following additional Corrective Actions:

4/15/08 Refer Non-responsive potential duplicate claim cases to its Audits Section

4/30/08 Implement Medical & Outpatient Claim Recoupment

5/30/08 Implement Recoupment of Duplicate/Overlapping Claims to Multiple LTC Facilities

Auditor's Comments on Department's View

Although claim examiners follow processing guidelines when reviewing claims suspended by the system, as identified in this finding, Health Care Services' guidelines may contain errors. If EDS does not document or track the reasons examiners override the claims suspended by the system, neither EDS nor Health Care Services can identify which claims were overridden using flawed criteria.

Health Care Services' description of the existing recoupment process is overly simplistic. Specifically, for each provider, the amount to be recouped is entered into a weekly financial report, as described by Health Care Services, and offsets subsequent claims for reimbursement. However, if not fully offset in the first week, the amount is maintained on the provider's statement as an accounts receivable. If the amount has not been recovered after 90 days, it is sent to a third party liability branch, which attempts to collect the money from the provider. However, because the process of recouping the money can pass through each of these stages, and the amount can change as it is offset against other claims or is paid off, multiple weekly financial reports may be necessary to confirm the total dollars paid by the provider and the amounts that remain outstanding. Further, although Health Care Services requested a 21-day extension to arrive at the $5.1 million in overpayments and the amount recouped, it did not retain documentation to support the amount recouped. Thus, as previously stated, we could not confirm the amounts reported by Health Care Services. To confirm the amount reported as recouped at a point in time, documentation should be retained in an easy-to-access format that allows for identification of recoupment amounts and facilitates the tracing of these amounts to all necessary source documents.

Reference Number:	2007-3-2
Federal Catalog Number:	93.958
Federal Program Title:	Block Grants for Community Mental Health Services
Federal Award Number and Year:	06B1CACMHS;2006
Category of Finding:	Cash Management
State Administering Department:	Department of Mental Health (Mental Health)

Criteria

TITLE 45—PUBLIC WELFARE, PART 96—BLOCK GRANTS, Subpart C—Financial Management, Section 96.30, Fiscal and Administrative Requirements

(a) Fiscal control and accounting procedures. Except where otherwise required by Federal law or regulation, a State shall obligate and expend block grant funds in accordance with the laws and procedures applicable to the obligation and expenditure of its own funds.

WELFARE AND INSTITUTIONS CODE, Section 5713.

Advances for funding mental health services may be made by the Director of Mental Health from funds appropriated to the department for local mental programs and services specified in the annual Budget Act. Any advances made pursuant to this section shall be made in the form and manner the Director of Mental Health shall determine. When certified by the Director of Mental Health, advances shall be presented to the Controller for payment. Each advance shall be payable from the appropriation made

for the fiscal year in which the expenses upon which the advance is based are incurred. The advance may be paid monthly in 12 equal increments but the total amount advanced in one fiscal year shall not exceed 95 percent of the county's total allocation for that year.

STATE OF CALIFORNIA 2006–07 FINAL BUDGET SUMMARY, CHAPTER 47/48, PAGE 364, PROVISION 2.

The Department of Mental Health may authorize advance payments of federal grant funds on a monthly basis to the counties for grantees. These advance payments may not exceed one-twelfth of Section 2.00 of the individual grant award for the 2006–07 fiscal year.

Condition

Mental Health's procedures for monitoring each county's Substance Abuse and Mental Health Services Administration's Block Grants for Community Mental Health Services (SAMHSA CMHS) do not adequately ensure that the advances made to the counties are appropriate. Mental Health has established procedures for monitoring each county's SAMHSA CMHS cash balance, and for adjusting its advances when a county's cash balance is too high. Specifically, Mental Health requires its staff, prior to making advances to the counties, to analyze the counties' past and current year expenditures. Staff are to compare the counties' advances and reported expenditures to verify that the counties do not have cash balances that are more than 15 percent of their monthly expenditures. Counties are not to have more cash on hand than they can spend in three days, and the 15 percent of expenditures is equal to three days of expenditures.

However, the formula in the Excel spreadsheet that performs the calculation is flawed. The formula calculates cash on hand as a percentage of total fiscal year expenditures to date. Mental Health's procedures stipulate that if the percentage is greater than 15 percent, staff should adjust or not make the next month's advance payment. The flaw is that 15 percent of the aggregated expenditures is an ever-increasing threshold that, when compared to the reported cash balances, artificially reduces the percentage. For example, a county reports cash on hand of $5,000 on each of its quarterly reports. If its total expenditures in the first quarter were $10,000, the percentage would be 50 percent. However, if its total expenditures in the fourth quarter were $40,000, the percentage would be 13 percent. The formula never achieves the stated intention of identifying a cash balance that is above three days of expenditures.

Additionally, the monthly 15 percent calculation is based on old information that often does not reflect current balances. Counties submit their grant cash transaction reports, which also include expenditures, on a quarterly basis, and county reports are frequently late, while advances are made on a monthly basis. Hence, depending upon the month and whether or not a county has recently submitted a quarterly report, the expenditures could be understated and the cash balance could appear erroneously high.

Furthermore, during the review period Mental Health did not follow the procedures that stipulate that a county's advance must be adjusted or not made when a county's cash balance exceeds 15 percent of its monthly expenditures. Of the 44 disbursements we reviewed, Mental Health made 27 disbursements to counties with cash balances in excess of 15 percent of expenditures according to its formula, and did not adjust any of those advances.

Mental Health explained that it is aware of the calculation error that occurs when the formula incorporates outdated and underrepresented expenditure amounts. Mental Health also stated that rather than adjusting advances strictly according to its written procedures, staff evaluate whether or not expenditure data is accurate and then contact counties via phone or e-mail to obtain current expenditure information. When complete expenditure information is factored into the calculation, the relative percentage of cash on hand goes down, which obviates the need to adjust the current month's advance.

Finally, Mental Health's procedures do not require supervisory review and approval of monthly advance amounts. Mental Health explained that accounting has a process to review advance amounts to ensure that counties are not overpaid, but that it could explore implementing a second review process prior to sending the advance requests to accounting.

These deficiencies hamper Mental Health's determination of acceptable cash balances for the counties and its ability to make appropriate adjustments to their cash advances if needed. Further, until it addresses this issue, it cannot demonstrate that the amount of federal funds it is requesting represents its actual immediate cash requirement for carrying out the program.

Questioned Costs

Not applicable.

Recommendations

Mental Health should establish procedures to accurately monitor county SAMHSA CMHS cash balances and to adjust its advances to them in accordance with its procedures. Mental Health should also document any exceptions and its supervisory review and approval.

Department's View and Corrective Action Plan

This issue has not been raised in recent federal reviews conducted by the Center for Mental Health Services which occurred in April 1996, May 1999, and May 2005, nor was it raised in a state audit conducted by the Bureau of State Audits in 2003. As of October 2007, Mental Health hired a cash manager and has instituted a system to monitor, report, and control cash balances. Mental Health will incorporate CMHS Block Grant funds into the new system.

Reference Number:	2007-3-3
Federal Catalog Number:	93.563
Federal Program Title:	Child Support Enforcement (CSE)
Federal Award Numbers and Years:	0604CA4004;2006 0704CA4004;2007
Category of Finding:	Cash Management
State Administering Department:	Department of Child Support Services (Child Support Services)

Criteria

TITLE 45—PUBLIC WELFARE, PART 304—OFFICE OF CHILD SUPPORT ENFORCEMENT (CHILD SUPPORT ENFORCEMENT PROGRAM), ADMINISTRATION FOR CHILDREN AND FAMILIES, DEPARTMENT OF HEALTH AND HUMAN SERVICES—FEDERAL FINANCIAL PARTICIPATION SECTION, Section 304.10, General Administrative Requirements

> As a condition for Federal financial participation, the provisions of part 74 of this title (with the exception of 45 CFR 74.23, Cost Sharing or Matching and 45 CFR 74.52, Financial Reporting) establishing uniform administrative requirements and cost principles shall apply to all grants made to States under this part.

TITLE 45—PUBLIC WELFARE, PART 74—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR AWARDS AND SUBAWARDS TO INSTITUTIONS OF HIGHER EDUCATION, HOSPITALS, OTHER NONPROFIT ORGANIZATIONS, AND COMMERCIAL ORGANIZATIONS, Subpart C—Post-Award Requirements—Financial and Program Management, Section 74.21, Standards for Financial Management Systems

(b)(3) Effective control over and accountability for all funds, property, and other assets.

Recipients shall adequately safeguard all such assets and assure they are used solely for authorized purposes.

TITLE 45—PUBLIC WELFARE, PART 74—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR AWARDS AND SUBAWARDS TO INSTITUTIONS OF HIGHER EDUCATION, HOSPITALS, OTHER NONPROFIT ORGANIZATIONS, AND COMMERCIAL ORGANIZATIONS, Subpart C—Post-Award Requirements—Financial and Program Management, Section 74.22, Payment

(a) Unless inconsistent with statutory program purposes, payment methods shall minimize the time elapsing between the transfer of funds from the U.S. Treasury and the issuance or redemption of checks, warrants, or payment by other means by the recipients. Payment methods of State agencies or instrumentalities shall be consistent with Treasury-State CMIA agreements, or the CMIA default procedures codified at 31 CFR 205.9, to the extent that either applies.

(b)(2) Unless inconsistent with statutory program purposes, cash advances to a recipient organization shall be limited to the minimum amounts needed and be timed to be in accordance with the actual, immediate cash requirements of the recipient organization in carrying out the purpose of the approved program or project. The timing and amount of cash advances shall be as close as is administratively feasible to the actual disbursements by the recipient organization for direct program or project costs and the proportionate share of any allowable indirect costs.

TITLE 31—MONEY AND FINANCE: TREASURY, PART B—REGULATIONS RELATING TO MONEY AND FINANCE, CHAPTER II—FISCAL SERVICE, DEPARTMENT OF THE TREASURY, PART 205—RULES AND PROCEDURES FOR EFFICIENT FEDERAL-STATE FUNDS TRANSFERS, Section 205.6—What Is a Treasury-State Agreement?

(a) A Treasury-State agreement documents the accepted funding techniques and methods for calculating interest agreed upon by us and a State and identifies the Federal assistance programs governed by this subpart A. If anything in a Treasury-State agreement is inconsistent with this subpart A, that part of the Treasury-State agreement will not have any effect and this subpart A will govern.

(b) A Treasury-State agreement will be effective until terminated unless we and a State agree to a specific termination date. We or a State may terminate a Treasury-State agreement on 30 days written notice.

Condition

Child Support Services lacks adequate policies and procedures to provide reasonable assurance that cash management requirements are met for the CSE program. Specifically, although Child Support Services is in the process of working with a team to document its current business processes, it has yet to approve CSE policies and procedures outlining its processes for requesting federal funds. Additionally, we found that Child Support Services failed to follow the funding techniques specified in the Treasury-State Agreement (TSA) for fiscal year 2006–07. Specifically, the agreement requires Child Support Services to use the "Monthly Estimate/Monthly Draw" funding technique for its payroll and operating expenses. Under this funding technique, operating and equipment expenditures are estimated monthly and recorded on the median day of the month. The amount of the requests shall be made in accordance with the appropriate federal agency cut-off time. The State requests payroll funds such that they are deposited to coincide with the State's monthly payroll cycle. Instead, Child Support Services used the "Pre-Issuance" funding technique, whereby it requested funds such that they were

deposited in the State's account not more than three business days prior to the day the payment was made. The Monthly Estimate/Monthly Draw technique is not subject to the interest calculation, but the Pre-Issuance technique does require the calculation. However, as a result of becoming aware of this error, Child Support Services states that it developed and began to implement a new process to be in compliance with the fiscal year 2007–08 agreement.

Furthermore, Child Support Services entered into an agreement with the Judicial Council of California (Judicial Council) to oversee the ongoing operation of the statewide Title IV D child support commissioner system and the family law facilitators' offices in the local courts. We found that Child Support Services advanced $6 million of working capital to the Judicial Council on October 19, 2006. Child Support Services did not adjust the Judicial Council's payments for the unused advance of $6 million until May and June 2007. We reported a similar finding last year.

In response to our finding last year, Child Support Services has worked with the Judicial Council to halt advances and to implement new procedures effective July 1, 2007, that will expedite reimbursement payments to the Judicial Council. This process involves the tracking of invoices from the courts to their payment by the State Controller's Office to identify ways to streamline the processes.

Questioned Costs

Not applicable.

Recommendations

Child Support Services should develop and approve policies and procedures to ensure that it complies with cash management requirements of the CSE program. Additionally, Child Support Services should ensure that it follows the funding techniques set forth in the TSAs applicable to each fiscal year. Finally, Child Support Services should continue to work with the Judicial Council to assess the timing and amount of federal funds the Judicial Council needs to correspond to its disbursement schedule.

Department's View and Corrective Action Plan

Child Support Services concurs with the finding and will complete and approve policies and procedures currently in development. In response to notification from BSA in late 2007 that it was not in compliance with the TSA, Child Support Services implemented the funding technique specified in the 2006–07 Treasury-State Agreement (agreement) for fiscal year 2007–08. In addition, Child Support Services has included a process to check with the Department of Finance for upcoming changes to the technique. Finally, Child Support Services has eliminated advances for Judicial Council and will continue to work with the council to meet their cash flow needs.

Reference Number:	2007-7-4
Federal Catalog Number:	93.958
Federal Program Title:	Block Grants for Community Mental Health Services
Federal Award Numbers and Years:	06B1CACMHS-03;2006 05B1CACMHS-01;2005 04B1CACMHS-01;2004
Category of Finding:	Earmarking
State Administering Department:	Department of Mental Health (Mental Health)

Criteria

TITLE 42—THE PUBLIC HEALTH AND WELFARE, CHAPTER 6A—PUBLIC HEALTH SERVICE, SUBCHAPTER XVII—BLOCK GRANTS, Part B—Block Grants Regarding Mental Health and Substance Abuse, Subpart i—Block Grants for Community Mental Health Services, Section 300X-5, Restrictions on Use of Payments

(b) Limitation on administrative expenses—

A funding agreement for a grant under Section 300x of this title is that the State involved will not expend more than 5 percent of the grant for administrative expenses with respect to the grant.

Condition

Mental Health does not have an official written policy or procedures in place to ensure that administrative costs are charged to the Substance Abuse and Mental Health Services Administration Community Mental Health Services (SAMHSA CMHS) Block Grant appropriately.

Mental Health charged roughly $2.4 million from the 2006 SAMHSA CMHS grant for administrative expenses, which was below the 5 percent cap for administrative expenses (4.4 percent of the total award of $55 million). Its practice has been to allocate as much money as possible to counties for community mental health services, and the remainder is used to cover administrative costs. Mental Health pays SAMHSA CMHS grant-related administrative expenses out of the State's General Fund and then requests federal reimbursements from the SAMHSA CMHS grant on a monthly basis.

According to Mental Health, administrative charges to the SAMHSA CMHS grant are made largely at staff discretion. Mental Health charges a portion or all salaries for certain key SAMHSA staff to the grant based on approved time sheets, but other expenditures such as travel are allocated to the SAMHSA CMHS grant by staff's choice. Without an official policy that outlines the allowable costs that may be claimed and procedures such a supervisory reviews, Mental Health cannot reasonably assure that earmarking requirements are met using only allowable costs.

Questioned Costs

Unknown

Recommendation

Mental Health should establish a written policy as well as processes and procedures to ensure that only allowable costs are used to meet the earmarking requirement.

Department's View and Corrective Action Plan

This issue has not been raised in recent federal reviews conducted by the Center for Mental Health Services which occurred in April 1996, May 1999, and May 2005, nor was it raised in a state audit conducted by the Bureau of State Audits in 2003. It should be noted that the methodology for calculating Mental Health's administrative charges to this grant have been consistent for 20 years and that Mental Health has always charged less than the 5 percent that is allowed. Mental Health administration is conducting a review of the current process and will develop written policy, processes and procedures ensuring that only allowable costs are used.

Reference Number:	2007-7-5
Federal Catalog Number:	93.958
Federal Program Title:	Block Grants for Community Mental Health Services
Federal Award Numbers and Years:	06B1CACMHS-03;2006 05B1CACMHS-01;2005 04B1CACMHS-01;2004
Category of Finding:	Level of Effort—Maintenance of Effort
State Administering Department:	Department of Mental Health (Mental Health)

Criteria

TITLE 42—THE PUBLIC HEALTH AND WELFARE, CHAPTER 6A—PUBLIC HEALTH SERVICE, SUBCHAPTER XVII—BLOCK GRANTS, Part B—Block Grants Regarding Mental Health and Substance Abuse, Subpart i—Block Grants for Community Mental Health Services, Section 300x-2, Certain Agreements

(a) Allocation for systems of integrated services for children

(1) In general

With respect to children with a serious emotional disturbance, a funding agreement for a grant under sections 300x of this title is that—

(A) in the case of a grant for fiscal year 1993, the State involved will expend not less than 10 percent of the grant to increase (relative to fiscal year 1992) funding for the system of integrated services described in Section 300x-1(b)(9)(1) of this title;

(B) in the case of a grant for fiscal year 1994, the State will expend not less than 10 percent of the grant to increase (relative to fiscal year 1993) funding for such a system; and

(C) in the case of a grant for any subsequent fiscal year, the State will expend for such a system not less than an amount equal to the amount expended by the State for fiscal year 1994.

(2) Waiver

(A) Upon the request of a State, the Secretary may provide to the State a waiver of all or part of the requirement established in paragraph (1) if the Secretary determines that the State is providing an adequate level of comprehensive community mental health services for children with a serious emotional disturbance, (2) as indicated by a comparison of the number of such children for which such services are sought with the availability in the State of the services.

(B) The Secretary shall approve or deny a request for a waiver under subparagraph (A) not later than 120 days after the date on which the request is made.

(C) Any waiver provided by the Secretary under subparagraph (A) shall be applicable only to the fiscal year involved.

TITLE 42—THE PUBLIC HEALTH AND WELFARE, CHAPTER 6A—PUBLIC HEALTH SERVICE, SUBCHAPTER XVII—BLOCK GRANTS, Part B—Block Grants Regarding Mental Health and Substance Abuse, Subpart I—Block Grants for Community Mental Health Services, Section 300x-4, Additional Provisions

(b) Maintenance of Effort regarding State expenditures for Mental Health

(1) In general

A funding agreement for a grant under Section 300x of this title is that the State involved will maintain State expenditures for community mental health services at a level that is not less than the average level of such expenditures maintained by the State for the two-year period preceding the fiscal year for which the State is applying for the grant.

(2) Exclusion of certain funds

The Secretary may exclude from the aggregate State expenditures under subsection (a) of this section, funds appropriated to the principal agency for authorized activities which are of a non-recurring nature and for a specific purpose.

(3) Waiver

The Secretary may, upon the request of a State, waive the requirement established in paragraph (1) if the Secretary determines that extraordinary economic conditions in the State justify the waiver.

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Federal Register Vol 66, No. 130 (July 6, 2001) contains a notice from the Substance Abuse and Mental Health Service Administration (SAMHSA) executive officer specifying that states are required as a condition of receipt of funds to maintain State expenditures for community based mental health services for adults with serious mental illness (SMI) and children with serious emotional disturbance (SED) at a level that was equal to the average expenditures for such purposes over the previous two years. The federal register also stated that the Secretary, as a matter within his discretion, had the authority to exclude from the calculation of the maintenance of effort "funds appropriated to the principal agency for authorized activities which are of a non-recurring nature and for a specific purpose."

Condition

Mental Health lacks processes and procedures to ensure that it complies with the maintenance of effort (MOE) requirement for this program. For the MOE requirement related to the allocation for systems of integrated services for children with SED, Mental Health reported in its federal fiscal year 2007 application that it had met the requirement. Specifically, Mental Health reported state fiscal year 1994–95 expenditures of $160 million and an estimate of the state fiscal year 2006–07 expenditures of $280 million.

Mental Health identified seven components to use in calculating the total of the State's General Fund expenditures needed to meet the MOE requirement for children's mental health services. Of these, two components—the Early Mental Health Initiative (EMHI) program and the California AIDS mental health project—do not target children with SED. Additionally, Mental Health did not provide documentation to support the percentages it applied against the total of managed care and realignment dollars to arrive at the amount it reported as expenditures for children with SED. The amount for these two programs represented $270 million, or 96 percent, of Mental Health's estimated state fiscal year 2006–07 expenditures used to meet the MOE requirement.

Finally, Mental Health was unable to provide documentation that shows the components and expenditures that were used to generate the fiscal year 1994–95 threshold of $160 million. Therefore, we cannot determine whether Mental Health uses the same methodology for calculating the expenditures as it did in fiscal year 1994–95 and whether it is in compliance with this MOE requirement.

For the MOE requirement related to the State expenditures for community mental health services, Mental Health reported in its application for federal fiscal year 2007 that it had met the requirement. Specifically, Mental Health reported that its estimated state fiscal year 2006–07 expenditures of

$1.9 billion exceeded the average of the State's actual fiscal year 2004–05 expenditures and estimated fiscal year 2005–06 expenditures of $1.5 billion. Although required to do so in accordance with guidance published in a July 6, 2001, federal register, Mental Health also did not report all state expenditures for community mental health services for adults with SMI and children with SED in this MOE calculation. Specifically, it did not include any expenditures made with funds from the Mental Health Services Act and it cannot positively state whether other state agencies fund community mental health programs for adults with SMI or children with SED.

Mental Health has selected six components for use in its calculation of total expenditures for community mental health services. These same six components are used in the MOE calculation for state fiscal years 2004–05 through 2006–07. However, of these, one component—the EMHI program—does not specifically target adults with SMI or children with SED. Thus, we also cannot determine whether Mental Health is in compliance with this MOE requirement.

Until Mental Health establishes processes and procedures, it cannot ensure that it complies with the MOE requirement for this program. For example, during our audit we found that Mental Health listed its actual expenditures for mental health services as $1.4 billion for fiscal year 2004–05 in both its 2006 and 2007 grant applications. However, one of the expenditures used to generate this total was $5 million lower in Mental Health's financial report for that year. Recalculating fiscal year 2004–05 total expenditures with this lower figure places Mental Health's total mental health expenditures below the MOE threshold for that year.

Questioned Costs

Not applicable.

Recommendations

Mental Health should recalculate total expenditures for integrated mental health services for children with SED using only allowable expenditures. Further, it should reevaluate the percentages used to support the managed care and realignment dollars used in its calculation and retain the supporting documentation. Finally, Mental Health should use the dollar amounts reported in the audited financial statements for the fiscal year 1994–95 threshold.

Mental Health should revise its methodology for calculating the community mental health services MOE requirement to accurately capture and report only state expenditures for adults with SMI and children with SED.

Department's View and Corrective Action Plan

This issue has not been raised in recent federal reviews conducted by the Center for Mental Health Services which occurred in April 1996, May 1999, and May 2005, nor was it raised in a state audit conducted by the Bureau of State Audits in 2003. Mental Health has begun discussions with SAMHSA staff about federal MOE requirements including whether states should include funds spent by other state agencies for community mental health programs in the MOE calculation. Information provided by SAMHSA staff indicates that federal guidelines related to states' MOE requirements for this program are currently in development. Mental Health will continue to work with SAMHSA to ensure that the methodology used to document MOE is consistent with federal guidelines.

Reference Number:	2007-7-6
Category of Finding:	Matching, Level of Effort, and Earmarking
State Administering Department:	Department of Aging (Aging)
Federal Catalog Number:	93.044
Federal Program Title:	Special Programs for the Aging—Title III, Part B—Grants for Supportive Services and Senior Centers
Federal Award Numbers and Years:	06AACAT3SP;2006 07AACAT3SP;2007
Federal Catalog Number:	93.045
Federal Program Title:	Special Programs for the Aging—Title III, Part C—Nutrition Services
Federal Award Numbers and Years:	06AACAT3SP;2006 07AACAT3SP;2007
Federal Catalog Number:	93.053
Federal Program Title:	Nutrition Services Incentive Program
Federal Award Numbers and Years:	06AACANSIP;2006 07AACANSIP;2007

Criteria

Title 45—PUBLIC WELFARE, PART 92—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE, LOCAL, AND TRIBAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 92.20, Standards for Financial Management Systems

(a) A State must expend and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contractors, must be sufficient to:

(1) Permit preparation of reports required by this part and the statutes authorizing the grant, and

(2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

Condition

Aging lacks adequate policies and procedures to provide reasonable assurance that matching, level of effort, and earmarking requirements are met for the programs it administers using only allowable funds or costs that are properly calculated and valued. Specifically, Aging does not have an official written policy that outlines factors such as its methods of valuing matching requirements and the allowable costs that may be claimed. According to its budget officer, a policy manual does not exist for the budgetary process. Thus, the budget unit does not have documented controls that it uses during the planning process that would ensure Aging's compliance with these requirements. Further, the

accounting section does not have written policies and procedures that include the review and approval of its calculations and the amounts reported to the federal government. Although we found that Aging met its requirements, the absence of controls hinders its ability to prevent errors or detect early any errors that may exist.

Questioned Costs

Not applicable.

Recommendation

Aging should establish written policies and procedures to ensure that it complies with the matching, level of effort, and earmarking requirements of the programs it administers.

Department's View and Corrective Action Plan

While Aging has complied with all matching, level of effort, and earmarking requirements, we do not have a written procedure manual that fully documents these processes across the Department. To meet matching requirements, States must contribute at least 25 percent of the cost of the State Plan, all services must be funded by a non-Federal match of 15 percent, and Area Agencies must contribute at least 25 percent of the costs of administration of area plans. To comply with level of effort requirements, State Agencies must spend for both services and administration at least the average amount of State funds it spent for the three previous years. Earmarking specifies a limit for the overall expenditures for administration, allowable program transfers, and Area Agencies earmark portions of their allotment.

To provide reasonable assurance that the above matching, level of effort, and earmarking requirements are met, Aging is compiling written desk procedures that document the underlying policies and the steps taken by Budgets, Accounting, and Program pre-, during-, and post-award. The procedures will also include the methods and calculations that are necessary to meet federal and state laws and regulations and provide for review and approval of the calculations to prevent and detect errors.

Reference Number:	2007-7-8
Federal Catalog Number:	93.568
Federal Program Title:	Low-Income Home Energy Assistance (LIHEAP)
Federal Award Numbers and Years:	G-06B1CALIEA;2006 G-07B1CALIEA;2007
Category of Finding:	Earmarking
State Administering Department:	Department of Community Services and Development (CSD)

Criteria

TITLE 42—THE PUBLIC HEALTH AND WELFARE, CHAPTER 94—LOW-INCOME ENERGY ASSISTANCE, Section 8626a, Incentive Program for Leveraging Non-Federal Resources

(c) Formula for distribution of amounts.

(2) A State may expend funds allocated under this subchapter as are necessary, not to exceed 0.08 percent of such allocation or $35,000 each fiscal year, whichever is greater, to identify, develop, and demonstrate leveraging programs. Funds allocated under this section shall only be used for increasing or maintaining benefits to households.

TITLE 45—PUBLIC WELFARE, PART 96—BLOCK GRANTS, Subpart H—Low Income Home Energy Assistance Program, Section 96.87—Leveraging Incentive Program

(c) LIHEAP funds used to identify develop, and demonstrate leveraging programs.

(1) Each fiscal year, States (excluding Indian tribes, tribal organizations, and territories) may spend up to the greater of $35,000 or 0.08 percent of their net Federal LIHEAP allotments (funds payable) allocated under section 2602(b) of Public Law 97-35 (42 U.S.C. 8621(b)) specifically to identify, develop, and demonstrate leveraging programs under section 2607A(c)(2) of Public Law 97-35 (42 U.S.C. 8626a(c)(2)). Each fiscal year, Indian tribes, tribal organizations, and territories may spend up to the greater of two (2.0) percent or $100 of their Federal LIHEAP allotments allocated under section 2602(b) of Public law 97-35 (42 U.S.C. 8621(b)) specifically to identify, develop, and demonstrate leveraging programs under section 2607A(c)(2) of Public Law 97-35 (42 U.S.C. 8626a(c)(2)). For the purpose of this paragraph, Federal LIHEAP allotments include funds from regular and supplemental appropriations, with the exception of leveraging incentive funds provided under section 2602(d) of Public Law 97-35 (42 U.S.C. 8621(d)).

(2) LIHEAP funds used under section 2607A(c)(2) of Public Law 97-35 (42 U.S.C. 8626a(c)(2)) specifically to identify, develop, and demonstrate leveraging programs are not subject to the limitation in section 2605(b)(9) of Public Law 97-35 (42 U.S.C. 8624(b)(9)) on the maximum percent of Federal funds that may be used for costs of planning and administration.

TITLE 45—PUBLIC WELFARE, PART 96—BLOCK GRANTS, Subpart C—Financial Management, Section 96.30, Fiscal and Administrative Requirements

(a) Fiscal control and accounting procedures. Except where otherwise required by Federal law or regulation, a State shall obligate and expend block grant funds in accordance with the laws and procedures applicable to the obligation and expenditure of its own funds. Fiscal control and accounting procedures must be sufficient to (a) permit preparation of reports required by the statute authorizing the block grant and (b) permit the tracing of funds to a level of expenditure adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of the statute authorizing the block grant.

Condition

CSD lacks a process to demonstrate that it met the earmarking requirement for identifying and developing leveraging programs. CSD staff stated that identifying and developing leveraging programs is a function both CSD and the local assistance agencies perform. CSD also stated it does not collect data from the local assistance agencies for the expenditures they incur because it would be costly and burdensome for them. Furthermore, CSD was unable to provide us with the expenditures it incurred because it does not separately account for these expenditures.

Specifically, CSD allocates LIHEAP funds to administration, weatherization, Assurance 16, Energy Crisis Intervention Program, and the Home Energy Assistance Program during its cost allocation process. However, CSD does not allocate funds separately for identifying and developing leveraging programs. Furthermore, CSD tracks expenditures for its main LIHEAP grant award and the leveraging incentive award with one program cost account. As a result, we were unable to determine if CSD is in compliance with the earmarking requirement for identifying and developing leveraging programs.

Questioned Costs

Unknown

Recommendations

CSD should develop policies and procedures to ensure it accounts for the funds used for identifying and developing leveraging programs. CSD should also separately account for leveraging incentive awards in its accounting records to ensure that these awards are not expended for identifying and developing leveraging programs. Finally, CSD should direct the local assistance agencies to establish policies and procedures to account for the funds they use for identifying and developing leveraging programs.

Department's View and Corrective Action Plan

CSD generally concurs with the recommendations. Because the statute cited above states that CSD "may spend up to the greater of $35,000 or 0.08 percent of their net Federal LIHEAP allotments . . . to identify, develop, and demonstrate leveraging programs," the earmark is an elective line item rather than a requirement. Because neither the federal LIHEAP laws, regulations nor applicable OMBs prevent the State or its contractors from charging leveraging activities to other funding sources that allow the costs of program administration including strategic planning activities, the 0.08 percent earmark does not act as an absolute cap on the amount that a contractor can spend on these leveraging activities; rather, it serves as an elective earmark beyond the statutory earmark for administrative and indirect costs within the main LIHEAP allocation. Additionally, since the costs of tracking such a small amount outweighs the potential benefits—assuming the earmark was distributed among each of the contractors—CSD has declined to distribute the earmark to the contractors in the past. However, recognizing that CSD could elect to retain the earmark to support the State's leveraging activities, CSD agrees with the recommendations to ensure proper accounting of the funds.

The following is CSD's Corrective Action Plan to address the recommendations of the BSA Audit for the "Earmarking" finding:

Action Steps:

1. CSD will develop written policies and procedures to clarify the use and accounting of the 0.08% earmark, should CSD elect to retain it to support the State's leveraging activities.

2. CSD will assign separate PCA codes to the 0.08 earmark and the leverage incentive awards to ensure the proper use and accounting of these funds.

3. CSD will revise the 2009 LIHEAP Contract to clarify the allowable and/or prohibited uses of Assurance 16 funds, administrative funds and leverage incentive awards to identify, develop, and/or demonstrate leveraging programs.

These steps will be completed and implemented for the 2009 LHEAP contracts.

Auditor's Comments on Department's View

CSD views the identifying and developing leveraging programs earmark as elective and states it has declined to distribute the earmark to its LIHEAP contractors in the past. However, in its federal fiscal year 2007 LIHEAP State Plan Application to the U.S. Department of Health and Human Services, CSD specifically stated its intent to use 0.08 percent of its LIHEAP award for this purpose.

Reference Number:	2007-7-10
Federal Catalog Number:	93.556
Federal Program Title:	Promoting Safe and Stable Families (PSSF)
Federal Award Numbers and Years:	G-0501CA00FP;2005 G-0601CA00FP;2006 G-0701CA00FP;2007
Category of Finding:	Level of Effort—Maintenance of Effort
State Administering Department:	Department of Social Services (Social Services)

Criteria

TITLE 42—THE PUBLIC HEALTH AND WELFARE, CHAPTER 7—SOCIAL SECURITY, SUBCHAPTER IV—GRANTS TO STATES FOR AID AND SERVICES TO NEEDY FAMILIES WITH CHILDREN AND FOR CHILD-WELFARE SERVICES, Part B—Child and Family Services-, Subpart 2—Promoting Safe and Stable Families, Section 629b, State Plans, (a) Plan Requirements

(7)(A) contains assurances that Federal funds provided to the State under this subpart will not be used to supplant Federal or non-Federal funds for existing services and activities which promote the purposes of this subpart; and

(B) provides that the State will furnish reports to the Secretary, at such times, in such format, and containing such information as the Secretary may require, that demonstrate the State's compliance with the prohibition contained in subparagraph (A).

U.S. DEPARTMENT OF HEALTH & HUMAN SERVICES—ADMINISTRATION FOR CHILDREN & FAMILIES—ADMINISTRATION ON CHILDREN, YOUTH AND FAMILIES—Children's Bureau—Program Instruction Log No. ACYF-CB-PI-07-05, Section B—Instructions for States, Puerto Rico and the District of Columbia, 11, Financial and Statistical Information Reporting

Provide State and local share expenditures for title IV-B, subpart 2 programs for FY 2005 for comparison with the 1992 base year amount required to meet the non-supplantation requirements in Section 432(a)(7)(A) of the Act, codified at 42USC629b.

Condition

In its Annual Progress and Services Report for federal fiscal year 2007, Social Services reported that it met the maintenance of effort (MOE) requirement for the Promoting Safe and Stable Families program (PSSF program), yet we found that Social Services lacks adequate processes and procedures to ensure that it has met the MOE requirement.

Specifically, in its report Social Services stated that it compared the state and local expenditures for its State Family Preservation program for fiscal years 1992 and 2005. However, although Social Services reported expenditures of $13.1 million for fiscal year 1992, it did not report the expenditures for fiscal year 2005. Additionally, Social Services was unable to provide us with documentation for the expenditures related to both fiscal years. Because of the lack of documentation, we are unable to conclude that it is meeting the requirement.

Questioned Costs

Unknown

Recommendation

Social Services should implement a system for annually monitoring its compliance with the MOE requirement, including the documentation of its 1992 base year and current year expenditures.

Department's View and Corrective Action Plan

Social Services concurs. Social Services will provide to Region IX the accounting records for federal fiscal year 2005 to support the amounts being reported, including county expenditures and the reports used as the source for the expenditure data, within 30 days. However, as we no longer have available records for federal fiscal year 1992, we will work with the Region IX, ACF staff to resolve this issue.

Reference Number:	2007-8-3
Federal Catalog Number:	93.958
Federal Program Title:	Block Grants for Community Mental Health Services
Federal Award Numbers and Years:	06B1CACMHS-03;2006 05B1CACMHS-01;2005 04B1CACMHS-01;2004
Category of Finding:	Period of Availability
State Administering Department:	Department of Mental Health (Mental Health)

Criteria

TITLE 42—THE PUBLIC HEALTH AND WELFARE, CHAPTER 6A—PUBLIC HEALTH SERVICE, SUBCHAPTER XVII—BLOCK GRANTS, PART B—Block Grants Regarding Mental Health and Substance Abuse, Subpart i—Block Grants for Community Mental Health Services, Section 300x-62, Availability to States of Grant Payments

Any amounts paid to a State for a fiscal year under Section 300x or 300x-21 of this title shall be available for obligation and expenditure until the end of the fiscal year following the fiscal year for which the amounts were paid.

Condition

We were unable to determine whether Mental Health is in compliance with the period-of-availability requirement because Mental Health does not have an adequate process to establish obligations of federal awards to counties for a predetermined time period.

For the federal fiscal year 2006 Substance Abuse and Mental Health Services Administration's Block Grants for Community Mental Health Services (SAMHSA CMHS) , the period of availability began on October 1, 2005, and ended September 30, 2007. Mental Health allocated these funds for the state fiscal year 2006–07, which extended from July 1, 2006, through June 30, 2007. The total amount obligated to counties for state fiscal year 2006–07 is unclear. In a letter to county mental health directors dated June 8, 2006, the total proposed allocation to counties was $50.9 million. However, in Mental Health's balance sheet for state fiscal year 2006–07, the total county allocation is listed as almost $52 million. Furthermore, the amount shown as encumbered for county payments under the 2006 SAMHSA CMHS grant for state fiscal year 2006–07 was $51.8 million.

Mental Health also does not ensure that the federal award is expended within the period of availability. Our review of Mental Health's accounting records indicates that its federal drawdowns from the 2006 SAMHSA CMHS grant for county payments totaled $52.3 million. However, its actual payments to the counties for this same grant period totaled $51.7 million, of which $2.5 million was paid from the 2005 SAMHSA CMHS grant. Therefore, only $49.2 million of the 2006 SAMHSA CMHS grant was used to make payments to counties for state fiscal year 2006–07. Mental Health used $3.1 million of the $52.3 million federal drawdown for the 2006 SAMHSA CMHS grant to pay for expenditures related to other state fiscal years. Specifically, the majority of this amount, $3 million, was used to make county payments allocated for state fiscal year 2007–08, which should be covered under the 2007 SAMHSA CMHS grant.

Mental Health stated that it uses federal drawdowns from the active grant to make county payments until the expiration of the award period. For example, Mental Health acknowledged that it used funds available from the 2006 SAMHSA CMHS grant to make payments for state fiscal year 2007–08. Mental Health stated that it made the first series of payments to counties on November 30, 2007, due to delays in processing county applications and delays in the state budget process. The first payments were made using funds from both the 2006 and 2007 SAMHSA CMHS grants and went to 23 of the 58 counties receiving SAMHSA CMHS grant funds.

Questioned Costs

$3,014,764.66

Recommendation

Mental Health should improve its processes and procedures to monitor county expenditures and ensure that SAMHSA CMHS grant funds are used within the two-year period of availability.

Department's View and Corrective Action Plan

This issue has not been raised in recent federal reviews conducted by the Center for Mental Health Services which occurred in April 1996, May 1999, and May 2005, nor was it raised in a state audit conducted by the Bureau of State Audits in 2003. Specifically information contained in the federal report associated with the May 2005 federal site review of this program indicates that "Federal MHBG funds are obligated and expended in accordance with State accounting requirements and within the two-year Federal fiscal requirement. These obligations were expended from two Federal fiscal year (FFY) appropriations, FFY03 and FFY04." Nonetheless, Mental Health will review and adjust as appropriate procedures relative to timelines for expenditure of funds.

Auditor's Comments on Department's View

In its report related to its May 17, 2005 through May 19, 2005 site visit, the Center for Mental Health Services (center) disclosed the following limitations:

- Site visits are usually completed within three days.
- Observations in the report are based only on data provided by the agency.
- Fiscal observations contained in the report do not constitute audit findings.
- Interviews are not conducted according to generally accepted auditing standards by the American Institute of Certified Public Accountants or *Government Auditing Standards* issued by the Comptroller of the United States.

Thus, it is inappropriate for Mental Health to compare the scope of the center's site visit with our audit that was conducted in accordance with the U.S. Office of Management and Budget, Circular A-133.

Reference Number:	2007-8-4
Category of Finding:	Period of Availability
State Administering Department:	Department of Aging (Aging)
Federal Catalog Number:	93.044
Federal Program Title:	Special Programs for the Aging—Title III, Part B—Grants for Supportive Services and Senior Centers
Federal Award Number and Year:	07AACAT3SP;2007

Criteria

Title 45—PUBLIC WELFARE, PART 92—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE, LOCAL, AND TRIBAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 92.23, Period of Availability of Funds

(a) General. Where a funding period is specified, a grantee may charge to the award only costs resulting from obligations of the funding period unless carryover of unobligated balances is permitted, in which case the carryover balances may be charged for costs resulting from obligations of the subsequent funding period.

(b) Liquidation of obligations. A grantee must liquidate all obligations incurred under the award not later than 90 days after the end of the funding period (or as specified in a program regulation) to coincide with the submission of the annual Financial Status Report (SF-269). The Federal agency may extend this deadline at the request of the grantee.

Condition

During our review, we noted two federal drawdowns that were not related to obligations for the federal fiscal year 2007 award. Specifically, according to its accounting manager, two executive orders were issued that required Aging to adjust the appropriation of the California Commission on Aging (commission) for fiscal year 2004. In January 2005 and March 2005, appropriation adjustments totaling $9,195 were made by the State Controller's Office for the commission. Aging charged the federal drawdown to the award period of October 1, 2006, to September 30, 2007. However, the obligations for the adjustments occurred before the period of availability for the federal fiscal year 2007 award. Moreover, although the funds were received in October 2007, Aging has not disbursed the funds to the commission as of January 31, 2008.

Questioned Costs

$9,195

Recommendation

Aging should establish policies and procedures to ensure that obligations are established and liquidated within the period of availability.

Department's View and Corrective Action Plan

Aging concurs with the findings of the audit and is writing step-by-step procedures that will include the federal and state requirements that guide the process and critical cross checks to ensure correct work. The procedures will also establish verification and independent review prior to department sign off to

ensure that drawdowns tie to appropriate expenditures and fiscal years. Training on the procedures will be provided to both staff and reviewers. These procedures will provide reasonable assurance that the error cited in the audit will not reoccur.

Reference Number:	2007-9-1
Federal Catalog Number:	93.958
Federal Program Title:	Block Grants for Community Mental Health Services
Federal Award Number and Year:	06B1CACMHS-03;2006
Category of Finding:	Procurement and Suspension and Debarment
State Administering Department:	Department of Mental Health (Mental Health)

Criteria

TITLE 2—GRANTS AND AGREEMENTS, PART 180—U.S. OFFICE OF MANAGEMENT AND BUDGET GUIDELINES TO AGENCIES ON GOVERNMENTWIDE DEBARMENT AND SUSPENSION (NONPROCUREMENT), Subpart C—Responsibilities of Participants Regarding Transactions Doing Business With Other Persons, Section 180.330, What Requirements Must I Pass Down to Persons at Lower Tiers With Whom I Intend to Do Business?

Before entering into a covered transaction with a participant at the next lower tier, you must require that participant to—

(a) Comply with this subpart as a condition of participating in the transaction. You may do so by using any method(s), unless the regulation of the Federal agency responsible for the transaction requires you to use specific methods.

(b) Pass the requirement to comply with this subpart to each person with whom the participant enters into a covered transaction at the next lower tier.

TITLE 2—GRANTS AND AGREEMENTS, PART 376—NONPROCUREMENT DEBARMENT AND SUSPENSION, Subpart C—Responsibilities of Participants Regarding Transactions—Section 376.332, What Methods Must I Use to Pass Requirements Down to Participants at Lower Tiers With Whom I Intend to Do Business?

To communicate the requirements to lower-tier participants, you must include a term or condition in the lower-tier transaction requiring the lower-tier participant's compliance with 2 CFR Part 180, as supplemented by this subpart.

Condition

Mental Health requires counties to sign a suspension and debarment certification, and include it with their application. Our review of certifications for the six counties we reviewed found that Mental Health does not require counties to ensure that lower-tier entities with which it enters into covered transactions are not suspended or debarred. Mental Health also does not require counties to pass the requirements down to each person with whom they enter into a covered transaction. As a result, counties could inadvertently pass federal Substance Abuse and Mental Health Services Administration's Block Grants for Community Mental Health Services funds to persons who are excluded from conducting business with the federal government.

Questioned Costs

Not applicable.

Recommendation

Mental Health should include the requirements to enforce suspension and debarment regulations with the next lower tier in the instructions to the suspension and debarment certification that it requires counties to submit with their applications.

Department's View and Corrective Action Plan

Although this issue has not been raised in either recent federal reviews or state audits, Mental Health acknowledges this issue and will take steps to correct procedures. Mental Health will add language to the current certification required from counties to ensure that county sub-contractors have not been suspended or debarred. Additionally, Mental Health will add language to the county performance contracts relative to suspension and debarment for county staff and their sub-contractors.

Reference Number:	2007-9-3
Category of Finding:	Procurement, Suspension and Debarment
State Administering Department:	Department of Social Services (Social Services)
Federal Catalog Number:	93.558
Federal Program Title:	Temporary Assistance for Needy Families (TANF)
Federal Award Number and Year:	GA-0602CATANF;2006

Federal Catalog Number:	93.566
Federal Program Title:	Refugee and Entrant Assistance—State Administered Programs (Refugee Program)
Federal Award Numbers and Years:	G-06AACA9100;2006 G-06AACA9110;2006

Federal Catalog Number:	93.556
Federal Program Title:	Promoting Safe and Stable Families (PSSF)
Federal Award Numbers and Years:	G-0501CA00FP;2005 G-0601CA00FP;2006 G-0701CA00FP;2007

Federal Catalog Number:	93.645
Federal Program Title:	Child Welfare Services—State Grants (CWS)
Federal Award Numbers and Years:	G-0601CA1400;2006 G-0701CA1400;2007

Criteria

TITLE 45—PUBLIC WELFARE, PART 92—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE, LOCAL AND TRIBAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 92.35, Subawards to Debarred and Suspended Parties

Grantees and subgrantees must not make any award or permit any award (subgrant or contract) at any tier to any party which is debarred or suspended or is otherwise excluded from or ineligible for participation in Federal assistance programs under Executive Order 12549, "Debarment and Suspension."

TITLE 2—GRANTS AND AGREEMENTS, PART 180—U.S. OFFICE OF MANAGEMENT AND BUDGET GUIDELINES TO AGENCIES ON GOVERNMENTWIDE DEBARMENT AND SUSPENSION (NONPROCUREMENT), Subpart B—Covered Transactions, Section 220, Are Any Procurement Contracts Included as Covered Transactions?

(b) Specifically, a contract for goods or services is a covered transaction if any of the following applies:

(1) The contract is awarded by a participant in a nonprocurement transaction that is covered under §180.210, and the amount of the contract is expected to equal or exceed $25,000.

U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES—ADMINISTRATION FOR CHILDREN AND FAMILIES—ADMINISTRATION ON CHILDREN, YOUTH AND FAMILIES TERMS AND CONDITIONS—FISCAL YEAR 2006, SURECIPIENTS AND VENDORS UNDER GRANTS

> "No organization may participate in this project in any capacity or be a recipient of federal funds designated for this project if the organization has been debarred or suspended or otherwise found to be ineligible for participation in Federal assistance programs under Executive Order 12549, "Debarment and Suspension." (See 45 CFR 92.35.) States must include a similar term and/or condition for all sub-awards or contracts awarded under this program. Prior to issuing subawards or contracts under this grant, the state must consult the ineligible parties list to ensure that organizations under funding consideration are not ineligible."

Condition

Social Services did not comply with either of the suspension and debarment requirements included in the Administration for Children and Families (ACF) grants' terms and conditions. Additionally, Social Services has inadequate controls in place to ensure that it is aware of and complies with all federal procurement requirements.

Specifically, during our evaluation of Social Services' internal controls, we found that the standard documents it uses to award funds to subrecipients that are counties, contracts with subrecipients that are other than counties such as nonprofit organizations, and vendors either did not include the suspension and debarment terms and/or conditions or the language it did include was incorrect. According to program staff, Social Services was not aware of the November 2003 changes made to suspension and debarment regulations or the ACF's additional suspension and debarment regulations or the ACF's additional requirements.

We found that Social Services' contracts with four of the five noncounty subrecipients and vendors that we reviewed included incorrect suspension and debarment terms and the fifth contract did not contain any terms. For example, the standard contract Social Services used for a noncounty subrecipient providing services for the Refugee Program incorrectly stated that "for federally funded agreements in the amount of $100,000 or more, the contractor agrees to certify that he/she and their principal are not debarred or suspended from federal financial assistance programs and activities."

Additionally, Social Services did not modify its standard contract with vendors not funded by an ACF grant to include revisions in November 2003 to federal regulations that reduced the amount from $100,000 to $25,000 or completely eliminate the threshold for contracts with its subrecipients. Further, Social Services did not modify its standard contracts for programs administered by ACF to comply with ACF's suspension and debarment requirements. According to Social Services contracts staff, they did not consult the ineligible parties list available at www.epls.gov prior to issuing any subawards or contracts because they were not aware of this ACF requirement. Finally, we found that Social Services did not obtain the signed suspension and debarment certification from one vendor that provided services for the PSSF program.

Until Social Services addresses the weakness in its contracting process, it cannot ensure that it does not enter into subawards or contracts with entities that have been suspended or debarred.

Questioned Costs

Not applicable.

Recommendations

Social Services should include in all of its subawards and contracts for programs administered by ACF the suspension and debarment terms and/or conditions required by the ACF.

Additionally, Social Services should revise its standard contract language to reflect current federal regulations, which include a $25,000 suspension and debarment threshold for vendor contracts that are funded by federal programs other than those under ACF.

Furthermore, Social Services should establish procedures to ensure that it consults the ineligible parties list prior to issuing subawards or contracts for programs administered by the ACF, as required.

Finally, Social Services should institute a system to ensure that it keeps abreast of changes to federal laws, regulations, and other relevant information, such as the terms and conditions of federal awards.

Department's View and Corrective Action Plan

At the time of contract development, Social Services verifies that the vendor is a current California Multiple Award Schedules (CMAS) vendor by checking the Department of General Services (General Services) Web site that identifies all CMAS vendors and by reviewing the information in the contract between the vendor and General Services. If the CMAS contract contains $25,000 or more of federal funds, the contracts analyst will send the debarment certification to the contractor for signature prior to contract execution. Based on audit findings, Social Services will change its contract processing procedures to include checking the federal ineligible list prior to contract execution. Finally, the Contracts Bureau is modifying the debarment language for those contracts or agreements with a $0 threshold pursuant to federal requirements.

Auditor's Comments on Department's View

We appreciate Social Services' efforts to correct its compliance with all suspension and debarment requirements. However, its corrective action should also apply to vendors that are not on CMAS because those vendors are subject to the requirements as well.

Finally, we would like to clarify Social Services' statement regarding a $0 threshold. Specifically, federal regulations apply the suspension and debarment requirement to nonprocurement transactions such as the grants it awards to subrecipients regardless of the dollar amount. Further, if a contract is funded by an ACF grant, all subawards or contracts, irrespective of the amount, must include a suspension and debarment term and/or condition.

Reference Number:	2007-12-6
Federal Catalog Number:	93.958
Federal Program Title:	Block Grants for Community Mental Health Services
Federal Award Number and Year:	06B1CACMHS-01;2006
Category of Finding:	Reporting
State Administering Department:	Department of Mental Health (Mental Health)

Criteria

TITLE 45—PUBLIC WELFARE, PART 96—BLOCK GRANTS, Subpart C—Financial Management, Section 96.30, Fiscal and Administrative Requirements

(b) Financial summary of obligation and expenditure of block grant funds—

(1) Block grants containing time limits on both the obligation and the expenditure of funds. After the close of each statutory period for the obligation of block grant funds and after the close of each statutory period for the expenditure of block grant funds, each grantee shall report to the Department:

(i) Total funds obligated and total funds expended by the grantee during the applicable statutory periods; and

(ii) The date of the last obligation and the date of the last expenditure.

(4) Submission of information. Grantees shall submit the information required by paragraph (b)(1), (2), and (3) of this section on OMB Standard Form 269A, Financial Status Report (short form). Grantees are to provide the requested information within 90 days of the close of the applicable statutory grant periods.

Condition

Mental Health does not have processes and procedures in place to ensure that the annual Standard Form 269A (SF269A), Financial Status Report, is accurate and submitted on a timely basis. Specifically, the same accounting specialist who prepared the SF269A report for the federal fiscal year 2005 Substance Abuse and Mental Health Services Administration's Block Grants for Community Mental Health Services was also responsible for keeping track of when the report was due and completing, signing, and submitting the report. Further, although the report was due December 29, 2006, Mental Health did not submit it until March 15, 2007. Until Mental Health establishes processes and procedures, it will be unable to ensure that the SF269A report is accurate and submitted on a timely basis.

Questioned Costs

Not applicable.

Recommendation

Mental Health should institute processes and procedures to ensure that the SF269A report is prepared accurately and submitted by the due date.

Department's View and Corrective Action Plan

Mental Health acknowledges that the annual Financial Status Report has not been submitted within 90 days of the close of the applicable grant period. Mental Health is conducting a review of the current reporting process and will develop written processes and procedures ensuring that reporting is timely.

Reference Number:	2007-12-7
Category of Finding:	Reporting
State Administering Department:	Department of Aging (Aging)
Federal Catalog Number:	93.044
Federal Program Title:	Special Programs for the Aging—Title III, Part B—Grants for Supportive Services and Senior Centers
Federal Award Numbers and Years:	06AACAT3SP;2006 07AACAT3SP;2007

Federal Catalog Number:	93.045
Federal Program Title:	Special Programs for the Aging—Title III, Part C—Nutrition Services
Federal Award Numbers and Years:	06AACAT3SP;2006 07AACAT3SP;2007

Federal Catalog Number:	93.053
Federal Program Title:	Nutrition Services Incentive Program
Federal Award Numbers and Years:	06AACANSIP;2006 07AACANSIP;2007

Criteria

Title 45—PUBLIC WELFARE, PART 92—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE, LOCAL, AND TRIBAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 92.20, Standards for Financial Management Systems

(a) A State must expend and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contractors, must be sufficient to:

(3) Permit preparation of reports required by this part and the statutes authorizing the grant, and

(4) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

Title 45—PUBLIC WELFARE, PART 92—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE, LOCAL, AND TRIBAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 92.41(a)(3), Financial Reporting

(a) General. (1) Except as provided in paragraphs (a) (2) and (5) of this section, grantees will use only the forms specified in paragraphs (a) through (e) of this section, and such supplementary or other forms as may from time to time be authorized by OMB, for:

(i) Submitting financial reports to Federal agencies, or

(ii) Requesting advances or reimbursements when letters of credit are not used.

(b) Financial Status Report—(1) Form. Grantees will use Standard Form 269 or 269A, Financial Status Report, to report the status of funds for all nonconstruction grants and for construction grants when required in accordance with Section 92.41(e)(2)(iii).

(c) Federal Cash Transactions Report—(1) Form. (i) For grants paid by letter of credit, Treasury check advances or electronic transfer of funds, the grantee will submit the Standard Form 272, Federal Cash Transactions Report, and when necessary, its continuation sheet, Standard Form 272a, unless the terms of the award exempt the grantee from this requirement.

Condition

Aging lacks adequate policies and procedures to provide reasonable assurance the SF-269, Financial Status Report and Administration on Aging Supplemental Form, and the PSC-272, Federal Cash Transaction Report, it submits to the federal government include all activities, are supported by accounting records, and are fairly presented. Specifically, Aging does not have a written policy that establishes responsibility for reporting, provides the procedures for periodic monitoring of due dates, and verifies the report content. For example, Aging's former accounting manager was the only person who was knowledgeable about its reporting process. Because of our inquiries, she was asked to document the reporting process, and we were provided with a "draft" version of the procedures. Without the establishment of policies and procedures, Aging is unable to prevent errors or detect early any errors that may exist in its reports. For example, although it did not affect the totals reported, we found a few errors in the underlying documentation used by the accounting manager to prepare the report.

Questioned Costs

Not applicable.

Recommendation

Aging should establish policies and procedures to ensure that its SF-269 and PSC-272 reports include all activities, are supported by accounting records, and are fairly presented.

Department's View and Corrective Action Plan

Aging acknowledges the lack of written procedures pertaining to forms SFR-269, Financial Status Report and Administration Aging Supplemental Form, and PSC-272, Federal Cash Transaction Report. Whereas the templates for these reports do include imbedded instructions, Aging recognizes its responsibility for start-to-finish procedures that cover the entire completion, verification and submittal process. Therefore, Aging is establishing procedures that include step-by-step methods, accounting backup and tie-points, and a protocol for review and approval. Once these are in place, Aging will have reasonable assurance that the SFR-269 and PSC-272 submittals are accurate, supported by accounting records, and fairly presented.

Reference Number:	2007-12-12
Federal Catalog Number:	93.568
Federal Program Title:	Low-Income Home Energy Assistance (LIHEAP)
Federal Award Numbers and Years:	G-06B1CALIEA;2006 G-07B1CALIEA;2007
Category of Finding:	Reporting
State Administering Department:	Department of Community Services and Development (CSD)

Criteria

TITLE 45—PUBLIC WELFARE, PART 96—BLOCK GRANTS, Subpart H—Low-Income Home Energy Assistance Program, Section 96.30, Fiscal and Administrative Requirements

(b) Financial summary of obligation and expenditure of block grant funds—

(2) Block grants containing time limits only on obligation of funds. After the close of each statutory period for the obligation of block grant funds, each grantee shall report to the Department:

(i) Total funds obligated by the grantee during the applicable statutory period; and

(ii) The date of the last obligation.

(4) Submission of information. Grantees shall submit the information required by paragraph (b)(1), (2), and (3) of this section on OMB Standard Form 269A, Financial Status Report (short form). Grantees are to provide the requested information within 90 days of the close of the applicable statutory grant periods.

TITLE 45—PUBLIC WELFARE, PART 96—BLOCK GRANTS, Subpart H—Low-Income Home Energy Assistance Program, Section 96.81, Carryover and Reallotment

(b) Required carryover and reallotment report. Each grantee must submit a report to the Department by August 1 of each year, containing the information in paragraphs (b)(1) through (b)(4) of this section. The Department shall make no payment to a grantee for a fiscal year unless the grantee has complied with this paragraph with respect to the prior fiscal year.

(1) The amount of funds that the grantee requests to hold available for obligation in the next (following) fiscal year, not to exceed 10 percent of the funds payable to the grantee;

(2) A statement of the reasons that this amount to remain available will not be used in the fiscal year for which it was allotted;

(3) A description of the types of assistance to be provided with the amount held available; and

(4) The amount of funds, if any, to be subject to reallotment.

Condition

CSD lacks adequate internal controls to ensure certain federal reporting requirements are met. Specifically, although CSD uses the *Federal Grant Management Handbook* and the *State Administrative Manual* to prepare federal reports, it does not have written policies and procedures to guide staff in the specific steps to use when preparing, reviewing, and approving the annual Financial Status Report or

the annual carryover and reallotment report. For example, CSD uses internally developed grant balance spreadsheets and the California State Accounting and Reporting System (CALSTARS) D17 report to aggregate supporting data used to report the total federal outlays and unliquidated obligations on the Financial Status Report. However, CSD has yet to document the procedural steps it uses to aggregate the data. CSD staff stated they are in the process of developing written policies and procedures. Without written policies and procedures that establish responsibility and provide guidance to staff on how to prepare, review, and approve the report, the risk of reporting errors increases.

CSD submits its carryover and reallotment report to the U.S. Department of Health and Human Services (Health and Human Services) annually. However, the carryover and reallotment report CSD submits each year does not include a description of the types of assistance to be provided with the amount held available. CSD staff stated that the description of the types of assistance to be provided with the amount held available was excluded from the carryover and reallotment report due to an oversight. CSD staff also stated that this information will be included in subsequent reports it submits to Health and Human Services.

Questioned Costs

Not applicable.

Recommendations

CSD should develop written policies and procedures to ensure all federal reporting requirements are consistently met. Additionally, CSD should ensure that it includes a description of the types of assistance to be provided with the amount held available on subsequent annual carryover and reallotment reports it submits to Health and Human Services.

Department's View and Corrective Action Plan

CSD agrees that written policies and procedures promote adherence to federal reporting requirements. As a result, in 2006–07 a staff person was tasked to develop desk procedures. Unfortunately, this person retired before the desk procedures could be finalized. CSD has been actively recruiting to fill this position, but qualified candidates for Accounting classifications are very much in demand at State agencies. Since CSD has a small Accounting Unit, a redirection of staff to complete the desk procedures is not feasible and would put all other accounting activities and functions at risk. Therefore this project has been "put on-hold" until such time the position is filled.

State regulations for administrative functions are contained in the *State Administrative Manual* (SAM). Accounting staff use SAM to provide general guidelines for their current processes. In addition, the CSD Accounting Unit has access to the various resources available within the office. The *Federal Grants Management Handbook* §464 (Financial Reporting) gives specific details on completion of the SF 269. Instructions for completing the SF 269 are available on the back of the standard form. Accounting staff also have access to all CALSTARS manuals that provide details on utilizing the CALSTARS reports and how they assist in preparing the SF 269. Accounting staff duties were given to the auditors at the beginning of the audit. The duty statements clearly establish functional responsibilities for the Unit. CSD believes that these resources and internal documents complies with the auditor's guidelines contained in the A-133 Compliance Supplement that states, "Control Activities are the policies and procedures that help ensure that management's directives are carried out." Additionally the Control Objectives as stated are "To provide reasonable assurance that reports of Federal awards submitted to the Federal awarding agency or pass-through entity include all activity of the reporting period, are supported by underlying accounting or performance records, and are fairly presented in accordance with program requirements." Further evidence of staffs' ability to utilize available resources to complete assignments in a timely and accurate manner is the absence of any material conditions applicable to the accounting and reporting functions during this audit.

In response to BSA's recommendation regarding the inclusion of a description of the types of assistance to be provided with the amount held available in carryover and reallotment funds, CSD's response remains the same as stated to the auditor. This omission was an oversight and CSD will be developing a procedure to ensure that descriptions of types of assistance are included in the carryover and reallotment report starting July 2008.

Auditor's Comments on Department's View

We acknowledge CSD's challenge in recruiting accounting staff. However, it does not relieve CSD of its responsibility for developing and maintaining adequate policies and procedures. Furthermore, we did not identify any errors in report preparation, but if key staff were to leave their position at CSD, it would be difficult for CSD to reconstruct the steps necessary to prepare the reports.

Reference Number:	2007-12-13
Federal Catalog Number:	93.566
Federal Program Title:	Refugee and Entrant Assistance—State Administered Programs (Refugee Program)
Federal Award Numbers and Years:	G-06AACA9100;2006 G-06AACA9110;2006
Category of Finding:	Reporting
State Administering Department:	Department of Social Services (Social Services)

Criteria

TITLE 45—PUBLIC WELFARE, PART 400—REFUGEE RESETTLEMENT PROGRAM, Subpart C—General Administration, Section 400.28, Maintenance of Records and Reports

(b) A State must submit statistical or programmatic information that the Director determines to be required to fulfill his or her responsibility under the Act on refugees who receive assistance and services which are provided, or the costs of which are reimbursed, under the Act.

ORR-6, Quarterly Performance Report, (OMB No.: 0970-0036.) states; "We ask for the information on this form in order to determine the effectiveness of the state cash and medical assistance, social services, and targeted assistance programs as required by 412(e) of the Immigration and Naturalization Act. We also calculate state-by-state Refugee Cash Assistance and Refugee Medical Assistance utilization rates for use in formulating program initiatives, priorities, standards, budget requests, and assistance policies. The Office of Refugee Resettlement (ORR) regulations require that this form be completed in order to participate in the program."

Condition

Social Services submitted its second quarter federal fiscal year 2007 ORR-6 report to the federal ORR despite the report containing several errors. Specifically, during our review of a summary chart that was used to report the number of recipients of refugee cash assistance, we found four instances where the number of families and individuals was more than the total number of persons. For example, in one instance, the report showed the total person count to be 34, but we found the family count to be 55. Refugee Program staff stated that the errors were due to either entering data incorrectly or entering incorrect data. Nevertheless, misstatements of the number of recipients of aid can affect the federal ORR's ability to determine the effectiveness of the program and to correctly calculate and allocate funds to the states.

Questioned Costs

Not applicable.

Recommendation

Social Services should review the ORR-6 report more thoroughly before submitting it to the ORR and ensure that the information in the report is logical and accurate.

Department's View and Corrective Action Plan

Social Services concurs. The Refugee Program Branch (RPB) corrected the errors related to the number of recipients and forwarded a revised Schedule B, 2007 ORR-6 second quarter report to the ORR on January 24, 2008. The RPB will review the FFY 2006–2007 first, third and fourth quarter ORR-6 reports by February 15, 2008, to ensure that all data was accurately reported. If errors are found, revised reports will be submitted to ORR. Finally, RPB will develop ORR-6 report procedures by July 1, 2008, and incorporate a review process to ensure that data is accurate and entered correctly.

Reference Number:	2007-13-3
Federal Catalog Number:	93.958
Federal Program Title:	Block Grants for Community Mental Health Services
Federal Award Number and Year:	06B1CACMHS-03;2006
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Mental Health (Mental Health)

Criteria

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133, *AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS* (OMB Circular A-133), Subpart D—Federal Agencies and Pass-Through Entities, Section .400, Responsibilities

(d) Pass-through entity responsibilities. A pass-through entity shall perform the following for the Federal awards it makes:

(1) Identify Federal awards made by informing each subrecipient of CFDA title and number, award name and number, award year, if the award is R&D, and name of Federal agency. When some of this information is not available, the pass-through entity shall provide the best information available to describe the Federal award.

(4) Ensure that subrecipients expending $300,000 (*$500,000 for fiscal years ending after December 31, 2003*) or more in Federal awards during the subrecipient's fiscal year have met the audit requirements of this part for that fiscal year.

OMB CIRCULAR A-133, Subpart B—Audits, Section .225, Sanctions

No audit costs may be charged to Federal awards when audits required by this part have not been made or have been made but not in accordance with this part. In cases of continued inability or unwillingness to have an audit conducted in accordance with this part, Federal agencies and pass-through entities shall take appropriate action using sanctions such as:

(a) Withholding a percentage of Federal awards until the audit is completed satisfactorily;

(b) Withholding or disallowing overhead costs;

(c) Suspending Federal awards until the audit is conducted; or

(d) Terminating the Federal award.

Condition

Our review of the county application correspondence for six counties found that Mental Health used the incorrect Catalog of Federal Domestic Assistance (CFDA) title in its correspondence to the counties. Specifically, Mental Health referred to the grant as the "Federal Substance Abuse and Mental Health Services Administration (SAMHSA) Block Grant."

Additionally, Mental Health does not have procedures in place to follow up when counties have not submitted their OMB Circular A-133 audits. The State Controller's Office notifies state agencies of those local governments that are required to submit an OMB Circular A-133 audit but have not done so. The status of the counties' submission of their OMB Circular A-133 audits can also be found in the Federal Audit Clearinghouse database. Until Mental Health establishes procedures, it will be unable to identify and take the appropriate action against the counties that fail to comply with the OMB Circular A-133 audit requirement.

Questioned Costs

Not applicable.

Recommendations

Mental Health should institute procedures to ensure that it is using the correct CFDA title on its correspondence to counties.

Mental Health should also establish procedures for following up with counties that have not submitted their OMB Circular A-133 audits and should sanction them as necessary.

Department's View and Corrective Action Plan

Mental Health acknowledges the recommendation with regards to the identification of the CFDA title and will be conducting a review of the processes and procedures to ensure that the appropriate CFDA title identification is addressed in all future correspondence to counties.

Mental Health will evaluate the feasibility of the recommendation.

Auditor's Comment on Department's View

Mental Health did not provide a plan to address the second recommendation regarding OMB Circular A-133 audits.

Reference Number:	2007-13-4
Federal Catalog Number:	93.563
Federal Program Title:	Child Support Enforcement (CSE)
Federal Award Numbers and Years:	0604CA4004;2006 0704CA4004;2007
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Child Support Services (Child Support Services)

Criteria

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133, *AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS* (OMB Circular A-133), Subpart D—Federal Agencies and Pass-Through Entities, Section .400, Responsibilities

(d) **Pass-through entity responsibilities.** A pass-through entity shall perform the following for the Federal awards it makes:

(1) Identify Federal awards made by informing each subrecipient of CFDA title and number, award name and number, award year, if the award is R&D, and name of Federal agency. When some of this information is not available, the pass-through entity shall provide the best information available to describe the Federal award.

(3) Monitor the activities of subrecipients as necessary to ensure that Federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.

(4) Ensure that subrecipients expending $300,000 ($500,000 for fiscal years ending after December 31, 2003) or more in Federal awards during the subrecipient's fiscal year have met the audit requirements of this part for that fiscal year.

(5) Issue a management decision on audit findings within six months after receipt of the subrecipient's audit report and ensure that the subrecipient takes appropriate and timely corrective action.

TITLE 45—Public Welfare—CHAPTER III—OFFICE OF CHILD SUPPORT ENFORCEMENT (CHILD SUPPORT ENFORCEMENT PROGRAM), ADMINISTRATION FOR CHILDREN AND FAMILIES, DEPARTMENT OF HEALTH AND HUMAN SERVICES PART 302—State Plan Requirements—Section 302.10 Statewide Operations:

(2) Regular planned examination and evaluation of operations in local offices by regularly assigned State staff, including regular visits by such staff; and through reports, controls, or other necessary methods.

Condition

Child Support Services did not completely fulfill its subrecipient monitoring responsibilities for its CSE program. Although Child Support Services identifies the federal laws that govern the program, it did not provide the Catalog of Federal Domestic Assistance (CFDA) title and number, the award number, and the name of the federal agency in its agreements that it executes with each local child support agency (LCSA).

We also found that Child Support Services did not effectively monitor the LCSAs' use of federal funds through site visits, limited scope audits, or other means. Specifically, Child Support Services entered into a contract with the Department of Finance (Finance) in August 2004 to assist it in, among other things, evaluating the LCSAs' compliance with Office of Management and Budget (OMB) Circulars A-133 and A-87, state codes and regulations applicable to the Administrative Expense Claim Schedule and Certification (CS 356), and related internal controls. Since the agreement in 2004, Finance has audited only 13 out of the 52 LCSAs and the last audit for which a report was issued was for fiscal year 2004–05. Furthermore, Child Support Services lacks an adequate process to follow up on the findings identified by Finance and has not fully resolved the findings for 10 of the completed audits. These audits are central to Child Support Services' oversight of the LCSAs' compliance with federal requirements. If these audits do not occur, Child Support Services cannot ensure that the LCSAs spend federal funds only on activities and costs that are allowable, as well as fulfill other federal requirements.

Finally, Child Support Services did not issue management decisions on audit findings within six months after receipt of the LCSAs' audit report and ensure that the LCSAs took appropriate and timely corrective action. The State has established a process whereby local governments submit copies of their OMB Circular A-133 reports to the State Controller's Office (Controller's Office). The Controller's Office will distribute copies of each audit report to state entities affected by audit findings. The state entities are responsible for following up on the audit findings related to federal programs. Child Support Services is calculating the six-month period from the date it receives copies of the audit report from the Controller's Office, as opposed to the date the State first receives the report when it is submitted to the Controller's Office. As a result, Child Support Services issued only three management decisions within the required time period for the eight findings that were identified in the LCSAs' OMB Circular A-133 audit reports for fiscal year 2005–06. Management decisions for four findings were up to two weeks late and a decision for one finding had not been issued as of December 31, 2007. Because Child Support Services is not using the correct report receipt date, it cannot ensure that it issues its management decisions timely.

Questioned Costs

Not applicable.

Recommendations

Child Support Services should ensure that it includes all required information when communicating with the LCSAs. Further, Child Support Services should implement a more effective during-the-award monitoring process to ensure that federal awards are used for authorized purposes in compliance with laws and regulations. Finally, Child Support Services should implement procedures that would ensure that it is able to issue management decisions within the required time.

Department's View and Corrective Action Plan

Child Support Services has included the required information into the current Plan of Cooperation that will be communicated to the LCSAs when finalized and approved. Child Support Services has an updated process to resolve findings on completed audits and will continue to conduct reviews of the LCSAs according to its contract with the Department of Finance. Child Support Services will use the Controller's Office report date and ensure that management decisions on single audit findings are issued within the required period.

Reference Number:	2007-13-5
Federal Catalog Number:	93.568
Federal Program Title:	Low-Income Home Energy Assistance (LIHEAP)
Federal Award Numbers and Years:	G-06B1CALIEA;2006 G-07B1CALIEA;2007
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Community Services and Development (CSD)

Criteria

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133, *AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS* (OMB Circular A-133), Subpart D—Federal Agencies and Pass-Through Entities, Section .400, Responsibilities

(d) **Pass-through entity responsibilities.** A pass-through entity shall perform the following for the Federal awards it makes:

(1) Identify Federal awards made by informing each subrecipient of CFDA title and number, award name and number, award year, if the award is R&D, and name of Federal agency. When some of this information is not available, the pass-through entity shall provide the best information available to describe the Federal award.

Condition

CSD's contract review and approval process lacks internal controls to ensure the federal awarding agency and all laws and regulations are identified at the time of the award. Specifically, the LIHEAP contract that CSD requires its subgrantees to abide by does not include the federal awarding agency, nor does it identify the federal regulation related to the program and block grants. CSD staff stated that they were unaware that the federal awarding agency must be included in the award documents it provides to the subgrantee. Additionally, CSD staff stated the exclusion of federal program and block grant regulations was an oversight. By not providing complete award information, CSD cannot ensure that its subgrantees are aware of the program requirements.

Questioned Costs

Not applicable.

Recommendation

CSD should include the federal awarding agency information and requirements imposed on the subgrantee by federal laws, regulations, and the provisions of contracts or grant agreements on all award documents.

Department's View and Corrective Action Plan

CSD concurs with the recommendation. Corrective action was implemented at the time of the auditor's finding and all appropriate 2008 contracts were revised to include the Federal awarding agency information and requirements addressed in the finding/condition.

Reference Number:	2007-13-7
Federal Catalog Number:	93.556
Federal Program Title:	Promoting Safe and Stable Families (PSSF)
Federal Award Numbers and Years:	G-0501CA1400;2005 G-0601CA1400;2006 G-0701CA1400;2007
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Social Services (Social Services)

Criteria

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133, *AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS* (OMB Circular A-133), Subpart D—Federal Agencies and Pass-Through Entities, Section .400, Responsibilities

(d) Pass-through entity responsibilities. A pass-through entity shall perform the following for the Federal awards it makes:

(4) Ensure that subrecipients expending $300,000 (*$500,000 for fiscal years ending after December 31, 2003*) or more in Federal awards during the subrecipient's fiscal year have met the audit requirements of this part for that fiscal year.

(5) Issue a management decision on audit findings within six months after receipt of the subrecipient's audit report and ensure that the subrecipient takes appropriate and timely corrective action.

Condition

Social Services does not have processes and procedures to ensure that its noncounty subrecipients have met the OMB Circular A-133 audit requirements. The PSSF program's noncounty subrecipients include entities such as nonprofit organizations. Our review of three noncounty contracts found that Social Services did include the OMB Circular A-133 audit requirement; however, it does not have a process in place to collect and review the OMB Circular A-133 audits, nor to ensure that it issues management decisions within six months after receiving the audit.

Social Services acknowledges that it currently does not have a process for collecting, reviewing, and monitoring the OMB Circular A-133 audits for its noncounty subrecipients. Social Services stated it does not have the resources to carry out such a function. Without performing these functions, Social Services is unable to ensure that these subrecipients have taken timely and appropriate corrective action on all audit findings and are complying with the applicable federal program requirements.

Questioned Costs

Not applicable.

Recommendations

Social Services should establish processes and procedures to do the following:

(1) Identify those noncounty subrecipients required to have an OMB Circular A-133 audit.

(2) Ensure that all required subrecipients meet the audit requirement.

(3) Issue a management decision on audit findings within six months after receipt of the audit report.

(4) Ensure that the subrecipient takes appropriate and timely corrective action.

Department's View and Corrective Action Plan

Social Services concurs. Social Services is re-evaluating staff resources dedicated to this item. Whereas we do collect some OMB Circular A-133 audit reports, we do not collect all of them. Therefore, we are drafting a process that will ensure that affected noncounty subrecipients submit an audit as required by OMB Circular A-133, and ensure that the audit will be reviewed. Any findings as described in the audit will be addressed in a management decision issued in a timely fashion. The new Internal Audit Coordinator's first priority was to address all of the management decisions for the 25 findings presented in the fiscal year 2005-06 OMB Circular A-133 audits for TANF relating to eligibility and four PSSF findings relating to subrecipient monitoring.

Reference Number:	2007-13-8
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Social Services (Social Services)
Federal Catalog Number:	93.558
Federal Program Title:	Temporary Assistance for Needy Families (TANF)
Federal Award Number and Year:	GA-0602CATANF;2006
Federal Catalog Number:	93.566
Federal Program Title:	Refugee and Entrant Assistance—State Administered Programs (Refugee Program)
Federal Award Numbers and Years:	G-06AACA9100;2006 G-06AACA9110;2006
Federal Catalog Number:	93.556
Federal Program Title:	Promoting Safe and Stable Families (PSSF)
Federal Award Numbers and Years:	G-0501CA00FP;2005 G-0601CA00FP;2006 G-0701CA00FP;2007
Federal Catalog Number:	93.645
Federal Program Title:	Child Welfare Services—State Grants (CWS)
Federal Award Numbers and Years:	G-0601CA1400;2005 G-0701CA1400;2006

Criteria

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133, *AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS*, Subpart D—Federal Agencies and Pass-Through Entities, Section .400, Responsibilities

(d) **Pass-through entity responsibilities.** A pass-through entity shall perform the following for the Federal awards it makes:

(1) Identify Federal awards made by informing each subrecipient of CFDA title and number, award name and number, award year, if the award is R&D, and name of Federal agency. When some of this information is not available, the pass-through entity shall provide the best information available to describe the Federal award.

(2) Advise subrecipients of requirements imposed on them by Federal laws, regulations, and the provisions of contracts or agreements as well as any supplemental requirements imposed by the pass-through entity.

Condition

Our review of the award letter to counties for each program and two contracts with noncounty subrecipients for the PSSF program and Refugee Program found that Social Services did not include all required federal award information. Specifically, Social Services did not include information such as the Catalog of Federal Domestic Assistance (CFDA) title or number or requirements imposed by federal laws, regulations, and grant provisions in its award letter to counties or contracts with its other subrecipients. By not providing complete award information, Social Services cannot be sure that its subrecipients are aware of and following all program requirements imposed on them.

Questioned Costs

Not applicable.

Recommendation

Social Services should revise its procedures to ensure that all award documents contain the required award information such as the CFDA title and number.

Department's View and Corrective Action Plan

Social Services concurs. Though Social Services makes every effort to ensure that the subrecipient adheres to all of the Federal Grant requirements, the addition of the CFDA or other appropriate language to the contract and associated award letter(s) would be beneficial in providing a reference and clearly defining the requirements of the contract. Future contracts and award letters will include the required federal award information.

Reference Number:	2007-13-9
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Social Services (Social Services)
Federal Catalog Number:	93.558
Federal Program Title:	Temporary Assistance for Needy Families (TANF)
Federal Award Number and Year:	GA-0602CATANF;2006

Federal Catalog Number:	93.556
Federal Program Title:	Promoting Safe and Stable Families (PSSF)
Federal Award Numbers and Years:	G-0501CA00FP;2005 G-0601CA00FP;2006 G-0701CA00FP;2007

Criteria

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133, *AUDITS OF STATES, LOCAL GOVERNMENTS AND NON-PROFIT ORGANIZATIONS* (OMB Circular A-133), Subpart D—Federal Agencies and Pass-Through Entities, Section .400, Responsibilities

(d) **Pass-through entity responsibilities.** A pass-through entity shall perform the following for the Federal awards it makes:

(5) Issue a management decision on audit findings within six months after receipt of the subrecipient's audit report and ensure that the subrecipient takes appropriate and timely corrective action.

Condition

Social Services lacks adequate processes and procedures to ensure that it fulfills its pass-through responsibilities. Social Services failed to issue timely management decisions for the findings presented in the fiscal year 2005–06 OMB Circular A-133 audits for 27 of its 58 county subrecipients. Our review of the OMB Circular A-133 audits found 25 findings for TANF, primarily related to eligibility, and four findings for the PSSF program, primarily relating to subrecipient monitoring. As of January 2008, Social Services had yet to issue any management decisions for these OMB Circular A-133 audit findings, and the delay ranged between one and five months. According to an administrative services branch chief, Social Services did not have a permanent staff member assigned to monitor the counties' OMB Circular A-133 audits, and although other department staff were monitoring and logging the date of receipt of the OMB Circular A-133 audits, they did not issue management decisions on the findings. If Social Services does not issue management decisions on findings in the required time frame, it cannot ensure that counties are addressing the audit findings in a timely and appropriate manner.

Questioned Costs

Not applicable.

Recommendation

Social Services should ensure that it issues management decisions in the required time frame.

Department's View and Corrective Action Plan

Social Services concurs. The Internal Audit Coordinator (IAC) position was vacant for ten months and successfully filled on October 18, 2007. During the ten months the position was vacant, staff, unfortunately, was not redirected to these activities. The new IAC first priority was to address all of the management decisions for the 25 findings presented in the fiscal year 2005–06 OMB Circular A-133 audits for TANF relating to eligibility and four PSSF findings relating to subrecipient monitoring. At the time the Bureau of State Audits spoke to the IAC, the IAC was working with staff who administer the program and program staff were working with the counties to complete the county corrective action plans.

The IAC is updating desk procedures to ensure adequate procedures exist, so that Social Services fulfills its pass-through entity responsibilities regardless of staffing. Finally, Social Services is cross-training staff to handle the workload to ensure all findings will be released in accordance with OMB Circular A-133.

Reference Number:	2007-14-1
Federal Catalog Number:	93.958
Federal Program Title:	Block Grants for Community Mental Health Services Block Grants
Federal Award Number and Year:	06B1CACMHS-03;2006
Category of Finding:	Special Tests and Provisions
State Administering Department:	Department of Mental Health (Mental Health)

Criteria

TITLE 42—THE PUBLIC HEALTH AND WELFARE, CHAPTER 6A—PUBLIC HEALTH SERVICE, SUBCHAPTER XVII—BLOCK GRANTS, Part B—Block Grants Regarding Mental Health and Substance Abuse, Subpart iii, General Provisions, Section 300x-53, Additional Requirements

(a) In general

A funding agreement for a grant under section 300x or 300x-21 of this title is that the State involved will—

(1)(A) for the fiscal year for which the grant involved is provided, provide for independent peer review to assess the quality, appropriateness, and efficacy of treatment services provided in the State to individuals under the program involved; and

(B) ensure that, in the conduct of such peer review, not fewer than 5 percent of the entities providing services in the State under such program are reviewed (which 5 percent is representative of the total population of such entities).

Condition

Mental Health did not facilitate peer reviews. In the past Mental Health had facilitated them in conjunction with its Substance Abuse and Mental Health Services Administration's Block Grants for Community Mental Health Services (SAMHSA CMHS) site reviews. However, Mental Health phased out peer reviews in 2004 after a departmental reorganization. Specifically, according to the branch chief of its County Programs Implementation Systems of Care Division, peer reviews were put on hold as a result of Mental Health's limited personnel and travel resources and its responsibilities to the competing priorities of the Mental Health Services Act. Nevertheless, the lack of peer reviews further diminishes Mental Health's oversight of the programs offered by the counties using SAMHSA CMHS grant funds.

Questioned Costs

Not applicable.

Recommendation

Mental Health should resume independent peer reviews as required by federal law.

Department's View and Corrective Action Plan

This issue has not been raised in recent federal reviews conducted by the Center for Mental Health Services that occurred in April 1996, May 1999, and May 2005, nor was it raised in a State audit conducted by the Bureau of State audits in 2003. Mental Health acknowledges that due to various workload priorities formal peer reviews of these programs have not been conducted since 2004. However, it must be noted that due to the ongoing, intensive level of engagement between Mental Health program staff and county grant programs, it is not apparent that there have been any negative consequences resulting from the temporary suspension of peer reviews. Mental Health agrees that these peer reviews should be conducted and will explore how to accomplish this given current workload and resources.

Reference Number:	2007-14-2
Federal Catalog Number:	93.053
Federal Program Title:	Nutrition Services Incentive Program (NSIP)
Federal Award Number and Year:	07AACANSIP;2007
Category of Finding:	Special Tests and Provisions
State Administering Department:	Department of Aging (Aging)

Criteria

TITLE 42—THE PUBLIC HEALTH AND WELFARE, CHAPTER 35—PROGRAMS FOR OLDER AMERICANS, SUBCHAPTER III—GRANTS FOR STATE AND COMMUNITY PROGRAMS ON AGING, Section 3030a(d), Option to Obtain Commodities From Secretary of Agriculture

(4) Each State agency shall promptly and equitably disburse amounts received under this subsection to recipients of grants and contracts. Such disbursements shall only be used by such recipients of grants or contracts to purchase United States agricultural commodities and other foods for their nutrition projects.

Condition

Aging lacks adequate procedures to provide reasonable assurance that cash received in lieu of commodities is distributed equitably. Although its policy states that NSIP funding to subrecipients is based on the number of meals served in the prior year in proportion to the meals served statewide, Aging does not have documentation of the procedures that it follows to ensure that cash received in lieu of commodities is distributed equitably to subrecipients. We also found that it lacks adequate segregation of duties. Specifically, its budget officer is responsible for preparing the annual allocation of NSIP funds to the subrecipients. However, there is no supervisory review and approval of the budget officer's calculation of the allocation. Although we found no errors in the calculation, the lack of adequate procedures and segregation of duties hinders Aging's ability to prevent errors or detect early any errors that may exist in the allocation.

Questioned Costs

Not applicable.

Recommendation

Aging should establish procedures for handling cash received in lieu of commodities for the Nutrition Services Incentive Program to ensure that it distributes the funds equitably.

Department's View and Corrective Action Plan

While Aging has distributed the NSIP cash in lieu of commodities equitably according to requirements, we acknowledge the lack of documented procedures for this activity. Therefore, Aging is establishing written procedures that outline the process, including validation of the calculations, and providing for a sign-off procedure to verify that the time periods are correct and the methodologies have been followed.

Reference Number:	2007-14-5
Federal Catalog Number:	93.563
Federal Program Title:	Child Support Enforcement (CSE)
Federal Award Numbers and Years:	0604CA4004;2006 0704CA4004;2007
Category of Finding:	Special Tests and Provisions
State Administering Department:	Department of Child Support Services (Child Support Services)

Criteria

TITLE 45—PUBLIC WELFARE, PART 303—STANDARDS FOR PROGRAM OPERATIONS, Section 303.7, Provision of Services in Interstate IV-D Cases

(a) Interstate central registry.

(1) The State IV-D agency must establish an interstate central registry responsible for receiving, distributing and responding to inquiries on all incoming interstate IV-D cases.

(2) Within 10 working days of receipt of an interstate IV-D case from an initiating State, the central registry must:

(i) Ensure that the documentation submitted with the case has been reviewed to determine completeness;

(ii) Forward the case for necessary action either to the State Parent Locator Services (PLS) for location services or to the appropriate agency for processing;

(iii) Acknowledge receipt of the case and ensure that any missing documentation has been requested from the initiating State; and

(iv) Inform the IV-D agency in the initiating State where the case was sent for action.

(3) If the documentation received with a case is inadequate and cannot be remedied by the central registry without the assistance of the initiating State, the central registry must forward the case for any action which can be taken pending necessary action by the initiating State.

(4) The central registry must respond to inquiries from other States within 5 working days of receipt of the request for a case status review.

Condition

Child Support Services lacks adequate controls to ensure that it fulfills its responsibilities for responding to interstate case requests and status review requests within the time required. Specifically, our review of 23 interstate case requests found that Child Support Services' responses for 10 requests were between 11 and 51 working days of receipt, instead of the 10 working days required. Additionally, our

review of 22 status requests found that Child Support Services' responses for 17 requests were between six and 46 working days of receipt, instead of the five days required. Finally, we found that Child Support Services' Quality Assurance Section recently completed a similar review of the department's responses to interstate requests and found noncompliance with the five working day requirement for status review requests. In its May 1, 2007, response to the review, the unit responsible for the California Central Registry outlined four specific internal control improvements that it believes will help achieve compliance. However, until the controls are implemented Child Support Services runs the risk of continuing to provide untimely information to other states.

Questioned Costs

Not applicable.

Recommendation

Child Support Services should implement and adhere to internal control procedures that will allow it to ensure that it complies with federal requirements to respond to interstate case requests and status review requests within the specified time periods.

Department's View and Corrective Action Plan

Child Support Services concurs with the recommendation. The unit overseeing the California Central Registry (CCR) is responsible for responding to interstate requests and had implemented the following procedures on May 1, 2007:

- Date stamp the initiating jurisdiction's transmittal upon receipt and keep a copy of the original with the case file.
- Keep a copy of the original status request with receipt date in the case file.
- Fax the first request to the LCSA requesting a 2-day turnaround time for the requested information. Note the date the first request was sent on the copy that is kept in the case file.
- If no response is received from the LCSA by the fourth day after receipt from the initiating jurisdiction, fax a second request to the LCSA and note the date of the second request on the copy kept in the case file.

In early February 2008, the CCR unit developed and implemented a work plan that took effect immediately. The work plan is as follows:

1. The CCR technicians were relieved of some of their duties. Less complex tasks currently being completed by the analysts were shifted to the technicians in the support group. The technicians will perform the tasks of making the telephone calls and searching available systems to verify information on cases and to enter all referrals in CSE, which is currently being done by the analysts.
2. The CCR analysts will continue to review the cases for legal sufficiency.

Data through February 25, 2008, reveals that our work plan is working and we feel confident that we will be able to meet our goal of being in compliance on or before June 30, 2008.

U.S. DEPARTMENT OF LABOR

Reference Number:	2007-1-3
Federal Catalog Number:	17.245
Federal Program Title:	Trade Adjustment Assistance (TAA)
Federal Award Numbers and Years:	TA-15886-07-55-A-6;2007 UI-15787-07-55;2007
Category of Finding:	Activities Allowed/Allowable Costs; Eligibility
State Administering Department:	Employment Development Department (EDD)

Criteria

TITLE 20—EMPLOYEES' BENEFITS, PART 617—TRADE ADJUSTMENT ASSISTANCE FOR WORKERS UNDER THE TRADE ACT OF 1974, Subpart C—Reemployment Services, Section 617.22, Approval of Training

(a) Conditions for approval. Training shall be approved for an adversely affected worker if the State agency determines that:

(1) There is no suitable employment (which may include technical and professional employment) available for an adversely affected worker.

(2) The worker would benefit from appropriate training.

(3) There is a reasonable expectation of employment following completion of such training.

(4) Training approved by the Secretary is reasonably available to the worker from either governmental agencies or private sources (which may include area vocational technical education schools, as defined in Carl D. Perkins Vocational and Applied Technology Education Act, and employers).

(5) The worker is qualified to undertake and complete such training.

(6) Such training is suitable for the worker and available at a reasonable cost.

Condition

EDD lacks adequate controls to ensure that its field offices make appropriate eligibility determinations for the TAA program. Specifically, EDD has not appropriately monitored its field offices' eligibility determinations.

In December 2006, the U.S. Department of Labor issued a report recommending that the State Trade Act Coordinator (coordinator) conduct on-site monitoring of the TAA at EDD's field offices and select the files for review randomly. Instead, the coordinator continues to conduct quarterly desk reviews by having field offices send him copies of 25 participant files. Further, the coordinator continues to ask each field office to select the files. The design of this internal control is ineffective because it allows field offices the opportunity to select their most compliant files. According to an assistant division chief, EDD does not conduct on-site monitoring because the increased cost of these visits could not be supported by the administrative funds allowable under the TAA.

Additionally, EDD's field offices lack the information necessary to determine how to document the six conditions of training approval. Specifically, although EDD provides general guidance through the DE8751 Training Plan form, the *Trade Act Manual*, and other training, it has not explicitly stated what documents should support each of the six conditions for training approval. In order to analyze whether participant files contained appropriate documentation, we asked EDD's Workforce Services Division TAA representative (TAA representative) to provide a description of the specific documents

that would support each of the conditions for training approval. Based on this description, we found that 16 participant files did not have support for two or more of the six conditions of approval and six files did not have support for one of the conditions of approval. An internal audit published in May 2007 and a Department of Labor review published in December 2006 had similar findings.

According to the TAA representative, there are several challenges to ensuring staff are aware of how to document the six conditions, including staff turnover and lack of resources for training, as well as the fact that TAA staff are not case managers and have various other duties within the Workforce Services Division.

Training is a prerequisite for receiving Training and Trade Readjustment Allowance payments. Because we could not determine eligibility for training for a number of TAA participants in our sample, we could not conclude that the payments they received were allowable costs. Without adequate controls in place to ensure that its field offices are making correct eligibility determinations, EDD cannot ensure that the payments made to training vendors and to recipients are appropriate.

Questioned Costs

Of the $22,502 in TAA payments we reviewed for our sample of 45 expenditures, we were unable to determine the eligibility of the associated participants for a total of $15,192.

Recommendations

EDD should improve its internal controls related to the TAA. Specifically, EDD should conduct quarterly on-site reviews of randomly selected participant files, as recommended by the U.S. Department of Labor. Additionally, EDD should develop policies and procedures specifying what documents should support each of the six conditions for training approval and include a checklist in the *Trade Act Manual*.

Department's View and Corrective Action Plan

The 2006 Department of Labor (DOL) review and the 2007 review by the Audit and Evaluation Division (A&ED) were similar to the findings of this Bureau of State Audits' review in that the DOL's six criteria for TAA training are not consistently documented.

The "TAA Training Plan—DE 8751" is designed to serve as the control document used to determine, document, and monitor that each of the six criteria has been met. Each line item the TAA Specialist completes on the DE8751 is designed to answer whether a criterion has been met. The TAA Specialist is also required to attach documentation to support certain line item answers. Monitoring results, as well as past DOL reviews, have consistently found certain documentation to be absent from the file, e.g., labor market information for the client's current occupation. In response to this finding, the Unemployment Insurance Branch (UIB) wrote and released an Unemployment Insurance Program Notice (UIPN) that included the policies and procedures related to the approval of the Trade Act Training Agreement, DE8751, to include instructions that the Job Service field office managers review the Training Plan for completeness prior to approval.

In response to this state review, as was in the response to the A&ED review, the UIB and Workforce Services Branch staff revised the DE8751 to include an additional page with a specific line item for each of the six criteria (a checklist), requiring the TAA Specialists to document (write out) how the client has met that criterion. The revised DE 8751 is in the clearance process and is expected to be available to field office staff by late April 2008. A UIPN will be written and released by UIB to provide completion instructions for the revised Training Plan (DE 8751) and will supersede incorporation into the TAA Manual. In this respect, a "checklist" of documentation supporting the six criteria will become a part of the TAA Manual.

In order to improve the reliability of the sampled cases, we are working on a methodology for future reviews to randomly select cases for review and thereby remove any potential manipulation of what is reviewed. Also we do have a five-day response time for the material to be sent to the review team, but that requirement is not documented. We hope to have the methodology completed within 90 days and revise Field Office Instructions to reinforce the five-day response requirement.

We acknowledge DOL's recommendation for in-person monitoring of cases and TAA operations. Given the limited administrative funding under the TAA act, we do not plan to implement in-person monitoring and instead rely on review of randomly selected cases for review. At such time as additional funding may become available, we will reconsider this option.

Reference Number:	2007-1-4
Federal Catalog Number:	17.207
Federal Program Title:	Employment Service Wagner-Peyser Act Funded Activities
Federal Award Number and Year:	ES-15684-06-55;2007
Category of Finding:	Activities Allowed/Allowable Costs
State Administering Department:	Employment Development Department (EDD)

Criteria

TITLE 2—GRANTS AND AGREEMENTS, PART 225—COST PRINCIPLES FOR STATE, LOCAL, AND INDIAN TRIBAL GOVERNMENTS (OMB CIRCULAR A-87)

Appendix B to Part 225—Selected Items of Cost

8. Compensation for personal services

   d. Fringe benefits.

      (1) Fringe benefits are allowances and services provided by employers to their employees as compensation in addition to regular salaries and wages. Fringe benefits include, but are not limited to, the costs of leave, employee insurance, pensions, and unemployment benefit plans. Except as provided elsewhere in these principles, the costs of fringe benefits are allowable to the extent that the benefits are reasonable and are required by law, governmental unit-employee agreement, or an established policy of the governmental unit.

      (2) The cost of fringe benefits in the form of regular compensation paid to employees during periods of authorized absences from the job, such as for annual leave, sick leave, holidays, court leave, military leave, and other similar benefits, are allowable if: they are provided under established written leave policies; the costs are equitably allocated to all related activities, including Federal awards; and, the accounting basis (cash or accrual) selected for costing each type of leave is consistently followed by the governmental unit.

   h. Support of salaries and wages. These standards regarding time distribution are in addition to the standards for payroll documentation.

      (5) Personnel activity reports or equivalent documentation must meet the following standards:

(a) They must reflect an after-the-fact distribution of the actual activity of each employee,

(b) They must account for the total activity for which each employee is compensated,

(c) They must be prepared at least monthly and must coincide with one or more pay periods, and

(d) They must be signed by the employee.

Condition

EDD needs to improve its controls to ensure that employee time sheets agree with the payroll data recorded in its accounting records. Our review of 36 employee time sheets found one instance where EDD's accounting records showed the employee had charged 141 hours to an Employment Services project code, but the time sheet on file indicated the employee charged 133 hours to Employment Services. According to the employee's manager, the employee's time was entered into an electronic system prior to the end of the reporting period. The attendance clerk at the employee's office failed to update the system when the employee took eight hours of sick leave. As a result, EDD charged hours to Employment Services that should not have been charged.

Questioned Costs

Roughly $147 of the $134,311 sampled.

Recommendation

EDD should ensure that all of its offices follow the established procedures for creating and amending time sheets.

Department's View and Corrective Action Plan

EDD will reissue the existing departmental procedures to managers and supervisors emphasizing their responsibility in reviewing and certifying the accuracy of employee monthly activity reports. Although the audit sample indicated an oversight by a field office attendance clerk in not having an updated time report submitted for one employee, the impact on the fiscal charges to the federal program in our opinion is immaterial as the expenditure variance is only 0.11%. The audit sample finding does not indicate the timekeeping control problem is widespread since only one incident was identified due to a clerical error. It should also be noted that hours reported in the monthly timekeeping system for employee leave time is allocated to the direct project codes within the cost center each month.

Auditor's Comments on Department's View

Statement on Auditing Standards Number 112 (SAS #112), titled *Communicating Internal Control Related Matters Identified in an Audit* and issued by the American Institute of Certified Public Accountants' Auditing Standards Board, sets forth new requirements for the evaluation of control deficiencies identified during audits. A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. SAS #112 requires the auditor to consider the likelihood of the chance of future events occurring. Because EDD management was not aware of the deficiency until we brought it to their attention and because the error remained uncorrected by the date of our exit conference, it is our opinion that it is reasonably possible that a future event or events will occur and remain undetected.

Additionally, as we explained to EDD, SAS #112 requires the auditor to consider quantitative and qualitative factors when determining the magnitude of the control deficiency. EDD chooses to focus solely on the dollar amount of the deficiency noted in our sample. However, auditors must consider qualitative factors such as the potential effect of the control deficiency on the entity's compliance with

regulatory provisions. OMB Circular A-87 requires the cost of fringe benefits in the form of regular compensation paid to employees during periods of unauthorized absences from the job, such as for sick leave, to be equitably allocated to all related activities, including federal awards. Although EDD has an allocation process to distribute sick leave to all activities, the sick leave hours charged on this time sheet were not included in its process. Moreover, the processing of time sheets is typically a low-dollar but high-frequency event that creates more opportunities for this type of error to occur. Therefore, it is our opinion that the control deficiency we found is more than inconsequential.

Reference Number:	2007-2-1
Federal Catalog Number:	17.503
Federal Program Title:	Occupational Safety and Health—State Program
Federal Award Numbers and Years:	60F6-0090;2006 60F7-0090;2007
Category of Finding:	Allowable Costs/Cost Principles
State Administering Department:	Department of Industrial Relations (Industrial Relations)

Criteria

TITLE 2—GRANTS AND AGREEMENTS, PART 225—COST PRINCIPLES FOR STATE, LOCAL, AND INDIAN TRIBAL GOVERNMENTS (OMB CIRCULAR A-87)

Appendix B to Part 225—Selected Items of Cost

8. Compensation for personal services

   h. Support of salaries and wages. These standards regarding time distribution are in addition to the standards for payroll documentation.

      (1) Charges to Federal awards for salaries and wages, whether treated as direct or indirect costs, will be based on payrolls documented in accordance with generally accepted practice of the governmental unit and approved by a responsible official(s) of the governmental unit.

      (3) Where employees are expected to work solely on a single Federal award or cost objective, charges for their salaries and wages will be supported by periodic certifications that the employees worked solely on that program for the period covered by the certification. These certifications will be prepared at least semi annually and will be signed by the employee or supervisory official having first hand knowledge of the work performed by the employee.

Condition

Industrial Relations lacks adequate controls to ensure that the personal services costs it charges to the California Occupational Safety and Health program (program) are allowable. Specifically, Industrial Relations does not require employees who are expected to work solely on the program to complete required certifications because it indicated that it was not aware of this requirement. As a result, the awarding federal agency has less assurance that the personal services costs charged to the program are valid.

Additionally, in our review of 33 personal services expenditures, we found three instances where Industrial Relations did not ensure that the employees' Absence and Additional Time Worked Report (STD 634) were approved by a responsible official. A personnel officer for Industrial Relations explained that, although the department has procedures to prevent these forms from being filed without an authorizing signature, once in a while an unsigned STD 634 will slip through these procedures undetected. As a result of these lapses in internal control, Industrial Relations has less assurance that the leave information contained in the unsigned reports is accurate. To the extent that the federal award is eventually charged for any monetary distribution of a leave balance, any inaccurate reporting of leave can result in inappropriate charges to the federal award.

Questioned Costs

Unknown

Recommendations

Industrial Relations should ensure that it prepares the required semi-annual certifications for its employees who work solely on that program. Furthermore, Industrial Relations should ensure that, if an STD 634 form is required, its supervisors sign all STD 634 forms for their employees.

Department's View and Corrective Action Plan

Industrial Relations plans to review its STD 634 procedures and retrain staff accordingly. It also indicated that it would contact all attendance reporting officers, managers, and supervisors to reiterate the importance of obtaining all necessary authorizations in a timely manner. Industrial Relations stated that it would contact the U.S. Department of Labor to determine whether the OMB Circular A-87 is applicable to the program. If so, it indicates that it will implement procedures to obtain required certifications.

Reference Number:	2007-3-1
Federal Catalog Number:	17.503
Federal Program Title:	Occupational Safety and Health—State Program
Federal Award Numbers and Years:	60F6-0090;2006 60F7-0090;2007
Category of Finding:	Cash management
State Administering Department:	Department of Industrial Relations (Industrial Relations)

Criteria

TITLE 29—LABOR, PART 97—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 97.21, Payment

> Reimbursement—Reimbursement shall be the preferred method when the requirements [for advances] are not met.

TITLE 31—MONEY AND FINANCE: TREASURY, PART 205—RULES AND PROCEDURES FOR EFFICIENT FEDERAL-STATE TRANSFERS, Section 205.2, Definitions

Pay out funds for Federal Assistance Program Purposes means, in the context of State payments, to debit a State account for the purpose of making a payment to:

(1) A person or entity that is not considered part of the State pursuant to the definition of "State" in this section; or

(2) A State entity that provides goods or services for the direct benefit or use of the payor State entity or the Federal government to further Federal assistance program goals.

Condition

Industrial Relations indicated that it uses the reimbursement method to obtain federal funds for the California Occupational Safety and Health program (program). However, for the monthly drawdowns reviewed, we found that Industrial Relations requested amounts exceeding the actual amounts spent. Furthermore, Industrial Relations obtained two advance payments but had no documentation to indicate that the advances had been approved by the awarding federal agency.

From the program's Federal/State Cash Reconciliation Report (drawdown report) for state fiscal year 2006–07, we selected two of the 12 monthly drawdowns to review. The November 2006 drawdown exceeded Industrial Relations' calculation of the total actual expenditures for the month by more than $360,000. The accounting officer who processes the federal drawdowns stated that she rounds up requested amounts to be sure that the program has enough funds to cover expenditures. Our review of the drawdown report for state fiscal year 2006–07 found that this rounding appears to occur quite frequently.

We also noted that another reason for the difference between actual expenditures and the drawdowns is the discrepancy existing between the two separate accounting reports Industrial Relations uses to determine monthly expenditures. In one month, this discrepancy exceeded $1 million. As evidenced by handwritten notes on the accounting officer's expenditure analysis, it was clear that, rather than discovering what the source of the discrepancy was, she requested reimbursement for a rounded figure that fell between the two accounting report totals. Further, the accounting officer's rounded figures were approved by her immediate supervisor, and based on the circulation of these approvals, would have been known to the Industrial Relations' accounting chief. After our inquiry into the discrepancy between these two reports, Industrial Relations discovered that one of the reports is more accurate to use than the other.

Additionally, based on the timing of the May 2007 drawdown, it was evident that the program obtained a partial advance. Specifically, the date for the May drawdown was May 24, 2007, and the expenditures associated with the drawdown were estimated through May 31, 2007, resulting in an estimated advance of more than $500,000. Our review of the drawdown report indicated that a similar advance was obtained in June 2007. Although Industrial Relations stated that it obtained verbal permission, it could not provide us with any provisions or written approvals indicating that these advance payments were allowable. Furthermore, the individual from whom Industrial Relations stated it obtained permission is not an officer within the Department of Labor but rather an accountant within the federal Department of Health and Human Services' Division of Payment Management System. We question whether this individual could authorize an override of the reimbursement method Industrial Relations uses. By deviating from cash-management regulations, Industrial Relations risks being financially penalized by its federal oversight agency.

Questioned Costs

Not applicable.

Recommendations

Industrial Relations should request reimbursement for only actual expenditures incurred. It should discontinue the practice of rounding up drawdowns and discontinue the use of the second accounting report that is less accurate. If it finds that it needs an advance of funds, Industrial Relations should obtain written authorization prior to doing so and then follow appropriate procedures to reconcile the advance to actual expenditures incurred during that period.

Department's View and Corrective Action Plan

Industrial Relations agrees that reimbursement should only be requested for actual expenditures incurred and, if an advance of funds is needed, a written authorization should first be obtained before any drawdown is made. In addition, Industrial Relations stated that it will establish appropriate procedures to reconcile any advances with actual expenditures.

Reference Number:	2007-8-2
Federal Catalog Number:	17.503
Federal Program Title:	Occupational Safety and Health—State Program
Federal Award Numbers and Years:	60F6-0090;2006 60F7-0090;2007
Category of Finding:	Period of Availability
State Administering Department:	Department of Industrial Relations (Industrial Relations)

Criteria

TITLE 29—LABOR, PART 97—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 97.23, Period of Availability of Funds

(a) General—Where a funding period is specified, a grantee may charge to the award only costs resulting from obligations of the funding period unless carryover of unobligated balances is permitted, in which case the carryover balances may be charged for costs resulting from obligations of the subsequent funding period.

(b) Liquidation of obligations—A grantee must liquidate all obligations incurred under the award not later than 90 days after the end of the funding period (or as specified in a program regulation) to coincide with the submission of the annual Financial Status Report (SF-269). The Federal agency may extend this deadline at the request of the grantee.

TITLE 29—LABOR, PART 97—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart A—General, Section 97.3, Definitions

Obligations means the amounts of orders placed, contracts and subgrants awarded, goods and services received, and similar transactions during a given period that will require payment by the grantee during the same or a future period.

Condition

Industrial Relations lacks adequate controls to ensure that it liquidates all obligations incurred not later than 90 days after the end of the funding period. The funding period of the federal awards used to partially fund the California Occupational Safety and Health program (program) is from October 1 of one year to September 30 of the next year. Although federal regulations require all obligations be liquidated by December 31 (90 days after the end of the funding period), Industrial Relations liquidated more than $140,000 in program obligations from the 2006 federal award after December 31, 2006. It also liquidated roughly $5,000 in program obligations associated with the 2005 federal award during state fiscal year 2006–07, all of which would be outside the period of availability for those funds.

In response to our inquiry regarding these expenditures, Industrial Relations stated that it encumbered funds for valid obligations during the funding period but that there were instances in which invoices were received late. However, as the examples below demonstrate, not all the obligations Industrial Relations created were based on orders placed during the funding period, and it was, in fact, the late placement of orders that contributed to invoices being received after the December 31 deadline.

In our sample of 42 expenditures, we noted that although Industrial Relations prepared a Purchasing Authority Purchase Order (purchase order) on September 28, 2006, (two days before the end of the federal fiscal year 2006), it did not order the computer equipment until November 1, 2006. Thus, a valid obligation for the funding period did not exist. Moreover, the invoice was not paid until May 2007, which is roughly four months beyond the December 31, 2006, deadline.

Because of the unusual nature of this transaction, we performed an analysis of Industrial Relations' purchase order activity. We found that between October 2005 and September 2006, Industrial Relations prepared 118 purchase orders totaling roughly $678,000, of which 24 totaling roughly $310,000 were prepared in September 2006. Of these 24 purchase orders, we selected five, totaling more than $99,000, and reviewed their associated invoices to determine when the actual orders were placed with the vendors. The invoices indicated that actual order placement dates for two of the purchase orders, totaling nearly $56,000, did not occur until October 4, 2006, and October 24, 2006, respectively. For the other three purchase orders, actual order placement dates could not be determined from the invoices. However, based on the examples cited, we are concerned that Industrial Relations is creating a number of obligations at the end of the funding period that are not supported by actual orders placed, but rather orders that it plans to place in the future. By definition, these are not valid obligations for the funding period to which they are being charged. As a result of these obligations and the amounts liquidated outside the period of availability, it appears that Industrial Relations is not in compliance with federal regulations regarding the period of availability.

Questioned Costs

$141,644 federal fiscal year 2006 obligations paid after December 31, 2006.

$5,230 federal fiscal year 2005 obligations paid during state fiscal year 2006–07.

$27,322 federal fiscal year 2006 obligations that were not based on a valid order placed during the funding period.

Recommendation

Industrial Relations must establish procedures to ensure that it only charges to the award costs resulting from valid obligations of the funding period and that it liquidates these obligations not later than 90 days after the end of the funding period.

Department's View and Corrective Action Plan

Industrial Relations agrees with the finding and stated that it will strengthen internal procedures to comply with federal requirements.

Reference Number:	2007-12-4
Federal Catalog Number:	17.503
Federal Program Title:	Occupational Safety and Health—State Program
Federal Award Number and Year:	60F6-0090; 2006
Category of Finding:	Reporting
State Administering Department:	Department of Industrial Relations (Industrial Relations)

Criteria

TITLE 29—LABOR, PART 1954—PROCEDURES FOR THE EVALUATION AND MONITORING OF APPROVED STATE PLANS, Subpart B—State Monitoring Reports and Visits to State Agencies, Section 1954.10, Reports From the States

(a) In addition to any other reports required by the Assistant Secretary under sections 18(c)(8) and 18(f) of the Act and 1902.3(1) of this chapter, the State shall submit quarterly and annual reports as part of the evaluation and monitoring of State programs.

Special provisions outlined in the federal award includes a financial report with the following frequency:

F2. Financial Status Report (SF-269) is due in the Regional Office 30 days after the end of each Federal fiscal quarter. Recipients are to submit two signed originals of the report.

(b) Close-out Reporting. All agreements must be closed 90 days after the end of the performance period (generally December 31). A copy of the Financial Status Report must accompany the recipient's close-out documents.

Condition

Industrial Relations submitted an inaccurate closeout report for the 2006 federal award associated with the California Occupational Safety and Health program (program). Specifically, in its closeout report for the 2006 federal award, Industrial Relations reported it spent the entire fiscal year 2006 award of $23.1 million and had no unliquidated obligations. However, based on data from its accounting records, Industrial Relations actually had $360,000 in unliquidated obligations at the end of December 2006.

According to a senior accounting officer, in preparing the closeout report, prior to December 31 she manually accrues or records as expenditures those unliquidated obligations that program staff indicate will be liquidated by December 31. Specifically, the senior accounting officer downloads an accounting report to identify the accrual adjustments she understands, based on information from the program, are necessary. She does not enter the adjustments into the accounting records, and they are only used to prepare the closeout report. However, this manual accrual process of zeroing out the unliquidated obligations and reporting them as expenditures is inconsistent with federal reporting requirements that Industrial Relations should report the unliquidated obligations on its closeout report.

According to the accounting chief, she was unaware that manual adjustments to the accounting records were being made. However, as the department official responsible for certifying the correctness and completeness of the financial reports, the accounting chief has a responsibility to review the process used to prepare these reports. By not accurately completing the closeout report, Industrial Relations limits the ability of the federal Department of Labor to make appropriate funding decisions.

Questioned Costs

Not applicable.

Recommendations

Industrial Relations should ensure that required financial reports are accurate and supported by its accounting records. Furthermore, Industrial Relations should require the official responsible for certifying the reports to review the underlying documentation prior to the reports being certified.

Department's View and Corrective Action Plan

Industrial Relations agrees that the federal reports it submitted were partly inaccurate because of the manual adjustments described above and agrees that it needs to establish procedures to ensure that it only charges to the award costs resulting from valid obligations of the funding period and that it liquidates the obligations not later than 30 days after the end of the funding period. Industrial Relations stated that its desk procedures have been updated to include the authorized signature or approval of the supervisor and accounting administrator before any adjustments are made.

Reference Number:	2007-12-9
Federal Catalog Number:	17.245
Federal Program Title:	Trade Adjustment Assistance (TAA)
Federal Award Numbers and Years:	TA-15886-07-55-A-6;2007 UI-15787-07-55;2007
Category of Finding:	Reporting
State Administering Department:	Employment Development Department (EDD)

Criteria

TITLE 20—EMPLOYEES' BENEFITS, PART 617—TRADE ADJUSTMENT ASSISTANCE FOR WORKERS UNDER THE TRADE ACT OF 1974, Subpart B—Trade Readjustment Allowances (TRA), Section 617.19, Requirement for Participation in Training

(d) Recordkeeping and reporting.

(1) State agencies must develop procedures for compiling and reporting on the number of waivers issued and revoked, by reason, as specified in paragraphs (b) and (c) of this section, and report such data to the Department of Labor as requested by the Department.

TITLE 20—EMPLOYEES' BENEFITS, PART 617—TRADE ADJUSTMENT ASSISTANCE FOR WORKERS UNDER THE TRADE ACT OF 1974, Subpart G—Administration by Applicable State Agencies, Section 617.57, Recordkeeping; Disclosure of Information

(a) Recordkeeping.

Each State agency will make and maintain records pertaining to the administration of the Act as the Secretary requires and will make all such records available for inspection, examination and audit by such Federal officials as the Secretary may designate or as may be required by law. Such recordkeeping will be adequate to support the reporting of TAA activity on reporting form ETA 563 approved under OMB control number 1205-0016.

TITLE 20—EMPLOYEES' BENEFITS, PART 617—TRADE ADJUSTMENT ASSISTANCE FOR WORKERS UNDER THE TRADE ACT OF 1974, Subpart G—Administration by Applicable State Agencies, Section 617.61, Information, Reports, and Studies

A State agency shall furnish to the Secretary such information and reports and conduct such studies as the Secretary determines are necessary or appropriate for carrying out the purposes of the Act and this part 617.

TRAINING AND EMPLOYMENT GUIDANCE LETTER NO. 23-06, Subject: Instructions for Implementing the Revised ETA-563 Trade Adjustment Assistance (TAA) Quarterly Activities Report

5. Action Required: State Administrators are required to provide the above information to appropriate staff. State Trade Act Coordinators (or the individuals assigned responsibility for submitting reports) are required to prepare and submit quarterly reports according to the instructions attached to this advisory [TEGL 23-06].

Condition

EDD lacks controls to ensure the accuracy of the data in the ETA-563 report that it submits to the U.S. Department of Labor (Federal Labor). Our review found that the ETA-563 report it submitted to Federal Labor for the quarter ending June 30, 2007, was not in compliance with federal requirements. Specifically, EDD did not follow Federal Labor's instructions for reporting the amount spent on training and the number of Trade Adjustment Assistance (TAA) participants co-enrolled in Workforce Investment Act or National Emergency Grant programs. Furthermore, EDD could not demonstrate the accuracy and completeness of the information it received from EDD field offices and used to calculate several figures in the report. As a result, the EDD double-counted reports from two field offices in calculating the figures in the ETA-563 report. Finally, EDD underreported the number of training waivers issued because of an error in summarizing data from the Unemployment Insurance Division's Special Claims Office.

EDD did not follow Federal Labor's instructions for reporting training costs. TEGL 23-06 instructs states to report tuition, transportation, and subsistence payments made to persons in TAA-approved training. The analyst who prepares the ETA-563 report stated that she receives the data from a database at EDD's Special Claims Office. The ETA-563 report for the quarter ending June 30, 2007, showed only $9,805 in training costs; however, EDD's accounting records showed almost $550,000 in institutional training costs for the month of June 2007 alone. The manager of the Special Claims Office said that its database includes only costs that the office approves directly, such as relocation assistance and transportation.

EDD also did not follow Federal Labor's instructions for reporting the number of TAA participants co-enrolled in the Workforce Investment Act Dislocated Worker and/or National Emergency Grants programs. TEGL 23-06 instructs states to report the number of individuals co-enrolled in these programs. The analyst who prepared the ETA-563 report stated that TAA staff instructed her to obtain this information from the Trade Act Participant Report (TAPR). The TAPR is a report of all participants who have left the program during a particular quarter. The database field the analyst used to identify participants within the quarter ending June 30, 2007, corresponded to the participant's "termination date." Therefore, EDD reported the co-enrollment status only of those participants who left the program and did not report the total number of participants who were co-enrolled in the other programs.

Further, EDD could not demonstrate the accuracy and completeness of the information it received from EDD field offices that was used to calculate several figures in the ETA-563 report. EDD field offices electronically submit a spreadsheet that summarizes information on TAA applicants to the analyst who prepares the ETA-563 report. The analyst compiles this information for reporting purposes. We identified two instances where the analyst counted information from two field offices twice. Additionally, when asked to compare the field offices on the analyst's checklist used to track those field offices submitting their data, the analyst identified some that did not submit their information.

Finally, the EDD underreported the number of training waivers issued. The TEGL 23-06 instructs states to report the number of training waivers issued using six reason codes, such as health issues or training not available. For five of the six codes, EDD underreported the number of waivers issued, resulting in a total of roughly 300 waivers that were not reported. According to the analyst, the pivot table used to calculate the number of waivers did not pick up the data for the new quarter. Until EDD establishes controls over the preparation of the ETA-563 report, errors and omissions of data such as those we identified will continue to go undetected.

Questioned Costs

Not applicable.

Recommendation

EDD should review Federal Labor's instructions for completing the ETA-563 report and establish controls that include, at a minimum, supervisory review and approval of the data contained in the ETA-563 report it submits to Federal Labor.

Department's View and Corrective Action Plan

The Workforce Services and Unemployment Insurance Branches are taking the following steps:

1. California is currently forming a workgroup with representation from WSB, One Stop areas and Unemployment Insurance (UI) to look at developing processes to co-enroll UI claimants and TAA participants with the local one stop. The charge of this team is reviewing State and local policies around services to Trade-affected workers and making recommendations for improvement. From this effort we are expecting to establish local models that will expand services through this integrated customer pool.

2. Data collection for the TAA program is being consolidated into the Job Training Automation system, the data collection system used to manage client information under the WIA. This will allow for integrated reporting of TAA client services between the WIA and the Job Services' staff who provide direct services to these customers, enable co-enrollment, and eliminate the need for duplicate data collection across these programs for TAA customers. This will include information currently reported and managed by the Special Claims Office (850).

3. When program policy recommendations are approved state- and local-level staff will receive training on the new policy and procedures. This should improve the quality of the data reported.

Reference Number:	2007-12-10
Federal Catalog Number:	17.245
Federal Program Title:	Trade Adjustment Assistance
Federal Award Numbers and Years:	TA-15886-07-55-A-6;2007 UI-15787-07-55;2007
Category of Finding:	Reporting
State Administering Department:	Employment Development Department (EDD)

Criteria

TITLE 20—EMPLOYEES' BENEFITS, PART 617—TRADE ADJUSTMENT ASSISTANCE FOR WORKERS UNDER THE TRADE ACT OF 1974, Subpart G—Administration by Applicable State Agencies, Section 617.61, Information, Reports, and Studies

A State agency shall furnish to the Secretary such information and reports and conduct such studies as the Secretary determines are necessary or appropriate for carrying out the purposes of the Act and this part 617.

EMPLOYMENT AND TRAINING ADMINISTRATION, OMB Control Number 1205-0392, *Trade Act Participant Report* (TAPR): General Reporting Instructions and Specifications, Revised 2006

I. GENERAL INSTRUCTIONS

States are required to maintain standardized individual records containing characteristics, activities and outcomes information for all individuals who receive services or benefits financially assisted by the Trade Adjustment Assistance (TAA) program (Trade Adjustment Assistance Reform Act of 2002 (P.L. 107-210) 20 CFR 617.57 and 617.61).

These individual records are collectively known as the Trade Act Participant Report (TAPR).

Condition

The U.S. Department of Labor (Federal Labor) requires EDD to submit electronic TAPR files no later than 45 calendar days after the end of each quarter of reporting. Our review found that EDD's reporting for the first calendar quarter of 2007 contained errors. It includes information on participants who exited the program in the fourth calendar quarter of 2005. According to EDD's staff programmer analyst (analyst), he submitted the report to Federal Labor on May 15, 2007.

The U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement issued in March 2007, suggests auditors focus on eight of the 58 line items shown on the TAPR that contain critical information. Our review of a sample of 35 TAA participants found exceptions related to two of the eight line items. Specifically, the wage data for the "first quarter following exit" line item for one participant was underreported by $4,500.

We also found 10 instances where participants who had wages were reported as not having wages in the "third quarter following exit" line item. It appears that the analyst who prepared the TAPR used data from the fourth quarter of 2006 instead of the second quarter of 2007. According to the analyst, this was the most recent data to which he was granted access in order to complete the TAPR. Until the analyst receives access to the appropriate data, EDD's TAPR will not accurately describe the outcomes of the individuals served by the TAA program.

Questioned Costs

Not applicable.

Recommendation

EDD should ensure that it uses the appropriate data to prepare the TAPR.

Department's View and Corrective Action Plan

The Workforce Services Branch (WSB) is reviewing the TAPR reporting system and related documents are being reviewed and revised. The Unemployment Insurance Branch, as needed, will be working along with WSB. Among the areas of study will be to ensure that the appropriate data is entered into the TAPR so that the identified deficiency is dealt with and the correct data is reported. We will have a target date for completion of these changes by the end of the third quarter of 2008.

Reference Number:	2007-12-11
Federal Catalog Numbers:	17.801 & 17.804
Federal Program Titles:	Disabled Veterans' Outreach Program (DVOP); Local Veterans' Employment Representative (LVER)
Federal Award Number and Year:	E-9-5-6-5085;2006
Category of Finding:	Reporting
State Administering Department:	Employment Development Department (EDD)

Criteria

TITLE 29—CODE OF FEDERAL REGULATIONS, PART 97—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 97.20, Standards for Financial Management Systems

(a) A State must expend and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contractors, must be sufficient to—

(1) Permit preparation of reports required by this part and the statutes authorizing the grant.

VETERANS PROGRAM LETTER NO. 02-06

Subject: Jobs for Veterans State Grant Reporting

V. Summary of Changes:

- All expenditures for LVER Activities, TAP, Incentive Awards and LVER Special Initiatives will be reported on the SF 269A report
- All expenditures for DVOP Activities and DVOP Special Initiatives will be reported on the DVOP SB 269A

Condition

Our review of two SF 269A reports EDD submitted to the U.S. Department of Labor (Federal Labor) revealed errors in calculating indirect costs for the DVOP and LVER programs. In the DVOP's final SF 269A report for federal fiscal year 2006, EDD reported $1,667,422 in indirect costs for the program. However, using the methodology described by an EDD budget analyst, we calculated indirect costs to be $2,113,787, a difference of $446,365. In the LVER program's final SF 269A report for federal fiscal year 2006, EDD reported $714,394 in indirect costs and we calculated $847,316, a difference of $132,922. EDD's budget analyst confirmed our figures and stated that a portion of each error was due to adjustments to the indirect costs that were not reported on the SF 269A. He also stated that a portion of each error was due to an error in the fourth quarter report that carried over into the final report. EDD made Federal Labor aware of these errors, and Federal Labor did not require it to submit a revised final report for federal fiscal year 2006.

According to a manager in its budget unit, the EDD has no written procedures for completing the SF 269A, and verifying the indirect cost calculations before submission was not part of the regular management review of the SF 269A. The manager also stated that, as of July 2007, the budget unit has

instituted a process where a second analyst will verify the calculations on the report. Although this will help to ensure future reports are in compliance, the lack of standard, written procedures for calculating indirect costs could continue to lead to future errors.

Questioned Costs

Not applicable.

Recommendation

EDD should create written procedures describing its process for preparing, reviewing, and approving the SF 269A report.

Department's View and Corrective Action Plan

The Bureau of State Audits (BSA) finding is correct that the indirect costs were underreported in the expenditure detail addendum to the SF-269A. However, to clarify the nature of the finding, it is important to note that the *total* costs reported to the Department of Labor (DOL) for the DVOP and LVER programs were correct. The expenditure detail addendum of the SF-269A categorizes the total costs into two subsets: direct charges and indirect charges. For the Federal fiscal year 2006, the indirect charges were underreported, but the amount underreported in the indirect charges category was reported in the direct charges category. When the EDD provided copies of the reports to the BSA for audit review, the EDD advised BSA of the calculation. Additionally, when the EDD discovered that a portion of the costs reported as direct charges should have been reported as indirect charges, the EDD asked the Director of Veterans' Employment and Training (DVET) if a corrected reported was needed. The DVET advised EDD that an amended report was not necessary.

To address and prevent future erroneous categorization of costs, the EDD instituted an additional step in the process of preparing and reviewing the SF-269A. Since July 2007, a second analyst verifies the calculations and reviews the line item reporting of the cost categories.

As the BSA recommends, the EDD will create written procedures for preparing, reviewing, and approving the SF-269A report. The EDD has already begun drafting the procedures and anticipates that final written procedures will be completed by the next Veterans quarterly report due date.

U.S. DEPARTMENT OF TRANSPORTATION

Reference Number:	2007-7-7
Federal Catalog Number:	20.505
Federal Program Title:	Federal Transit Metropolitan Planning Grants/ Consolidated Planning Grants
Federal Award Number and Year:	None; State fiscal year 2006–07
Category of Finding:	Matching
State Administering Department:	Department of Transportation (Caltrans)

Criteria

TITLE 49—TRANSPORTATION, SUBTITLE III—GENERAL AND INTERMODAL PROGRAMS, CHAPTER 53—MASS TRANSPORTATION, Section 5305, Planning Programs

(f) Government's Share of Costs.—The Government's share of the cost of an activity funded using amounts made available under this section may not exceed 80 percent of the cost of the activity unless the Secretary determines that it is in the interests of the Government not to require a State or local match.

TITLE 23—HIGHWAYS, PART 420—PLANNING AND RESEARCH PROGRAM ADMINISTRATION, Subpart A—Administration of FHWA Planning and Research Funds, Section 420.121, What Other Requirements Apply to the Administration of FHWA Planning and Research Funds?

(m) *Subgrants to local governments.* The State DOTs and subrecipients are responsible for administering FHWA planning and research funds passed through to MPOs and local governments, for ensuring that such funds are expended for eligible activities, and for ensuring that the funds are administered in accordance with this part, 49 CFR part 18, Uniform Administrative Requirements for Grants and Agreements to State and Local Governments, and applicable OMB cost principles. The State DOTs shall follow State laws and procedures when awarding and administering subgrants to MPOs and local governments and must ensure that the requirements of 49 CFR 18.37(a) have been satisfied.

TITLE 49—TRANSPORTATION, PART 18—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements Financial Administration, Section 18.24, Matching or Cost Sharing

(a) *Basic rule: Costs and contributions acceptable.* With the qualifications and exceptions listed in paragraph (b) of this section, a matching or cost sharing requirement may be satisfied by either or both of the following:

(1) Allowable costs incurred by the grantee, subgrantee or a cost-type contractor under the assistance agreement. This includes allowable costs borne by non-Federal grants or by other cash donations from non-Federal third parties.

(2) The value of third party in-kind contributions applicable to the period to which the cost sharing or matching requirements apply.

Condition

Caltrans requires its subrecipients, metropolitan planning organizations (MPOs), to show at least the mandatory local match amount for each work element presented on their requests for reimbursement. However, Caltrans does not have a process in place to ensure that MPO local matches originate only from allowable sources and meet the allowable cost/cost principles requirements. Specifically, according to its associate transportation planner, neither the Caltrans Office of Regional Interagency Planning (ORIP) staff, who oversee the program for the State, nor the district offices verify that the MPOs draw their local matches only from allowable sources that meet the allowable cost/cost principles requirements.

Additionally, according to its audit manager, during Caltrans' incurred cost audits, staff review the MPOs' local matches to ensure that the amounts and fund sources are allowable and supported properly. However, she also stated that an incurred cost audit is generally performed on one MPO annually pursuant to a risk analysis, and that none were completed during fiscal year 2006–07. Consequently, Caltrans has no assurance that the MPOs complied with the local match requirements.

Questioned Costs

Not applicable.

Recommendations

Caltrans should establish policies and procedures that require its district offices to review periodically the MPOs' invoices and supporting financial records that detail the source of the funds used to meet their local match obligation. The district offices should then retain the documentation and report the results to ORIP.

Department's View and Corrective Action Plan

Caltrans stated that it will utilize a series of procedures to ensure that the district offices review periodically the MPOs' invoices and supporting financial records that detail the source of the funds used to meet their local match obligation. The procedures will include adding additional language to the invoicing process that will require the MPOs to certify that no federal funds have been used to meet their local match obligation and that receipts substantiating the source of the local match are included with the invoices. The district offices will be required to retain the documentation and report to the ORIP.

U.S. DEPARTMENT OF VETERANS AFFAIRS

Reference Number:	2007-12-1
Federal Catalog Number:	64.114
Federal Program Title:	Veterans Housing—Guaranteed and Insured Loans
Federal Award Number and Year:	None; State fiscal year 2006–07
Category of Finding:	Reporting
State Administering Department:	California Department of Veterans Affairs (Veterans Affairs)

Criteria

TITLE 38—PENSIONS, BONUSES, AND VETERANS' RELIEF, PART 36—LOAN GUARANTY, Section 4315, Notice of Default and Acceptability of Partial Payments, (a)(1) Reporting of Defaults

The holder of any guaranteed or insured loan shall give notice to the Secretary within 45 days after any debtor is in default by reason of nonpayment of any installment for a period of 60 days from the date of first uncured default.

Condition

Veterans Affairs is approved by the U.S. Department of Veterans Affairs (department) to offer department-guaranteed home loans to eligible veterans. During state fiscal year 2006–07, Veterans Affairs held 54 department-guaranteed loans for which the homeowner became 60 days delinquent in payment, but it only notified USDVA of eight (15 percent) of these delinquencies.

According to its manager, Veterans Affairs had a verbal policy among its staff that submission of default notices to the department was not required if there was sufficient equity in a home with a delinquent loan because Veterans Affairs would not file a claim with the department. However, if there was insufficient equity in a home with a delinquent loan, Veterans Affairs would submit a default notice to the department so as not to incur a loss on the loan.

Although the Veterans Affairs manager initially indicated that this policy was verbally approved by a department representative, Veterans Affairs subsequently contacted the department, and was informed that it should notify the department of every default, as required, so that it can contact the delinquent borrower and engage in activities designed to prevent foreclosures. By not providing the default notices to the department as required, Veterans Affairs denied the department the opportunity to contact the delinquent borrowers and offer them additional services.

Questioned Costs

Not applicable.

Recommendation

Veterans Affairs should notify the department of each 60-day delinquency on department-guaranteed loans as required.

Department's View and Corrective Action Plan

Veterans Affairs manager stated that due to a declining housing market, it has changed its business practices and the old policy no longer applies.

Reference Number:	2007-12-2
Federal Catalog Number:	64.114
Federal Program Title:	Veterans Housing—Guaranteed and Insured Loans
Federal Award Number and Year:	None; State fiscal year 2006–07
Category of Finding:	Reporting
State Administering Department:	California Department of Veterans Affairs (Veterans Affairs)

Criteria

TITLE 38—PENSIONS, BONUSES, AND VETERANS' RELIEF, PART 36—LOAN GUARANTY, Section 4317, Notice of Intention to Foreclose

Except upon the express waiver of the U.S. Department of Veterans Affairs (department), a holder of a department-guaranteed home loan shall not begin proceedings in court or give notice of sale under power of sale, or otherwise take steps to terminate the debtor's rights in the security until the expiration of 30 days after the delivery by registered mail to the department of a notice of intention to take such action.

Condition

Veterans Affairs is approved by the department to offer department-guaranteed home loans to eligible veterans. During state fiscal year 2006–07, Veterans Affairs foreclosed on the homes of four veterans having department-guaranteed home loans, but it only provided the department with notice of two of these foreclosures.

According to its manager, Veterans Affairs did not submit the required foreclosure notices because the homes in question had sufficient equity and it did not foresee needing to file a claim with the department for any losses on the foreclosures. However, this practice does not align with federal regulations or Veterans Affairs' own written policies. By not notifying the department of its intent to foreclose, Veterans Affairs did not give the department the option to engage in activities designed to help the borrowers avoid foreclosure on their homes.

Questioned Costs

Not applicable.

Recommendation

Veterans Affairs should not foreclose on a department-guaranteed home loan until 30 days after it has notified the department of its intent to foreclose.

Department's View and Corrective Action Plan

Veterans Affairs agrees that notices of foreclosure should have been sent to the department in the instances we identified and indicates that, in the future, it plans on submitting all such notices as required.

THE CORPORATION FOR NATIONAL AND COMMUNITY SERVICE

Reference Number:	2007-1-1
Federal Catalog Number:	94.006
Federal Program Title:	AmeriCorps
Federal Award Numbers and Years:	03ACHCA001;2003 03AFHCA002;2003 06ACHCA001;2006 06AFHCA001;2006
Category of Finding:	Activities Allowed/Allowable Costs
State Administering Department:	CaliforniaVolunteers

Criteria

TITLE 45—PUBLIC WELFARE, PART 2541—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, SECTION 2541.200, Standards for Financial Management Systems

(a) A State must expend and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contractors, must be sufficient to—

(2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

TITLE 45—PUBLIC WELFARE, PART 2541—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, SECTION 2541.400, Monitoring and Reporting Program Performance

(a) Monitoring by grantees. Grantees are responsible for managing the day-to-day operations of grant and subgrant supported activities. Grantees must monitor grant and subgrant supported activities to assure compliance with applicable Federal requirements and that performance goals are being achieved. Grantee monitoring must cover each program, function or activity.

Condition

CaliforniaVolunteers' processes do not ensure that subgrantees' expenses are only for allowable activities and costs. Specifically, CaliforniaVolunteers allows its subgrantees to submit invoices for reimbursement of expenses either monthly or quarterly. Subgrantees must also submit a periodic expense report (PER) with their invoices that includes summary-level expense data. CaliforniaVolunteers processes the subgrantee invoices without routinely reviewing any supporting documentation to verify the allowability of the activities or costs. Instead, CaliforniaVolunteers has established a policy that includes an invoice validation process that requires its fiscal unit to review a sample of invoices submitted by each subgrantee once during their three-year grant period. However, CaliforniaVolunteers did not conduct invoice validation for the roughly $30 million in expenses incurred by it's subgrantees during fiscal year 2006–07.

CaliforniaVolunteers stated that the last time an invoice validation was completed was in the fall of 2006. This invoice validation was done for all programs in existence during the 2004–05 AmeriCorps program year. It also stated that the period covered by the audit of the Bureau of State Audits includes portions of the 2005–06 and 2006–07 AmeriCorps program years, and any of the subgrantee programs that were active during these program years were reviewed during the last invoice validation. Finally, CaliforniaVolunteers stated that those subgrantee programs that are new since the 2004–05 program

year have not yet completed the three-year cycle. Therefore, although an invoice validation was not available for review during the time period covered by the scope of this audit, CaliforniaVolunteers was in compliance with its existing policies on the timing and performance of the invoice validation process.

Nevertheless, although CaliforniaVolunteers is in compliance with its policy, the policy is ineffective because it does not ensure that CaliforniaVolunteers reviews the subgrantee expenses annually to determine the allowability of subgrantees' activities and costs.

Questioned Costs

Unknown

Recommendation

CaliforniaVolunteers should strengthen its invoice validation process to ensure federal funds awarded are expended only for allowable activities and costs.

Department's View and Corrective Action Plan

CaliforniaVolunteers stated that it is updating its policies and procedures to replace the current invoice validation process with new procedures that will result in a more complete "Fiscal Desk Review" process. This new policy will establish the following:

— A schedule for the timing of completion of these reviews that ensures that a set of subgrantees are reviewed annually;

— How much underlying documentation to request and review;

— Procedures for documenting the review of specific issues, such as checking for allowable costs, activities, match documentation, and earmarking;

— Procedures for addressing findings made during an invoice validation;

— Management review and approval of this process.

Part of this policy will ensure that a Fiscal Desk Review process occurs each year for a set of CaliforniaVolunteers' subgrantees (approximately one-third). Therefore, in any given fiscal year, underlying documentation for a sample of the subgrantees will be reviewed to verify allowable activities and costs. The new Fiscal Desk Review process will require subgrantees to submit more underlying documentation, and will require them to be reviewed early in their three-year grant cycle. Any findings from this review will result in a documented corrective action plan and follow-up monitoring or reviews as appropriate. The new Fiscal Desk Review process will be implemented during the 2007–08 fiscal year.

Reference Number:	2007-7-1
Federal Catalog Number:	94.006
Federal Program Title:	AmeriCorps
Federal Award Numbers and Years:	03ACHCA001;2003 03AFHCA002;2003 06ACHCA001;2006 06AFHCA001;2006
Category of Finding:	Earmarking
State Administering Department:	CaliforniaVolunteers

Criteria

TITLE 45—PUBLIC WELFARE, PART 2541—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, SECTION 2541.200, Standards for Financial Management Systems

(a) A State must expend and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contractors, must be sufficient to—

(2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

2006 AMERICORPS GRANT PROVISIONS, Section V—General Provisions

B. FINANCIAL MANAGEMENT STANDARDS.

1. General. The grantee must maintain financial management systems that include standard accounting practices, sufficient internal controls, a clear audit trail and written cost allocation procedures, as necessary. Financial management systems must be capable of distinguishing expenditures attributable to this grant from expenditures not attributable to this grant. The systems must be able to identify costs by programmatic year and by budget category and to differentiate between direct and indirect costs or administrative costs. For further details about the grantee's financial management responsibilities, refer to OMB Circular A-102 and its implementing regulations (45 C.F.R.§2543) or A-110 and its implementing regulations (45 C.F.R.§2541), as applicable.

APPLICATION INSTRUCTIONS FOR STATE COMMISSIONS: AMERICORPS STATE AND TERRITORY COMPETITIVE EDUCATION AWARD PROGRAM AND FORMULA GRANTS, Section V—Grant Requirements, Part D—Subgrant Administrative Cost Allocation

Since we provide direct administrative funding and program development assistance and training funds to support your operations, we strongly encourage you to provide the full 5 percent allowed for administrative funds to your operating programs. However, the commission may retain up to 1 percent for this purpose.

Any administrative funds you retain must be solely in support of the AmeriCorps programs from which you have retained them. Your accounting system must track and allocate these administrative funds separately. Please see Appendix E of the Application Instructions for guidance in calculating your administrative costs.

Condition

CaliforniaVolunteers lacks an adequate process to identify separately its administrative expenditures in its accounting records. Specifically, although CaliforniaVolunteers produced handwritten notes and a spreadsheet that identify the 1 percent administrative cost allocation, it does not track and allocate these administrative funds separately in its accounting records. As a result, we are unable to trace the reimbursement of the Corporation for National and Community Service (Corporation) to the CaliforniaVolunteers' accounting records.

Additionally, CaliforniaVolunteers' process for requesting funds from the Corporation lacks documentation of its review and approval of the request. CaliforniaVolunteers lumps the expenditures associated with the AmeriCorps 1 percent administrative earmark with the expenditures associated with another grant it receives from the Corporation into one program cost account (PCA) in its accounting records. CaliforniaVolunteers stated a former employee initially established this process, and no specific documentation of the approval process was maintained. Until CaliforniaVolunteers establishes a process to track these administrative funds separately, there is no way to ensure that the administrative expenditures claimed for the AmeriCorps grant relate solely to this grant.

Questioned Costs

Unknown

Recommendation

CaliforniaVolunteers should develop procedures to ensure it tracks separately the 1 percent administrative cost allocation in its accounting records.

Department's View and Corrective Action Plan

CaliforniaVolunteers stated it has established a separate PCA in its accounting system to track the 1 percent administrative cost allocation. This PCA is used on its invoice coding system to separately identify expenditures for this account, on staff timesheets to separately identify staff time charged to this account, and on the CaliforniaVolunteers' internal budget documents to ensure that these funds are only spent for allowable activities. These changes were implemented beginning in fiscal year 2007–08.

CaliforniaVolunteers has also developed a process for documenting the approval for requesting federal funds to cover state operations expenditures, including the 1 percent administrative cost allocation. The following is a summary of this process: On a monthly basis, the CaliforniaVolunteers' Director of Finance and Administration reviews the accounting system reports from the prior month to ensure that expenditures were appropriately categorized and determines what federal reimbursements are necessary. This person then fills out a form titled "Federal Draws to be applied to California Volunteers Expenditures for State Operations." This chart indicates the PCA, the amount of expenditures reported on the accounting system monthly report, the fiscal year of the expenditure, the federal award that the funds should be drawn against, and provides a place for notes regarding the draws for the month indicated. The following statement is at the bottom of the form: "The OPR Accounting Officer is authorized to draw funds from the federal grant awards indicated above for the expenditures listed above during this month." This form is then signed by the Director of Finance and Administration and sent to the Accounting Officer. The Director of Finance and Administration maintains a copy of this form and the supporting documentation of the expenditure data referenced for that month. This process was implemented beginning in fiscal year 2007–08.

Reference Number:	2007-7-2
Federal Catalog Number:	94.006
Federal Program Title:	AmeriCorps
Federal Award Numbers and Years:	03ACHCA001;2003 03AFHCA002;2003 06ACHCA001;2006 06AFHCA001;2006
Category of Finding:	Matching
State Administering Department:	CaliforniaVolunteers

Criteria

TITLE 45—PUBLIC WELFARE, PART 2521—ELIGIBLE AMERICORPS SUBTITLE C PROGRAM APPLICANTS AND TYPES OF GRANTS AVAILABLE FOR AWARD, Subpart 2521.35—Who Must Comply With Matching Requirements?

(a) The matching requirements described in §§2521.40 through 2521.95 apply to you if you are a subgrantee of a State commission or a direct program grantee of the Corporation. These requirements do not apply to Education Award Programs.

(b) If you are a State commission, you must ensure that your grantees meet the match requirements established in this part, and you are also responsible for meeting an aggregate overall match based on your grantees' individual match requirements.

TITLE 45—PUBLIC WELFARE, PART 2521—ELIGIBLE AMERICORPS SUBTITLE C PROGRAM APPLICANTS AND TYPES OF GRANTS AVAILABLE FOR AWARD, Subpart 2521.45—What Are the Limitations on the Federal Government's Share of Program Costs?

(b) Program operating costs. The Corporation share of program operating costs may not exceed 67 percent. These costs include expenditures (other than member support costs described in paragraph (a) of this section) such as staff, operating expenses, internal evaluation, and administration costs.

(1) You may provide your share of program operating costs with cash, including other Federal funds (as long as the other Federal agency permits its funds to be used as match), or third party in-kind contributions.

(2) Contributions, including third party in-kind must:

(i) Be verifiable from your records;

(ii) Not be included as contributions for any other Federally assisted program;

(iii) Be necessary and reasonable for the proper and efficient accomplishment of your program's objectives; and

(iv) Be allowable under applicable OMB cost principles.

Condition

CaliforniaVolunteers processes do not adequately ensure that only allowable sources were used by its subgrantees to meet the matching requirements. CaliforniaVolunteers requires subgrantees to obtain memorandums of understanding (MOUs) from all partners who have made cash commitments to their program or who are supporting unstipended members prior to entering into a contract with CaliforniaVolunteers. Three of the 12 subgrantee files tested were missing MOUs. CaliforniaVolunteers

has found that, at the time of contracting, some MOUs are not ready for submission, primarily due to some subgrantees requiring board approval and board meetings are not scheduled until the next quarter. In this situation CaliforniaVolunteers processes a contract without the MOU and requires its senior program officer to follow up with the subgrantee to complete the file. According to CaliforniaVolunteers, former staff who were responsible for their oversight did not diligently maintain these three files.

Furthermore, CaliforniaVolunteers does not review the underlying documentation that supports the expenses used for matching as reported on the subgrantee's periodic expense report (PER) to ensure they are from allowable sources. Instead, CaliforniaVolunteers has established a policy that includes an invoice validation process that requires its fiscal unit to review a sample of invoices submitted by each subgrantee once during its three-year grant period. CaliforniaVolunteers did not conduct invoice validation of the match amounts reported on the subgrantees' PER during fiscal year 2006–07. Consequently, CaliforniaVolunteers has no assurance that subgrantee match amounts, as reported on the PER, are from allowable sources.

Questioned Costs

Unknown

Recommendation

CaliforniaVolunteers should strengthen its current policies and procedures regarding its subgrantees' cash commitments and its invoice validation process to ensure match contributions are met and are from an allowable source.

Department's View and Corrective Action Plan

CaliforniaVolunteers stated it would no longer process any contracts for subgrantees until it receives their MOUs with partners who have made cash commitments. This change has been implemented beginning with the 2007–08 program year contracts.

CaliforniaVolunteers stated that it is updating its policies and procedures to replace the current invoice validation process with new procedures that will result in a more complete "Fiscal Desk Review" process. This new policy will establish the following:

— A schedule for the timing of completion of these reviews that ensures that a set of subgrantees is reviewed annually;

— How much underlying documentation to request and review;

— Procedures for documenting the review of specific issues, such as checking for allowable costs, activities, match documentation, and earmarking;

— Procedures for addressing findings made during an invoice validation;

— Management review and approval of this process.

Part of this policy will ensure that a Fiscal Desk Review process occurs each year for a set of CaliforniaVolunteers' subgrantees (approximately one-third). Therefore, in any given fiscal year, underlying documentation for a sample of the subgrantees will be reviewed to verify allowable activities and costs. The new Fiscal Desk Review process will require subgrantees to submit more underlying documentation, and will require them to be reviewed early in their three-year grant cycle. Any findings from this review will result in a documented corrective action plan and follow-up monitoring or reviews as appropriate. The new Fiscal Desk Review process will be implemented during the 2007–08 fiscal year.

Reference Number:	2007-8-1
Federal Catalog Number:	94.006
Federal Program Title:	AmeriCorps
Federal Award Numbers and Years:	03ACHCA001;2003 03AFHCA002;2003
Category of Finding:	Period of Availability
State Administering Department:	CaliforniaVolunteers

Criteria

TITLE 45—PUBLIC WELFARE, PART 2541—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart 2541.230—Period of Availability of Funds

(a) General. Where a funding period is specified, a grantee may charge to the award only costs resulting from obligations of the funding period unless carryover of unobligated balances is permitted, in which case the carryover balances may be charged for costs resulting from obligations of the subsequent funding period.

(b) Liquidation of obligations. A grantee must liquidate all obligations incurred under the award not later than 90 days after the end of the funding period (or as specified in a program regulation) to coincide with the submission of the annual Financial Status Report (SF-269). The Federal agency may extend this deadline at the request of the grantee.

Condition

Our review of the CaliforniaVolunteers accounting records between April 1, 2007, and June 30, 2007, identified 13 invoices totaling $2.2 million that were paid more than 90 days after the end of the grant funding period. CaliforniaVolunteers explained that in June 2006 the Corporation for National and Community Service (Corporation) requested that it estimate the amount of unused competitive grant funds that would be remaining at the end of the 2006–2007 program year so that the Corporation could redistribute the funds. The Corporation warned CaliforniaVolunteers to be conservative in estimating the unused amount because it could not reverse the process. CaliforniaVolunteers stated that its chief financial officer at the time estimated 7 percent of the funds, or $3.6 million would be unused. After the end of the program year, CaliforniaVolunteers realized that there would not be enough funds left to pay all subgrantee obligations. Once it identified the problem, CaliforniaVolunteers began communicating with the Corporation regarding how to resolve the funding problem. Although the documentation provided to the Bureau of State Audits indicates that the Corporation worked with CaliforniaVolunteers to transfer funds from its formula grant to cover the subgrantee obligations, it also indicates the Corporation did not provide CaliforniaVolunteers with an official closeout extension letter. Without adequate procedures in place, CaliforniaVolunteers cannot ensure that a similar error will not occur in the future.

Questioned Costs

$2,218,471.69

Recommendation

CaliforniaVolunteers should communicate with its subgrantees regarding their estimate of unused funds remaining at the end of the funding periods prior to submitting estimates to the Corporation in the future.

Department's View and Corrective Action Plan

CaliforniaVolunteers stated that, in the future, if the Corporation requests it to report on available unused funds that were previously obligated to subgrantees, it will only report on funds that have been verified to be returned by subgrantees as a result of program completion, budget changes, repayments, or other situations where a program will not be using all funds included in their original contract. CaliforniaVolunteers stated it has put into place a system for tracking these unused funds for all subgrantees on a monthly basis.

Reference Number:	2007-12-3
Federal Catalog Number:	94.006
Federal Program Title:	AmeriCorps
Federal Award Numbers and Years:	03ACHCA001;2003 06ACHCA001;2006
Category of Finding:	Reporting
State Administering Department:	CaliforniaVolunteers

Criteria

2006 AMERICORPS GRANT PROVISIONS, SECTION IV—AMERICORPS SPECIAL PROVISION, Section N—Reporting Requirements

1. Financial Status and Progress Reports. Progress and Financial Status reporting requirements in these Provisions apply only to the grantee. Grantees are required to review, analyze, and follow up on progress and financial status reports they receive from AmeriCorps sub-grantees or operating sites. Each grantee must submit Progress and Financial Status Reports by the required due dates.

Condition

CaliforniaVolunteers lacks adequate processes to ensure that it meets federal reporting requirements. CaliforniaVolunteers' staff were not able to demonstrate how it arrived at the unliquidated obligations amount reflected on the Financial Status Reports submitted to the Corporation for National and Community Service (Corporation) during fiscal year 2006–2007. Specifically, CaliforniaVolunteers could not determine how unliquidated obligations of $3.5 million for grant award 03ACHCA001during the period of April 1, 2006, through September 30, 2006, and $21.5 million for grant award 06ACHCA001 during the period of July 10, 2006, through March 31, 2007, were calculated. CaliforniaVolunteers stated these reports were prepared by a former employee, and its current employees could not determine how the amounts were calculated because they are inconsistent, appear to reflect point-in-time data, and lack supporting documentation. Until CaliforniaVolunteers establishes a standard process for preparing federal financial reports, which includes the retention of the documents it uses to prepare the reports, it cannot demonstrate that it is meeting federal reporting requirements.

Questioned Costs

Not applicable.

Recommendation

CaliforniaVolunteers should develop a standard process to ensure the unliquidated obligations of federal grant awards it reports to the Corporation on its Financial Status Report are accurate, complete, and properly supported.

Department's View and Corrective Action Plan

CaliforniaVolunteers stated it has implemented a standard methodology for calculating and reporting unliquidated obligations on the Financial Status Reports submitted to the Corporation. This methodology is based on identifying the total amount of funds obligated to subgrantees through contracts with CaliforniaVolunteers and subtracting from that amount the total expenses reported against those obligations to date through the reporting period. In addition, CaliforniaVolunteers has implemented a process for ensuring that the underlying documentation of the data and calculations supporting Financial Status Reports are maintained in a complete and consistent manner. This process was implemented beginning with the Financial Status Reports submitted to the Corporation on October 31, 2007, which reported on the period from April 1, 2007, through September 30, 2007.

Reference Number:	2007-13-1
Federal Catalog Number:	94.006
Federal Program Title:	AmeriCorps
Federal Award Numbers and Years:	03ACHCA001;2003 03AFHCA002;2003 06ACHCA001;2006 06AFHCA001;2006
Category of Finding:	Subrecipient Monitoring
State Administering Department:	CaliforniaVolunteers

Criteria

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133, *AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS* (OMB CIRCULAR A-133), Subpart D—Federal Agencies And Pass-Through Entities, Section .400, Responsibilities,

(d) Pass-through entity responsibilities. A pass-through entity shall perform the following for the Federal awards it makes:

(1) Identify Federal awards made by informing each subrecipient of CFDA title and number, award name and number, award year, if the award is R&D, and name of Federal agency. When some of this information is not available, the pass-through entity shall provide the best information available to describe the Federal award.

(2) Advise subrecipients of requirements imposed on them by Federal laws, regulations, and the provisions of contracts or grant agreements as well as any supplemental requirements imposed by the pass-through entity.

(3) Monitor the activities of subrecipients as necessary to ensure that Federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.

TITLE 45—PUBLIC WELFARE, PART 2541—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart 2541.400—Monitoring and Reporting Program Performance

(a) Monitoring by grantees. Grantees are responsible for managing the day-to-day operations of grant and subgrant supported activities. Grantees must monitor grant and subgrant supported activities to assure compliance with applicable Federal requirements and that performance goals are being achieved. Grantee monitoring must cover each program, function or activity.

Condition

Award Identification

CaliforniaVolunteers' award letter and contract review and approval process lack internal controls to ensure the Catalog of Federal Domestic Assistance (CFDA) number is identified to its subgrantees at the time of the award. Specifically, the award letter that CaliforniaVolunteers sends to new subgrantees does not include the CFDA number. Furthermore, although each subgrantee contract includes a federal application face sheet that states the CFDA number and title, the CFDA number and title is not prominently placed in the contract language. CaliforniaVolunteers staff were not aware that its subgrantees must be properly notified of the CFDA number.

During-the-Award Monitoring

CaliforniaVolunteers has a process for monitoring subgrantees that includes site visits. Staff conduct each site visit according to a common site visit assessment instrument. While on site, among other things, staff will review the subgrantee's member files and financial management systems. CaliforniaVolunteers stated that the program operations manager reviews the site visit documentation and final report; however, there is no evidence on the site visit assessment instrument or final report to demonstrate these reviews occurred. Furthermore, the site visit documentation includes notes, but does not include any documentation of the procedures performed, or the records reviewed to arrive at the staff's conclusions related to the fiscal issues and fiscal compliance/fiscal management systems. According to CaliforniaVolunteers, the site visit process was designed to have program staff review source documentation and systems to verify sufficient internal controls at the site. However, it was not designed to collect evidence or work papers.

CaliforniaVolunteers' process of monitoring subgrantees also includes desk reviews. The purpose of a desk review is to assure ongoing oversight and to assist programs with staying abreast of changing policies and compliance issues. However, we found that CaliforniaVolunteers' desk reviews are not signed by a preparer, and although staff indicated that the desk reviews are reviewed by the program operations manager, there is no evidence of this review. Furthermore, desk reviews do not include a fiscal monitoring component.

Questioned Costs

Not applicable.

Recommendations

CaliforniaVolunteers should include the CFDA number on all award documents. Furthermore, it should improve upon its subrecipient monitoring procedures in such a manner that it ensures subgrantees are in compliance with all applicable federal requirements.

Department's View and Corrective Action Plan

Award Identification:

CaliforniaVolunteers stated it is updating its policies and procedures to ensure that the CFDA number is included on the appropriate documents. For the 2007–08 program year CaliforniaVolunteers is updating the standard invoice form it uses to include the CFDA number and sending all subgrantees a letter clearly indicating that the grant they have received is from the federal award identified by the CFDA number. This is because all of the award letters and many of the contracts have already been sent to subgrantees for this program year. For future program years this number will be prominently cited on the award letter, contracts, and invoices. These changes will be implemented during the 2007–08 fiscal year.

During-the-Award Monitoring:

Site Visits: CaliforniaVolunteers stated that its organizational structure has changed significantly since the period covered by the audit. In the past, senior program officers reported to a Deputy Director who was responsible for the entire agency. Currently, the AmeriCorps department consists of a Director, Assistant Director, three manager positions and five associate positions. Restructuring of the AmeriCorps department strengthened supervision and management of program associates who conduct the programmatic monitoring of subgrantees. The Assistant Director reviews and approves all work of the program associates; the Director oversees the work of the department. Current forms documenting site visit reports include supervisor signatures.

Additionally, CaliforniaVolunteers stated it is in the process of evaluating the current site visit policies and procedures and updating these, as necessary, to improve and clarify the review of fiscal information on a site visit, the procedures to follow on a site visit, and how to document information gathered on a site visit. CaliforniaVolunteers expects to complete its review and policy revision by June 30, 2008. Once these policies and procedures are in place, staff will be trained and begin to conduct site visits based on these changes. CaliforniaVolunteers anticipates that full implementation will occur during the 2008–09 fiscal year.

Desk Reviews: As noted under the corrective action above for site visits, restructuring of the AmeriCorps department strengthened supervision and management of program associates who conduct the programmatic monitoring of subgrantees. The Assistant Director reviews and approves all work of the program associates; the Director oversees the work of the department. CaliforniaVolunteers is in the process of updating current forms documenting desk reviews to include preparer and supervisor signatures.

U.S. ELECTION ASSISTANCE COMMISSION

Reference Number:	2007-7-3
Federal Catalog Number:	90.401
Federal Program Title:	Help America Vote Act (HAVA) Requirements Payments
Federal Award Numbers and Years:	None; 2004 None; 2005
Category of Finding:	Level of Effort—Maintenance of Effort (MOE)
State Administering Department:	Office of the Secretary of State (Secretary of State)

Criteria

TITLE 42—THE PUBLIC HEALTH AND WELFARE, CHAPTER 146—ELECTION ADMINISTRATION IMPROVEMENT, SUBCHAPTER II—COMMISSION, Part D—Election Assistance, Subpart 1—Requirements Payments, Section 15404, State Plan

(a) In general.—The State plan shall contain a description of each of the following:

(7) How the State, in using the requirements payment, will maintain the expenditures of the State for activities funded by the payment at a level that is not less than the level of such expenditures maintained by the State for the fiscal year ending prior to November 2000.

EAC ADVISORY 07-003—MAINTENANCE OF EFFORT FUNDING—Question 1: What Is Maintenance of Effort (MOE)?

—Response 1:

HAVA ties the MOE requirement to the State's fiscal year. Because State funding is allocated on an annual or in some cases biennial basis, the State must continue to commit annually or biennially the same amount of funding to the effort that it committed prior to the availability of Federal funding. Furthermore, HAVA requires that these funds be expended, not just appropriated. Because the intent of the MOE requirement is to prevent a State from replacing its own funding with Federal funding, expenditures at the State, county, and, where appropriate, the local level must be considered. In other words, a State, county or local government may not replace or supplant its prior level of funding with Federal dollars.

However, the MOE provision in Section 254(a)(7) of HAVA is limited. The MOE requirement is only related to activities that the State, county or local government spent money on that are consistent with the requirements of Title III of HAVA. Activities that State, county and local governments may have funded in the past include:

- Purchasing voting equipment;
- Developing, operating and/or maintaining a list of registered voters who are eligible to vote in Federal elections;
- Providing information to voters at the polling place for Federal elections;
- Implementing and/or operating a system of provisional voting during Federal elections;
- Verifying voter registration information using other Federal, State, county or local data;

- Other activities that improve the administration of elections for Federal office.

The expenditures are also limited to those made in the State fiscal year that ended prior to November 2000.

EAC ADVISORY 07-003—MAINTENANCE OF EFFORT FUNDING—Question 4: How Should States Document That They Have Maintained Their Effort?

—Response 4:

The first step in documenting MOE is to determine the base level of expenditure in the state fiscal year preceding November 2000 (base year). This number should be derived by examining the State and county or local government spending on HAVA funded activities during the base year. These activities include:

- Purchasing voting equipment;
- Developing, operating and/or maintaining a list of registered voters who are eligible to vote in Federal elections;
- Providing information to voters at the polling place on Federal elections;
- Implementing and/or operating a system of provisional voting during Federal elections;
- Verifying voter registration information using other Federal, State, county or local data;
- Other activities that improve the administration of elections for Federal office.

Once a base level of expenditure is obtained, the State can demonstrate that it has maintained its effort by providing documentation that shows that the State spent the same amount of money (base level of expenditures) on any election-related activities during any Federal fiscal year in which the State had and used requirements payments distributed under Title II of HAVA. A State can also demonstrate that they have maintained their effort by documenting the same or greater level of expenditures as the base level of expenditure in each year that the State had and used requirements payments.

Condition

The Secretary of State did not comply with the HAVA MOE requirement because it failed to include all of the appropriate expenditures. Specifically, the information that the Secretary of State provided us to support its assertion that it met the MOE requirement was based on its appropriations instead of actual expenditures.

The Secretary of State calculated its MOE requirement and submitted it to the U.S. Elections Assistance Commission (EAC) on March 26, 2007, along with its annual Financial Status Report. According to its deputy secretary of state of HAVA activities, an EAC official informed him on March 9, 2007, that issues relating to how to establish and document the baseline for the MOE were currently under discussion by the EAC. Also, according to the deputy secretary, the EAC official stated that it was best if states simply report the total state expenditures on election division activities for the sake of reporting on the MOE. However, as previously mentioned, the report submitted by the Secretary of State included appropriations rather than expenditures. Further, the $2.1 million in appropriations reported for fiscal 1999–2000 was substantially lower than the $19.5 million expended by its elections division in the same fiscal year.

In May 2007 the EAC issued an advisory memo that describes how to determine the base level of expenditures for the MOE requirement. In September 2007, EAC issued another memo to further clarify the responsibilities of the state and counties for meeting the MOE requirement. In light of these memos, the Secretary of State recognizes that its MOE calculation is incorrect. However, as of January 2008, the Secretary of State has yet to revise its MOE calculation to reflect the methodology in the EAC's advisory memos. According to the Secretary of State, it is in the process of collecting the necessary MOE information from the counties. Until it does, the Secretary of State is unable to demonstrate its compliance with the MOE requirement.

Questioned Costs

Not applicable.

Recommendations

The Secretary of State should revise its method of calculating the MOE base level and subsequent level of expenditures so that it agrees with the requirements outlined in the EAC's advisories. Additionally, the Secretary of State should submit its methodology to the EAC for approval. Finally, the Secretary of State should also establish a process to obtain and validate county information, which it must use to establish its MOE calculation.

Department's View and Corrective Action Plan

Generally, the Secretary of State concurs that additional EAC guidance on calculating the MOE base level and subsequent level of expenditures is needed. It should be noted, however, that the official advisory from the EAC about the MOE requirement is dated September 6, 2007. (The advisory is available on the EAC website at: http://www.eac.gov/election/HAVA%20Funds/eac-funding-advisories/.) In March 2006, when the EAC requested the Secretary of State to report this information, its staff attempted to clarify the MOE reporting requirement, but no official guidance was provided. In the absence of guidance, the Secretary of State staff informed the EAC that it was reporting this information in the manner found deficient by the Bureau of State Audits, but received no further EAC guidance that this was incorrect. When the guidance did become official, the EAC requirement to provide the MOE baseline was six months past the deadline specified by the EAC; in other words, the guidance came after the time the EAC requested the information to be reported.

Nonetheless, the Secretary of State concurs there is a need to seek clarification from the EAC regarding this guidance, up to and including, seeking EAC approval on the methodology for arriving at the MOE. Such a letter seeking EAC clarification and a proposed methodology was sent to the EAC on January 30, 2008.

Although gathering the MOE cost information from counties as directed by the EAC was problematic, in part because the EAC advisory was issued nearly five years after HAVA's enactment and nearly two years after full compliance with HAVA requirements was required, the Secretary of State gathered the information and reported to the EAC in its March 30, 2008, annual report on HAVA expenditures. It should be noted, as well, that the EAC voted on April 30, 2008, to suspend the requirement to report county cost data in the MOE, and has proposed to further modify its policy in consultation with states in response to California's request for clarification and similar submissions and comments from numerous other states. The Secretary of State will continue to monitor EAC actions to stay abreast of the revised federal requirements.

Reference Number:	2007-12-5
Federal Catalog Number:	90.401
Federal Program Title:	Help America Vote Act (HAVA) Requirements Payments
Federal Award Numbers and Years:	None; 2004 None; 2005
Category of Finding:	Reporting
State Administering Department:	Office of the Secretary of State (Secretary of State)

Criteria

TITLE 41—PUBLIC CONTRACTS AND PROPERTY MANAGEMENT, CHAPTER 105—GENERAL SERVICES ADMINISTRATION, PART 105-71—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS WITH STATE AND LOCAL GOVERNMENTS, Section 105-71.120, Standards for Financial Management Systems

(a) A State must expend and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contractors, must be sufficient to—

(1) Permit preparation of reports required by this part and the statutes authorizing the grant, and

(2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

(b) The financial management systems of other grantees and subgrantees must meet the following standards:

(1) Financial reporting. Accurate, current, and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant or subgrant.

TITLE 41—PUBLIC CONTRACTS AND PROPERTY MANAGEMENT, SUBTITLE C—FEDERAL PROPERTY MANAGEMENT REGULATIONS SYSTEM, CHAPTER 105—GENERAL SERVICES ADMINISTRATION, Part 105-71—Uniform Administrative Requirements for Grants and Cooperative Agreements With State and Local Governments, Section 105-71.141, Financial Reporting

(b) *Financial Status Report—*

(1) *Form.* Grantees will use Standard Form 269 or 269A, Financial Status Report, to report the status of funds for all non-construction grants and for construction grants when required in accordance with paragraph (e)(2)(iii) of this section.

Condition

The Secretary of State did not accurately report the amounts in its annual Financial Status Report. Our review of the annual Financial Status Report for the federal fiscal year ending September 2006 revealed that some of the cumulative amounts reported by the Secretary of State appeared to be incorrect. For instance, the sum of the recipient's share and federal share of unliquidated obligations equals $269 million; however, the total unliquidated obligations are reported as $169 million. Also, the recipient's share of unliquidated obligations is exactly the same as the amount reported for total recipient share of net outlays. Although it is possible that both could be exactly the same, it is very unlikely.

Although the Secretary of State has a process to review and approve the report, this process is ineffective for ensuring the accuracy of the report. The Secretary of State and the U.S. Election Assistance Commission (EAC) are aware of the errors. Inaccurate reporting prevents the EAC from knowing the true status of the funding provided to the State for HAVA.

Questioned Costs

Not applicable.

Recommendation

The Secretary of State should ensure that staff who prepare and review the annual Financial Status Report are knowledgeable of the federal financial reporting requirements.

Department's View and Corrective Action Plan

The Secretary of State acknowledges there was some confusion in posting unliquidated obligations on the Financial Status Report and stated that while its expenditures and obligations, as reported on its financial statements, are correct, the amounts carried forward were placed in the wrong field. The Secretary of State's staff will correct the reports and submit revised Financial Status Reports to the EAC. Furthermore, staff have been given additional training on the proper completion of Financial Status Reports.

Reference Number:	2007-13-2
Federal Catalog Number:	90.401
Federal Program Title:	Help America Vote Act (HAVA) Requirements Payments
Federal Award Numbers and Years:	None; 2004 None; 2005
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Office of the Secretary of State (Secretary of State)

Criteria

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133, *AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS* (OMB Circular A-133), Subpart D—Federal Agencies and Pass-Through Entities, Section .400, Responsibilities

(d) Pass-through entity responsibilities: A pass-through entity shall perform the following for the Federal awards it makes:

(1) Identify Federal awards made by informing each subrecipient of CFDA title and number, award name and number, award year, if the award is R&D, and name of Federal agency. When some of this information is not available, the pass-through entity shall provide the best information available to describe the Federal award.

(4) Ensure that subrecipients expending $300,000 (*$500,000 for fiscal years ending after December 31, 2003*) or more in Federal awards during the subrecipient's fiscal year have met the audit requirements of this part for that fiscal year.

OMB CIRCULAR A-133, Subpart B—Audits, Section .225, Sanctions

No audit costs may be charged to Federal awards when audits required by this part have not been made or have been made but not in accordance with this part. In cases of continued inability or unwillingness to have an audit conducted in accordance with this part, Federal agencies and pass-through entities shall take appropriate action using sanctions such as:

(a) Withholding a percentage of Federal awards until the audit is completed satisfactorily;

(b) Withholding or disallowing overhead costs;

(c) Suspending Federal awards until the audit is conducted; or

(d) Terminating the Federal award.

Condition

The Secretary of State did not include all required federal award information pertaining to HAVA when it awarded funds to its subrecipients. Specifically, the Secretary of State did not include the Catalog of Federal Domestic Assistance (CFDA) title or number in the HAVA requirements payments agreements with its subrecipients. Additionally, although the Secretary of State includes the name of the federal agency in passing when discussing the reasonable costs of certain expenses, this information is not prominently placed in the section of the agreement that describes the purpose of the agreement. By not providing complete award information, the Secretary of State cannot be sure that its subrecipients are aware of all the program's requirements.

Further, the Secretary of State has no controls to ensure that subrecipients expending federal awards in excess of $500,000 have had their OMB Circular A-133 audits completed or submitted on time. The Secretary of State must track this information so it can take appropriate actions, using sanctions when necessary. The deputy secretary of state of HAVA activities stated that the Secretary of State is working toward ensuring its subrecipients submit the required audit reports.

Questioned Costs

Not applicable.

Recommendations

The Secretary of State should update the terms in the agreements with its subrecipients to include the CFDA title and number and the prominent placement of the federal agency name. The Secretary of State should also continue its plans for developing a process that identifies counties with a continued inability or unwillingness to have their single audits completed and take appropriate actions as necessary.

Department's View and Corrective Action Plan

The Secretary of State acknowledges that the standard agreement (contract) executed with California counties to distribute this federal funding does not include the CFDA title or number. This information has been provided to the counties, upon request and proactively, by the Secretary of State's staff. The Secretary of State has also made clear in numerous memos and continual communication with counties that the EAC is the federal agency from which HAVA funds originate, and further that the Secretary of State relies in large part on EAC guidance to determine what costs are allowable. Finally, the contract also includes explicit language at Exhibit D, A. 3. stating that the terms of OMB Circular A-133 apply.

The Secretary of State understands and appreciates fully that including the CFDA information in the contract, and providing more prominent placement of the federal agency name in the contract is useful in assisting counties with compliance. Therefore, these agreements will be amended accordingly.

The Secretary of State's staff responsible for HAVA administration are now receiving directly from the State Controller's Office notice of counties delinquent in fulfilling single audit requirements. A formal process will be put in place to ensure the Secretary of State receives this information, reviews the information, and acts accordingly.

KPMG LLP

U.S. DEPARTMENT OF AGRICULTURE

Reference Number:	2007-14-6
Federal Catalog Number:	10.557
Federal Program Title:	Special Supplemental Nutrition Program for Women, Infants and Children (WIC)
Federal Award Numbers and Years:	7CA700CA7;2007 7CA700CA7;2006
Category of Finding:	Special Tests and Provisions
State Administering Department:	Department of Public Health (Public Health)[2]

Criteria

TITLE 7—AGRICULTURE, CHAPTER II—FOOD AND NUTRITION SERVICE (FNS), DEPARTMENT OF AGRICULTURE, PART 246—SPECIAL SUPPLEMENTAL NUTRITION PROGRAM FOR WOMEN, INFANTS AND CHILDREN, Subpart G—Miscellaneous Provisions, Section 246.25, Records and Reports

(a) Recordkeeping requirements: Each State and local agency shall maintain full and complete records concerning Program operations. Such records shall comply with 7 CFR Part 3016 and the following requirements:

(1) Records shall include, but not limited to, information pertaining to financial operations, food delivery systems, food instrument issuance and redemption, equipment purchases and inventory, certification, nutrition education, civil rights and fair hearing procedures.

(2) All records shall be retained for a minimum of three years following the date of submission of the final expenditure report for the period to which the report pertains. If any litigation, claim, negotiation, audit or other action involving the records has been started before the end of the three-year period, the records shall be kept until all issues are resolved, or until the end of the regular three-year period, whichever is later. If FNS deems any of the Program records to be of historical interest, it may require the State or local agency to forward such records to FNS whenever either agency is disposing of them.

Condition

Public Health obtained a waiver from the U.S. Department of Agriculture (USDA) that allowed it to destroy redeemed food instruments (FIs) prior to the end of the regulated three-year retention period. However, this waiver is contingent upon the ability to retrieve copies of these destroyed FIs (up to three years after redemption) routinely and in a timely manner through existing bank records. Public Health is only able to retrieve copies of the FIs redeemed from one year ago.

A plan was developed that would require the California State Treasurer's Office (Treasurer's Office) to box up these source-of-receipt documents after the first-year period and hand them over to Public Health, which would then store them in WIC warehouses by category of date received and processed by the Treasurer's Office for the required three-year period. This would allow Public Health to trace the redeemed FIs to the related bank in order to view an electronic image of the original FI. Since May of 2007 Public Health has been retaining these receipt documents from the Treasurers Office.

Even though this corrective action is now being undertaken, the federal regulation for retaining FI records for three years was not met during the fiscal year under audit.

[2] Effective July 1, 2007, the Department of Health Services was reorganized. The Department of Public Health was formerly the Department of Health Services.

Questioned Costs

Not determined.

Recommendation

Public Health should continue to implement its corrective action and work with the Treasurer's Office in retaining the FIs for the regulated three-year period.

Department's View and Corrective Action Plan

Public Health agrees with the auditor's recommendation. Public Health is continuing to collect and store the source of receipt documents while working with USDA to find an electronic solution.

U.S. DEPARTMENT OF JUSTICE

Reference Number:	2007-7-11
Federal Catalog Number:	16.575
Federal Program Title:	Crime Victim Assistance (VOCA)
Federal Award Number and Year:	2003-VA-GX-4025;2003
Category of Finding:	Earmarking
State Administering Department:	Governor's Office of Emergency Services (Emergency Services)

Criteria

VOCA FINAL PROGRAM GUIDELINES, III—VOCA Victim Assistance Application Process, B—Administrative Cost Provision for State Grantees

Each state grantee may retain up to, but not more than, 5% of each year's grant for administering the VOCA victim assistance grant at the state grantee level with the remaining portion being used exclusively for direct services to crime victims or to train direct service providers in accordance with these program guidelines.

Condition

Emergency Services exceeded the allowed amount to be expended on state administration costs for the 2003 VOCA grant award. We noted that the total amount allowed per the grant agreement was $1,980,650; however, Emergency Services spent $2,204,504. As a result, Emergency Services exceeded the allowed amount by $223,854.

Emergency Services believes there was a coding error in the accounting records that resulted in an overstatement of state administrative costs. Failure to properly record transactions can result in materially misleading reporting of grant expenditures and could lead to reimbursement of the federal funding agency of amounts overspent.

Questioned Costs

$223,854 (amount that exceeded the maximum administration limit)

Recommendation

Emergency Services should establish processes and procedures to ensure it is in compliance with the requirement that it does not spend more than 5 percent of the total grant award on state administrative costs.

Department's View and Corrective Action Plan

Emergency Services agrees with the finding. The California State Accounting and Reporting System (CALSTARS) Program Cost Accounting (PCA) tables were set up incorrectly, therefore causing an error in distribution of administration expenditures. Emergency Services was unaware that the setup of the sequence of numbers in the PCA codes was incorrect and caused the CALSTARS table to incorrectly distribute costs. Staff consulted with an analyst at the California Department of Finance who works on CALSTARS to determine and remedy the problem.

Reference Number:	2007-12-15
Federal Catalog Number:	16.575
Federal Program Title:	Crime Victim Assistance (VOCA)
Federal Award Number and Year:	2006-VA-GX-0049;2006
Category of Finding:	Reporting
State Administering Department:	Governor's Office of Emergency Services (Emergency Services)

Criteria

2006-VA-GX-0049 GRANT AWARD, SPECIAL CONDITIONS

#7 states: The Grantee agrees to submit a Subgrant Award Report (SAR) to OVC (Office of Victims of Crime) for each subgrantee of the VOCA victim assistance funds, within ninety (90) days of awarding funds to subgrantees. States and territories are required to submit this information through the automated system.

Condition

Emergency Services failed to comply with the Special Reports requirement to notify the OVC of subawards made within 90 days of the subgrant. We noted 11 out of 30 subgrantee sampled items where the notification has not yet been submitted to the OVC. We also noted no controls over this requirement to ensure that Emergency Services is in compliance. Based on the procedures performed, it appears Emergency Services is not in compliance with the requirement that it notify the OVC of subgrants made.

Questioned Costs

Not determined.

Recommendations

Emergency Services should establish processes and procedures to ensure compliance with the requirement to submit SARs to OVC for each subgrantee within 90 days of awarding the funds to subgrantees. Emergency Services should also retain a hard copy of the SAR at the time of submission on the federal automated system, in order to establish an audit trail of its compliance with this requirement.

Department's View and Corrective Action Plan

Emergency Services agrees with the finding. It has implemented the following practice with regard to the input of the SARs into the Federal Grants Management System.

- When the specialist submits a grant for processing, a copy of the completed SAR is included with the grant. Grants control will make a copy of the SAR and give it to the staff services analyst (SSA) responsible for data entry.

- If there are any questions regarding the data on the SAR, the SSA will bring this to the attention of the specialist who submitted the SAR.

- The staff services manager who supervises the Grants Control Unit will check the Federal System on a weekly basis to ensure that the SARs are being input and to notify those managers of any missing SARs.

- The section managers will be responsible for having their staff submit any missing SARS or make any necessary revisions.

- The date that the report is entered into the Grants Management System is in the OVC automated system (The column that says date last edited). However, the system changes the date when a new update is made. LEVS staff will print out the OVC report when the initial input is done so a baseline audit trail exists as to when the data was initially entered. When any updates are made, LEVS staff will print out the summary and indicate on the page that this is an update and the date the original entry was made. That report will be retained in the central files at LEVS offices.

- Writing in the date on the report pertains only to instances where records have been updated. It will be a flag that auditors could then use to go back to the original report (when subgrants were first entered) to verify that the record had been previously entered. The other option is to compare the initial subgrant report (printed when reports first entered) to a report run by auditors at the time of the audit. The auditor could then look at the dates and for those that were over 90 days old, go back to the original report to see if they were entered on time and that this is an update, or those that were submitted late.

Reference Number:	2007-12-16
Federal Catalog Number:	16.575
Federal Program Title:	Crime Victim Assistance (VOCA)
Federal Award Numbers and Years:	2004-VA-GX-0009;2004 2005-VA-GX-0052;2005 2006-VA-GX-0049;2006
Category of Finding:	Reporting
State Administering Department:	Governor's Office of Emergency Services (Emergency Services)

Criteria

TITLE 28—JUDICIAL ADMINISTRATION, CHAPTER I—DEPARTMENT OF JUSTICE, PART 66—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 66.20, Standards for Financial Management Systems

(a) A State must expend and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contractors, must be sufficient to:

(1) Permit preparation of reports required by this part and the statutes authorizing the grant, and

(2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

OFFICE OF JUSTICE PROGRAMS, *FINANCIAL GUIDE 2006*, Part III, Chapter 19

Awards are subject to conditions of fiscal, program and general administration to which the recipient expressly agrees. Accordingly, the audit objective is to review the recipient's administration of funds and required non-Federal contributions for the purpose of determining whether the recipient has submitted financial reports (which may include Financial Status Reports, Cash Reports, and Claims for Advances and Reimbursements), which contain accurate and reliable financial data, and are presented in accordance with the terms of applicable agreements.

Condition

During procedures performed over reporting, we were unable to trace amounts on the Financial Status Report (FSR) to supporting documentation or accounting records for eight of the 17 sampled FSRs. We noted the total unliquidated obligations amount (on line d) could not to be traced to supporting accounting records.

- For five of the eight reports, the incorrect amounts reported did not impact the overall expenditures reported.

- For three of the eight reports, Emergency Services over-reported federal expenditures by $822,904.

We inquired of the accounting manager at Emergency Services, noting the amount is generally calculated but there is no general rule for the calculation. Per the accounting manager, the amount usually includes the local funding, encumbrance, state administrative cost, reimbursement submitted by the subgrantees but not yet drawn or submitted into accounting, or a net between the Total Federal Share and Total Federal Funds authorized for this funding period.

The accounting manager stated they received no training on how to prepare the report and are in the process of learning how to properly prepare it. Without adequate controls in place to ensure accurate reporting, Emergency Services could be materially misstating the unliquidated obligations on its reports.

Questioned Costs

Not applicable.

Recommendation

Emergency Services should establish processes and procedures to ensure that the Financial Status Reports (SF-269s) can be accurately traced to accounting records.

Department's View and Corrective Action Plan

Emergency Services basically agrees with the finding. While we did locate inaccurate posting in some reports, we were able to trace the numbers in others. We feel this is primarily due to a posting error. Emergency Services has established a process and procedure to assure that each FSR has the corresponding fiscal reports attached as documentation to support the quarterly calculations.

Reference Number:	2007-13-11
Federal Catalog Number:	16.575
Federal Program Title:	Crime Victim Assistance (VOCA)
Federal Award Numbers and Years:	2003-VA-GX-4025;2003 2004-VA-GX-0009;2004 2005-VA-GX-0052;2005 2006-VA-GX-0049;2006 2007-VA-GX-0049;2007
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Governor's Office of Emergency Services (Emergency Services)

Criteria

TITLE 31—MONEY AND FINANCE, SUBTITLE V—GENERAL ASSISTANCE ADMINISTRATION, CHAPTER 75—REQUIREMENTS FOR SINGLE AUDITS, Section 7502, Audit Requirements; Exemptions

(f)(2) Each pass-through entity shall:

(B) monitor the subrecipient's use of Federal awards through site visits, limited scope audits, or other means.

(C) review the audit of a subrecipient as necessary to determine whether prompt and appropriate corrective action has been taken with respect to audit findings, as defined by the Director, pertaining to federal awards provided to the subrecipient by the pass-through entity.

TITLE 28—JUDICIAL ADMINISTRATION, CHAPTER I—DEPARTMENT OF JUSTICE, PART 66—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-award Requirements, Section 66.40, Monitoring and Reporting Program Performance

(a) *Monitoring by grantees.* Grantees are responsible for managing the day-to-day operations of grant and subgrant supported activities. Grantees must monitor grant and subgrant supported activities to ensure compliance with applicable Federal requirements and that performance goals are being achieved. Grantee monitoring must cover each program, function or activity.

Condition

Emergency Services did not adequately monitor its subrecipients of funds for the VOCA program for the fiscal year ending June 30, 2007. According to the chief of Emergency Services' Grants Management Branch, there is a backlog in performing the reviews and preparing management letters due to lack of staffing. Emergency Services has not reviewed an estimated 80 audit reports submitted by subrecipients dating back to 2003. Additionally, Emergency Services has not followed up with subrecipients who have not submitted their single audit reports. Further, Emergency Services does not have processes or controls in place to accurately track whether subrecipients' audit reports have been submitted or reviewed.

Emergency Services stated that it lacks sufficient staff to adequately monitor the receipt of the reports, review them, issue management decisions on the findings contained in them, and ensure that the subrecipients have taken timely and appropriate corrective action on all audit findings. Without performing these procedures, Emergency Services cannot ensure that subrecipients are complying with federal program requirements.

Questioned Costs

Not determined.

Recommendation

Emergency Services should develop a process to review subrecipient audit reports, respond and resolve findings noted in those reports, and ensure appropriate corrective action is taken within six months after receipt of the subrecipient report in accordance with federal guidelines.

Department's View and Corrective Action Plan

Emergency Services agrees with the finding. It has completed a review of the backlog of the U.S. Office of Management and Budget Circular A-133 audit reports, and the workload is current at this time. This includes the initial desk review of the audit reports, follow-up contacts with the sub-recipient for corrective action and issuance of management decision memos. Current workload is within the six-month requirement.

Emergency Services has developed procedures to determine the sub-grantees who have exceeded the $500,000 threshold for total funding, and who have completed the required audit.

U.S. DEPARTMENT OF EDUCATION

Reference Number:	2007-2-6
Federal Catalog Numbers:	84.027 & 84.173
Federal Program Titles:	Special Education Cluster: Special Education Grants to States & Special Preschool Grants
Federal Award Number and Year:	H027A060116; 2006
Category of Finding:	Allowable Costs
State Administering Department:	Department of Education (Education)

Criteria

TITLE 2—GRANTS AND AGREEMENTS, PART 225—COST PRINCIPLES FOR STATE, LOCAL, AND INDIAN TRIBAL GOVERNMENTS (OMB Circular A-87)

Attachment B—Selected Items of Cost, Part 8—Compensation for personal services

(a) *General.* Compensation for personnel services includes all remuneration, paid currently or accrued, for services rendered during the period of performance under Federal awards, including but not necessarily limited to wages, salaries, and fringe benefits. The costs of such compensation are allowable to the extent that they satisfy the specific requirements of this Circular, and that the total compensation for individual employees:

(1) Is reasonable for the services rendered and conforms to the established policy of the governmental unit consistently applied to both federal and non-federal activities.

Condition

During our procedures performed for state administrative expenditures charged to the program, we selected a sample of payroll expenditures that had been charged to the program and reviewed Education's documentation to support the rate paid and the time and effort documentation to support the allocation of hours charged to the program. In our sample of 30 employees charged as direct program expense, we noted the following two exceptions:

- One employee worked as a warehouse manager at Education, which should have either been charged as indirect or as a multifunded employee. Education indicated the warehouse was used for federal and state special education materials; however, the State does not allow salaries to be charged to the program, so the entire amount was charged to the federal program. Since this warehouse is not 100 percent dedicated to the federal program, a 100 percent dedication of salary charged is not appropriate.

- For another employee charged to the program, the time sheet supported more hours than what the employee was paid. The time sheet signed by both the employee and the employee's supervisor indicated the employee should be paid for eight hours of holiday pay; however, that amount was not paid to the employee. This employee is classified as a full-time employee but works as a part-time employee and is docked each month for the hours not worked. We were unable to obtain a policy from Education to support that an employee who is working under this type of arrangement is not entitled to any portion of holiday pay.

It appears that Education's monitoring of salaries charged to the program may not be at a detailed enough level to identify the appropriateness of the charges. Without appropriately designed controls in place, there is risk that Education could inappropriately charge salaries to the federal program.

Total salaries paid to these employees amounted to $44,436 and $29,760 for the inaccurately charged employee and the unsupported salary rate, respectively, for the fiscal year ended June 30, 2007. Total administrative salary expenditures for the program totaled $11.6 million for the same fiscal year.

Questioned Costs

$74,196 ($3,703 and $2,480 exceptions for months of January and May, respectively, multiplied by 12 months for estimated questioned costs for the fiscal year)

Recommendation

Education should strengthen its processes and controls to reduce the risk of inappropriate charges to federal programs.

Department's View and Corrective Action Plan

Education does not concur with this finding. In accordance with the Individuals With Disabilities Education Act (IDEA), Education is required to provide instructional materials to blind persons or other persons with print disabilities in a timely manner. To meet this requirement, Education adopted and purchased core instructional materials through a variety of media; these instructional materials are stored in a designated warehouse. Since the warehouse manager's duties all relate to the storage of the federally required instructional materials, the warehouse manager is charged directly to federal special education funding.

Education will strengthen processes over charging employee salaries to federal programs. For example, Education will provide appropriate updates at bi-monthly staff meetings on state Department of Personnel Administration policies and procedures regarding when to apply paid holidays to employees on dock. Furthermore, Education is processing the payment to the employee specified in this condition for the May 2007 holiday underpayment.

Reference Number:	2007-2-7
Federal Catalog Number:	84.367
Federal Program Title:	Improving Teacher Quality State Grants
Federal Award Numbers and Years:	S367A040005;2004 S367A050005;2005 S367A060005;2006
Category of Finding:	Allowable Costs
State Administering Department:	Department of Education (Education)

Criteria

TITLE 34—EDUCATION, PART 76—STATE ADMINISTERED PROGRAMS, Subpart E—How a Subgrant Is Made to an Applicant, Section 76.400, State Procedures for Reviewing an Application

A State that receives an application for a subgrant shall take the following steps:

(a) *Review.* The State shall review the application.

(b) *Approval—entitlement programs.* The State shall approve an application if:

(1) The application is submitted by an applicant that is entitled to receive a subgrant under the program; and

(2) The applicant meets the requirements of the Federal statutes and regulations that apply to the program.

(c) *Approval—discretionary programs.* The State may approve an application if:

(1) The application is submitted by an eligible applicant under a program in which the State has the discretion to select subgrantees;

(2) The applicant meets the requirements of the Federal statutes and regulations that apply to the program; and

(3) The State determines that the project should be funded under the authorizing statute and implementing regulations for the program.

(d) *Disapproval—entitlement and discretionary programs.* If an application does not meet the requirements of the Federal statutes and regulations that apply to a program, the State shall not approve the application.

Condition

Education has a formal control process for approving grants to Local Educational Agencies (LEAs). The LEAs submit a consolidated plan that outlines the proposed activities that will be performed under multiple No Child Left Behind (NCLB) programs. These plans are reviewed by Education for the appropriateness of the proposed activities in connection with the allowable activities in the federal program guidance. Education's review process consists of multiple levels of approval (for example, program manager and director, the deputy, chief deputy) as appropriate, to approve the award to the LEA, which are documented on a Summary Cover Memo (Form EXE-100f).

In our sample of subgrant awards that were made to LEAs, there was no evidence of approval on the Summary Cover Memos for two of the 30 samples selected. In our discussion with the program staff, they indicated they did not believe a formal sign-off of the Summary Cover Memo was necessary as long as the individual goals have been reviewed and approved. However, without a formal sign-off there is no evidence that these goals have actually been reviewed and approved, and Education cannot demonstrate support for the proper approval of grants.

Questioned Costs

Not applicable.

Recommendation

Education should retain copies of the Summary Cover Memos in the program files as evidence of controls over the grant award approval process.

Department's View and Corrective Action Plan

The purpose of the Summary Cover Memos is to facilitate internal distribution and approval processes; however, Education will retain documentation indicating the required grant approvals as evidence of controls over the grant award approval process.

Reference Number:	2007-3-6
Category of Finding:	Cash Management
State Administering Department:	Department of Education (Education)
Federal Catalog Number:	84.010
Federal Program Title:	Title I Grants to Local Educational Agencies
Federal Award Numbers and Years:	S010A040005;2004 S010A050005;2005 S010A060005;2006

Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education—State Grant Program
Federal Award Numbers and Years:	S011A040005;2004 S011A050005;2005 S011A060005;2006

Federal Catalog Numbers:	84.027 & 84.173
Federal Program Titles:	Special Education Cluster—Special Education Grants to States & Special Preschool Grants
Federal Award Numbers and Years:	H027A040116;2004, H173A040120;2004 H027A050116;2005, H173A050120;2005 H027A060116;2006, H173A060120;2006

Federal Catalog Number:	84.186
Federal Program Title:	Safe and Drug-Free Schools and Communities—State Grants
Federal Award Numbers and Years:	Q186A040005;2004 Q186A050005;2005 Q186A060005;2006

Federal Catalog Number:	84.282
Federal Program Title:	Charter Schools
Federal Award Numbers and Years:	Q282A040006;2004 Q282A050006;2005 Q282A060006;2006

Federal Catalog Number:	84.318
Federal Program Title:	Education Technology State Grants
Federal Award Numbers and Years:	S318X040005;2004 S318X050005;2005 S318X060005;2006

Federal Catalog Number:	84.365
Federal Program Title:	English Language Acquisition Grants
Federal Award Numbers and Years:	S365A040005;2004 S365A050005;2005 S365A060005;2006

Federal Catalog Number:	84.367
Federal Program Title:	Improving Teacher Quality State Grants
Federal Award Numbers and Years:	S367A040005;2004 S367A050005;2005 S367A060005;2006

Federal Catalog Number:	84.369
Federal Program Title:	Grants for State Assessments and Related Activities
Federal Award Number and Years:	S369A040005;2004 S369A050005;2005 S369A060005;2006

Criteria

TITLE 34—EDUCATION, PART 75—DIRECT GRANT PROGRAMS, Subpart F—What Are the Administrative Responsibilities of a Grantee? Section 75.702, Fiscal Control and Fund Accounting Procedures

> A grantee shall use fiscal control and fund accounting procedures that ensure proper disbursement of and accounting for Federal funds.

Condition

During our procedures performed over payments made to subrecipients, we reviewed Education's processes and controls for preparing drawdown requests from the Federal Grant Administrative and Payment System (GAPS) to make disbursements to its Special Education Local Plan Areas (SELPAs) and Local Educational Agencies (LEAs). An Education employee prepares a package of supporting documentation to compile the amount that will be paid to the SELPAs and LEAs. This package consists of a cover memorandum, identification of the claims schedules, project numbers and work phases, project amounts, cash on hand, and the final amount to be drawn. The package does not include evidence to support the review and approval of the advance amount made for the federal program.

On a quarterly basis Education prepares a worksheet that reconciles its drawdowns to its claims schedules to the warrants issued for the quarter; however, since this reconciliation is only prepared on a quarterly basis and claims are drawn down on an almost daily basis, this would not appear to be an effective mitigating control.

Based on our discussion with Education, we noted that its current policies and procedures do not require that evidence of reviews and approvals be documented on the memorandum that supports the drawdown request. Without appropriately designed controls in place, there is risk that Education could draw down funds on the federal program in excess of its immediate needs without it being detected in a timely manner.

Questioned Costs

Not applicable.

Recommendation

Education should strengthen its processes and controls to reduce the risk of excess advances of federal funds.

Department's View and Corrective Action Plan

Education does not concur with this finding. Processes and controls are already in place to reduce the risk of advances of federal funds. The Federal Funds unit has one staff person to input and prepare the draw into the Grant Card System which produces the Letter of Credit Draw Voucher Report. This staff person also prepares the remittance advice to the State Treasurer's Office and is listed as the contact person. These reports, along with the supporting documents, are used by another staff person to review and input the draw into the federal GAPS. The staff person who reviews the draw signs the remittance advice after verifying the draw voucher, remittance advice(s), and GAPS are in agreement.

Reference Number:	2007-3-7
Category of Finding:	Cash Management
State Administering Department:	Department of Education (Education)
Federal Catalog Number:	84.010
Federal Program Title:	Title I Grants to Local Educational Agencies
Federal Award Numbers and Years:	S010A040005;2004 S010A050005;2005 S010A060005;2006

Federal Catalog Numbers:	84.027 & 84.173
Federal Program Titles:	Special Education Cluster: Special Education Grants to States & Special Preschool Grants
Federal Award Numbers and Years:	H027A040116;2004, H173A040120;2004 H027A050116;2005, H173A050120;2005 H027A060116;2006, H173A060120;2006

Federal Catalog Number:	84.186
Federal Program Title:	Safe and Drug-Free Schools and Communities—State Grants
Federal Award Numbers and Years:	Q186A040005;2004 Q186A050005;2005 Q186A060005;2006

Federal Catalog Number:	84.282
Federal Program Title:	Charter Schools
Federal Award Numbers and Years:	U282A040006;2004 U282A050006;2005 U282A060006;2006

Federal Catalog Number:	84.318
Federal Program Title:	Education Technology State Grants
Federal Award Numbers and Years:	S318X040005;2004 S318X050005;2005 S318X060005;2006

Federal Catalog Number:	84.365
Federal Program Title:	English Language Acquisition Grants
Federal Award Numbers and Years:	S365A040005;2004 S365A050005;2005 S365A060005;2006

Federal Catalog Number:	84.367
Federal Program Title:	Improving Teacher Quality State Grants
Federal Award Numbers and Years:	S367A050005;2005 S367A060005;2006

Criteria

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 80.20, Standards for Financial Management Systems

(7) *Cash Management.* Procedures for minimizing the time elapsing between the transfer of funds from the U.S. Treasury and disbursement by grantees and subgrantees must be followed whenever advance payment procedures are used. Grantees must establish reasonable procedures to ensure the receipt of reports on subgrantees cash balances and cash disbursements in sufficient time to enable them to prepare complete and accurate cash transactions reports to the awarding agency. When advances are made by letter-of-credit or electronic transfer of funds methods, the grantee must make drawdowns as close as possible to the time of making

disbursements. Grantees must monitor cash drawdowns by their subgrantees to ensure that they conform substantially to the same standards of timing and amount as apply to advances to the grantees.

Condition

During our procedures performed over Education's payments made to Local Educational Agencies (LEAs), we noted it does not have an adequate process in place for assessing the cash needs of its subrecipients.

Title I Grants to Local Educational Agencies

Education requests advance funds from the federal government and makes three predetermined payment advances to LEAs during the fiscal year. Education does not require periodic expenditure reporting or input by the LEAs during the award period and relies upon the expenditures reported in Part II of the annual two-part consolidated application (CONAPP), the year-end expenditure report that is due to Education seven months after the end of the fiscal year. The timing of the payments made to LEAs does not take their cash needs into consideration as no expenditure data or input was obtained from them during the award year. As a result, Education disbursed more than $1.7 billion to LEAs during the fiscal year ending June 30, 2007, with no assurances that these subrecipients minimized the time between the receipt and disbursement of federal funds, which would not comply with federal guidelines.

Special Education Cluster

During our audit procedures we noted four of 30 sampled Special Education Local Plan Areas (SELPAs) and LEAs were either overpaid or underpaid at the time of assessment; however, the next periodic assessment where the adjustment was made did not occur for another three to six months. Based on our discussion with Education, it indicated there was an error in the worksheet used for the calculations that resulted in the overpayments and underpayments. The lateness of the error corrections was due to Education waiting until the next assessment cycle, the year-end final report, to make the corrections. As a result, Education disbursed $1.1 billion during the fiscal year ending June 30, 2007, with limited assurances that these subrecipients minimized the time between the receipt and disbursement of federal funds, which would not comply with federal guidelines.

Safe and Drug-Free Schools and Communities—State Grants

Education requests advance funds from the federal government and makes three predetermined payment advances to LEAs during the fiscal year. Education does not require periodic expenditure reporting or input by the LEAs during the award period and relies upon the expenditures reported in Part II of the annual two-part CONAPP, the year-end expenditure report that is due to Education seven months after the end of the fiscal year. The timing of the payments made to LEAs does not take their cash needs into consideration as no expenditure data or input was obtained from them during the award year. As a result, Education disbursed more than $31 million to LEAs during the fiscal year ending June 30, 2007, with no assurances that these subrecipients minimized the time between the receipt and disbursement of federal funds, which would not comply with federal guidelines.

Charter Schools

Education requests advance funds from the federal government and makes four predetermined payment advances to LEAs during the fiscal year. Education requires quarterly expenditure reporting and additional programmatic information by the LEAs during the award period. Each status report is reviewed to ensure LEAs are spending the federal funding issued. However, payments are not adjusted to ensure that the LEAs will have a steady supply of cash for their needs. The timing of the payments made to LEAs does not fully take their cash needs into consideration. Payments are either made at the scheduled amount, or are not paid. As a result, Education disbursed more than $18 million to LEAs

during the fiscal year ending June 30, 2007, with no assurances that these subrecipients minimized the time between the receipt and disbursement of federal funds, which would not comply with federal guidelines.

Education Technology State Grants

Education's process consists of three assessments of its LEAs' cash needs made during the award year. However, these assessments do not appear to be periodic enough to adequately assess the cash needs of its LEAs with Education's scheduled disbursements. As a result, Education disbursed $44 million during the fiscal year ending June 30, 2007, with limited assurances that these subrecipients minimized the time between the receipt and disbursement of federal funds, which would not comply with federal guidelines.

English Language Acquisition Grants

Education's process consists of three assessments of its LEAs' cash needs made during the award year. However, these assessments do not appear to be periodic enough to adequately assess the cash needs of its LEAs with Education's scheduled disbursements. As a result, Education disbursed $158 million during the fiscal year ending June 30, 2007, with limited assurances that these subrecipients minimized the time between the receipt and disbursement of federal funds, which would not comply with federal guidelines.

Improving Teacher Quality State Grants

Education's process consists of three assessments of its LEAs' cash needs made during the award year. However, these assessments do not appear to be periodic enough to adequately assess the cash needs of its LEAs with Education's scheduled disbursements. As a result, Education disbursed $318 million during the fiscal year ending June 30, 2007, with limited assurances that these subrecipients minimized the time between the receipt and disbursement of federal funds, which would not comply with federal guidelines.

Questioned Costs

Not applicable.

Recommendation

Education should review its current policies and procedures over the issuance of cash advances to LEAs and SELPAs to include a more effective monitoring of their cash needs with the timing of the payments to minimize the time elapsing between the advance of federal funds and expenditure by the LEAs and SELPAs.

Department's View and Corrective Action Plan

On January 15, 2008, Education met with members of the U.S. Department of Education, Office of the Secretary, Risk Management Service (RMS) to seek the advice and assistance of the RMS in strengthening Education's cash management over federal funds. Education will work collegially with the RMS in determining and implementing the cash management process improvements that are deemed practical and achievable within Education's available resources. Education's foremost cash management goals are to: (1) improve expenditure reporting, fiscal monitoring, and disbursement processes to minimize the time between sub-recipients' receipt and disbursement of federal funds; and (2) appropriately collect and revert interest earned on unspent federal funds back to the Federal government.

Reference Number:	2007-3-8
Category of Finding:	Cash Management
State Administering Department:	Department of Education (Education)
Federal Catalog Number:	84.010
Federal Program Title:	Title I Grants to Local Educational Agencies
Federal Award Number and Year:	S010A060005;2006

Federal Catalog Number:	84.282
Federal Program Title:	Charter Schools
Federal Award Number and Year:	U282A060006;2006

Federal Catalog Number:	84.186
Federal Program Title:	Safe and Drug-Free Schools and Communities—State Grants
Federal Award Number and Year:	Q186A060005;2006

Federal Catalog Number:	84.318
Federal Program Title:	Education Technology State Grants
Federal Award Number and Year:	S318X060005;2006

Federal Catalog Number:	84.365
Federal Program Title:	English Language Acquisition Grants
Federal Award Number and Year:	S365A060005;2006

Federal Catalog Number:	84.367
Federal Program Title:	Improving Teacher Quality State Grants
Federal Award Number and Year:	S367A040005;2006

Criteria

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 80.21, Payment

(i) Interest earned on advances. Except for interest earned on advances of funds exempt under the Intergovernmental Cooperation Act (31 U.S.C. 6501 et seq.) and the Indian Self-Determination Act (23 U.S.C. 450), grantees and subgrantees shall promptly, but at least quarterly, remit interest earned on advances to the Federal agency. The grantee or subgrantee may keep interest amounts up to $100 per year for administrative expenses.

Condition

Title I Grants to Local Educational Agencies, Charter Schools, Safe and Drug-Free Schools and Communities—State Grants, Improving Teacher Quality State Grants

During our procedures performed over cash management, we noted Education did notify the Local Educational Agencies (LEAs) of the requirement to return interest earned on advances; however, it did not require the interest earned to be reported on the Consolidated Application (CONAPP) or the Charter School Status Report—Financial Report of Expenditures, nor did it identify any processes or controls in place to collect and return the interest earned over $100 to the U.S. Department of Education.

Currently, LEAs voluntarily send a check to Education, who then forwards those payments to the U.S. Department of Education. We noted in one subrecipient's U.S. Office of Management and Budget Circular A-133 audit report the interest earned on the Title I program alone to be $2.3 million for the fiscal year ended June 30, 2006. This specific interest has been subsequently remitted to Education after a federal Office of Inspector General follow-up; however, this is only one of the more than 1,000 LEAs that received funding advances under these programs that would be accumulating interest.

Through our review of the expenditure reporting mechanisms, we noted that the CONAPP and the Charter School Status Report—Financial Report of Expenditures are not adequately designed to require the LEAs to report this information to Education. Without knowledge of the interest earned by the LEAs on the program advances, Education cannot properly monitor compliance with their submission of that interest to Education on a quarterly basis to comply with Federal requirements.

Education Technology State Grants, English Language Acquisition Grants

We noted that Education did notify the LEAs of their requirement to annually return interest earned on advances and report it. Education submits a bill to the LEA to repay the interest reported annually and then returns the collected amounts to the U.S. Department of Education. Although it appears Education is collecting interest earned by the LEAs for these programs, it is not being done on a quarterly basis as indicated by the federal requirements.

Education's current policies and procedures for these programs only address the reporting and collection of interest on an annual basis. As a result of the current policies and procedures, Education is not collecting and remitting interest in a timely manner to the federal government.

Questioned Costs

Not determined.

Recommendation

Education should establish processes and controls to communicate and obtain this information from the LEAs as well as to collect and return the funds back to the federal government on a quarterly basis, as applicable.

Department's View and Corrective Action Plan

On January 15, 2008, Education met with members of the U.S. Department of Education, Office of the Secretary, Risk Management Service (RMS) to seek the advice and assistance of the RMS in strengthening Education's cash management over federal funds. Education will work collegially with

the RMS in determining and implementing the cash management process improvements that are deemed practical and achievable within Education's available resources. Education's foremost cash management goals are to: (1) improve expenditure reporting, fiscal monitoring, and disbursement processes to minimize the time between sub-recipients' receipt and disbursement of federal funds; and (2) appropriately collect and revert interest earned on unspent federal funds back to the federal government.

Reference Number:	2007-3-9
Category of Finding:	Cash Management
State Administering Department:	Department of Education (Education)
Federal Catalog Numbers:	84.027 & 84.173
Federal Program Titles:	Special Education Cluster—Special Education Grants to States & Special Preschool Grants
Federal Award Numbers and Years:	H027A060116;2006, H173A060120;2006 H027A050116;2005, H173A050120;2005

Federal Catalog Number:	84.318
Federal Program Title:	Education Technology State Grants
Federal Award Numbers and Years:	S318X050005;2005 S318X060005;2006

Federal Catalog Number:	84.365
Federal Program Title:	English Language Acquisition Grants
Federal Award Numbers and Years:	S365A050005;2005 S365A060005;2006

Federal Catalog Number:	84.369
Federal Program Title:	Grants for State Assessments and Related Activities
Federal Award Numbers and Years:	S369A050005;2005 S369A060005;2006

Criteria

TITLE 31—MONEY AND FINANCE: TREASURY, CHAPTER II—FISCAL SERVICE, DEPARTMENT OF THE TREASURY, PART 205—RULES AND PROCEDURES FOR EFFICIENT FEDERAL-STATE FUNDS TRANSFERS, Subpart B—Rules Applicable to Federal Assistance Programs Not Included in a Treasury-State Agreement, Section 205.33, How Are Funds Transfers Processed?

(a) A State must minimize the time between the drawdown of Federal funds from the Federal government and their disbursement for Federal program purposes. A Federal Program Agency must limit a funds transfer to a State to the minimum amounts needed by the State and must

time the disbursement to be in accord with the actual, immediate cash requirements of the State in carrying out a Federal assistance program or project. The timing and amount of funds transfers must be as close as is administratively feasible to a State's actual cash outlay for direct program costs and the proportionate share of any allowable indirect costs. States should exercise sound cash management in funds transfers to subgrantees in accordance with OMB Circular A-102.

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENT, Subpart C—Post-Award Requirements, Section 80.20, Standards for Financial Management Systems

(a) A State must expend and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contractors, must be sufficient to:

(1) Permit preparation of reports required by this part and the statutes authorizing the grant, and

(2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

Condition

During our procedures performed over cash management requirements and Education's payments to its Special Education Local Plan Areas (SELPAs) and Local Educational Agencies (LEAs), we reviewed a sample of SELPA and LEA final expenditure reports (reports) for any reimbursement amounts due back to SELPAs or LEAs to ascertain if Education was minimizing the time between the expenditure of program funds and their subsequent reimbursement from Education. We reviewed the dates the reports were received by Education, if no date received was indicated, the date the request was signed by the SELPA or LEA was used and compared those dates received to the dates payments were actually disbursed to the SELPAs and LEAs.

As a basis for determining the reasonableness of Education's minimization of the payment timing, we reviewed the State of California Prompt Payment Act (Act) that addresses minimizing the timing of payments to certain types of grant award subrecipients. The Act encourages payments to be made within 45 days of receipt of the reimbursement request. Although these programs are not defined as specifically applicable for this regulation, the intent of the legislation appears to be consistent with the intent of federal cash management requirements; therefore this regulation would appear to be provide an appropriate basis for determining the reasonableness for timing of payments.

Special Education Cluster

In our sample of 30 payments, we noted four (totaling $4.6 million) were made more than 45 days after the request. These untimely disbursements made ranged from 49 to 60 days from the date of the SELPA or LEA reports.

Education does not have a policy that addresses the minimization of timing of reimbursement payments made to the SELPAs and LEAs. Education indicated that these exceptions were due to expenditure reports being submitted past the due date, which caused them to be held until another material batch of payments was accumulated. As a result, Education made untimely reimbursements of $4.6 million (in our sample, which totaled $90 million) from the $1.1 billion total in subgrant payments made in the fiscal year ended June 30, 2007.

English Language Acquisition Grants

In our sample of 30 reports, we noted 25 included expenditures that were greater than the cash advances provided by Education, thus requiring reimbursement of $8.5 million. We noted 15 (totaling $2.5 million) of the 25 reimbursement payments were made more than 45 days after the request. These untimely disbursements ranged from 55 to 133 days after the date of the LEA reports.

Education does not have a policy that addresses the minimizing of the timing of reimbursement payments it makes to the LEAs. Education indicated the delays were caused by an administrative backlog as the requests were routed through multiple departments to process the payments. As a result, Education made untimely reimbursements of $2.5 million in our sample of $8.5 million of reimbursements from the $158 million total in subgrant payments made in the fiscal year ended June 30, 2007.

Grants for State Assessments and Related Activities

In our sample of 60 subcontract payment requests, we noted 30 were paid more than 45 days after the date the request was received. These untimely disbursements, which totaled $21.5 million, ranged from 46 to 152 days after the date of the invoice.

Education does not have a policy that addresses minimizing the timing of payments it makes to subcontractors. As a result, Education made untimely reimbursements of $21.5 million in our sample (totaling $28.6 million) from the $30.6 million total in contractor payments made in the fiscal year ended June 30, 2007.

Education Technology State Grants

We noted that all 30 of the reports we sampled included expenditures that were greater than the cash advances provided by Education, thus requiring reimbursement of $5 million. Only four of those 30 reports were reimbursed within 45 days. These untimely disbursements ranged from 46 to 80 days after the date of the invoice.

Education does not have a policy that addresses the minimizing of the timing of reimbursement payments it makes to the LEAs. As a result, Education made untimely reimbursements of $3.75 million in our sample (totaling $22 million) of the total $44 million in subgrant payments made in the fiscal year ended June 30, 2007.

Questioned Costs

Not applicable.

Recommendation

Education should develop policies and procedures to ensure that reimbursement payments are made to LEAs in a timely manner to ensure that Education is minimizing the time between the LEAs' expenditure of program funds and their subsequent reimbursement.

Department's View and Corrective Action Plan

Education does not concur with the inference drawn from the conditions delineated in this finding. Education's existing program funding practices are designed to minimize the time between an LEA's expenditure and receipt of program funds, while also ensuring that program funds are being appropriately claimed and expended. For example, grant funding may not be disbursed as scheduled because of the time delays in resolving disputed, questionable, or unallowable claims for reimbursement. Furthermore, although the auditors cite the California Prompt Payment Act as an appropriate gauge for timeliness, Education believes that the intent of the Act is specifically directed towards payments of undisputed invoices and claims for reimbursement.

However, in an effort to further improve existing program funding practices, on January 15, 2008, Education met with members of the U.S. Department of Education, Office of the Secretary, Risk Management Service (RMS) to seek the advice and assistance of the RMS in strengthening Education's cash management over federal funds. Education will work collegially with the RMS in determining and implementing the cash management process improvements that are deemed practical and achievable within Education's available resources. Education's foremost cash management goals are to: (1) improve expenditure reporting, fiscal monitoring, and disbursement processes to minimize the time between sub-recipients' receipt and disbursement of federal funds; and (2) appropriately collect and revert interest earned on unspent federal funds back to the federal government.

Reference Number:	2007-3-10
Federal Catalog Number:	84.282
Federal Program Title:	Charter Schools
Federal Award Number and Year:	U282D040008;2004
Category of Finding:	Cash Management
State Administering Department:	California School Finance Authority (Authority)

Criteria

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 80.20, Standards for Financial Management Systems

(7) *Cash Management.* Procedures for minimizing the time elapsing between the transfer of funds from the U.S. Treasury and disbursement by grantees and subgrantees must be followed whenever advance payment procedures are used. Grantees must establish reasonable procedures to ensure the receipt of reports on subgrantees cash balances and cash disbursements in sufficient time to enable them to prepare complete and accurate cash transactions reports to the awarding agency. When advances are made by letter-of-credit or electronic transfer of funds methods, the grantee must make drawdowns as close as possible to the time of making disbursements. Grantees must monitor cash drawdowns by their subgrantees to ensure that they conform substantially to the same standards of timing and amount as apply to advances to the grantees.

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 80.21, Payment

(i) *Interest earned on advances.* Except for interest earned on advances of funds exempt under the Intergovernmental Cooperation Act (31 U.S.C. 6501 et seq.) and the Indian Self-Determination Act (23 U.S.C. 450), grantees and subgrantees shall promptly, but at least quarterly, remit interest earned on advances to the Federal agency. The grantee or subgrantee may keep interest amounts up to $100 per year for administrative expenses.

Condition

During our procedures performed over the Authority's payments made to its subrecipients, we noted it does not have an adequate process in place for assessing the cash needs of its subrecipients. Payments are made twice a year based on a payment schedule established by the Authority. This payment schedule is based on the nature of the reimbursements (for example, purchases are paid 100 percent during

the first payment period while lease, rent and debt service payments are paid 50 percent during each of the two approved payment months). Due to the nature of the awards, the majority of expenditures incurred by the subrecipients are for fixed amounts paid on a monthly basis (for example, rent, lease, debt service payments); however, this does not eliminate the requirement to ensure its subrecipients are being paid in line with their actual expenditure patterns.

The statewide policy requires noncash management improvement act (CMIA) payments to be paid within 15 days of the date of the drawdown; however, the Authority is not using substantially the same standards of timing and amount for advances made to subrecipients. We noted no controls in place by the Authority to ensure compliance with this 15-day policy. Previously the Authority had prepared a quarterly reconciliation to determine the number of days between the date of the drawdown and the date of disbursement to the subrecipient; however, this reconciliation is no longer prepared since it deemed the risk of noncompliance to be minimal.

We also noted the Authority did not notify its charter school subrecipients of their requirement to return interest earned on advances, nor did it identify any processes or controls in place to collect and return the interest earned over $100 to the U.S. Department of Education.

The Authority established the limited payment schedule to reduce the administrative burden of its grant awards. As a result of this condition, the Authority disbursed $5.6 million during the fiscal year ending June 30, 2007, with no assurances that subrecipients minimized the time between the receipt and disbursement of federal funds, which would not comply with federal guidelines.

Questioned Costs

Undetermined

Recommendations

The Authority should review its current policies and procedures over the issuance of cash advances to more accurately match the timing of the advances to the cash needs of the subrecipients.

The Authority should also establish processes and controls to communicate and obtain the interest earned information from its subrecipients to either collect or require them to submit the interest to the U.S. Department of Education, as required.

Department's View and Corrective Action Plan

As the Authority implemented this program, it strove to comply with all applicable federal laws and guidelines. As such, it developed language in its grant agreement and other program documents (such as the disbursement request template subgrantees utilize to draw down funds) that convey to subgrantees federal funds should be expended immediately, and that subgrantees should minimize the amount of time the federal funds are held. However, to ensure compliance with this requirement, Authority staff are recommending the following procedural changes to our disbursement process.

The Authority will implement the following changes to ensure that it is complying with all federal requirements:

1. Notify all current subgrantees and reiterate the requirement that interest cannot be earned on these federal funds.

2. Notify subgrantees of the requirement to return any interest earned on any advanced federal funds.

3. Evaluate disbursement schedules of each subgrantee and adjust disbursement of funds to match the cash needs of the subgrantees, i.e., monthly payments to a landlord will warrant a monthly disbursement to subgrantees, and semi-annual debt service or loan payments will remain on a semi-annual disbursement schedule. This change will required grant agreements to be amended.

4. Any other recommended changes suggested by the U.S. Department of Education after reviewing the audit findings.

Reference Number:	2007-5-1
Federal Catalog Number:	84.367
Federal Program Title:	Improving Teacher Quality State Grants
Federal Award Number and Year:	S367A060005;2006
Category of Finding:	Eligibility
State Administering Department:	Department of Education (Education)

Criteria

TITLE 20—EDUCATION, CHAPTER 70—STRENGTHENING AND IMPROVEMENT OF ELEMENTARY AND SECONDARY SCHOOLS, SUBCHAPTER II—PREPARING, TRAINING, AND RECRUITING HIGH QUALITY TEACHERS AND PRINCIPALS, PART A—TEACHER AND PRINCIPAL TRAINING AND RECRUITING FUND, Subpart 2—Subgrants to Local Educational Agencies, Section 6621, Allocations to Local Educational Agencies

(a)(3) Allocation of additional funds

For any fiscal year for which the funds reserved by a State under section 6613(a)(1) of this title exceed the total amount required to make allocations under paragraph (2), the State educational agency shall allocate to each of the eligible local educational agencies in the State the sum of:

(a) an amount that bears the same relationship to 20 percent of the excess amount as the number of individuals age 5 through 17 in the geographic area served by the agency, as determined by the Secretary on the basis of the most recent satisfactory data, bears to the number of those individuals in the geographic areas served by all the local educational agencies in the State, as so determined; and

(b) an amount that bears the same relationship to 80 percent of the excess amount as the number of individuals age 5 through 17 from families with incomes below the poverty line in the geographic area served by the agency, as determined by the Secretary on the basis of the most recent satisfactory data, bears to the number of those individuals in the geographic areas served by all the local educational agencies in the State, as so determined.

Condition

During our procedures performed over eligibility of subrecipients of amounts awarded to Local Educational Agencies (LEAs), we selected a sample of LEAs that received program funding and tested the accuracy of the census and poverty data used in the award calculations to ascertain the accuracy of the amounts awarded to LEAs. In our sample of 60 grant awards made, we noted the following exceptions related to amounts awarded in excess of the hold harmless amount (for example, funds received by the LEA in the fiscal year 2001) that are required to be distributed under a specified federal formula:

- Of the 60 LEA awards sampled, 34 contained differences in the poverty census data used in Education's award calculation worksheet compared to the poverty figures contained in the 2003 U.S. poverty census data located at www.census.gov/hhs/www/saipe/district.html. These differences resulted in an overstatement of 570 students used in the calculation who received $1,492,029, which resulted in excess awards totaling $32,782 for the 80 percent poverty allocation.

- Of the 30 LEA awards sampled, three contained differences in the geographic census data used in Education's award calculation worksheet compared to the geographic census data contained on the same Web site. These differences resulted in an understatement of 396 students who received $508,292 used in the calculation, which resulted in underawards totaling $1,110 for the 20 percent geographic allocation.

Education stated that the LEA calculation worksheet is reviewed and approved before the awards are granted; however, there was no documented evidence of such reviews or approvals. Total LEA awards that were made in excess of the hold harmless amount from 2001 amounted to $100 million of the $318 million in total LEA awards made during the fiscal year ending June 30, 2007.

Questioned Costs

$31,672 of the sampled $1,994,321 awards in excess of the 2001 hold harmless amount ($32,840 overawarded to 33 LEAs—$1,168 underawarded to four LEAs)

Recommendation

Education should enhance its current policies and procedures over the LEA award calculations to ensure there is evidence of appropriate reviews and approvals and that source data used in the calculations are accurate.

Department's View and Corrective Action Plan

In 2006–07, Education inadvertently used formula child counts in place of poverty counts in the Title II, Part A entitlement calculation. Formula child counts are used in the Title I, Part A entitlement calculations and include poverty counts as well as counts of additional categories of children. The inclusion of the additional categories of children led to the differences in census poverty data noted for the 34 LEAs. It should be noted that Education correctly used poverty counts and not formula child counts in calculating the 2007–08 Title II, Part A entitlement. Education will continue this practice in future years.

In 2007–08, Education commenced a formal approval process documenting the review of entitlement calculations. The census poverty and population data Education uses for school districts is the same data provided to Education for the Title I, Part A entitlement calculations by the U.S. Department of Education (ED). Education reviewed the three LEAs found to have differences in May 17 census population data and determined that the data used in the Title II, Part A, Improving Teacher Quality entitlement calculations matches the source data received from ED for the Title I, Part A calculation. A copy of the data received from ED is available at:

http://www.thompson.com/public/nclb/fundinginformation/allocation-october-2006.html.

Reference Number:	2007-7-12
Category of Finding:	Level of Effort—Maintenance of Effort
State Administering Department:	Department of Education (Education)
Federal Catalog Number:	84.010
Federal Program Title:	Title I Grants to Local Educational Agencies
Federal Award Numbers and Years:	S010A040005;2004 S010A050005;2005 S010A060005;2006

Federal Catalog Number:	84.318
Federal Program Title:	Education Technology State Grants
Federal Award Numbers and Years:	S318X040005;2004 S318X050005;2005 S318X060005;2006

Federal Catalog Number:	84.186
Federal Program Title:	Safe and Drug-Free Schools and Communities—State Grants
Federal Award Numbers and Years:	Q186A040005;2004 Q186A050005;2005 Q186A060005;2006

Federal Catalog Number:	84.365
Federal Program Title:	English Language Acquisition Grants
Federal Award Numbers and Years:	T365A040005;2004 T365A050005;2005 T365A060005;2006

Federal Catalog Number:	84.367
Federal Program Title:	Improving Teacher Quality State Grants
Federal Award Numbers and Years:	S367A040005;2004 S367A050005;2005 S367A060005;2006

Criteria

TITLE 34—EDUCATION—SECONDARY EDUCATION, DEPARTMENT OF EDUCATION, PART 299—GENERAL PROVISIONS, Subpart D—Fiscal Requirements, Section 299.5, What Maintenance of Effort Requirements Apply to ESEA Programs?

(a) *General.* An Local Educational Agency (LEA) receiving funds under an applicable program listed in paragraph (b) of this section may receive its full allocation of funds only if the State Educational Agency (SEA) finds that either the combined fiscal effort per student or the aggregate expenditures of State and local funds with respect to the provision of free public Education in the LEA for the preceding fiscal year was not less than 90% of the combined fiscal effort per student or the aggregate expenditures for the second preceding fiscal year.

(d) *Expenditures.*

(1) In determining a LEAs compliance with paragraph (a) of this section, the SEA shall consider only the LEAs expenditures from State and local funds for free public education. These include expenditures for administration, instruction, attendance and health services, pupil transportation services, operation and maintenance of plant, fixed charges, and net expenditures to cover deficits for food services and student body activities.

(2) The SEA may not consider the following expenditures in determining a LEAs compliance with the requirements in paragraph (a) of this section:

(i) Any expenditures for community services, capital outlay, debt service or supplemental expenses made as a result of a Presidentially declared disaster.

(ii) Any expenditures made from funds provided by the Federal Government.

Condition

1. Education was using unaudited LEA expenditure figures to calculate compliance with the maintenance of effort (MOE) requirements instead of using the final audited expenditures. Per further inquiry, we noted that LEAs are required to submit their unaudited financial trial balances electronically in the state-required format, Standard Account Code Structure (SACS), to Education by October 15 of each year. These SACS trial balances are then used for all LEA financial measurement calculations (for example, level of effort) performed by Education. The final audited financial statements are submitted in hard copy or electronically to Education through the State Controller's Office by December 15; however, there is not a required follow-up submission of the final SACS trial balance to Education. The financial statements submitted are not at the level of detail that would allow Education to prepare these fiscal-effort calculations. There is no policy or procedure in place to review and reconcile the unaudited SACS trial balance to the final audited financial statement or review of the subsequent-year SACS trial balance submission in the following October for any material adjustments to the fund balance for prior-year audit adjustments.

   Education states that it cannot require LEAs to make an additional submission of the final audited expenditure data used to make these fiscal-effort calculations due to state law. However, by using the unaudited figures, there is a risk that material adjustments or omissions may not be adequately reflected and computed in the MOE calculation.

2. We identified expenditures for several state-funded programs that were incorrectly excluded from prior-year total expenses for free public education in Education's MOE calculations. In our sample of LEA calculations, we noted 19 of the 60 were not calculated correctly, resulting in a lower free public education expenditure total and an inaccurate lower threshold of expenditures that the LEA would be required to meet in the next year. As a result of our identified exceptions, Education revised its MOE calculations; however, its internal processes and controls did not identify the errors in the calculations.

   Education uses the SACS to compile the expenditure data that is used to prepare the MOE calculations. The errors in these calculations appear to have been caused by Education using a template based on fiscal year 2005–06 SACS format for the fiscal year 2004–05 expenditures, which are used in the fiscal year 2006–07 calculation. However, due to changes in funding sources in some special education programs from federally funded to state-funded, it caused noncomparability

between the two years by using the same unadjusted template format. Noncomparable calculations could cause inaccurate fiscal-effort assessments, causing LEAs to either receive more or less funding than they were entitled to receive.

Education prepares the MOE calculations on behalf of its LEAs; however, the calculations are not being prepared with adjustments made for failures to maintain fiscal effort in a timely manner. Education finalized its state fiscal year 2006–07 calculations, which compare expenditures for the state fiscal year ending June 30, 2004, to that ending June 30, 2005, in September 2007. Education received the required SACS expenditure data that it used to perform the calculation on or before October 15, 2005, which should have provided adequate time to complete the required calculations and either collect or adjust subsequent payments by June 30, 2007. For any LEAs failing to maintain fiscal effort, Education is required to reduce the amount of allocation of funds under the applicable program for LEAs. Education has adopted an alternative procedure to reducing the allocations and submits separate requests for failing LEAs to repay the funds that were already paid for that allocation. We noted the amounts owed by LEAs for failing to maintain fiscal effort for 2006–07 had not yet been requested to be repaid or reduced as of the end of our fieldwork in October 2007. The MOE failures related to June 30, 2005, expenditures have a period of availability ending September 30, 2007. Education is not permitted to reallocate grant funds from one LEA to another after the period of availability.

By not performing and providing these calculations to its LEAs in a timely fashion, Education is not providing information required to be audited each year. Also, by not performing these calculations in a timely manner, Education cannot reallocate unearned funds to another LEA if the assessment is made after the end of the period of availability. For example, amounts awarded for June 30, 2005, that would be required to be reduced due to MOE failures performed in fiscal year 2006–07 have a period of availability ending September 30, 2007. The reduction of the amounts to these noncompliant LEAs could not be reallocated to other compliant LEAs after September 30, 2007.

3. Education does not send the final MOE calculations to each LEA annually. Education only performs follow-up on any LEA that fails to maintain fiscal effort. According to the *U.S. Office of Management and Budget Circular A-133 Compliance Supplement*, which provides audit guidance to auditors of Education's LEAs, since Education prepares the calculation from information provided by the LEAs, the auditors of the LEAs are required to perform procedures to verify that the amounts provided to Education were derived from the books and records from which the audited financial statements were prepared.

   Education's current policies and procedures do not include a submission of final fiscal-effort calculations to the LEAs. If these calculations are not provided to the LEAs, their auditors will not be able to provide assurances to Education regarding compliance over this requirement.

Questioned Costs

Not applicable.

Recommendation

Education should enhance its current MOE policies and procedures to ensure that they are compliant with required federal guidelines.

Department's View and Corrective Action Plan

Condition 1—Education acknowledges that using unaudited rather than audited expenditure data from LEAs poses a risk that audit adjustments or omissions may not be adequately reflected in the maintenance of effort calculations based on that data; Education believes that this risk is minimal. However, to enhance existing processes, Education will propose a change to the Audit Guide for audits

of LEAs to require auditors to assess the impact of audit adjustments on the MOE calculation and, where the impact is material, to quantify the impact in the audit report in sufficient detail to enable Education to take the adjustment into account when calculating MOE.

Condition 2—Education notes that the incorrect exclusion had already been identified and corrected at the time of the audit. Education implemented procedures to correct this condition. Education completed its fiscal year 2007–08 MOE calculations in September 2007, and reduced the entitlements of LEAs that failed to maintain the required level of effort. Education has committed to writing and trained staff on the new policy that funding will be reduced in a timely manner to LEAs that fail to meet the MOE requirement.

Condition 3—Education does not concur with this condition. The MOE calculation is based on expenditure data submitted by LEAs. Since LEAs see the preliminary MOE calculation, Education deems that there is no need to send the final calculation back to the LEA except where the final calculation differs from the preliminary calculation.

Reference Number:	2007-7-13
Federal Catalog Number:	84.282
Federal Program Title:	Charter Schools
Federal Award Number and Year:	U282D040008;2004
Category of Finding:	Level of Effort—Supplement not Supplant
State Administering Department:	California School Finance Authority (Authority)

Criteria

U.S. DEPARTMENT OF EDUCATION—THE STATE CHARTER SCHOOL FACILITIES INCENTIVE GRANTS PROGRAM, CFDA 84.282D—Guidance, Issued February 2, 2004.

D.8. How does the "supplement not supplant" requirement work?

- At the State level all State applicants, but in particular those that are enhancing existing charter facilities programs, must ensure that neither they nor their charter school recipients violate this program's statutory non-supplanting requirements. A State may use these grant funds only to the extent that the grant funds and the required nonfederal match would supplement the total amount of funding provided to charter schools for any type of cost, including operating and capital costs. Example of supplanting: If a State had been providing $100 million a year on behalf of charter schools for their facility expenses and operating expenses and intended to continue that level of funding in future years, it would be supplanting if it reduced the level of its financial contribution to charter schools after it received a grant.

- At the local level, charter schools may use these grant funds only to the extent that the grant funds and the required non-Federal match would supplement the total amount of State and local funding provided to charter schools. Example of supplanting: If a school district had been providing $1 million a year on behalf of a charter school for its facility expenses and operating expenses and intended to continue that level of funding in future years, it would be supplanting if it reduced the level of its financial contribution to the charter school after it received grant funds from the State.

Condition

During our procedures performed to ascertain if the Authority complied with the program's requirement against the supplanting of funds, we obtained the total level of services provided applicable to the requirement for the past two years to ascertain if it increased in proportion to the level of federal contribution. To perform this procedure we compiled the total federal and state program dollars to ascertain if the increase in state support was proportionate to the increase in the federal support. Based on the information obtained, it appears the Authority supplanted its current state program:

	STATE PROGRAM LEVEL OF FUNDING	FEDERAL PROGRAM LEVEL OF FUNDING
For the fiscal year ended June 30, 2006	$26,983,328	$2,617,913
For the fiscal year ended June 30, 2007	21,360,123	5,597,372
Increase/(decrease) in level of Funding	(5,623,205)	2,979,459

Additionally, we performed procedures to ascertain whether the individual federal-program-funded services (for example, charter school subgrants) were previously provided with nonfederal funds. We selected a sample of 16 charter school subgrants and tested if they were previously funded with state program funds. The following summarizes the results of those procedures:

- Through discussions with the program director, we noted one school had rescinded its state-funded program to be able to apply for the federally funded program due to the reduced restrictions placed upon the use of the funding and less rigorous requirements to receive funding. Based on the information obtained, it appears these services were previously funded with nonfederal funds.

- We were unable to obtain support for the remaining 15 sampled schools to ascertain if they were previously funded with one of the Authority's other two state-funded programs (for example, Charter School Facility Program and SB-740). Therefore, we were unable to ascertain if the funding was supplanted.

The Authority asserted that it had obtained authorization from the U.S. Department of Education to establish the program as designed; however, it was unable to provide documentation to support that assertion. As a result of the Authority reducing its state program expenditures by approximately the same amount as the federal award expenditures of $5.6 million during the fiscal year ending June 30, 2007, it is not in compliance with federal nonsupplantation guidelines.

Questioned Costs

$5,597,372 total program expenditures for the fiscal year ending June 30, 2007

Recommendation

The Authority should enhance its current policies and procedures to ensure programs are supplemented and not supplanted in accordance with federal requirements.

Department's View and Corrective Action Plan

The Authority is confident that it is in compliance with the level of effort—supplement not supplant requirement.

Reference Number:	2007-7-14
Category of Finding:	Earmarking
State Administering Department:	Department of Education (Education)
Federal Catalog Number:	84.010
Federal Program Title:	Title I Grants to Local Educational Agencies
Federal Award Numbers and Years:	S010A040005;2004 S010A050005;2005 S010A060005;2006

Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education-State Grant Program
Federal Award Numbers and Years:	S011A040005;2004 S011A050005;2005 S011A060005;2006

Federal Catalog Numbers:	84.027 & 84.173
Federal Program Titles:	Special Education Cluster: Special Education Grants to States & Special Preschool Grants
Federal Award Numbers and Years:	H027A040116;2004, H173A040120;2004 H027A050116;2005, H173A050120;2005 H027A060116;2006, H173A060120;2006

Federal Catalog Number:	84.186
Federal Program Title:	Safe and Drug-Free Schools and Communities—State Grants
Federal Award Numbers and Years:	Q186A040005;2004 Q186A050005;2005 Q186A060005;2006

Federal Catalog Number:	84.282
Federal Program Title:	Charter Schools
Federal Award Numbers and Years:	U282A040006;2004 U282A050006;2005 U282A060006;2006

Federal Catalog Number:	84.318
Federal Program Title:	Education Technology State Grants
Federal Award Numbers and Years:	S318X040005;2004 S318X050005;2005 S318X060005;2006

Federal Catalog Number:	84.365
Federal Program Title:	English Language Acquisition Grants
Federal Award Numbers and Years:	S365A040005;2004 S365A050005;2005 S365A060005;2006

Criteria

TITLE 34—EDUCATION, PART 75—DIRECT GRANT PROGRAMS, Subpart F—What Are the Administrative Responsibilities of a Grantee? Section 75.702, Fiscal Control and Fund Accounting Procedures

> A grantee shall use fiscal control and fund accounting procedures that insure proper disbursement of and accounting for Federal funds.

Condition

Education does not have appropriately designed controls in place to monitor program earmarking requirements. Additionally, it does not perform actual calculations on required earmarks to ascertain if it has complied within required limitations. In order to ascertain compliance with required earmarking, we obtained expenditure information from Education's California State Accounting and Reporting System general ledger reports and performed the calculations to ensure that they met requirements for the grant that closed out during the current fiscal year. Based on the expenditure information provided, the multiyear awards for the fiscal year ended September 30, 2005, appeared to fall within the required limitations; however, there are no properly designed controls in place to monitor actual compliance with earmarking requirements.

Education believes a formal calculation of the earmarking is not necessary since it deems the established budget alone ensures compliance. However, since actual expenditures are not always expended exactly according to budget (for example, local educational agencies not expending full grant awards) without a formal calculation being prepared, there is no evidence to support that the final actual program expenditures met the required earmarking limitations.

Questioned Costs

Not applicable.

Recommendation

Education should enhance its current policies and procedures to include an actual calculation of required earmarks be performed to ensure compliance with specified earmarking requirements.

Department's View and Corrective Action Plan

Education will add a column to its budget memos that are prepared for each grant award to designate the appropriate percentage used to calculate the earmarking requirement.

Reference Number:	2007-7-15
Federal Catalog Number:	84.282
Federal Program Title:	Charter School
Federal Award Number and Year:	U282D040008;2004
Category of Finding:	Earmarking
State Administering Department:	California School Finance Authority (Authority)

Criteria

TITLE 34—EDUCATION, PART 75—DIRECT GRANT PROGRAMS, Subpart F—What Are the Administrative Responsibilities of a Grantee? Section 75.702, Fiscal Control and Fund Accounting Procedures

> A grantee shall use fiscal control and fund accounting procedures that insure proper disbursement of and accounting for Federal funds.

Condition

The Authority does not have appropriately designed controls in place to monitor program earmarking requirements. Additionally, it does not perform actual calculations on required earmarks to ascertain if it has complied within required limitations. In order to ascertain compliance with required earmarking, we obtained expenditure information from the Authority's California State Accounting and Reporting System general ledger reports and performed the calculations to ensure that they met requirements for the grant that closed out during the current fiscal year.

The Authority informally monitors its expenditure levels throughout the year and believes a formal calculation of the earmarking is not necessary. However, since actual expenditures are not always expended exactly according to budget (for example, subrecipients not expending full grant awards) without a formal calculation being prepared, there is no evidence to support a conclusion that the final actual program expenditures met the required earmarking limitations.

Questioned Costs

Not applicable.

Recommendation

The Authority should enhance its current policies and procedures to include an actual calculation of required earmarks be performed to ensure compliance with specified earmarking requirements.

Department's View and Corrective Action Plan

The Authority will work with management of the Administrative Division of the State Treasurer's Office to ensure that the accounting division is conducting calculations of actual expenditures to ensure that the appropriate program earmarking requirements are being met.

The Authority will evaluate the monitoring and reports that were conducted during the first year of the program that it reported as being conducted, and make sure that the same type of monitoring remains in place for the remainder of the program.

Finally, the Authority will work with the State Treasurer's Office accounting division to conduct a retroactive analysis of the earmarking requirement to ensure adherence with this earmarking requirement.

Reference Number:	2007-8-6
Category of Finding:	Period of Availability
State Administering Department:	Department of Education (Education)
Federal Catalog Number:	84.010
Federal Program Title:	Title I Grants to Local Educational Agencies
Federal Award Numbers and Years:	S010A040005;2004 S010A050005;2005 S010A060005;2006

Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education—State Grant Program
Federal Award Numbers and Years:	S011A040005;2004 S011A050005;2005 S011A060005;2006

Federal Catalog Numbers:	84.027 & 84.173
Federal Program Titles:	Special Education Cluster: Special Education Grants & Special Preschool Grants to States
Federal Award Numbers and Years:	H027A040116;2004, H173A040120;2004 H027A050116;2005, H173A050120;2005 H027A060116;2006, H173A060120;2006

Federal Catalog Number:	84.186
Federal Program Title:	Safe and Drug-Free Schools and Communities—State Grants
Federal Award Numbers and Years:	Q186A040005;2004 Q186A050005;2005 Q186A060005;2006

Federal Catalog Number:	84.282
Federal Program Title:	Charter Schools
Federal Award Numbers and Years:	Q282A040005;2004 Q282A040006;2005 Q282A060006;2006

Federal Catalog Number:	84.318
Federal Program Title:	Education Technology State Grants
Federal Award Numbers and Years:	S318X040005;2004 S318X050005;2005 S318X060005;2006

Federal Catalog Number:	84.365
Federal Program Title:	English Language Acquisition Grants
Federal Award Numbers and Years:	S365A040005;2004 S365A050005;2005 S365A060005;2006

Federal Catalog Number:	84.367
Federal Program Title:	Improving Teacher Quality State Grants
Federal Award Numbers and Years:	S367A040005;2004 S367A050005;2005 S367A060005;2006

Federal Catalog Number:	84.369
Federal Program Title:	Grants for State Assessments and Related Activities
Federal Award Numbers and Years:	S369A040005;2004 S369A050005;2005 S369A060005;2006

Criteria

TITLE 34—EDUCATION, PART 75—DIRECT GRANT PROGRAMS, Subpart F—What Are the Administrative Responsibilities of a Grantee? Section 75.702, Fiscal Control and Fund Accounting Procedures

> A grantee shall use fiscal control and fund accounting procedures that insure proper disbursement of and accounting for Federal funds.

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Sec. 80.20, Standards for Financial Management Systems

(a) A State must expend and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contractors, must be sufficient to:

(2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

(b) The financial management systems of other grantees and subgrantees must meet the following standards:

(1) *Accounting records.* Grantees and subgrantees must maintain records which adequately identify the source and application of funds provided for financially assisted activities. These records must contain information pertaining to grant or subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income.

(2) *Internal control.* Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes.

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 80.23, Period of Availability of Funds

(a) *General.* Where a funding period is specified, a grantee may charge to the award only costs resulting from obligations of the funding period unless carryover of unobligated balances is permitted, in which case the carryover balances may be charged for costs resulting from obligations of the subsequent funding period.

Condition

During our procedures performed over period of availability, we selected a sample of adjusting journal entries (entries) made during the fiscal year to ascertain if underlying obligations for those entries occurred within the appropriate period of availability. We noted that 15 of the 17 entries sampled were prepared and posted into the California State Accounting and Reporting System (CALSTARS) by the same employee, resulting in a lack of segregation of duties. The remaining two entries did not contain evidence of the employee who posted the other entries into CALSTARS; therefore, we were unable to assess if those two entries also were subject to segregation-of-duties-control deficiencies. Additionally, there was no evidence of review or approval on all 17 of these entries.

We requested the supporting documentation of the underlying transactions for those entries recorded that carried back or forward expenditures between award years and noted that Education does not maintain support in the level of detail that includes specified transactions so that transactions can be sampled and tested for appropriateness of period recorded. Rather, the support for the entries consists of pools of funds (for example, voluminous listing of claims schedules that significantly exceed the amount of the entry); however no specified claims schedules or underlying transactions are identified as the specific transactions that are being adjusted.

Previous correspondence between Education and the U.S. Department of Education regarding exceptions noted in prior-year audits indicated that unambiguous support should be maintained to support the first-in, first-out (FIFO) close out journal entries. For example, correspondence included this excerpt: "The FIFO method depends upon clear documentation of the transactions falling within the Tydings period. To the extent that a recipient relies on principles of FIFO accounting, the recipient must also establish that such a method has been consistently used from year to year and must document clearly and unambiguously that the transactions giving rise to the obligations in question arose before the relevant Tydings cutoff date."

Education does not require journal entries to be reviewed and approved, nor does it require segregation of duties between the preparer and the recorder of the entry. Without appropriately designed controls in place, there is risk that Education could incorrectly adjust expenditures between grant award years. We also noted Education's current policies and procedures do not require that detailed transaction-supporting documentation be maintained to support FIFO amounts adjusted. Without this unambiguous detailed documentation that identifies specific transactions to support that they were incurred during the proper period, a reviewer cannot ascertain if the transactions are being transferred between the appropriate grant award years.

Questioned Costs

Not applicable.

Recommendations

Education should strengthen its policies and procedures to ensure appropriate segregation of duties is maintained and adjusting FIFO entries are reviewed and approved. Education should also ensure appropriate supporting documentation is maintained to adequately support adjusting transactions between federal funding years.

Department's View and Corrective Action Plan

Education does not concur with this finding. The supporting documentation provided for the FIFO entries encompassed all expenditures that were incurred prior to the close of the performance period of the grant. These transactions are adjusting entries in the Grant and Administration Payment System (GAPS) and do not constitute a cash withdrawal from the federal system. Reconciliations, such as carryover worksheets, are completed by staff and reviewed by management. These reconciliations summarize all activity associated with each grant. Education deems that additional approvals are an unnecessary administrative burden. However, Education will continue to ensure that documentation is maintained to identify specific detailed information where applicable.

Auditor's Comments on Department's View

Education's response is not supported by the test work performed and resulting finding described above. Specifically, there was no readily available unambiguous detailed documentation supporting the FIFO entries.

Reference Number:	2007-8-7
Federal Catalog Number:	84.318
Federal Program Title:	Education Technology State Grants
Federal Award Number and Year:	S318X040005;2004
Category of Finding:	Period of Availability
State Administering Department:	Department of Education (Education)

Criteria

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 80.23, Period of Availability of Funds

(b) *Liquidation of obligations.* A grantee must liquidate all obligations incurred under the award not later than 90 days after the end of the funding period (or as specified in the program regulation) to coincide with the submission of the annual Financial Status Report (SF-269). The Federal agency may extend this deadline at the request of the grantee.

Condition

During our procedures performed over the timing of the liquidation payments made during the closeout of the 2004–05 grant award, we noted six of the 30 items sampled and required to be liquidated by December 29, 2006, were paid on January 2, 2007.

There does not appear to be effective monitoring of liquidation deadlines to ensure that final payments are made before the 90-day deadline. As a result, these payment requests were submitted past the due date.

Questioned Costs

$849,964 of the $7,499,328 sampled

Recommendation

Education should strengthen controls over its grant closeout process to ensure that all program funds are liquidated within the required time frame.

Department's View and Corrective Action Plan

Education's existing controls over the grant award closeout process ensures that requests to the State Controller's Office are made in a timely manner. Grant funds were available for drawdown in the Grant Administration and Payment System (GAPS) until December 31, 2006. Education drew the federal cash on December 15, 2006, for deposit on December 18, 2006. On December 19, 2006 (prior to the end of the liquidation period), Education liquidated the obligations on GAPS and submitted the claim schedules to the State Controller's Office for payment to the individual county offices. However, due to circumstances beyond Education's control, including two state holidays, the State Controller's Office issued the payments on January 2, 2007.

Reference Number:	2007-9-4
Federal Catalog Number:	84.282
Federal Program Title:	Charter Schools
Federal Award Number and Year:	U282D040008;2004
Category of Finding:	Procurement, Suspension and Debarment
State Administering Department:	California School Finance Authority (Authority)

Criteria

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 80.35, Subawards to Debarred and Suspended Parties

Grantees and subgrantees must not make any award or permit any award (subgrant or contract) at any tier to any party which is debarred or suspended or is otherwise excluded from or ineligible for participation in Federal assistance programs under Executive Order 12549, "Debarment and Suspension".

Condition

The Authority does not have policies or procedures in place to review subrecipient charter schools and the corresponding school officials against the Excluded Parties List System (EPLS), nor is there language related to certification of nonsuspension or debarment contained within its grant award agreements or Legal Status Questionnaire. We tested a sample of 30 charter school subrecipients against the EPLS and noted no sampled items were contained in the database; however, the Authority did not comply with its requirement to obtain the certification or verify EPLS for its charter school subrecipients.

This omission appears to have occurred due to lack of knowledge of the requirement by the Authority. By not performing procedures to ascertain if subrecipients are suspended or debarred before award amounts are paid, the Authority risks those program costs being disallowed if the subrecipient is suspended or debarred from participating in federal programs. Total subgrant award expenditures for the year ended June 30, 2007, amounted to $5,531,930.

Questioned Costs

Not applicable.

Recommendation

The Authority should review its current policies, procedures, and subaward documents to ensure that nonsuspension and debarment of subrecipients is appropriately addressed in accordance with federal program requirements.

Department's View and Corrective Action Plan

The Authority vets all criminal or civil matters of applicants applying for funding through the Authority's programs. The Authority utilizes a Legal Status Questionnaire (LSQ) to gather information regarding any criminal or civil matters that involve the school or anyone in a leadership capacity at the school (i.e. board members, schools leaders, chief financial or operation officers, etc.). The LSQ requires applicants to disclose information for cases dating back 10 years. The Authority and our legal counsel evaluate all disclosed items before determining program eligibility. Additionally, staff seeks verification from charter authorizers that applicants are in good standing with their authorizer and in compliance with the terms of their charter.

The Authority was unaware of the requirement to review charter schools and their officials against the Excluded Parties List System (EPLS). Instead, the Authority utilizes other means (described above) to ascertain whether officials of a subgrantee charter school are facing or have faced any civil or criminal matters.

The Authority will implement the following corrective steps to ensure compliance with this requirement:

1. Under its current round, staff will run all applicants through the EPLS. Staff will run the names of charter school leaders, board members, and other top management through the database to ensure the eligibility of all applicant charter schools.

2. Staff will amend program regulations for the fifth funding round to include as an eligibility criterion that applicants found on the EPLS are not eligible for program participation.

3. Staff will conduct an analysis of current recipients to ensure that no subgrantees are on the EPLS.

Reference Number:	2007-12-17
Federal Catalog Number:	84.010
Federal Program Title:	Title I Grants to Local Educational Agencies
Federal Award Number and Year:	S010A060005;2006
Category of Finding:	Reporting
State Administering Department:	Department of Education (Education)

Criteria

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section. 80.20, Standards for Financial Management Systems

(b) The financial management systems of other grantees and subgrantees must meet the following standards:

(1) *Financial reporting.* Accurate, current, and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant or subgrant.

Condition

During procedures performed over required performance reporting, we selected a sample of information that was reported on Education's National Public Education Financial Survey (NPEFS) and traced that information to supporting documentation to ascertain the accuracy of the information reported. We noted that Education was using unaudited Local Educational Agency (LEA) expenditure figures instead of using the final audited expenditures in reporting total state expenditures. This practice is consistent with other state expenditure calculations (for example, maintenance of effort) where the Standard Account Code Structure (SACS) trial balances are then used for all LEA financial measurement calculations (for example, level of effort) performed by Education. There is no policy or procedure in place to review and reconcile the unaudited SACS trial balance to the final audited financial statement or review of the subsequent year SACS trial balance submission in the following October for any material adjustments to the fund balance for prior year audit adjustments.

Education indicated current state law only requires LEAs to submit the unaudited financials by October 15 and does not require LEAs to submit the final financial information after the audits are completed by December 15. By using the unaudited numbers, Education may be reporting inaccurate expenditures if material adjustments are made in the LEAs audits.

Questioned Costs

Not applicable.

Recommendation

Education should enhance its current policies and procedures to ensure accurate reporting.

Department's View and Corrective Action Plan

Education acknowledges that using unaudited rather than audited expenditure data from LEAs may pose a risk that audit adjustments or omissions may not be adequately reflected in the NPEFS survey. However, Education deems that the risk is minimal and that the potential impact on statewide data is negligible.

Reference Number:	2007-12-18
Federal Catalog Number:	84.282
Federal Program Title:	Charter Schools
Federal Award Number and Year:	Q282A060006;2006
Category of Finding:	Reporting
State Administering Department:	Department of Education (Education)

Criteria

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 80.20, Standards for Financial Management Systems

(a) A State must expend and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contractors, must be sufficient to:

(1) Permit preparation of reports required by this part and the statutes authorizing the grant, and

(2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 80.42, Retention and Access Requirements for Records

(b) *Length of retention period.* (1) Except as otherwise provided, records must be retained for three years from the starting date specified in paragraph (c) of this section.

(c) *Starting date of retention period.* (1) General. When grant support is continued or renewed at annual or other intervals, the retention period for the records of each funding period starts on the day the grantee or subgrantee submits to the awarding agency its single or last expenditure report for that period.

Condition

During procedures performed over required reporting, we selected a sample of information that was reported on Education's Public Charter School Grant Program (PCSGP) Fiscal Year 2006 Grant Performance Report and traced that information to supporting documentation to ascertain the accuracy of the information reported. Although we noted evidence of a review and approval, our inquiries with the persons that performed the review indicated that they did not review the information included on the report with the detail documentation that was used to prepare the report to ensure accuracy. The absence of appropriate reviews and approvals of the compilation of required reporting increases the risk of inaccuracies going undetected.

In our sample line items of data reported, Education was unable to provide supporting documentation for 18 of the 34 sample selections made. The sample items that were not supported included budget information, grantee and administration expenditure information, and performance measures related to PCSGP. There do not appear to be policies in place that require the retention of documentation to support required performance reporting.

Questioned Costs

Not applicable.

Recommendation

Education should enhance its current policies and procedures to ensure documentation is retained to support required reporting.

Department's View and Corrective Action Plan

Although Education currently retains PCSGP records for the required retention period to strengthen policies and procedures, Education will maintain data records to support the information on the PCSGP reports. Additionally, reported information will be clearly identified by document source. Furthermore, to protect the integrity of electronic documentation, the files will be saved as "read only."

Reference Number:	2007-12-19
Federal Catalog Number:	84.282
Federal Program Title:	Charter Schools
Federal Award Number and Year:	U282D040008;2004
Category of Finding:	Reporting
State Administering Department:	California School Finance Authority (Authority)

Criteria

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 80.20, Standards for Financial Management Systems

(b) The financial management systems of other grantees and subgrantees must meet the following standards:

(1) *Financial reporting.* Accurate, current, and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant or subgrant.

Condition

During procedures performed over required reporting, we selected a sample of information that was reported on the Authority's Annual Performance Report (APR) and traced that information to supporting documentation to ascertain the accuracy of the information reported. In our sample of 21 items reported, we noted four of the 21 sampled line items contained differences as follows:

- Section A—Size of the nonfederal match for next year was reported as $500 million, but the source document only supported $487.5 million.

- Section A—Number of students served in this year of the grant was reported as 21,584, but the documentation supplied from the California Department of Education's consolidated application reporting system that was used for this report contained 24,303.

- Section B—Actual year three expenses for per pupil funding was reported as $9,781,536, but the documentation only supported $4,249,606.

- Section B—Actual year two expenses for per pupil funding was reported as $18,538,320, but the documentation only supported $2,617,483.

The difference in the size of the non-federal match was caused by the Authority not deducting administrative allowance of $12.5 million from the amount reported. The underreporting of students served in Section A was due to an oversight. The differences in the Section B expenditure reporting were due to the Authority reporting amounts obligated instead of actual expenditures. Based on the exceptions noted during the audit, the Authority has asserted it submitted a revised APR in January 2008. There does not appear to be an adequate control process in place to ensure accuracy in the amounts reported.

Questioned Costs

Not applicable.

Recommendation

The Authority should enhance its policies and procedures to ensure accurate reporting.

Department's View and Corrective Action Plan

The Authority works diligently when preparing our performance reports for the federal government to ensure accuracy in our reporting. In previous reporting periods, the Authority and staff of the U.S. Department of Education have amended reports after the performance reports were filed.

The Authority will institute the following measures to ensure the accuracy of our reports:

1. A draft preliminary report will be prepared 15 days prior to the performance report due date to allow ample time to answer any questions or resolve any discrepancies between Authority staff and representatives of the U.S. Department of Education.

2. When reporting student data such as enrollment, staff will print out the data from the CDE Web site, as data such as enrollment can fluctuate throughout the year and from year to year.

3. The Authority will present all supporting documents, reports, and ledgers when compiling data for our performance report. It has traditionally filed these documents internally with every draft of the report, but will ask if U.S. Department of Education representatives would like to see supporting documentation presented with the performance report.

Reference Number:	2007-12-20
Federal Catalog Number:	84.186
Federal Program Title:	Safe and Drug-Free Schools and Communities—State Grants
Federal Award Number and Year:	Q186A060005;2006
Category of Finding:	Reporting
State Administering Department:	Department of Education (Education)

Criteria

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 80.20, Standards for Financial Management Systems

(b) The financial management systems of other grantees and subgrantees must meet the following standards:

(1) *Financial reporting.* Accurate, current, and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant or subgrant.

Condition

During procedures performed over required reporting, we selected a sample of information that was reported on Education's Consolidated State Performance Report (CSPR) and traced that information to supporting documentation to ascertain the accuracy of the information reported. We noted no evidence of a review and approval of the data reported on the CSPR. The absence of appropriate reviews and approvals of the compilation of required reporting increases the risk of inaccuracies going undetected. In tracing the amounts reported to supporting documentation, we noted one difference in the data reported that may have been identified had appropriately designed controls been in place over the compilation of data used to report in the CSPR.

Questioned Costs

Not applicable.

Recommendation

Education should enhance its current policies and procedures to ensure accurate reporting.

Department's View and Corrective Action Plan

The error reported by the auditors was a transcription error that was not identified by the reviewer. To ensure accurate transcriptions, Education will strengthen controls by requiring reviewers to proof-read data, initial approval, and maintain hard copies of the CSPR used to support the PCSGP reports.

Reference Number:	2007-12-21
Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education—State Grant Program
Federal Award Number and Year:	S011A060005;2006
Category of Finding:	Reporting
State Administering Department:	Department of Education (Education)

Criteria

TITLE 34—EDUCATION, PART 75—DIRECT GRANT PROGRAMS, Subpart F—What Are the Administrative Responsibilities of a Grantee? Section 75.702, Fiscal Control and Fund Accounting Procedures

A grantee shall use fiscal control and fund accounting procedures that insure proper disbursement of and accounting for Federal funds.

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 80.20, Standards for Financial Management Systems

(a) A State must expend and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contractors, must be sufficient to:

(1) Permit preparation of reports required by this part and the statutes authorizing the grant; and

(2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

(b) The financial management systems of other grantees and subgrantees must meet the following standards:

(1) *Accounting records.* Grantees and subgrantees must maintain records which adequately identify the source and application of funds provided for financially assisted activities. These records must contain information pertaining to grant or subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income.

(2) *Internal control.* Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes.

Condition

During our procedures performed over program reporting requirements, we reviewed Education's processes and controls over the reporting of information on the *Consolidated State Performance Report and the Migrant Child Count Report for State Formula Grant Migrant Education Programs Under the Elementary and Secondary Education Act, as amended by the No Child Left Behind Act of 2001*. We noted that the data used to prepare these required reports is prepared by an outside subcontractor. Education relies upon the work performed by the outside subcontractor and does not perform any monitoring controls to ensure the subcontractor's controls in place to gather and compile

the information are effective to help ensure the accuracy and completeness of the data supplied to Education. The absence of appropriate reviews and approvals of the compilation of required reporting increases the risk of inaccuracies going undetected.

We also noted that Education does not maintain supporting documentation for its submitted reports. Upon our request to ascertain the accuracy of the information reported, Education was able to recreate the information for the samples selected to support the accuracy of the information.

Questioned Costs

Not applicable.

Recommendation

Education should enhance its current policies and procedures to include that a detailed review be performed and evidenced as part of its reporting approval process to reduce the risk of material inaccurate reporting and to maintain all supporting documentation for required reporting for the required documentation period.

Department's View and Corrective Action Plan

In July 2007 Education strengthened controls to reduce the risk of material inaccurate reporting for the CSPR and Child Count reports by implementing the procedures summarized below:

1. Requiring subcontractors to provide the following reports on a monthly basis to ensure that the records used in the final CSPR and Child Count report computations are accurate:

    - Student counts by region
    - Regional progress report on resolving potential duplicate records
    - Record of student data files submitted by region and action taken (files applied, correction to error files)
    - Project progress report identifying data issues and outcomes/resolutions

2. Establishing a quarterly meeting schedule to review and discuss the aforementioned reports. For the 2005–06 CSPR, Education communicated with subcontractors on a weekly basis after the CSPR data was received from the regions. This information was compared against prior year data. If major discrepancies were found, Education contacted the subcontractor and/or the region to clarify any discrepancy. Comments were noted on the CSPR to clarify discrepancies as needed. The submitted CSPR information went through a secondary review by Education's School and District Accountability Office (SDAO). If further discrepancies were identified, SDAO staff communicated directly with the Migrant Education Office to resolve the discrepancies. This same process was used in the review of 2006–07 CSPR data.

3. Beginning in 2008, Education will implement the following additional procedures:

    - Select a sampling of data submissions by region
    - Verify the data submissions for completeness and accuracy
    - If discrepancies are found, forward report to regional office for corrective actions
    - Review corrected data submissions

- If discrepancies persist, require region to submit original source documents to validate data submissions (i.e. Certificates of Eligibility, service logs, referrals, etc)

Reference Number:	2007-12-22
Federal Catalog Numbers:	84.027 & 84.173
Federal Program Titles:	Special Education Cluster: Special Education Grants to States & Special Preschool Grants
Federal Award Numbers and Years:	H027A060116;2006 H173A060120;2006
Category of Finding:	Reporting
State Administering Department:	Department of Education (Education)

Criteria

TITLE 34—EDUCATION, PART 75—DIRECT GRANT PROGRAMS, Subpart F—What Are the Administrative Responsibilities of a Grantee? Section 75.702, Fiscal Control and Fund Accounting Procedures

A grantee shall use fiscal control and fund accounting procedures that insure proper disbursement of and accounting for Federal funds.

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 80.20, Standards for Financial Management Systems

(b) The financial management systems of other grantees and subgrantees must meet the following standards:

(1) *Accounting records.* Grantees and subgrantees must maintain records which adequately identify the source and application of funds provided for financially assisted activities. These records must contain information pertaining to grant or subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income.

(2) *Internal control.* Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes.

Condition

During procedures performed over special reporting, we obtained the *Report of Children and Youth With Disabilities Receiving Special Education Under Part B of the Individuals With Disabilities Education Act* and reviewed Education's processes and controls to ensure accuracy and completeness of the required reporting. Education's data gathering process consisted of obtaining raw data on students reported by its Special Education Local Plan Areas (SELPAs) using its CASEMIS reporting system. Once the data is received by Education, a series of edit checks and comparative analyses are run to validate the accuracy of the data and to identify potential discrepancies. Any significant anomalies are provided to the SELPA to explain and report back to Education. We noted that five in our sample of 30 SELPAs did not submit an explanation and Education failed to follow up.

In the reports obtained from Education's CASEMIS system, we noted that 638 students were identified as duplicate students. Education included these identified duplicate students in its submitted reports. Education accepted the certifications from the SELPAs that the data submitted was accurate and did not require explanation or justification from the SELPAs to validate the duplicates.

These duplicated students reported resulted in Education overreporting 50 students of the 67,052 reported in its preschool program and 588 students of the 672,737 reported in the regular program for the fiscal year ended June 30, 2007.

Questioned Costs

Not applicable.

Recommendation

Education should enhance its current policies and procedures to ensure accurate reporting.

Department's View and Corrective Action Plan

Education's allocation of Preschool grant funds is in accord with the federal accounting procedures of Title 34-Education, Part 75.702. Education allocates these special education funds on the basis of the California Basic Education Data System (CBEDS) and California Work Opportunity and Responsibility to Kids (CalWORKs) Free and Reduced child counts, not data submitted into CASEMIS by SELPAs.

However, commencing with the December 2007 data submissions, Education will strengthen existing controls to eliminate duplicate student counts by implementing the following:

- Verifying the statewide student data file for possible duplicate report of students.
- Sending a cover letter and instructions to each SELPA involved, requiring SELPAs to verify the reports showing possible duplicates against their data file and remove students as appropriate. SELPAs will submit new unduplicated data files to Education as directed. Also, SELPAS must provide documentation describing the methods used for determining the students included in their data files.
- Re-verifying the statewide student data file for duplicates.
- Removing duplicate students from the SELPAs that failed to submit a revision or failed to meet the initial timeline. If SELPAs resubmit duplicate student records, Education will omit the duplicate students.

Reference Number:	2007-13-12
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Education (Education)
Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education—State Grant Program
Federal Award Number and Year:	S011A060005;2006

Federal Catalog Number:	84.282
Federal Program Title:	Charter Schools
Federal Award Number and Year:	U282A060006;2006

Federal Catalog Number:	84.318
Federal Program Title:	Education Technology State Grants
Federal Award Number and Year:	S318X060005;2006

Federal Catalog Number:	84.365
Federal Program Title:	English Language Acquisition Grants
Federal Award Number and Year:	T365A060005;2006

Federal Catalog Number:	84.367
Federal Program Title:	Improving Teacher Quality State Grants
Federal Award Number and Year:	S367A060005;2006

Criteria

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 80.37, Subgrants

(a) *States.* States shall follow state law and procedures when awarding and administering subgrants of financial assistance to local and Indian tribal governments. States shall:

(1) Ensure that every subgrant includes any clauses required by Federal statute and executive orders and their implementing regulations;

(2) Ensure that subgrantees are aware of requirements imposed upon them by Federal statute and regulation;

(3) Ensure that a provision for compliance with Section 80.42 (retention and access requirements for records) is placed in every cost reimbursement subgrant; and

(4) Conform any advances of grant funds to subgrantees substantially to the same standards of timing and amount that apply to cash advances by Federal agencies.

TITLE 31—MONEY AND FINANCE, SUBTITLE V—GENERAL ASSISTANCE ADMINISTRATION, CHAPTER 75—REQUIREMENTS FOR SINGLE AUDITS, Section 7502, Audit Requirements; Exemptions

(f)(2) Each pass-through entity shall:

(A) provide such subrecipient the program names (and any identifying numbers) from which such assistance is derived, and the Federal requirements which govern the use of such awards and the requirements of this chapter;

(D) require each of its subrecipients of Federal awards to permit, as a condition of receiving Federal awards, the independent auditor of the pass-through entity to have such access to the subrecipient's records and financial statements as may be necessary for the pass-through entity to comply with this chapter.

Condition

During our procedures performed over award identification, we were unable to identify controls to ensure that award information was properly identified to the Local Educational Agencies (LEAs).

Migrant Education—State Grant Program

We noted the program uses Grant Award Notifications (Form AO-400) as its means to communicate award identification to its LEAs. We noted the following errors or omissions in the communication:

- Missing identification of federal agency as the U.S. Department of Education.
- Missing authorizing regulations of Title I, Part C of the Elementary and Secondary Education Act of 1965, as amended (ESEA)(20 USC 6391 through 6399).
- Missing Education Department General Administrative Regulations (EDGAR) at 34 CFR, parts 76, 77, 80, 82, and 85.
- Missing other requirements in 34 CFR, Part 200, Subparts C (34 CFR, sections 200.81 through 200.88) and E (34 CFR, sections 200.100 through 200.103) and 34 CFR, Part 299.
- We noted inclusion of some Education Code in the amendments; however, there was no indication that this was the California Education Code.

Charter Schools

We noted the program uses Grant Award Notifications (Form AO-400) as its means to communicate award identification to its LEAs. We noted the following errors or omissions in the communication:

- Missing identification of federal agency as the U.S. Department of Education.
- Missing Catalog of Federal Domestic Assistance (CFDA) number and federal program title.
- Missing identifying federal award number of U282A060006.
- Missing authorizing regulations of Title V, Part B, Subpart 1 of Elementary and Secondary Education Act of 1965 (ESEA), as amended by the No Child Left Behind Act of 2001 (20 USC 7221-7221j).
- Missing EDGAR at 34 CFR, parts 75, 76, 77, 80, 81, 82, 85, 86, and 99.
- Missing administrative requirements for states and LEAs regarding allocating funds to new or expanding charter schools 34 CFR, parts 76.785 through 76.799.

Education Technology State Grants

We noted the program uses Grant Award Notifications (Form AO-400) as its means to communicate award identification to its LEAs. We noted the following errors or omissions in the communication:

- Included title of authorizing regulation of Title II, Part D of No Child Left Behind but did not include the regulatory citations of 20 USC 6761 through 6766; Section 2411 et seq. of Pub. L. No. 107-110 (ESEA), 115 Sat. 1673, January 8, 2002.

- Missing EDGAR at 34 CFR, parts 76, 77, 79, 80, 81, 82, 85 and 86.

English Language Acquisition Grants

We noted the program used the Notices of Apportionment, as opposed to the Grant Award Notifications (Form AO-400) as its means to communicate award identification to its LEAs. We noted the following errors or omissions in the communication:

- Missing disclosures of federal laws, implementing regulations, and provisions which should include the following: Title III, Part A of the ESEA, as amended by No Child Left Behind Act (Pub. L. No. 107-110) (20 USC 6821 through 6871, 7011 through 7014).

- Missing EDGAR at 34 CFR, parts 76, 77, 81, and 82, which also apply to this program.

Improving Teacher Quality State Grants

We noted the program used the Notices of Apportionment, as opposed to the Grant Award Notifications (Form AO-400),as its means to communicate award identification to its LEAs. We noted the following errors or omissions:

- Included only the name Teacher and Principal Training and Recruiting Fund but did not also include the name from the grant award agreement of Improving Teacher Quality State Grants, which is the name that matches the CFDA number that LEAs use for audit identification.

- Incorrect identification of applicable EDGAR. Incorrectly identified 34 CFR 79, "Intergovernmental Review of Department of Education Programs and Activities," and did not include 34 CFR 82, "New Restrictions on Lobbying" or 34 CFR 86 "Drug and Alcohol Abuse Prevention."

- Missing the regulations for program purpose and definitions in Title II, Part A of the ESEA, Sections 2101 and 2102 (20 USC 6601-6602), and the accountability provisions in Title II, Part A, Subpart 4, Section 2141 (20 USC 6641).

- Incorrectly identified Title II regulations as 34 CFR 200, "Title I—Improving the Academic Achievement of the Disadvantaged."

Based on our discussions with Education personnel, we noted each program unit/division is responsible for ensuring that all required disclosures are made in its own grant award notifications, whether it be by Grant Award Notices or by Apportionment Letter Notifications. Through our discussion with Education's deputy general counsel, we noted there is no formal required routing of such forms through the Office of the General Counsel to ensure the accuracy and completeness of these required disclosures. Without effective monitoring controls and/or standardization of templates used to communicate this information, there is increased risk that complete required disclosures will not be made to its LEAs.

Questioned Costs

Not applicable.

Recommendation

Education should implement policies and procedures to ensure that complete award information is provided to its subrecipients.

Department's View and Corrective Action Plan

To ensure that complete award information is provided to subrecipients, Education has revised its AO-400 form. The revision to the AO-400 makes it clear on the form that the grant requirements (i.e. terms, conditions, assurances, and certifications) are identified on the application (in grants where there is an application) or the AO-400 itself, or both. In cases where there is no application, program staff will cite the grant requirements on the AO-400 itself. Additionally, Education will ensure that references to federal statutes and regulations are complete and accurate in the Notices of Apportionment.

Reference Number:	2007-13-13
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Education (Education)
Federal Catalog Number:	84.010
Federal Program Title:	Title I Grants to Local Educational Agencies
Federal Award Numbers and Years:	S010A040005;2004 S010A050005;2005 S010A060005;2006

Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education—State Grant Program
Federal Award Numbers and Years:	S011A040005;2004 S011A050005;2005 S011A060005;2006

Federal Catalog Number:	84.186
Federal Program Title:	Safe and Drug-Free Schools and Communities—State Grants
Federal Award Numbers and Years:	Q186A040005;2004 Q186A050005;2005 Q186A060005;2006

Federal Catalog Number:	84.365
Federal Program Title:	English Language Acquisition Grants
Federal Award Numbers and Years:	T365A040005;2004 T365A050005;2005 T365A060005;2006

Federal Catalog Number:	84.367
Federal Program Title:	Improving Teacher Quality State Grants
Federal Award Numbers and Years:	S367A040004;2004 S367A050005;2005 S367A060005;2006

Criteria

TITLE 31—MONEY AND FINANCE, SUBTITLE V—GENERAL ASSISTANCE ADMINISTRATION, CHAPTER 75—REQUIREMENTS FOR SINGLE AUDITS, Section 7502, Audit Requirements; Exemptions

(f)(2) Each pass-through entity shall:

(B) monitor the subrecipient's use of federal awards through site visits, limited scope audits, or other means.

(D) review the audit of a subrecipient as necessary to determine whether prompt and appropriate corrective action has been taken with respect to audit findings, as defined by the Director, pertaining to federal awards provided to the subrecipient by the pass-through entity.

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 80.40, Monitoring and Reporting Program Performance

(a) *Monitoring by grantees.* Grantees are responsible for managing the day-to-day operations of grant and subgrant supported activities. Grantees must monitor grant and subgrant supported activities to assure compliance with applicable Federal requirements and that performance goals are being achieved. Grantee monitoring must cover each program, function or activity.

Condition

During procedures performed over subrecipient monitoring, we noted the program is monitored by Education's Consolidated Program Monitoring Unit (CPM). The CPM performs program monitoring site reviews on its subrecipients, where Education selects a subrecipient Local Educational Agency (LEA) and monitors a number of its larger No Child Left Behind (NCLB) programs. During the year ending June 30, 2007, Education performed CPM visits on 158, or 15 percent, of its LEAs.

We selected a sample of schools that had been monitored and noted the following regarding CPM's policies and procedures:

- Documentation of the monitoring visit is evidenced by the Cross-Program Instrument (CP). This CP is the only official documentation that is retained to support the procedures performed during the monitoring visit. CPM does not retain detail work paper documentation of the scope of the procedures that are performed (for example, samples tested and interviews performed) to support the conclusions reached. Typically the only documented evidence for procedures performed is a check mark next to a type of document reviewed (for example, LEA plan, LEA policies, or Complaint records/files), a checkmark next to a level of authority (for example, staff, parent, or student) interviewed, and a checkmark next to "meets requirements."

- The monitoring procedures contain limited fiscal procedures and do not cover all major functions and activities of the program. Procedures performed may be limited to reviewing that the school has a policy rather than selecting a sample of transactions to test the effectiveness of that policy.

- There was no documented sign-off of approval for the procedures performed and conclusions reached for the monitoring visit on the CP by someone other than the preparer. We noted instances where the team leader performed the monitoring procedures and signed off on the overall conclusions on the Notification of Findings.

The design of the CPM monitoring instrument contains a section to document the evidence reviewed; however, it only contains checkboxes to mark a type of evidence, as opposed to a fill-in section for the reviewer to indicate the scope of the procedures and exact evidence reviewed (for example, selected five students and reviewed the Notification to Parent or reviewed the school's policy for teacher attendance entitled "Salaried Employees Bulletin 05-178") to support a more precise account of the procedures performed.

We also noted CPM's policies and procedures (CPM protocols) do not require segregation of duties for the CP and Notification of Findings to be reviewed by someone other than the preparer; since the team leaders are also performing portions of the actual procedures, they do not constitute an independent review. Nonsegregation of duties increases risk of errors or potential fraud. The current CPM protocols do not require the CPM team to maintain documentation other than the checkmarks on the instrument which indicate completion, nor do they require evidence of Education's internal reviews and approvals of the conclusions reached and approvals of the Notifications of Findings issued. By not maintaining adequate documentation of the procedures performed or ensuring that appropriate reviews and approvals are performed, Education is not able to adequately support conclusions reached during its monitoring visits.

In our sample of 60 schools from 27 districts that were monitored between November 2006 and May 2007, we noted 58 were issued Notification of Findings reports. We reviewed the support for the follow-up that had been performed on those findings to ascertain if it was conducted in a timely manner. Education requires the schools to respond with a proposed resolution or corrective action plan within 45 days of receipt of the Notification of Findings.

a. For the 58 schools required to submit a proposed corrective action plan within 45 days, we noted that 34 submitted a plan between 46 and 94 days after the receipt of the Notification of Findings.

b. In reviewing the timeliness of the resolution of these proposed corrective action plans, we noted the following:

    - Of the 58 schools, 18 had been fully resolved in a timely manner.

    - Of the 58 schools, 25 had not been resolved by the proposed completion date; however, there was documented evidence of continued follow-up by Education.

    - Of the 58 schools, 15 were past the proposed corrective action completion date and remained unresolved, and there was no evidence of follow-up performed by CPM in the last 30 days.

Effective sanctions do not appear to be imposed by Education on its LEAs for untimely implementation of its LEAs' correction action plans. Per review of the CPM protocols policy, Education's resolution process includes mailing follow-up letters after 45 days, 145 days, 225 days, and 365 days. The sanction threatened to be imposed is for an additional monitoring visit to be performed the subsequent year. Without significant repercussions, the LEAs do not have incentive to implement corrective actions in a timely manner.

Questioned Costs

Not applicable.

Recommendation

Education should enhance its current policies, procedures, and monitoring instruments to help ensure that adequate evidence is maintained for monitoring visits performed and that LEA-proposed corrective actions from those visits are implemented in a timely manner.

Department's View and Corrective Action Plan

To strengthen existing controls, Education conducted the following actions:

Monitoring protocols specify the standard for writing findings—Current CPM protocols require all compliance reviewers to "Identify the evidence analyzed to determine compliance or noncompliance." Also, on January 9, 2008, Education's Categorical Program Monitoring Unit (CPMU) manager advised reviewers to specifically identify the documents, interviews and observations used as evidence of non-compliance.

The Categorical Program Monitoring Unit (CPMU) reviews the findings for each monitoring visit—On January 9, 2008, the CPMU initiated review of the Notifications of Findings for each monitoring visit. This review verifies that documentation of the procedures performed (i.e., program and fiscal samples tested, interviews and observations performed, etc.) support the conclusions reached. Signed verification documents are maintained with the Notification of Findings.

Education has entered into an agreement with the California Comprehensive Center at West Ed to develop a web-based compliance tracking system—On December 18, 2007, a meeting between representatives of Education and the California Comprehensive Center at West Ed resulted in an agreement to develop a web-based computerized tracking system to support categorical program monitoring. This new system will facilitate more timely follow-up and corrective action by the appropriate Education program manager when a LEA fails to resolve findings of non-compliance within the time period allowed.

Reference Number:	2007-13-14
Federal Catalog Numbers:	84.027 & 84.173
Federal Program Titles:	Special Education Cluster: Special Education Grants to States & Special Preschool Grants
Federal Award Numbers and Years:	H027A040116;2004, H173A040120;2004 H027A050116;2005, H173A050120;2005 H027A060116;2006, H173A060120;2006
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Education (Education)

Criteria

TITLE 31—MONEY AND FINANCE, SUBTITLE V—GENERAL ASSISTANCE ADMINISTRATION, CHAPTER 75—REQUIREMENTS FOR SINGLE AUDITS, Section 7502, Audit Requirements; Exemptions

(f)(2) Each pass-through entity shall:

(B) monitor the subrecipient's use of Federal awards through site visits, limited scope audits, or other means.

(C) review the audit of a subrecipient as necessary to determine whether prompt and appropriate corrective action has been taken with respect to audit findings, as defined by the Director, pertaining to Federal awards provided to the subrecipient by the pass-through entity.

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 80.40, Monitoring and Reporting Program Performance

(a) *Monitoring by grantees:* Grantees are responsible for managing the day-to-day operations of the grant and subgrant supported activities. Grantees must monitor grant and subgrant supported activities to ensure compliance with applicable Federal requirements and that performance goals are being achieved. Grantee monitoring must cover each program, function or activity.

Condition

During procedures performed over subrecipient monitoring, we noted Education's Focused Monitoring and Technical Assistance Unit (FTMA) conducts site visits of its Local Educational Agencies (LEAs) and Special Education Local Plan Areas (SELPAs). However, we noted that these monitoring site visits consisted of programmatic procedures and did not include any fiscal procedures to gain assurance on compliance with fiscal requirements of the program.

Of the 19 LEAs and SELPAs that were monitored by the FTMA between February and June 2006, we noted all 19 had resulted in compliance findings that required follow-up corrective action. Education requires the LEA or SELPA to respond with evidence of corrective action within approximately six months of receipt of the Notification of Audit Results in the majority of instances. We reviewed the support for the resolution follow-up that had been performed on those findings to ascertain if it has been completed in a timely manner.

- Seventeen of the 19 LEA or SELPA closure letters for the acceptance of corrective action were dated between February 2007 and January 2008, which is approximately 11 to 19 months from the date of the monitoring visit.

- Two of the 19 LEAs or SELPAs had compliance findings that still had not been resolved by January 2008, which is approximately 20 months from the date of the monitoring visit.

This untimely resolution of corrective actions appears to be the result of the follow-up schedule that is dictated by Education. Allowing a generous length of time to respond with support for corrective action increases the length of time to resolve findings, since approximately nine months have already passed from the site visit to when Education can make its initial assessment of whether appropriate steps have been taken or additional follow-up will be needed. By not requiring timely follow-up on monitoring visit findings of noncompliance with program regulations, the period of noncompliance for subrecipients is extended, causing noncompliance in subsequent grant periods.

Questioned Costs

Not applicable.

Recommendation

Education should enhance its current policies and procedures over subrecipient monitoring, specifically during the award monitoring visits, to ensure that all material program elements are covered, including fiscal, and that resolution of corrective actions on deficiencies noted during the award monitoring is performed in a timely manner.

Department's View and Corrective Action Plan

Education does not concur with the condition related to the timeliness of following up on monitoring visit findings. Although staff turnover contributed to a longer-than-normal follow-up period, Education conducted follow-up visits within six months to ensure that all required corrective actions have been implemented. In cases where corrective action was not fully implemented, subsequent follow-up monitoring visits have been scheduled within six months. For example, in reference to the two of 19 LEA/SELPAs that had not resolved compliance findings by January 2008:

High School District A

The High School District verification review was completed on May 10, 2006. A report was sent to the district; the district made appropriate corrective actions within required timelines. To ensure ongoing compliance, a six-month follow-up visit was completed on September 12, 2007; this follow-up visit also reported non-complaint findings. The district submitted documentation per timelines, and a second follow-up visit has been scheduled; therefore, no sanctions are warranted at this time.

Elementary School District B

The Elementary School District verification review was completed on June 19, 2006. A report was sent to the district; the district made appropriate corrective actions within required timelines. To ensure on-going compliance, a six-month follow-up visit was completed on October 30, 2007; this follow-up visit also reported non-compliant findings. The district was informed of these findings and was given a due date of January 18, 2008 to submit corrections. Education received the district corrective documentation on February 18, 2008.

Education will assess the costs and available resources in implementing fiscal review elements during on-site monitoring visits.

Reference Number:	2007-13-15
Federal Catalog Number:	84.282
Federal Program Title:	Charter Schools
Federal Award Numbers and Years:	Q282A040006;2004 Q282A050005;2005 Q282A060006;2006
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Education (Education)

Criteria

TITLE 31—MONEY AND FINANCE, SUBTITLE V—GENERAL ASSISTANCE ADMINISTRATION, CHAPTER 75—REQUIREMENTS FOR SINGLE AUDITS, Section. 7502, Audit Requirements; Exemptions

(f)(2) Each pass-through entity shall:

(B) monitor the subrecipient's use of Federal awards through site visits, limited scope audits, or other means;

(C) review the audit of a subrecipient as necessary to determine whether prompt and appropriate corrective action has been taken with respect to audit findings, as defined by the Director, pertaining to Federal awards provided to the subrecipient by the pass-through entity.

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 80.40, Monitoring and Reporting Program Performance

(a) *Monitoring by grantees.* Grantees are responsible for managing the day-to-day operations of grant and subgrant supported activities. Grantees must monitor grant and subgrant supported activities to assure compliance with applicable Federal requirements and that performance goals are being achieved. Grantee monitoring must cover each program, function or activity.

Condition

During procedures performed over subrecipient monitoring, we noted the Charter School Division of Education monitors its subrecipients. Education committed to performing monitoring visits on 50 percent of the 23 charter schools that were in their second year of implementation; however, it only performed monitoring visits on five charter schools or approximately 11 percent of charter schools in their second year during the fiscal year ended June 30, 2007. Therefore, Education did not meet its monitoring plan objective for the year.

Documentation of the monitoring visit is evidenced by either the monitoring checklist or the visitation report. This is the only official documentation that is retained to support the procedures performed during the monitoring visit. Education also does not retain detail work paper documentation of the scope of the procedures that are performed (for example, samples tested or interviews performed), to support the conclusions reached. Typically the only documented evidence for procedures performed are a check mark next to a type of procedure performed (for example, timely progress toward achieving your grant objectives as specified in your grant proposal) and signatures by the reviewer and the recipient. We also noted no documented sign-off of approval for the procedures performed and conclusions reached for the monitoring visit by someone other than the preparer.

Questioned Costs

Not applicable.

Recommendation

Education should enhance its current policies, procedures, and monitoring instruments to help ensure that adequate evidence is maintained for monitoring visits performed and that LEA-proposed corrective actions from those visits are implemented in a timely manner.

Department's View and Corrective Action Plan

In April 2007, Education received a one-year extension from the United States Department of Education, Office of Innovation and Improvement, to complete the goals and objectives of the 2004-2007 charter school grant; the new end date of the grant project period is September 30, 2008.

An additional 55 grant-funded schools began their second year of operation in 2007; the total commitment for monitoring visits went from 23 to 50 schools. Education is currently scheduling monitoring visits for these schools and plans to complete all scheduled reviews by March 31, 2008. Education enhanced its monitoring over charter schools by implementing the following improvements:

- Site monitoring forms have been revised to capture information regarding evidence reviewed, school representatives interviewed, and noted observations.

- Site monitoring forms have been revised to require the signature of the Public Charter School Grant Program (PCSGP) Project Director, signifying review of the monitoring visit and compliance with monitoring procedures.

- The grantee database has been amended to include a column noting monitoring corrections required, contact between grantee, and date corrective action was completed. Verification of timely implementation of required corrective action by grantees is the responsibility of Education's PCSGP Project Director.

Reference Number:	2007-13-16
Federal Catalog Number:	84.282
Federal Program Title:	Charter Schools
Federal Award Number and Year:	U282D040008;2004
Category of Finding:	Subrecipient Monitoring
State Administering Department:	California School Finance Authority (Authority)

Criteria

TITLE 31—MONEY AND FINANCE, SUBTITLE V—GENERAL ASSISTANCE ADMINISTRATION, CHAPTER 75—REQUIREMENTS FOR SINGLE AUDITS, Section 7502, Audit Requirements; Exemptions

(f)(2) Each pass-through entity shall:

(A) provide such subrecipient the program names (and any identifying numbers) from which such assistance is derived, and the Federal requirements which govern the use of such awards and the requirements of this chapter.

(B) monitor the subrecipient's use of Federal awards through site visits, limited scope audits, or other means.

(C) review the audit of a subrecipient as necessary to determine whether prompt and appropriate corrective action has been taken with respect to audit findings, as defined by the Director, pertaining to Federal awards provided by the subrecipient by the pass-through entity.

Condition

1. During our procedures performed over subrecipient monitoring, we noted the program uses grant award letters and the Application Agreement and Certification (CSFA Form 05-01) as its means to communicate award identification to its subrecipient charter schools. In our review of these communications, we noted the following errors or omissions of information:

   - Missing Catalog of Federal Domestic Assistance (CFDA) number.

   - The identified applicable regulations are listed as California Code of Regulations, sections 10175 and 10191, which is on the Application Agreement and Certification. Upon further investigation into the details of the state regulations cited, they do identify the funding as U.S. Department of Education and include a few of the required federal regulations (for example, 34 CFR, 80.26);

however, these few regulations are not a complete listing of federal administrative regulations that are required to be followed. Citations should include 34 CFR, parts 75, 76, 77, 79, 80, 81, 82, 85, 86 and 99.

- Missing disclosure of the U.S. Office of Management and Budget Circular A-133, (OMB Circular A-133) audit requirements for charter school subgrantees.

These omissions appear to have occurred due to lack of knowledge of federal disclosure requirements by the Authority. We were unable to identify controls to ensure that complete grant award information was properly identified to the subrecipient charter schools. By not adequately disclosing federal program information to subrecipient charter schools, there is significant increased risk that they will not comply with appropriate federal requirements.

2. The Authority's during-the-award monitoring procedures consisted of each charter school subrecipient's submission of a legal status questionnaire, which is a certification of no civil or criminal issues by the administrator, and an updated lease agreement. These are submitted every six months when a grant payment is requested. Although the program purpose of the grant funds is for the acquisition, rental, and construction of real property, the Authority's monitoring policies do not include any visits. By only reviewing the agreements and not physically reviewing any sites, there is risk that manipulation of the agreements may occur and not be detected.

   In order to test the monitoring procedures in place, we selected a sample of subrecipients that participated in the program during the year and reviewed their file for a copy of the legal status questionnaire and lease agreement that were dated within six months of receiving a program payment in accordance with the Authority's policies. In our sample of 15 charter school subrecipients, we noted two did not have current legal status questionnaires on file as required. Adequate control policies do not appear to be in place to ensure that these required updated documents are received before payments are disbursed.

3. We reviewed the Authority's policies and procedures regarding subrecipient OMB Circular A-133 audits and noted it did not have adequate processes and controls in place to disclose, identify, and obtain required OMB Circular A-133 audit reports from its charter school subrecipients that expend $500,000 or more in total federal funds. The Authority did not request or obtain any OMB Circular A-133 audit reports for any of its charter school subrecipients. In our sample of 15 charter school subrecipient awards, we noted six were made for more than $500,000 with this funding alone and without any consideration to other federal program funding received, which would very likely require all its subrecipients to obtain an OMB Circular A-133 audit. Without properly designed processes and controls in place to notify, obtain, and review required OMB Circular A-133 audits, there is increased risk that subrecipient charter schools may not be complying with federal program rules and regulations without being detected. Total subgrant award expenditures for the year ended June 30, 2007, amounted to $5,531,930.

Questioned Costs

Not applicable.

Recommendation

The Authority should implement policies and procedures to ensure that complete award information is provided and adequate monitoring procedures are performed to ensure its charter school subrecipients are complying with applicable program rules and regulations.

Department's View and Corrective Action Plan

All program documents reference that this program is a federal or federally funded program. The Authority will employ the following:

Response to Condition #1:

1. The Authority will integrate the CDFA number into all program related documents.

2. The Authority will identify the funding as Federal Department of Education, and cite the following CFR parts, 75, 76, 77, 79, 80, 81, 82, 85, 86 and 99, in the appropriate program documents.

3. The Authority will disclose in all program related documents the OMB Circular A-133 audit requirements for subgrantees.

Response to Condition #2: The Authority verifies, by evaluating all lease and rental agreements, that funds are being expended to pay for facilities that are for educational purposes only, and that the charter school or operator is a party to said lease and rental agreement.

There is no formal regulatory or statutory policy regarding the intervals at which updated Legal Status Questionnaire (LSQ) information is requested and evaluated. However, the Authority has implemented a policy that no semi-annual disbursements be released without an updated and current LSQ being submitted to Authority staff for evaluation.

1. The Authority has begun scheduling site visits to commence in June 2008 to ensure that no manipulation of the program agreements exists.

2. The Authority will continue to request updated LSQ information before funds are disbursed. If disbursements schedules are modified to match the cash needs of subgrantees, staff will not recommend that monthly updates to the LSQ be evaluated on a monthly basis, but rather on a semi-annual basis.

Response to Condition #3:

1. The Authority will notify all subgrantees of the requirement to conduct an A-133 audit once $500,000 or more in total federal funds are expended.

2. The Authority has begun evaluating which subgrantees (under this program) have received more than $500,000 in one fiscal year. We will work with these subgrantees to ensure that they comply with this requirement.

Reference Number:	2007-13-17
Federal Catalog Number:	84.318
Federal Program Title:	Education Technology State Grants
Federal Award Numbers and Years:	S318X040005;2004 S318X050005;2005 S318X060005;2006
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Education (Education)

Criteria

TITLE 31—MONEY AND FINANCE, SUBTITLE V—GENERAL ASSISTANCE ADMINISTRATION, CHAPTER 75—REQUIREMENTS FOR SINGLE AUDITS, Section 7502, Audit Requirements; Exemptions

(f)(2) Each pass-through entity shall:

(B) monitor the subrecipient's use of Federal awards through site visits, limited scope audits, or other means.

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 80.40, Monitoring and Reporting Program Performance

(a) *Monitoring by grantees.* Grantees are responsible for managing the day-to-day operations of the grant and subgrant supported activities. Grantees must monitor grant and subgrant supported activities to ensure compliance with applicable Federal requirements and that performance goals are being achieved. Grantee monitoring must cover each program, function or activity.

Condition

During procedures performed over subrecipient monitoring, we noted the program has formal policies and procedures to perform monitoring of its Local Educational Agencies (LEAs); however, none of these procedures were performed during the year ended June 30, 2007. We also noted that this program was not included in Education's consolidated program monitoring visits.

Education indicated that it did not have sufficient resources available to perform monitoring procedures during the fiscal year ending June 30, 2007. By not performing monitoring procedures over fiscal requirements, Education risks material noncompliance of subrecipients going undetected on a timely basis.

Questioned Costs

Not applicable.

Recommendation

Education should enhance its current policies and procedures to ensure that adequate monitoring is performed over its LEAs to ensure that they are complying with applicable rules and regulations.

Department's View and Corrective Action Plan

Education will implement procedures to strengthen the monitoring over Enhancing Education Through Technology (EETT) subrecipients. With over 1,000 EETT formula recipients and a 60 percent reduction in EETT funding, Education will concentrate its limited resources on monitoring the subrecipients that received the largest funding awards.

To strengthen the monitoring of subrecipients, Education will:

- Hire a retired annuitant to be the subrecipient monitoring coordinator. The subrecipient monitoring coordinator will develop, coordinate, and participate in a comprehensive program to insure that adequate monitoring is performed by ETO and California Technology Assistant Project (CTAP) staff.

- Perform site visits for the largest EETT awards and troubled districts. The ETO will examine EETT Competitive and Formula awardees, examine school site implementations, interview teachers and administrators, and examine financial records/source documentation which reconcile to the EETT funds received.

- Review mid-year and end-of-year performance reports for EETT Competitive awards to monitor progress of implementation.

- Provide guidance and monitoring for EETT Formula and Competitive awardees throughout the state. In addition to technology training provided, the ETO and CTAP will assist LEAs in the completion of EETT Formula and Competitive expenditure reports and will provide training on the expenditures allowed for hardware, software, and professional development in accordance with the program regulations.

- Continue review and approval of over 1,100 fiscal year 2005–06 EETT Formula and Competitive end-of-period expenditure reports.

- Continue review and approval of EETT Profile data, technology hardware/access surveys, and technology plans to monitor the LEAs' progress in implementing technology.

- Obtain and follow-up on federal and state compliance findings related to the EETT program from LEAs' annual independent certified public accountant audit reports.

Reference Number:	2007-13-18
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Education (Education)
Federal Catalog Number:	84.010
Federal Program Title:	Title I Grants to Local Educational Agencies
Federal Award Numbers and Years:	S010A040005;2004 S010A050005;2005 S010A060005;2006

Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education—State Grant Program
Federal Award Numbers and Years:	S011A040005;2004 S011A050005;2005 S011A060005;2006

Federal Catalog Number:	84.186
Federal Program Title:	Safe and Drug-Free Schools and Communities—State Grants
Federal Award Numbers and Years:	Q186A040005;2004 Q186A050005;2005 Q186A060005;2006

Federal Catalog Number:	84.318
Federal Program Title:	Education Technology State Grants
Federal Award Numbers and Years:	S318X040005;2004 S318X050005;2005 S318X060005;2006

Federal Catalog Number:	84.365
Federal Program Title:	English Language Acquisition Grants
Federal Award Numbers and Years:	S365A040005;2004 S365A050005;2005 S365A060005;2006

Federal Catalog Number:	84.367
Federal Program Title:	Improving Teacher Quality State Grants
Federal Award Numbers and Years:	S367A040005;2004 S367A050005;2005 S367A060005;2006

Criteria

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart B—Pre-Award Requirements, Section 80.12, Special Grant or Subgrant Conditions for 'High-Risk' Grantees

(a) A grantee or subgrantee may be considered "high risk" if an awarding agency determines that a grantee or subgrantee:

(1) Has a history of unsatisfactory performance, or

(2) Is not financially stable, or

(3) Has a management system which does not meet the management standards set forth in this part, or

(4) Has not conformed to terms and conditions of previous awards, or

(5) Is otherwise not responsible; and if the awarding agency determines that an award will be made, special conditions and/or restrictions shall correspond to the high risk condition and shall be included in the award.

(b) Special conditions or restrictions may include:

(1) Payment on a reimbursement basis;

(2) Withholding authority to proceed to the next phase until receipt of evidence of acceptable performance within a given funding period;

(3) Requiring additional, more detailed financial reports;

(4) Additional project monitoring;

(5) Requiring the grantee or subgrantee to obtain technical or management assistance; or

(6) Establishing additional prior approvals.

(c) If an awarding agency decides to impose such conditions, the awarding official will notify the grantee or subgrantee as early as possible, in writing, of:

(1) The nature of the special conditions/restrictions;

(2) The reason(s) for imposing them;

(3) The corrective actions which must be taken before they will be removed and the time allowed for completing the corrective actions; and

(4) The method of requesting reconsideration of the conditions/restrictions imposed.

Condition

In our review of Education's U.S. Office of Management and Budget Circular A-133, (OMB Circular A-133) audit reports received by its subrecipients, we noted two districts that demonstrated continued history of unsatisfactory performance and/or financial instability that appears to qualify them as higher-risk LEAs. During our procedures performed over these programs, we did not identify any special conditions or restrictions imposed on either of these districts to help ensure compliance with applicable rules and regulations. The following potential concerns were identified on the two districts' reports:

1. One district's most recent audit report, which was for June 30, 2005, but was not received by Education until February 15, 2007 (approximately 11 months past the due date), with the June 30, 2006 report still outstanding (currently approximately nine months late), contained the following concerns:

   - Financial statement audit

     —Disclaimed opinion

     —Negative $10 million in total net assets

     —Going concern paragraph

     —Material weaknesses in internal controls

   - OMB Circular A-133 audit:

     —Disclaimed opinion

     —Material weaknesses

     —Qualification of all five major programs audited

2. Another district's audit report, which was for June 30, 2006, received by Education in a timely manner, contained the following concerns:

   - Significant deficiencies in internal control over similar financial reporting for past two years

   - Qualified opinions on compliance with 17 major programs in 2006 and 12 major programs in 2005

   - Numerous significant deficiencies in internal controls over federal programs

- Material findings repeated in 2006 from 2005 and 2004
- Several million dollars in questioned annual costs in 2006 and 2005

During our procedures performed over these programs, we did not identify any special conditions or restrictions imposed on either of these districts to help ensure compliance with applicable rules and regulations.

Consistent with our prior-year finding, we were unable to obtain or identify any policies or procedures for assessing Special Education Local Plan Area (SELPA) and Local Educational Agency (LEA) subrecipients as high-risk either on the individual program level or on the overall SELPA and LEA level. Identification of higher-risk SELPAs and LEAs is a critical component in determining the extent of award monitoring procedures to be performed by Education and by the LEAs' auditors in their OMB Circular A-133 single audits. Total amounts paid to these SELPAs and LEAs during the fiscal year ending June 30, 2007, amounted to $603 million of the $4.5 billion paid to all SELPAs and LEAs for their combined programs.

Questioned Costs

Not applicable.

Recommendation

Education should enhance its current monitoring and evaluation policies and procedures to ensure material risks are considered and adequately addressed in the monitoring process for its LEAs.

Department's View and Corrective Action Plan

Education will utilize information from program monitoring and audits to obtain sufficient knowledge to identify any special conditions or restrictions necessary to be imposed on an LEA, and to determine whether an LEA should be designated as high risk. To assist in this process, Education will continue to disseminate summary reports of OMB Circular A-133 audit findings and audit resolution updates to program staff.

Reference Number:	2007-14-7
Federal Catalog Number:	84.010
Federal Program Title:	Title I Grants to Local Educational Agencies
Federal Award Number and Year:	S010A060005;2006
Category of Finding:	Special Tests and Provisions
State Administering Department:	Department of Education (Education)

Criteria

TITLE 20—EDUCATION, CHAPTER 70—STRENGTHENING AND IMPROVEMENT OF ELEMENTARY AND SECONDARY SCHOOLS, SUBCHAPTER I—IMPROVING THE ACADEMIC ACHIEVEMENT OF THE DISADVANTAGED, PART A—IMPROVING BASIC PROGRAMS OPERATED BY LOCAL EDUCATIONAL AGENCIES, Subpart 1—Basic Program Requirements, Section 6311, State Plans

(c) *Other provisions to support teaching and learning.* Each State plan shall contain assurances that—

(6) the State educational agency will notify local educational agencies and the public of the content and student academic achievement standards and academic assessments developed under this section, and of the authority to operate schoolwide programs, and will fulfill the State educational agency's responsibilities regarding local educational agency improvement and school improvement under section 6316 of this title, including such corrective actions as are necessary.

Condition

During our procedures performed to ascertain if Education had taken steps to notify its Local Educational Agencies (LEAs) of the authority to consolidate federal, state, and local funds in schoolwide programs, we noted the last formal correspondence that Education had submitted to its LEAs regarding the notification was made several years ago. A search of Education's Web site indicates that information is available, but in order for LEAs to locate this information, they would have to know where to search.

We reviewed the notifications of the grant awards to ascertain if notification was included of the award either through providing the information or guiding them to the subsite of Education's Web site. We noted the Title I program used the Notices of Apportionment, as opposed to the Grant Award Notifications (Form AO-400), as its means to communicate award identification to its LEAs. In our review of the information contained in this communication, we noted no notification of this requirement was communicated, nor was a link to the page on Education's Web site that would provide them with this information.

Questioned Costs

Not applicable.

Recommendation

Education should enhance its current communication with its LEAs to include its authority to consolidate in its annual notifications of grant awards to ensure that there is appropriate communication made in accordance with required federal guidelines.

Department's View and Corrective Action Plan

Education will ensure that the Notices of Apportionment provide Web site links to the LEAs for accessing information on the authority to consolidate funds in schoolwide programs.

Reference Number:	2007-14-8
Federal Catalog Number:	84.010
Federal Program Title:	Title I Grants to Local Educational Agencies
Federal Award Numbers and Years:	S010A050005;2005 S010A060005;2006
Category of Finding:	Special Tests and Provisions
State Administering Department:	Department of Education (Education)

Criteria

TITLE 20—EDUCATION, CHAPTER 70—STRENGTHENING AND IMPROVEMENT OF ELEMENTARY AND SECONDARY SCHOOLS, SUBCHAPTER I—IMPROVING THE ACADEMIC ACHIEVEMENT OF THE DISADVANTAGED, PART A—IMPROVING BASIC PROGRAMS OPERATED BY LOCAL EDUCATIONAL AGENCIES, Subpart 1—Basic Program Requirements, Section 6321, Fiscal Requirements

(c) *Comparability of services*

(3) Procedures and records. Each local educational agency assisted under this part shall:

(a) develop procedures for compliance with this subsection; and

(b) maintain records that are updated biennially documenting such agency's compliance with this subsection.

Condition

During our procedures performed over comparability, we noted Education has developed specific policies and procedures to assess Local Educational Agencies (LEAs) for compliance with Title I comparability. We were unable to obtain documentation to support that comparability assessments were performed as of either June 30, 2006, or June 30, 2007. Education has indicated it performed assessments for the year ended June 30, 2006, and is in the process of revising its policies and procedures for comparability calculations to be performed again for the fiscal year ended June 30, 2008. However, since we were unable to obtain documentation to support that the June 30, 2006, assessment was performed, we are unable to assess Education's compliance with the comparability requirements.

Questioned Costs

Not applicable.

Recommendation

Education should enhance its current policies and procedures to ensure that comparability assessments are performed in a timely manner.

Department's View and Corrective Action Plan

Education tested comparability for the 2005–06 school year by performing initial calculations for each LEA, using data from the California Basic Education Data System (CBEDS). The process tested comparability using the pupil/teacher ratio (PTR) methodology. For any LEA that could not establish comparability for all schools using this method, the state requested further information to determine if comparability could be established through one of the alternate methods allowed by law.

Reports from the test process indicated that 39 LEAs were not compliant as measured by PTR. An e-mail notification with all pertinent documentation was sent out to the 39 LEAs to request them to correct and/or update their data. They were allowed to use current enrollment data (all from the same date) or data other than PTR to calculate their comparability such as Pupil/Teacher Salary Expenditure Ratio (P/TSER) and comparison of Title I school to non-Title I schools of the similar sizes. At that time, supporting class list documentation was not required, although some included it anyway. As of May 2006, all 39 LEAs had come into compliance in their comparability.

In the 2006–07 school year, Education initiated the collection of individual student level data. However, districts were unable to complete their data submission in time for Education to run comparability calculations as planned. Therefore, before the beginning of the 2007–08 school year, Education created a new process to directly collect comparability calculations from the LEAs; those reports were initially submitted in October 2007.

Education strengthened procedures to assess whether local educational agencies (LEAs) are meeting comparability requirements. Effective with the 2007–2008 school year, Education will verify comparability by:

- Annually identifying which LEAs are required to demonstrate comparability with Title I, Part A, and those LEAs that are not required to demonstrate comparability (i.e., LEAs with a single attendance area, a single attendance area at each grade span, or less than 1,000 students).

- Notifying the appropriate LEAs in August of their responsibility to determine compliance with Title I, Part A, and provide LEAs with electronic worksheets and instructions to complete the calculations and determine comparability. These worksheets include at least two options that LEAs may use to demonstrate comparability. Education developed and posted on its Web site forms, guidance, and instructions for meeting comparability requirements at http://www.cde.ca.gov/sp/sw/t1/titleparta.asp.

- Requiring LEAs to complete and submit their comparability reports in October of each year. LEAs with schools that fail the initial comparability test, are given additional time to hire staff, adjust student enrollment, provide additional funding, and/or correct or provide more current data by which they have calculated new reports to resolve non-comparability issues; the second reporting date is mid to late November. The first apportionment for those LEAs failing to submit comparability reports by the November due date will be withheld.

- Those LEAs that failed to demonstrate compliance in comparability are required to submit revised reports along with the supporting documentation on which the revised report was based. The supporting documents may include enrollment data and the number of instructional staff per grade span when the LEA uses the option to compare the student-to-instructional-staff ratio. In the case of using the LEA option to compare the student-to-instructional-staff-salary ratio, the supporting documents may include enrollment data and the instructional staff salary data. In addition, any documents to show that LEAs made adjustments in staffing and funding must be included.

- Second apportionment of Title I funds in February/March will not be released to any LEA that has not submitted comparability reports or has not established comparability by the end of the first semester. Education provides technical assistance to LEAs not showing comparability in all schools in order to ensure that all required LEAs meet comparability requirements before the end of the first semester.

- Requiring LEAs to provide annual written assurances through the state Consolidated Application that comparability calculations were conducted and comparability requirements were met and source documents maintained. LEAs submit their comparability reports electronically to Education on a two-year cycle, thus one half of the LEAs will submit their reports one year, and the other half the second year. In addition, Education will conduct a random sampling of 2.5 percent of all LEAs required to calculate comparability each year in order to verify the data submitted. For the 2007-2008 school year, Education will visit and review seven LEAs for data verification.

Reference Number:	2007-14-9
Federal Catalog Number:	84.010
Federal Program Title:	Title I Grants to Local Educational Agencies
Federal Award Number and Year:	S010A060005;2006
Category of Finding:	Special Tests and Provisions
State Administering Department:	Department of Education (Education)

Criteria

UNITED STATES CODE, TITLE 20—EDUCATION, CHAPTER 70—STRENGTHENING AND IMPROVEMENT OF ELEMENTARY AND SECONDARY SCHOOLS, SUBCHAPTER V—PROMOTING INFORMED PARENTAL CHOICE AND INNOVATIVE PROGRAMS, PART B—PUBLIC CHARTER SCHOOLS, Subpart 1—Charter School Programs, Section. 7221e, Federal Formula Allocation During First Year and for Successive Enrollment Expansions

(a) In general

For purposes of the allocation to schools by the States or their agencies of funds under part A of subchapter I of this chapter, and any other Federal funds which the Secretary allocates to States on a formula basis, the Secretary and each State educational agency shall take such measures as are necessary to ensure that every charter school receives the Federal funding for which the charter school is eligible not later than 5 months after the charter school first opens, notwithstanding the fact that the identity and characteristics of the students enrolling in that charter school are not fully and completely determined until that charter school actually opens. The measures similarly shall ensure that every charter school expanding its enrollment in any subsequent year of operation receives the Federal funding for which the charter school is eligible not later than 5 months after such expansion.

Condition

During our procedures performed over the timing of disbursements made to new or significantly expanded charter schools to ascertain if the payments had been made within five months from the date of opening or significant expansion, we selected a sample of new and expanded charter schools and reviewed documentation to support that the Local Educational Agency (LEA) completed the required prerequisites (for example, consolidated application) that made them eligible to receive a payment. We then reviewed the support for the dates the eligible LEAs were paid to ascertain the timeliness of the payment made and noted the following:

- In our sample of new charter schools we noted two of the 13 eligible sampled schools did not receive payments within the required five months.

- In our sample of significantly expanded charter schools (Education uses a definition of 20 percent of enrollment to be significant), we noted five of the 16 eligible sampled schools did not receive a payment within the required five months.

Additionally, we reviewed Education's procedures for allocating the program funds based on poverty and enrollment. Education indicated it surveyed the charter schools as the basis for the estimated enrollment used in the initial apportionment calculations and then adjusted the initial estimates to actual enrollment, which is submitted in January with Part II of the consolidated application.

- Education was unable to provide the charter school surveys to support that the initial apportionments were based on estimated enrollment.

- In our review of the final calculations, which we traced to enrollment information submitted on the consolidated application, we noted four of the 29 schools sampled contained differences between the enrollment or poverty data used in the calculation.

Questioned Costs

Not applicable.

Recommendations

Education should enhance its current policies and procedures to ensure the accuracy of its initial program entitlement estimate that is based on estimated enrollment and of its final calculation of program entitlements that is based on actual enrollment, and to require the retention of documentation to support these calculations. Education should also ensure eligible required payments are made to new or significantly expanded charter schools no later than the required five months after the first day of the school opening or a significant expansion.

Department's View and Corrective Action Plan

Education does not concur with this condition. Of the 5 significant expansions to charter schools noted, 3 of those charter schools either declined the funds or did not provide data to Education within five months of the significant expansion to allow Education to calculate an entitlement and make a payment. Therefore, Education did not pay these significantly expanding charter schools within the 5 months of expansion and believes these not to be exceptions. Furthermore, since the entitlement calculation is drawn from the consolidated application at a specific point in time, the data reflected on the consolidated application may have been subsequently updated or revised by the schools.

However, Education will strengthen its policies and procedures to ensure the accuracy of the data included in its calculations and the timeliness of payments made to new and significantly expanding charter schools.

Reference Number:	2007-14-10
Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education—State Grant Program
Federal Award Number and Year:	S011A060005;2006
Category of Finding:	Special Tests and Provisions
State Administering Department:	Department of Education (Education)

Criteria

TITLE 34—EDUCATION, PART 75—DIRECT GRANT PROGRAMS, Subpart F—What Are the Administrative Responsibilities of a Grantee? Section 75.702, Fiscal Control and Fund Accounting Procedures

> A grantee shall use fiscal control and fund accounting procedures that insure proper disbursement of and accounting for Federal funds.

TITLE 34—EDUCATION, PART 80—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 80.20, Standards for Financial Management Systems

(b) The financial management systems of other grantees and subgrantees must meet the following standards:

(2) *Internal control.* Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes.

Condition

During our procedures performed over the subgrant process, we reviewed Education processes and controls to ensure the accuracy of the amounts awarded and that the calculation takes into account the numbers and needs of migratory children. We noted that the funding formula is prepared by an outside subcontractor. Education relies upon the work performed by the outside subcontractor and does not perform any monitoring to ensure the subcontractor's controls are in place and effective to help ensure the accuracy of the funding formula supplied to Education.

Education does not have a policy in place to monitor the outside subcontractor or to test the information it provides. The absence of appropriate reviews and approvals of the compilation of required reporting increases the risk of inaccuracies going undetected.

Questioned Costs

Not applicable.

Recommendation

Education should enhance its current policies and procedures to include a detailed review to be performed and evidenced as part of its reporting approval process to reduce the risk of inaccurate subgrant awards.

Department's View and Corrective Action Plan

In July 2007 Education assigned a consultant to conduct a detailed review of child count reports submitted by the vendors. Furthermore, Education strengthened its current procedures to ensure that all quality control processes are adhered to by reviewing and validating regional summary reports used in calculating the subgrant reports. This process utilizes the following steps:

- Vendor sends out unduplicated count to the regions for validation.
- Once the student count for the previous year is established, staff will meet with vendors to review the preliminary final report.
- Both the vendor and Education check the reports for accuracy by comparing the subgrant report with data of other vendor reports that are provided by each region.
- Drawing a sampling of data submissions by region and checking the data submissions for completeness and accuracy. If discrepancies are found, forward report to regional office for corrective actions.
- Review corrected data submissions. If discrepancies persist, requiring region to submit original source documents to validate data submissions, i.e. Certificates of Eligibility, service logs, referrals, etc.

Reference Number:	2007-14-11
Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education—State Grant Program
Federal Award Number and Year:	S011A060005;2006
Category of Finding:	Special Tests and Provisions
State Administering Department:	Department of Education (Education)

Criteria

TITLE 20—EDUCATION, CHAPTER 70—STRENGTHENING AND IMPROVEMENT OF ELEMENTARY AND SECONDARY SCHOOLS, SUBCHAPTER I—IMPROVING THE ACADEMIC ACHIEVEMENT OF THE DISADVANTAGED, Part C—Education of Migratory Children, Section 6394, State Applications; Services

(b) Program information. Each such application shall include:

(2) a description of the steps the State is taking to provide all migratory students with the opportunity to meet the same challenging State academic content standards that all children are expected to meet.

Condition

During our procedures performed over the review of the *Report and the Migrant Child Count Report for State Formula Grant Migrant Education Programs Under the Elementary and Secondary Education Act, as amended by the No Child Left Behind Act of 2001*, we reviewed the description of the quality control process to ascertain if Education had carried out the quality control process as described in the report. The report indicated the quality controls process includes the following materials developed for the program: *Identification and Recruitment Handbook*, *California Quality Assurance Guidelines for Collecting and Entering Data*, COE Instructions (incorporated into the Identification and Recruitment Handbook) and the *Electronic Recruiter's Guide*. The process also indicated that Education had hired a consultant to review the subreports submitted by the vendors, which are the basis of information that is reported to the U.S. Department of Education.

Education was unable to provide the *Electronic Recruiter's Guide* that was described in the quality control process, nor were we able to locate it on Education's Web site to ascertain if Education had carried out the quality control process. We also noted Education was unable to provide evidence that the consultant reviewed the subreports submitted by the vendors, as indicated in the control process.

Questioned Costs

Not applicable.

Recommendation

Education should enhance its current policies and procedures to ensure that all quality control processes reported are carried out as described.

Department's View and Corrective Action Plan

Education conducted a statewide re-interview initiative in 2005 to validate child counts. This re-interview initiative established a defect rate of 5.4 percent for the California Migrant Education Program. This defect rate, and the protocols and procedures used for the re-interview process, were

validated by an external auditing group contracted in August 2007. However, beginning in 2008, Education will establish and conduct prospective and retrospective re-interview processes to further reduce the risk of inaccurate subgrant awards.

In December 2006 Education updated its Identification and Recruitment (I&R) Handbook for recruiters. This handbook contains a section on Quality Assurance to ensure that recruiters are making correct eligibility determinations that establish child counts. Education updated the I&R Handbook in November 2007 and provided training to all regions on the revisions and other related topics in December 2007. However, an Electronic Education Recruiter's Guide was not fully developed as previously planned; accordingly, all reference to this guide should be deleted.

In July 2007 Education assigned a consultant to conduct a detailed review of child count reports submitted by the vendors. Furthermore, Education strengthened its current procedures to ensure that all quality control processes are adhered to by:

1. Requiring vendors to provide the following summary reports by region:

    - A1 and A2 Child Counts
    - Moved Within a Year Counts
    - Priority for Services Counts
    - Age 19-21 Counts
    - Academic Need Counts
    - Other Federal and State Funds Counts

2. Reviewing and validating regional summary reports used in calculating the subgrant reports. This process utilizes the following steps:

    - Vendor sends out unduplicated count to the regions for validation.
    - Once the student count for the previous year is established, staff will meet with vendors to review the preliminary final report.
    - Both the vendor and Education check the reports for accuracy by comparing the subgrant report with data of other vendor reports that are provided by each region.
    - Drawing a sampling of data submissions by region and checking the data submissions for completeness and accuracy. If discrepancies are found, forward report to regional office for corrective actions.
    - Review corrected data submissions if discrepancies persist, requiring region to submit original source documents to validate data submissions, i.e. Certificates of Eligibility, service logs, referrals, etc.

U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Reference Number:	2007-1-10
Federal Catalog Number:	93.778
Federal Program Title:	Medicaid Cluster: Medical Assistance Program (Medi-Cal)
Federal Award Numbers and Years:	05-0605CA5028;2006 05-0705CA5028;2007
Category of Finding:	Activities Allowed
State Administering Department:	Department of Health Care Services (Health Care Services)

Criteria

Title 2—GRANTS AND AGREEMENTS, PART 225—COST PRINCIPLES FOR STATE, LOCAL, AND INDIAN TRIBAL GOVERNMENTS (OMB CIRCULAR A-87), ATTACHMENT A—GENERAL PRINCIPLES FOR DETERMINING ALLOWABLE COSTS, Part C—Basic Guidelines

(1) Factors affecting allowability of costs. To be allowable under Federal awards, costs must meet the following general criteria:

(a) Be necessary and reasonable for proper and efficient performance and administration of Federal awards.

CALIFORNIA CODE OF REGULATIONS, TITLE 22, Section 51476:

Each provider shall keep, maintain, and have readily retrievable, such records as are necessary to fully disclose the type and extent of services provided to a Medi-Cal beneficiary. Required records shall be made at or near the time at which the service is rendered.

DEPARTMENT OF HEALTH SERVICES PROVIDER MANUAL—PROVIDER REGULATIONS

Medi-Cal requires providers to: Agree to keep necessary records for a minimum period of three years from the date of service to disclose fully the extent of services furnished to the patient. The provider also must agree to furnish these records and any information regarding payments claimed for providing the services, on request, to the California Department of Health Services.

Condition

We could not determine the medical necessity of five of the 50 fee-for-service claims sampled. The results are as follows:

- One claim paid was not deemed medically necessary.
- One claim was billed by a provider not rendering the service to the Medi-Cal beneficiary. The provider rendering the service to the beneficiary is not a Medi-Cal-eligible provider. Both the provider that billed Medi-Cal and the provider that rendered the service are owned by the same individual.
- Three claims did not have sufficient supporting documentation to support whether the required medical procedures were rendered to the beneficiary.

Recommendations

Health Care Services should strengthen its internal controls to ensure only medically necessary claims and only eligible providers are paid. Health Care Services should also strengthen its internal control process to detect providers in violation of record retention rules.

Questioned Costs

$3,478 of the $114,859 sampled Medi-Cal claims

Department's View and Corrective Action Plan

Annually, the Department of Health Care Services processes and pays more than 200 million fee-for-service claims. The verification of each of the 200 million fee-for-service claims processed and paid annually for adequacy of documentation would not be financially feasible. Health Care Services agrees that a level of surveillance and control is necessary to ensure only medically necessary claims and eligible providers are paid. Health Care Services also agrees that an internal control process is needed to detect providers in violation of record retention rules. Health Care Services has implemented various pre-payment and post-payment review methods to identify violations and, if warranted, expand the scope of reviews.

In an effort to maximize claims monitoring efficiency, staff and resources, Health Care Services has developed several pre- and post-payment reviews:

Random Claims Review (RCR) is a pre-payment review of randomly selected claims. Claims are randomly selected each week for review, and the provider is required to submit supporting documentation before the claim is paid. RCRs have aided Health Care Services in identifying providers that do not maintain adequate supporting documentation for services billed to the Medi-Cal program. Health Care Services has developed four different post-payment reviews: Self-Audits, Desk Audits, Field Audit Reviews (FAR), and Audits for Recovery. The type of review is based on materiality (i.e. the amount of the provider's utilization in the Medi-Cal program.). For all post-payment reviews, providers are asked to submit records to support Medi-Cal billings and payments made during a review period. The review period is within the prescribed record retention period as specified in the provider manual. If the provider is unable to supply the supporting documents, recoveries for the unsupported services are made and/or recommendations are made for a more detailed review and possible sanctions.

Health Care Services has also carried out provider education reviews to aid in the identification of potential problems and issues that were common among the same provider type. The Medi-Cal Payment Error Rate Study (MPES) has been one of the tools used to identify any potential problem trends. In the last four years of conducting the MPES, Health Care Services has been able to identify significant documentation issues with pharmacies, adult day health centers, and local educational agencies. Based on the findings of the MPES, Health Care Services developed the Pharmacy Outreach Project (POP). The POP consisted of Health Care Services conducting visits of 2,000 pharmacies to determine if the pharmacy maintains proper and adequate documentation to support their Medi-Cal billings. The findings were shared with the providers to educate them and prevent future errors.

Health Care Services has consistently and aggressively addressed the issues of monitoring and controls to ensure only medically necessary claims and eligible providers are paid and that the providers are observing the record retention rules.

Of the 50 claims selected and reviewed it was determined there were exceptions for five of the claims: one claim was not deemed medically necessary; one claim was billed by a provider who did not provide the service to the beneficiary; and the remaining three claims did not have sufficient documentation to support the billed service. Recoveries for the paid amounts will be requested from the five providers where exceptions were found. Additional reviews will also be requested to ensure the providers are properly billing.

A FAR will be requested for the provider of the claim where medical necessity was the issue. An inpatient hospital billed for services that were provided by another inpatient hospital. Inpatient hospitals are subject to annual cost report review where cost and charges are reviewed. The billing exception will be addressed at the annual cost report review. The other hospital that did provide the service does not have an active Medi-Cal number and will not be reviewed.

The exceptions for the remaining three claims were due to lack of sufficient supporting documentation of the billed service. One claim is also from an inpatient hospital and will also be subject to annual cost report review. The remaining two claims were from physician groups. A FAR will be requested for the two physician groups.

Reference Number:	2007-1-11
Federal Catalog Number:	93.778
Federal Program Title:	Medicaid Cluster: Medical Assistance Program (Medi-Cal)
Federal Award Numbers and Years:	05-0605CA5028;2006 05-0705CA5028;2007
Category of Finding:	Activities Allowed
State Administering Department:	Department of Health Care Services (Health Care Services)

Criteria

TITLE 42—PUBLIC HEALTH, CHAPTER IV—CENTERS FOR MEDICARE AND MEDICAID SERVICES, DEPARTMENT OF HEALTH AND HUMAN SERVICES, PART 431—STATE ORGANIZATION AND GENERAL ADMINISTRATION, Subpart A—Single State Agency, Section 431.10, Single State Agency

(e) Authority of the single State agency. In order for an agency to qualify as the Medicaid agency:

(1) The agency must not delegate, to other than its own officials, authority to:

(i) Exercise administrative discretion in the administration or supervision of the plan, or

(ii) Issue policies, rules, and regulations on program matters.

(2) The authority of the agency must not be impaired if any of its rules, regulations, or decisions are subject to review, clearance, or similar action by other offices or agencies of the State.

(3) If other State or local agencies or offices perform services for the Medicaid agency, they must not have the authority to change or disapprove any administrative decision of that agency, or otherwise substitute their judgment for that of the Medicaid agency with respect to the application of policies, rules, and regulations issued by the Medicaid agency.

Condition

Business users (who do not have any system administration responsibilities) have full, unrestricted administrative access to the Centers for Medicare and Medicaid Services 64 (CMS-64) database. Administrative users have the ability to change data and disable any controls on the system, thereby removing the ability to trace actions of the user.

This is a repeat finding from the prior year.

Recommendations

Health Care Services should implement system access and segregation of duties controls. Only personnel with system administrative duties and no program responsibilities should be given administrative access to the system. Further, adequate system-based capability should be developed to provide the required data-correction capabilities with adequate controls and safeguards.

Questioned Costs

Not determined.

Department's View and Corrective Action Plan

The Department of Health Care Services agrees with the recommendation.

Some important elements of the current CMS-64 Accounting System updates are traceable to transaction authors which are recorded in separate tables. For users of the CMS-64 Accounting System, there is no distinction between business users and administrative users.

Health Care Services is in the process of removing access to the CMS-64 Database for all business and administrative users. New update screens are being developed for accounting staff to allow users to update certain elements of the tables due to either user error or policy decision. The new data corrections screen will protect the system with adequate controls, safeguard the data, and eliminate user errors.

System Development Notice (SDN) 07006 has been staffed and work is underway. Electronic Data Systems (EDS) anticipated completion, testing, and implementation of the new interface screens by December 31, 2007; however, the requestors of this SDN asked for additional requirements. This resulted in additional development work by EDS staff. Therefore, the revised implementation date is February 25, 2008.

Reference Number:	2007-2-8
Federal Catalog Number:	93.917
Federal Program Title:	HIV Care Formula Grants
Federal Award Numbers and Years:	6X07HA00041-16-02;2007 2X07HA00041-17-00;2006
Category of Finding:	Allowable Costs/Cost Principles
State Administering Department:	Department of Public Health (Public Health)

Criteria

Title 2—GRANTS AND AGREEMENTS, PART 225—COST PRINCIPLES FOR STATE, LOCAL, AND INDIAN TRIBAL GOVERNMENTS (OMB CIRCULAR A-87), ATTACHMENT A—GENERAL PRINCIPLES FOR DETERMINING ALLOWABLE COSTS, Part C—Basic Guidelines

(1) Factors affecting allowability of costs. To be allowable under Federal awards, costs must meet the following general criteria:

(a) Be necessary and reasonable for proper and efficient performance and administration of Federal awards.

Condition

During procedures performed over the HIV Care Formula Grants program, we reviewed available audit and investigation reports related to the program that were published and released during the fiscal year ended June 30, 2007. The following is a summary of the findings cited in the report prepared by the Audits and Investigation Division (AI) during the fiscal year 2004–05:

- In the summary of the contract compliance section, AI proposed to recover a total of $14,698 of improper payments made by the AIDS Drug Assistance Program (ADAP).

- The contract terms for the fiscal year ended June 30, 2002, stated that drugs purchased under this program shall be reimbursed by the State at the actual cost charged by the wholesaler or manufacturer plus 2 percent. Based on a sample of invoices for highly utilized drugs from pharmacies participating in both ADAP and the Federal Drug Pricing Program (FDPP), AI found that contractors' estimated rates per the request for proposal were, on an average, 16 percent higher than the invoice amounts.

- During the 2006 follow-up review, AI tested the generic drugs and the branded drugs, and its report states in the fiscal findings section, based on the review of nine invoices for generic drugs and 267 invoices for branded drugs received from 10 PHS responding pharmacies, that the contracted rates ranged from 32 percent to 61 percent higher than the invoice amounts for generic drugs, and 2 percent to 68 percent higher than the invoice amounts for branded drugs.

The condition described previously resulted in unallowed costs charged to the federal program. Total ADAP expenditures amounted to $100 million of the $117 million of total program expenditures. Based on the error percentages noted in the report, the risk of noncompliance with allowable costs is considered material.

Questioned Costs

$14,698 at a minimum

Recommendation

Public Health should strengthen its internal control procedures to prevent, deter, and detect potential overpayments to providers and follow existing policies and procedures to ensure payments are made for allowable services.

Department's View and Corrective Action Plan

The audit recommended Public Health strengthen its internal control procedures to prevent, deter, and detect potential overpayments to providers and follow existing policies and procedures to ensure payments are made for allowable services. Public Health, and specifically the Office of AIDS, ADAP generally agree with the findings.

In the contractor's response to the AI audit, Public Health was credited $14,698 in overpayments to three pharmacies. Additionally, one of the pharmacies was removed from the participating pharmacy network.

As a result of the audit and under the new contract, the reimbursement methodology for pharmacies participating in the FDPP was changed. Due to the confidentiality associated with the 340b FDPP pricing, the reimbursement for pharmacies participating in the FDPP is now a percentage of Average Wholesale Price.

ADAP continues to have AI review invoices from the pharmacies on an annual basis to verify appropriate reimbursement.

ADAP notes that while the AI audit did identify $14,698 in improper payments made by the program, and while this ultimately resulted in ADAP's recovery of these funds, this AI finding was not related to the finding regarding reimbursement to Public Health pharmacies (340b) being 16% above invoice amounts. Rather, the recovery was related to duplicate payments to pharmacies made by ADAP and Medi-Cal.

Reference Number:	2007-2-9
Federal Catalog Number:	93.778
Federal Program Title:	Medicaid Cluster: Medical Assistance Program (Medi-Cal)
Federal Award Numbers and Years:	05-0605CA5028;2006 05-0705CA5028;2007
Category of Finding:	Allowable Costs/Cost Principles
State Administering Department:	Department of Health Care Services (Health Care Services)

Criteria

TITLE 42—PUBLIC HEALTH, CHAPTER IV—CENTERS FOR MEDICARE AND MEDICAID SERVICES, DEPARTMENT OF HEALTH AND HUMAN SERVICES, Part 431—State Organization and General Administration, Subpart A—Single State Agency, Section 431.10, Single State Agency

(e) Authority of the single State agency. In order for an agency to qualify as the Medicaid agency:

(1) The agency must not delegate, to other than its own officials, authority to:

(i) Exercise administrative discretion in the administration or supervision of the plan, or

(ii) Issue policies, rules, and regulations on program matters.

(2) The authority of the agency must not be impaired if any of its rules, regulations, or decisions are subject to review, clearance, or similar action by other offices or agencies of the State.

(3) If other State or local agencies or offices perform services for the Medicaid agency, they must not have the authority to change or disapprove any administrative decision of that agency, or otherwise substitute their judgment for that of the Medicaid agency with respect to the application of policies, rules, and regulations issued by the Medicaid agency.

Condition

We reviewed the Statement on Auditing Standards (SAS) 70 Audit Report for the State's fiscal intermediary, Electronic Data Systems (EDS), as of June 30, 2007. The following is a summary of internal control findings noted:

EDS has established procedures for approval and testing of changes to programs. However, EDS did not consistently retain the necessary documentation to demonstrate these approvals had been obtained. This resulted in the following control objective not being achieved: Controls provide reasonable assurance that EDS is only operating or utilizing approved programs or approved changes to programs.

EDS makes use of edit criteria and processing guidelines approved by the user organization to assist with its adherence to Medi-Cal policies. However, EDS did not consistently communicate expiration dates of guidelines or retain approval of edit criteria updates. This resulted in the following control objective not being achieved: Controls provide reasonable assurance that claims are approved in accordance with current Medi-Cal policies.

Recommendation

Health Care Services and EDS should strengthen their internal control procedures over the processing of Medi-Cal claims and retain all necessary documentation to demonstrate approvals were obtained for processing changes.

Questioned Costs

Not determined.

Department's View and Corrective Action Plan

In the SAS 70 Audit Report, Section IV Additional Information Provided by EDS, page 38, Control Objective 9, Management's Response, states:

> "Until the end of 2006, EDS/Change Support SOPs (Standard Operating Procedures) did not require retaining e-mail approval of criteria. EDS has incorporated the requirement to retain e-mail approvals until an official approval has been received. EDS received approvals for subsequent submission of criteria edits for different changes to the same error codes and interprets this to stand as approval for the previous submissions as well."

Health Care Services has also made the following related changes and improvements with regards to the edit criteria approval process in the past 12 months:

> The entire Error Code review and approval process is now paperless. Error Codes are fully reviewed and approved by all Health Care Services stakeholders via email and are electronically archived. Prior to this change, all Error Code/edit criteria updates were distributed and archived in hard-copy form. To address the backlog of Error Code approval reviews, the inventory of 983 Error Code updates in the backlog were scanned to electronic format and distributed electronically for final approval by Health Care Services stakeholders. Formal (FI) letters conveying Health Care Services' approval of the Error Code updates were completed, changing the status of these updated Error Codes to "approved."
>
> All approvals are subsequently followed up by Health Care Services staff to confirm that EDS has listed the approval status on the updated Error Code and filled in the "reference" area at the bottom of the Error Code with the FI letter ID number. This is important to all involved because it is used as a trail back to the approval.
>
> A reconciliation by Health Care Services staff of EDS' "Error Code Tracking Log" is done monthly to confirm that each Error Code has been approved, issued a Fl letter, and that the Error Code has the approval information and Fl letter ID number listed in its reference area. Follow-up is immediately initiated with the involved Health Care Services staff on those Error Codes that are still in a pending approval status to resolve any delays in the review and approval.

Health Care Services has instructed EDS to save indefinitely all approval emails sent from Health Care Services so that a backup system and an audit trail are in place. Health Care Services has confirmed that EDS is complying and is saving the approval emails to their computer drive.

This internal control item and the procedure put into place will also be subject to review in the 2007 SAS 70 audit of EDS. Due to the increase level of tracking, monitoring, and archiving of the Error Code approval documents, Health Care Services is anticipating significant improvement in the audit testing results with no reportable findings.

Reference Number:	2007-2-10
Federal Catalog Number:	93.778
Federal Program Title:	Medicaid Cluster: Medical Assistance Program (Medi-Cal)
Federal Award Numbers and Years:	05-0605CA5028;2006 05-0705CA5028;2007
Category of Finding:	Allowable Costs/Cost Principles
State Administering Department:	Department of Health Care Services (Health Care Services)

Criteria

Title 2—GRANTS AND AGREEMENTS, PART 225—COST PRINCIPLES FOR STATE, LOCAL, AND INDIAN TRIBAL GOVERNMENTS (OMB CIRCULAR A-87), ATTACHMENT A—GENERAL PRINCIPLES FOR DETERMINING ALLOWABLE COSTS Part C—Basic Guidelines

(1) Factors affecting allowability of costs. To be allowable under Federal awards, costs must meet the following general criteria:

(a) Be necessary and reasonable for proper and efficient performance and administration of Federal awards.

Condition

During our procedures performed over Medi-Cal, we reviewed all available audit and investigations reports to the program that were published and released during the fiscal year ended June 30, 2007. The following is a summary of the findings cited in the second annual Medi-Cal Payment Error Study (MPES) performed during the fiscal year 2004–05:

The sampling strategy included 1,123 Fee-for-Service (FFS) and Dental Program claims, with a minimum of 50 claims from each stratum to ensure that statistically valid conclusions could be drawn. Also added to the review process in the MPES 2005 was reviewing for vulnerabilities in the eligibility process for both FFS and Medi-Cal Managed Care.

The results of the MPES indicated that 8.40 percent of the total dollars paid had some indication that they contained a provider error. Included in the claim errors are those attributable to compliance issues. The dollars associated with such claims are not considered at risk of having been paid inappropriately by the Medi-Cal Program.

These compliance errors are a subset of the 8.40 percent representing 0.97 percent of the total dollars paid. The remaining 7.43 percent represents the percentage of payment errors attributable to Medi-Cal program dollars at risk of being paid inappropriately. The 8.40 percent equates to services in calendar year 2004. Of the $1.4 billion in annual payments, $1.25 billion is viewed as being at risk of being paid inappropriately. The $1.25 billion represents payments for claims with errors, such as a lack medical necessity, abuse, or fraud. It does not include payments for claims with compliance errors. Of the total payments, 3.23 percent, or $542 million, were for claims submitted by providers that disclosed characteristics of potential fraud.

In addition, the MPES 2005 reviewed all 1,123 claims within the sample study designed to determine if the FFS beneficiary was eligible for Medi-Cal at the time he/she received services. The review of the claims found that 5.5 percent of Medi-Cal-only beneficiaries within the MPES sample were in error due to the beneficiary being ineligible. The sample reviewed was reviewed as part of the MPES. The eligibility errors are not included in the 8.40 percent of payment error calculation since the MPES focuses on payment errors due to provider behavior rather than due to errors in the eligibility determination process.

Lastly, the MPES also included a review of the eligibility of 1,000 managed care beneficiaries and found 56 eligibility errors, or 5.6 percent.

Based on the error percentage related to Medi-Cal payments and incorrect eligibility determinations, the risk of noncompliance with allowable costs and activities and eligibility is considered material.

Recommendation

Health Care Services should strengthen its internal control procedures to prevent, deter, and detect potential overpayments to providers and follow existing policies and procedures to ensure payments are made for allowable services and to eligible recipients.

Questioned Costs

Not determined.

Department's View and Corrective Action Plan

Health Care Services concurs with the above recommendation and will continue to implement the corrective action steps outlined in the Medi-Cal Payment Error Study (MPES) 2005.

The annual MPES provides opportunities for identifying new patterns of payment errors and areas of potential fraud, waste and abuse in the Medi-Cal program. The MPES findings reinforce the need to continuously and systematically identify those areas of the program most vulnerable to fraud and abuse and to use these findings to guide Health Care Services in its allocation of fraud control resources and its development of innovative anti-fraud strategies and fraud prevention tools.

The MPES 2005 identified newly emerging fraud and abuse patterns. Health Care Services initiated corrective actions for all providers identified in the study against which actions are warranted. In addition, Health Care Services took additional actions to focus anti-fraud efforts on those areas identified by the study as most vulnerable to fraud and abuse. These additional actions included: on-site reviews of 2,000 pharmacies, expanded use of new technology to better identify potential fraud schemes, reform of the Adult Day Health Care program, an increase of the number of investigational and routine field compliance audits, and development of a joint action plan with provider regulatory boards and provider associations to address provider claiming errors identified as potential fraud and abuse.

The MPES is available at www.dhcs.ca.gov/individuals/pages/auditsinvestigations.aspx.

Reference Number:	2007-2-11
Federal Catalog Number:	93.778
Federal Program Title:	Medicaid Cluster: Medical Assistance Program (Medi-Cal)
Federal Award Numbers and Years:	05-0605CA5028;2006 05-0705CA5028;2007
Category of Finding:	Allowable Costs/Cost Principles
State Administering Department:	Department of Health Care Services (Health Care Services)

Criteria

SOCIAL SECURITY ACT, TITLE XIX—GRANTS TO STATE FOR MEDICAL ASSISTANCE PROGRAMS, Section 1927—Payment for Covered Outpatient Drugs, (b) Terms of Rebate Agreement, (2) State Provision of Information

> State Responsibility—Each State agency under this title shall report to each manufacturer not later than 60 days after the end of each rebate period and in a form consistent with a standard reporting format established by the Secretary, information on the total number of units of each dosage form and strength and package size of each covered outpatient drug dispensed after December 31, 1990, for which payment was made under the plan during the period, and shall promptly transmit a copy of such report to the Secretary.

Condition

Drug manufacturers/labelers are required to provide a listing to the Centers for Medicare and Medicaid Services (CMS) of all covered outpatient drugs and, on a quarterly basis, are required to provide their average manufacturer's price and their best price for each covered outpatient drug. Based upon this data, CMS calculates a unit rebate amount for each drug and provides the rebate information to the states. CMS provided the calendar fourth quarter 2006 (October to December 2006) drug data on February 19, 2007. The State Medicaid Agency is required to provide to drug manufacturers/labelers the drug utilization data no later than 60 days after the end of the quarter. Drug utilization data for the calendar fourth quarter 2006 would have to be mailed by the State Medicaid Agency on March 1, 2007, to the labelers. However, we tested 30 rebate invoices from this period and found that the drug utilization data was mailed to labelers on March 15, 2007, which is 14 days late.

Recommendation

Health Care Services should ensure that drug utilization data are provided to drug manufacturers/labelers on a timely basis (no later than 60 days after the end of the quarter) and to proactively monitor the receipt of payment from labelers.

Questioned Costs

Not determined.

Department's View and Corrective Action Plan

Health Care Services agrees with reservations. The guide for State Medicaid Drug Rebate Programs only addresses the reporting of drug utilization to drug manufacturers for a single drug utilization area related to the contracts initiated by CMS. Currently there are 575 active labelers for which CMS contracts for drug rebates. California reports drug utilization to 444 labelers each quarter for multiple

invoices. However, when the CMS guide was instituted, there were only 225 labelers contracting with CMS, less than half the volume of labelers there are today. The timelines have not changed to account for the increase in labelers and drug utilization reports, which leaves the State with only 15 calendar days, not working days, to produce, validate and mail these reports.

Unlike most States, California issues drug utilization for multiple programs which may be under a waiver with CMS, such as Family Planning, Access, Care and Treatment (FamilyPACT) or additional supplemental contracts. As a result of these additional drug utilization reports, California issues over 1,100 utilization reports for over 15,000 National Drug Codes (NDCs) per quarter. Due to the volume, California has recently purchased a second large capacity printer to speed-up the printing time. However, the volume of drug utilization reports requires an extensive review period to ensure that the reports are accurate prior to printing and mailing.

To meet the heavy volume of drug utilization reports that California produces each year, a Rebate Accounting and Information Subsystem (RAIS) equipment refresh occurred in February 2007. This refresh also allowed for RAIS to run independent from other systems, so that updates and weekly claim loads could be done immediately, versus scheduled due to other systems using the same hardware and load software. This has decreased the amount of time needed to actually run the utilization reports and associated activities. In addition, Health Care Services is looking at ways to improve the review process so that the time required will be shorter.

However, Health Care Services strongly suggests that as the number of labelers for which a state must produce a drug utilization report grows and the number of program types required to participate in the drug rebate are added, such as physician drugs, CMS should consider expanding the timeline necessary to produce these reports and mail to the drug manufacturers. In addition, CMS should consider changing the requirements to reflect working days, versus calendar days.

Reference Number:	2007-2-12
Federal Catalog Number:	93.794
Federal Program Title:	Reimbursement of State Costs for Provision of Part D Drugs
Federal Award Number and Year:	None; State fiscal year 2006–07
Category of Finding:	Allowable Costs/Cost Principles/Eligibility
State Administering Department:	Department of Health Care Services (Health Care Services)

Criteria

Title 2—GRANTS AND AGREEMENTS, PART 225—COST PRINCIPLES FOR STATE, LOCAL, AND INDIAN TRIBAL GOVERNMENTS (OMB CIRCULAR A-87), ATTACHMENT A—GENERAL PRINCIPLES FOR DETERMINING ALLOWABLE COSTS Part C—Basic Guidelines

(1) Factors affecting allowability of costs. To be allowable under Federal awards, costs must meet the following general criteria:

(a) Be necessary and reasonable for proper and efficient performance and administration of Federal awards.

TITLE 42—PUBLIC HEALTH, CHAPTER IV—CENTERS FOR MEDICARE & MEDICAID SERVICES, DEPARTMENT OF HEALTH AND HUMAN SERVICES, Part 431—State Organization and General Administration, Subpart A—Single State Agency, Section 431.10, Single State Agency, (c) Determination of Eligibility

(1) The plan must specify whether the agency that determines eligibility for families and for individuals under 21 is:

(i) The Medicaid agency; or

(ii) The single State agency for the financial assistance program under Title IV-A (in the 50 States or the District of Columbia), or under Title I or XVI (AABD), in Guam, Puerto Rico, or the Virgin Islands.

(2) The plan must specify whether the agency that determines eligibility for the aged, blind, or disabled is:

(i) The Medicaid agency;

(ii) The single State agency for the financial assistance program under title IV-A (in the 50 States or the District of Columbia) or under Title I or XVI (AABD), in Guam, Puerto Rico, or the Virgin Islands; or

(iii) The Federal agency administering the supplemental security income program under Title XVI (SSI). In this case, the plan must also specify whether the Medicaid agency or the Title IV-A agency determines eligibility for any groups whose eligibility is not determined by the Federal agency.

TITLE 42—PUBLIC HEALTH, CHAPTER IV—CENTERS FOR MEDICARE & MEDICAID SERVICES, DEPARTMENT OF HEALTH AND HUMAN SERVICES, Part 435—Eligibility in the States, District of Columbia, the Northern Marina Islands, and American Samoa, Subpart J—Eligibility in the States and District of Columbia, Section 435.916, Periodic Redeterminations of Medicaid Eligibility

The agency must redetermine the eligibility of Medicaid recipients, with respect to circumstances that may change, at least every 12 months.

Condition

During our procedures performed we noted that the recipients are required to be "dual eligible" for the program. A dual eligible person is someone who is eligible under both Medicare and Medi-Cal. The period of eligibility and claims for the program are from January 1, 2006, to March 31, 2006. The determination of the dual eligibility follows the same procedures as the Medi-Cal eligibility determination, which falls under the fiscal year ended June 30, 2006. In our prior year audit we reported that, "The Health Services MEQC process reviewed 2,734 cases during April 2005 through March 2006. Of the 2,734 cases sampled Health Services determine that 244 cases were ineligible for Medicaid resulting in a 9 percent error rate. The results of the *Medi-Cal Payment Error Study* (MPES) indicated that 8.40 percent of the total dollars paid had some indication that they contained a provider error."

Based on the error percentages related to Medi-Cal payments and incorrect eligibility determinations, the risk of noncompliance with allowable costs and activities and eligibility for the program is considered material.

Questioned Costs

Unknown

Recommendation

Health Care Services should strengthen its internal control procedures to prevent, deter, and detect potential overpayments to providers and follow existing policies and procedures to ensure payments are made for allowable services and to eligible recipients.

Department's View and Corrective Action Plan

Health Care Services agrees with the recommendation and will continue to follow existing policies and procedures to ensure payments are made for eligible recipients.

However, Health Care Services does not agree with the implied level of erroneous payments. States are required to operate a Medicaid Eligibility Quality Control (MEQC) system in accordance with requirements established by the Centers for Medicare and Medicaid Services (CMS). The MEQC system redetermines eligibility for individual sample cases of beneficiary eligibility made by State Medicaid agencies, or their designees. The State of California has been granted a waiver from the traditional MEQC program described in regulation. This waiver differs from the traditional MEQC program by performing special studies, targeted reviews, or other activities that are designed to ensure program integrity or improve program administration. It is not reasonable to transfer assumptions from these reviews to the general Medi-Cal population or the special population of dual eligible Medicare/Medi-Cal beneficiaries.

Auditors' Comments on Department's View

As the program relies on data from the Medi-Cal system, which was found to have noncompliance, we believe it is reasonable to transfer the assumptions from these reviews to this population of dual eligible Medicare/Medi-Cal beneficiaries, in order to question compliance.

Reference Number:	2007-3-11
Category of Finding:	Cash Management
State Administering Department:	Department of Public Health (Public Health)
Federal Catalog Number:	93.283
Federal Program Title:	Centers for Disease Control and Prevention—Public Health Preparedness and Response for Bioterrorism
Federal Award Numbers and Years:	U90/CCU917016;2006 U90/CCU917016;2007

Federal Catalog Number:	93.889
Federal Program Title:	National Bioterrorism Hospital Preparedness Program
Federal Award Numbers and Years:	U3RHS03890;2004 U3RHS05953;2005 U3RHS007572;2006

Federal Catalog Number:	93.566
Federal Program Title:	Refugee and Entrant Assistance—State Administered Programs
Federal Award Numbers and Years:	G-07AACA9115;2007 G-06AACA9115;2006

Criteria

TITLE 45—PUBLIC WELFARE, SUBTITLE A—DEPARTMENT OF HEALTH AND HUMAN SERVICES, PART 92—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE, LOCAL, AND TRIBAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 92.20, Standards for Financial Management Systems

(b)(3) *Internal control.* Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes.

Condition

During procedures performed over cash management, we noted that there is no evidence of review or approval on the federal cash drawdown requests by someone other than the preparer.

Public Health's current policies and procedures do not require that evidence of reviews and approvals be documented on the memorandum that supports the drawdown request. Without appropriately designed controls in place, there is risk that Public Health could draw down funds on the federal program in excess of its immediate needs without being detected in a timely manner.

Questioned Costs

Not determined.

Recommendation

Public Health should enhance its current policies and procedures to implement segregation-of-duties control. For effective control and accountability over the safeguarding of assets, someone other than the preparer should review and approve the federal draw request.

Department's View and Corrective Action Plan

Public Health agrees with the findings. It has implemented immediate corrective action to have all Federal draw requests be reviewed by a second level staff to assure accuracy and appropriateness of the draws.

Reference Number:	2007-3-12
Federal Catalog Number:	93.283
Federal Program Title:	Centers for Disease Control and Prevention—Public Health Preparedness and Response for Bioterrorism
Federal Award Numbers and Years:	U90/CCU917016;2006 U90/CCU917016;2007
Category of Finding:	Cash Management
State Administering Department:	Department of Public Health (Public Health)

Criteria

TITLE 31—MONEY AND FINANCE TREASURY, DEPARTMENT OF THE TREASURY, PART 205—RULES AND PROCEDURES FOR EFFICIENT FEDERAL-STATE FUNDS TRANSFERS, Subpart B—Rules Applicable to Federal Assistance Programs Not Included in a Treasury-State Agreement, Section 205.33, How Are Funds Transfers Processed?

(a) A State must minimize the time between the drawdown of Federal funds from the Federal government and their disbursement for Federal program purposes. A Federal Program Agency must limit a funds transfer to a State to the minimum amounts needed by the State and must time the disbursement to be in accord with the actual, immediate cash requirements of the State in carrying out a Federal assistance program or project. The timing and amount of funds transfers must be as close as is administratively feasible to a State's actual cash outlay for direct program costs and the proportionate share of any allowable indirect costs. States should exercise sound cash management in funds transfers to subgrantees in accordance with OMB Circular A-102.

TITLE 45—PUBLIC WELFARE, SUBTITLE A—DEPARTMENT OF HEALTH AND HUMAN SERVICES, PART 92—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE, LOCAL AND TRIBAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 92.20, Standards for Financial Management Systems

(b)(7) Cash Management. Procedures for minimizing the time elapsed between the transfer of funds from the U.S. Treasury and disbursement by grantees and subgrantees must be followed whenever advance payment procedures are used. Grantees must establish reasonable procedures to ensure the receipt of reports on subgrantees cash balances and cash disbursements in sufficient time to enable them to prepare complete and accurate cash transactions reports to the awarding agency. When advances are made by letter-of-credit or electronic transfer of funds methods, the grantee must make drawdowns as close as possible to the time of making disbursements. Grantees must monitor cash drawdowns by their subgrantees to ensure that they conform substantially to the same standards of timing and amount as apply to advances to the grantees.

Condition

During procedures performed over cash management, we noted that Public Health's Emergency Preparedness Office (EPO) follows the California Health and Safety Codes (State Plan). Specifically, the California Health and Safety Code, sections 101317(d)(1) and (2), requires Public Health to disburse funds quarterly to local health departments and counties (subrecipients) for the Public Health

Preparedness and Response for Bioterrorism program contingent upon completion of certain tasks. Subsequent payments are made contingent upon the approval of a subrecipient's plan and budget and progress in implementing that plan, as well as submission of fiscal reports.

At the beginning of the funding year (September 1 to August 31), EPO allocates each subrecipient a certain amount of the grant for that year and then splits the amount into four 25 percent payments to be given to each subrecipient throughout the year based on certain criteria being met by the subrecipient before payment is made. For the first 25 percent payment, the subrecipient needs to submit a signed funding agreement, nonsupplantation certification form, and a certification regarding lobbying. The second 25 percent payment requires that the subrecipient submitted all items necessary in receiving the first payment and additionally submits its approved work plan and budget. The third 25 percent payment requires that the first two payment requirements are met and additionally that the subrecipient submit to the program its prior-year-end progress report, which shows the actual expenditures for the prior fiscal year (September 1 through August 31). The fourth 25 percent payment requires the subrecipient to have submitted the first three payment requirement items and additionally to submit its current midyear progress report, which shows the actual expenditures for the first half (September 1 through February 28) of the current fiscal year.

However, because the EPO makes payments contingent on receipt of certain information from the subrecipients, these advances are not necessarily sent at the beginning of each quarter, and these payments may occur after the end of the quarter. For instance, in regard to the first quarter 25 percent payment for the months of September, October, and November, most subrecipients did not receive their warrant from the State Controller's Office until March 1 of the following calendar year. In this instance, the 25 percent payment is received by the subrecipient months after the related service period of that payment.

The California Prompt Payment Act (Government Code 927) establishes the State's intent that state agencies pay properly submitted, undisputed invoices within 45 days of receipt, or automatically calculate and pay the appropriate late penalties. As such, 45 days (from the time of payment request receipt by the program to the issuance of the warrant payment) serves as a basis for defining "administratively feasible" as stated in 31 CFR, Part 205, Subpart B. As the EPO does not receive invoices from the subrecipients, but rather the subrecipients must submit required items before a payment is issued, the date the last required item was turned in by the subrecipients making them eligible to receive the payment from the program is used in place of an invoice receipt.

During testing, we noted that several subrecipients were given their 25 percent payment for a three-month service period well after the 45-day time limit as set forth in the Prompt Payment Act and as mandated by 31 CFR, Part 205, Subpart B regarding the minimization of time between the receipt of request for payment and the federal draw and subsequent payment issuance by the state program. Approximately $2,457,334 of the $6,390,719 tested (35 of 60 selections) related to disbursements exceeding the 45-day time limit.

Further, Public Health does not have procedures in place to ensure that the Public Health Preparedness and Response for Bioterrorism program's subrecipient can demonstrate the ability to minimize the time between receipt and disbursement of federal program funds as stated in 45 CFR, Part 92, sections 92.20 and 92.21.

More specifically, we noted Public Health does not have a process in place for assessing the cash needs of its subrecipients. The program's only criteria for issuing payments to the subrecipients are listed above. The program does not review the actual invoices in order to monitor how the money is being spent, or whether all of the prior funding was fully spent before issuing the next 25 percent payment. 45 CFR, Part 92, sections 92.20 and 92.21 mandate that states have procedures in place that monitor the cash used by their subrecipients.

As a result of these weaknesses, Public Health disbursed $33 million to subrecipients during fiscal year 2006–07 with no assurance that these subrecipients minimized the time between the receipt and disbursement of federal funds.

Questioned Costs

Not determined.

Recommendations

Public Health should review and amend its current policies and procedures over cash disbursements to subrecipients to match the cash needs of the subrecipients and ensure the timing of the payments minimize the time elapsing between the request for federal funds from the subrecipient and the federal draw and subsequent payment to the subrecipient by adhering to the 45-day time limit set forth in the Prompt Payment Act and as mandated by 45 CFR, Part 92, regarding the minimization of time between the receipt of request for payment from the subrecipient and the federal draw and subsequent payment issuance to the subrecipient.

Further, Public Health should review and amend its current policies and procedures over cash disbursements to subrecipients to establish consistent monitoring of their expenditures to provide assurance that subrecipients demonstrate the ability to minimize the time between receipt and disbursement of federal program funds.

Department's View and Corrective Action Plan

On the first recommendation, Public Health agrees that there was a one-time delay in issuing payments to some local health departments (LHDs) that qualified to receive a payment. This delay was a result of the following situations:

- Public Health included 25% of the CDC Base allocation and 25% of the CDC Pandemic Influenza Allocation in the first quarter payments to LHDs. However, the CDC Pandemic Influenza Allocation could not be paid because these funds were originally received in the 2005–06 grant year and Public Health had not yet received approval from CDC to carry over those funds. Public Health had to revise all of the invoices to remove the CDC Pandemic Influenza portion and prepare new first quarter invoices that only included 25% of the CDC Base allocation. This is part of the reason for the delay in payment to the LHDs.

- Additionally, Public Health, at that time, had one analyst performing all duties for 58 LHDs. Once additional staff was hired, the first quarter invoices were prepared for all LHDs that qualified to receive payment.

- The delay in payments was due to unique situations. Procedures are in place to issue payments promptly and staff have been hired.

Public Health does not concur with the second recommendation. Public Health continues to disagree with the auditor's findings as there have been no changes in state or federal requirements related to these issues. The basis for Public Health's disagreement is: (1) Public Health is required by federal regulation to comply with state law, which expressly requires quarterly payments; (2) there is no guidance or criteria upon which to base a finding that a quarterly payment is inconsistent with the federal timely disbursement requirement; and (3) federal regulations provide for, contemplate, and acknowledge alternative methods of disbursing grant funds and circumstances under which a grantee would not be able to meet the requirement to minimize the time between receipt and disbursement of funds.

- First, the auditor refers to federal regulations applicable to these grants, but ignores a threshold criteria applicable to financial administration of the grant. Specifically, federal regulations on financial administration of the grant first require that states "must expend and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds." (42 CFR 92.20(a) Therefore, by federal rule, California is required to comply with its own laws applicable to this grant. That directly brings into play the State statutory requirements of Health & Safety Code Section 101317(d), and others that apply generally to financial administration of grant funds. Health & Safety Code Section 101317(d) mandates that funds "shall be disbursed quarterly to local health jurisdictions. Accordingly, the State is required by federal rule to disburse funds quarterly.

- Second, the audit bases its findings in large part on the timely disbursement criteria without any statutory or legal standard upon which timeliness is measured, or to conclude that quarterly payments are inconsistent with the federal requirement to minimize the lapse in time. CDPH was unable to find a regulation that addresses or provides a measurement for what constitutes an appropriate timeframe. There is also nothing upon which to base a conclusion that a quarterly disbursement schedule is inconsistent with the federal requirement of minimizing the time lapse between receipt of funds and disbursements. As an aside, an argument can be made that the requirement to minimize the time lapse between the receipt and disbursement of funds applies whenever advance payment procedures are used. (42 CFR 92.20(b)(7) [see Attachment A].

- The third area under which this audit finding is vulnerable is that the federal regulations on post-grant award requirements provide for several alternative methods of payment and acknowledge there will be circumstances under which a state cannot meet the time lapse requirement. The methods of payment include advance payments, reimbursement, and cash or a working capital advance basis (42 CFR 92.21). The "Basic Standard" for payment requires methods and procedures in place to "minimize the time elapsing between the transfer of funds and disbursement by the grantee or subgrantee, in accordance with Treasury regulations at 31 CFR Part 205." (Again, the Treasury regulations contain provisions for funding and discretion to add other requirements in the event the federal or state government agencies do not comply with the requirements, including timely disbursement.) The regulation provides for alternative methods or standards for payment including but not limited to the "Basic Standard" with the timely disbursement requirement. In addition to providing alternative methods, the regulations also contemplate situations when states or subgrantees cannot meet the timely disbursement requirements. Specifically, reimbursement method of payment is to be used when the "requirements of paragraph (c) of this section [procedure for timely disbursement] are not met." This language expressly acknowledges and authorizes alternative methods of disbursing grant funds outside the timely disbursement criteria.

Public Health concludes that both the State and federal requirements for grant financial funding apply. Both contain timely administration of payment criteria which are not inconsistent. State disbursement requirements are quarterly. Federal requirements must ensure a procedure to limit any time lags between receipt and disbursement of funds. It is unclear how a quarterly disbursement is inconsistent or noncompliant with a procedure that minimizes the time between receipt of grant funds and disbursements. Without specific criteria, there is nothing upon which to base a finding that these timeframes are inconsistent. Moreover, with the federal regulation requiring states to administer grant funds in accordance with state requirements, doing anything other than quarterly disbursements (or whatever methodology required by state law) would violate this federal requirement. Assuming the State is disbursing funds in accordance with state law (including but not limited to H&S 101317), and has a procedure in place that minimizes the lapse in time between receipt and disbursement of grant funds, it is reasonable to conclude that the grant funds are being administered in accordance with federal requirements.

Attachment A.

Sec. 92.20 Standards for financial management systems. Financial Administration

- A State must expand and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. (Emphasis provided)

- The financial management systems of other grantees and subgrantees must meet the following standards:

  —Cash management. Procedures for minimizing the time elapsing between the transfer of funds from the U.S. Treasury and disbursement by grantees and subgrantees must be followed whenever advance payment procedures are used. Grantees must establish reasonable procedures to ensure the receipt of reports on subgrantees' cash balances and cash disbursements in sufficient time to enable them to prepare complete and accurate cash transactions reports to the awarding agency. When advances are made by letter-of-credit or electronic transfer of funds methods, the grantee must make drawdowns as close as possible to the time of making disbursements. Grantees must monitor cash drawdowns by their subgrantees to assure that they conform substantially to the same standards of timing and amount as apply to advances to the grantees.

Subpart C_Post-Award Requirements

Sec. 92.21 Payment.

- Scope. This section prescribes the basic standard and the methods under which a Federal agency will make payments to grantees, and grantees will make payments to subgrantees and contractors.

- Basic standard. Methods and procedures for payment shall minimize the time elapsing between the transfer of funds and disbursement by the grantee or subgrantee, in accordance with Treasury regulations at 31 CFR Part 205.

- Advances. Grantees and subgrantees shall be paid in advance, provided they maintain or demonstrate the willingness and ability to maintain procedures to minimize the time elapsing between the transfer of the funds and their disbursement by the grantee or subgrantee.

- Reimbursement. Reimbursement shall be the preferred method when the requirements in paragraph (c) of this section are not met. Grantees and subgrantees may also be paid by reimbursement for any construction grant. Except as otherwise specified in regulation, Federal agencies shall not use the percentage of completion method to pay construction grants. The grantee or subgrantee may use that method to pay its construction contractor, and if it does, the awarding agency's payments to the grantee or subgrantee will be based on the grantee's or subgrantee's actual rate of disbursement.

- Working capital advances. If a grantee cannot meet the criteria for advance payments described in paragraph (c) of this section, and the Federal agency has determined that reimbursement is not feasible because the grantee lacks sufficient working capital, the awarding agency may provide cash or a working capital advance basis.

Sec. 92.23 Period of availability of funds.

- General. Where a funding period is specified, a grantee may charge to the award only costs resulting from obligations of the funding period unless carryover of unobligated balances is permitted, in which case the carryover balances may be charged for costs resulting from obligations of the subsequent funding period.

- Liquidation of obligations. A grantee must liquidate all obligations incurred under the award not later than 90 days after the end of the funding period (or as specified in a program regulation) to coincide with the submission of the annual Financial Status Report (SF-269). The Federal agency may extend this deadline at the request of the grantee.

Sec. 92.37 Subgrants.

- States. States shall follow state law and procedures when awarding and administering subgrants (whether on a cost reimbursement or fixed amount basis) of financial assistance to local and Indian tribal governments.

Reference Number:	2007-3-13
Category of Finding:	Cash Management
State Administering Department:	Department of Public Health (Public Health)
Federal Catalog Number:	93.889
Federal Program Title:	National Bioterrorism Hospital Preparedness Program
Federal Award Numbers and Years:	U3RHS03890;2004 U3RHS05953;2005 U3RHS007572;2006
Federal Catalog Number:	93.917
Federal Program Title:	HIV Care Formula Grants
Federal Award Numbers and Years:	2X07HA00041-17-00;2006 6X07HA00041-16-02;2007
Federal Catalog Number:	93.566
Federal Program Title:	Refugee and Entrant Assistance—State Administered Programs
Federal Award Numbers and Years:	G-06AACA9115;2006 G-07AACA9115;2007

Criteria

TITLE 45—PUBLIC WELFARE, SUBTITLE A—DEPARTMENT OF HEALTH AND HUMAN SERVICES, PART 92—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE, LOCAL, AND TRIBAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 92.21, Payment

Basic standard. Method and procedures for payment shall minimize the time elapsing between transfer of funds and disbursement by the grantee, in accordance with treasury regulations at 31 CFR Part 205.

TITLE 31—MONEY AND FINANCE TREASURY—DEPARTMENT OF THE TREASURY,
PART 205—RULES AND PROCEDURES FOR EFFICIENT FEDERAL-STATE FUNDS TRANSFERS,
Subpart B—Rules Applicable to Federal Assistance Programs Not Included in a Treasury-State Agreement, Section 205.33, How Are Funds Transfers Processed?

(a) A State must minimize the time between the drawdown of Federal funds from the Federal government and their disbursement for Federal program purposes. A Federal Program Agency must limit a funds transfer to a State to the minimum amounts needed by the State and must time the disbursement to be in accord with the actual, immediate cash requirements of the State in carrying out a Federal assistance program or project. The timing and amount of funds transfers must be as close as is administratively feasible to a State's actual cash outlay for direct program costs and the proportionate share of any allowable indirect costs. States should exercise sound cash management in funds transfers to subgrantees in accordance with OMB Circular A-102.

Condition

During our procedures performed over cash management requirements and Public Health's payments to its subrecipients/vendors, we reviewed a sample of invoices for any reimbursement amounts due back to ascertain if Public Health was minimizing the time between the subrecipient/vendor expenditure of program funds and their subsequent reimbursement from Public Health. We reviewed the dates the invoices were received by Public Health, or if no date was received indicated by Public Health, the date the request was signed by the subrecipient/vendor was used, and compared those dates to the dates payments were actually disbursed.

As a basis for determining the reasonableness of Public Health's minimization of the payment timing we reviewed the State of California Prompt Payment Act (Act) that addresses the minimization of timing of payments to certain types of grant award subrecipients. The Act encourages payments to be made within 45 days of receipt of the reimbursement request. Although these programs are not defined as specifically applicable for this regulation, the intent of the legislation appears to be consistent with the intent of federal cash management requirements; therefore this regulation would appear to be provide an appropriate basis for determining the reasonableness for timing of payments.

National Bioterrorism Hospital Preparedness Program

During our procedures performed over cash management, we noted four invoices totaling $156,000 out of the 60 sampled where undisputed invoices submitted by subrecipients/vendors were reimbursed later than 45 days. These untimely disbursements ranged from 70 to 123 days beyond the date of the subrecipient reports. We also noted one invoice for $13,408 in the sample where the federal funds were deposited in the state bank account and not disbursed to subrecipients within 15 calendar days of receipt.

Public Health does not have a policy that addresses the minimization of timing of reimbursement payments made to subrecipients. Public Health indicated that these exceptions were due to expenditure reports being submitted past the due date, which caused them to be held until another material batch of payments was accumulated. As a result, Public Health made untimely reimbursements of $156,000 out of the total sample of $840,000 from the $41 million total in subgrant payments made in the fiscal year ended June 30, 2007.

HIV Care Formula Grants

During our procedures performed over cash management, we noted 11 invoices totaling $1.15 million out of the 20 tested where undisputed invoices submitted by subrecipients were reimbursed later than 45 days. These untimely disbursements ranged from 49 to 84 days from the date of the subrecipient invoices received. Furthermore, two of the same 30 warrants, totaling $39,954, were issued more than 15 calendar days after the claim was received by the State Controller's Office (Controller's Office).

Public Health does not have a policy that addresses (or adequately controls) the minimization of timing of reimbursement payments made to subrecipients. Public Health indicated that these exceptions were due to expenditure reports being submitted after the due date, which caused them to be held until another material batch of payments was accumulated. As a result, Public Health made untimely reimbursements of $1.15 million out of the total sample of $1.6 million from the $10 million total in subgrant payments made in the fiscal year ended June 30, 2007.

Refugee and Entrant Assistance— State Administered Programs

During our procedures performed over cash management, we noted 12 invoices totaling $783,000 out of the 30 tested where undisputed invoices submitted by subrecipients were reimbursed after 45 days.

Public Health does not have a policy that addresses (or adequately controls) the minimization of timing of reimbursement payments made to subrecipients. Public Health indicated that these exceptions were due to expenditure reports being submitted after the due date, which caused them to be held until another material batch of payments was accumulated. As a result, Public Health made untimely reimbursements of $783,000 out of the total sample of $1.8 million from the $4.8 million total in subgrant payments made in the fiscal year ended June 30, 2007.

Questioned Costs

Not determined.

Recommendation

Public Health should have processes in place to minimize the time between the receipt of undisputed payment requests and the disbursement of funds in order to be in compliance with program requirements.

Department's View and Corrective Action Plan

National Bioterrorism: Public Health acknowledges that these invoices were paid outside of the required 45-day timeframe. Payments for these invoices were delayed due to various reasons. Some of them were due to reorganization tasks, staff vacancies and/or contract problems. Additionally, there were cash flow problems for payment of claim schedules from the General Fund's clearing account. Because the invoice was scheduled for payment from the General Fund's clearing account, the claim schedule was held until funds were available for release to the Controller's Office for payment.

It should also be noted that sometimes the invoices are held too long in the program, thus not leaving enough time for the accounting office staff to process them within the allotted 45-day time frame. Public Health will remind its departments of the importance of timely approval and submission of invoices in order to comply with the Prompt Payment Act.

The invoice that was paid after 15 calendar days was scheduled on June 18, 2007. There were cash flow problems for payment of claim schedules from the General Fund's clearing account. As a result of the invoice being scheduled from the General Fund's clearing account, the claim schedule was held until funds were available for release to the SCO for payment. The accounting staff responsible for scheduling the invoices for payment was not informed about the cash flow issue. Had staff been informed, the invoice would have been processed as direct pay from the ultimate funds thus avoiding delay of payment. In the interim, because the expenditure has been recorded in the General Fund's clearing account and the monthly cost allocation/fund Split was processed in California's State Accounting and Reporting System (CALSTARS) to the ultimate fund (Federal Trust Fund), a draw was generated to provide federal funds for the expenditures. This draw occurred on June 27, 2007 while the claim schedule itself was not released and paid until August 10, 2007.

Public Health is making every effort to identify and pay invoices directly from the source federal funds instead of using the General Fund clearing account to minimize the cash flow issues. This would also facilitate the timely draw of federal funds at the time of disbursement by the State Controller's Office.

HIV Care Formula Grant: Public Health partially agrees with the finding that processes are not in place to minimize the time between the drawdown and the disbursement of Federal funds. The process in place uses a daily CALSTARS report (H07) to prepare the draws associated with the claim schedules. This report indicates the claim schedules prepared and entered into CALSTARS the previous day. From this report the draw is prepared within a day or two of the claim schedule being released to the SCO for payment. The AIDS grants do not qualify for the Cash Management Information Act (CMIA) that requires a three-day turn around. The SCO has 15 days to process the payments. The process in place assures that the funds are received and recorded in the appropriations responsible for the payment in time to cover the claim schedule when paid.

Public Health agrees that the time elapsed between the receipt of the invoices in the accounting office to the preparation of the claim schedule for submission to the SCO was in excess of the appropriate amount of time. During the time frame under audit there was some staff turnover. Because of the staff turnover, training is required that could have contributed to the delay in the process. However, Public Health agrees that sufficient care was not given to the timeliness of processing of the invoices in question. Currently Public Health's accounting office has undergone reorganization into a functional arrangement. The newly established payable and receivables section has procedures in place for the proper monitoring of the invoices received. This should assure the timely processing of invoices for payment as required by the California Prompt Payment Act (Government Code 927) within the 45-day timeframe.

The Public Health Office of AIDS (OA) partially agrees with the audit conditions outlined in this finding. Per an Administrative Information Memorandum that outlined internal departmental procedures regarding meeting the California Prompt Payment Act requirements for 45 days for payments, programs are allowed 15 days to process and submit invoices to the OA's accounting office for payment. OA records show that only one invoice listed was delayed in our office past the 15-day time limit. The delay in our internal payment processing was due to several factors. This was the first invoice for the contract period, it was submitted for ten months rather than quarterly, and the contractor did not include all of the necessary back-up material to approve the invoice. This resulted in additional time needed to investigate the details of the invoice prior to approving it for payment. Another factor was that the staff responsible for approving that invoice was attending an out-of-state conference, which delayed our internal payment processing by one week. OA will ensure that in the future we have appropriate staff coverage.

Refugee Entrant Assistance: Public Health acknowledges that these invoices were paid outside of the required 45-day timeframe. Payments for these invoices were delayed due to the reorganization, staff vacancies and turnover.

Public Health has procedures in place to comply with the California Prompt Payment Act requirements. These procedures are geared toward vendor payments and small business. Payments made to grant recipients were not included in these procedures as they were developed prior to grant recipient payments being included in the California Prompt Payment Act. This requirement was adopted into law in September 2006 (AB 2541, Chapter 861 (Statutes of 2006), and Public Health has failed to amend its procedures. Our procedures will be updated to include any payments made to grant recipients that can be made to local governments. We also will develop a method to distinguish these invoices from other local government payments for our claims payment staff.

The accounting office has recently been reorganized with a focus on functions. Previously, it was organized around program teams performing a wide variety of functions. When vacancies occurred, it was difficult to cover the vacant workload. Now that it is organized around functions, it will be easier to track invoices that require prompt payment.

Public Health does have processes in place to minimize the time between the drawdown of federal funds from the federal government and their disbursement for federal program purposes. In fact the payments in question were paid from the General Fund clearing account. Draws for those types of expenditures are typically done two to three weeks after the close of the fiscal month for which cost allocation/fund split must occur. The appropriateness of the timing of these draws is covered in the CMIA agreement between the appropriate federal agency and the Department of Finance. The federal agency acknowledges the fact that the draw occurs after the disbursement has occurred for expenditures processed through the General Fund clearing account.

Reference Number:	2007-3-14
Federal Catalog Numbers:	93.575 & 93.596
Federal Program Titles:	Child Care Development Fund Cluster—Child Care and Development Block Grant & Child Care Mandatory and Matching Funds of the Child Care and Development Fund
Federal Award Numbers and Years:	G996005;2006 G994231;2006 G994232;2006
Category of Finding:	Cash Management
State Administering Department:	Department of Education (Education)

Criteria

TITLE 45—PUBLIC WELFARE, SUBTITLE A—DEPARTMENT OF HEALTH AND HUMAN SERVICES, PART 98—CHILD CARE AND DEVELOPMENT FUND, Subpart G—Financial Management, Section 98.67, Fiscal Requirements

(c) Fiscal control and accounting procedures shall be sufficient to permit:

(1) Preparation of reports required by the Secretary under this subpart and under subpart H; and

(2) The tracing of funds to a level of expenditure adequate to establish that such funds have not been used in violation of the provisions of this part.

Condition

Education has a formal control process for making payments to program contractors. A program analyst reviews the attendance and fiscal reports submitted by the contractor to determine the appropriate amount to be paid and forwards a payment request to the Fiscal Services Division. A claims schedule is then prepared by the Fiscal Services Division for the amounts approved from the analyst and is input into the California State Accounting and Reporting System general ledger. A supervisor then reviews and approves the work performed by the staff by initialing the claims schedule. The original copy of the approved claims schedule is sent to the State Controller's Office to be paid; however, a copy of the approved schedule is not retained as evidence of the review and approval process for the claim. An unsigned copy of the claims schedule is retained along with the other documentation as support for the payment. In our sample of payments made to contractors, we noted nine of the 60 claims schedules did not contain evidence of the review and approval process performed by the Fiscal Services Division.

Through our discussion with the program staff, they indicated their control process to retain signed copies of the claims schedules was implemented in May 2007. The exceptions noted occurred prior to May 2007. Without formal evidence of a sign-off there is no evidence of the review and approvals performed by Education.

Questioned Costs

Not applicable.

Recommendation

Education should retain copies of the approved claims schedules instead of the unapproved schedules as part of the supporting documentation package retained as evidence of controls over the payment approval process.

Department's View and Corrective Action Plan

As indicated by the auditor, effective May 2007, Education will retain copies of the approved claims schedules as evidence of controls over the payment approval process.

Reference Number:	2007-3-15
Federal Catalog Numbers:	93.575 & 93.596
Federal Program Titles:	Child Care Development Fund Cluster—Child Care and Development Block Grant & Child Care Mandatory and Matching Funds of the Child Care and Development Fund
Federal Award Numbers and Years:	G996005;2006 G994231;2006 G994232;2006
Category of Finding:	Cash Management
State Administering Department:	Department of Education (Education)

Criteria

TITLE 45—HEALTH AND HUMAN SERVICES, PART 92—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 92.20, Standards for Financial Management Systems

(b)(7) *Cash Management.* Procedures for minimizing the time elapsing between the transfer of funds from the U.S. Treasury and disbursement by grantees and subgrantees must be followed whenever advance payment procedures are used. Grantees must establish reasonable procedures to ensure the receipt of reports on subgrantees cash balances and cash disbursements in sufficient time to enable them to prepare complete and accurate cash transactions reports to the awarding agency. When advances are made by letter-of-credit or electronic transfer of funds methods, the grantee must make drawdowns as close as possible to the time of making disbursements. Grantees must monitor cash drawdowns by their subgrantees to assure that they conform substantially to the same standards of timing and amount as apply to advances to the grantees.

Condition

During our procedures performed over payments made to the subgrantees, we noted that Education requests cash advances from the federal government and then requests payments to be made to the Local Educational Agencies (LEAs) and subgrantee contractors by the State Controller's Office (Controller's Office). Both programs fall under the Cash Management Improvement Act (CMIA) with a required funding technique of pre-issuance for payments to local agencies. The pre-issuance technique requires the State to disburse cash advances to LEAs not more than three days after the advance is deposited in the state account. In our sample of drawdowns from the federal government and payments to LEAs for the Child Care Development programs, we noted one drawdown of the 60 sampled was paid eight days after the cash was received by the Controller's Office, which exceeds the days allowed for preissuance.

Questioned Costs

$22,835 of the $29,798,859 drawdowns sampled

Recommendation

Education should review its current policies and procedures over the issuance of cash advances to LEAs to more effectively monitor the cash needs of its LEAs with the timing of the payments to minimize the time elapsing between the advance of federal funds and expenditure by the LEAs.

Department's View and Corrective Action Plan

The requested deposit date for this draw was August 14, 2006. The State Treasurer did not record the cash as received until August 21, 2006. The CMIA worksheet, sent along with the claim in question, requested a paid date of August 17, 2006. The claim schedule was voided by the SCO on the date of issuance, August 17, because the funds were not deposited. Once the funds were deposited, SCO re-processed the claim schedule and it was paid on August 29, 2006. The payment of this claim was outside of our control.

Education did not deviate from its current policies and procedures, established by the Department of Finance (DOF) with agreement by the SCO for the CMIA, when processing this claim. The CMIA report submitted to DOF reflected the delay, but Education is not required to provide an explanation unless payment exceeds 10 days from the time of deposit.

Reference Number:	2007-5-2
Federal Catalog Number:	93.917
Federal Program Title:	HIV Care Formula Grants
Federal Award Numbers and Years:	6X07HA00041-16-02;2007 2X07HA00041-17-00;2006
Category of Finding:	Eligibility
State Administering Department:	Department of Public Health (Public Health)

Criteria

TITLE 42—THE PUBLIC HEALTH AND WELFARE, CHAPTER 6A—PUBLIC HEALTH SERVICE, SUBCHAPTER XXIV—HIV HEALTH CARE SERVICES PROGRAM, PART B—CARE GRANT PROGRAM, Subpart I—General Grant Provisions, Section 300ff-26, Provision of Treatments

(b) Eligible Individual

To be eligible to receive assistance from a State under this section an individual shall have a medical diagnosis of HIV disease; and be a low-income individual, as defined by the State.

Condition

During procedures performed over the HIV Care Formula Grants program (program), we reviewed all available audit and investigations reports related to the program that were published and released during the fiscal year ended June 30, 2007. The following is a summary of the findings cited in the report prepared by the Department of Health Care Services' Audits and Investigation Division (AI) during the fiscal year 2004–2005:

- Of 310 AIDS Drug Assistance Program (ADAP) clients sampled (or 11.94 percent) by AI, 37 were Medi-Cal eligible with no patient share of cost.
- Of 310 ADAP clients sampled (or 1.94 percent) by AI, six were Medi-Cal eligible with patient share of cost.

Further, the program coordinators are required to visit the ADAP enrollment sites every five years in accordance with requirements established by the agreement between the sites and the State.

This quality control process redetermines eligibility for individually sampled cases of beneficiary eligibility made by enrollment workers at the local enrollment sites. Enrollment site visits are performed to ensure individuals receiving services meet eligibility requirements. Site visit reports are conducted by program coordinators and reviewed by the program chief.

We selected 30 site visit reports and noted that four out of the 30 were completed six months after the site visit date. Further, we noted that the reports written by the program coordinators detailed several instances of noncompliance with the eligibility requirements such as: lack of proof of income documentation, residency, identity, and diagnosis. Based on the 30 reports reviewed, it appears the error rate in eligibility determination is between 10 percent and 20 percent.

Total ADAP expenditures amounted to $100 million of the $124 million of total program expenditures.

Questioned Costs

Unknown

Recommendations

Public Health should strengthen its internal controls over the eligibility process to ensure payments are only made to eligible recipients. Public Health should also implement procedures to ensure cases with errors are addressed and resolved in a timely manner.

Department's View and Corrective Action Plan

The audit recommends that Public Health strengthen internal controls over the eligibility process to ensure payments are made to eligible recipients. The audit also recommends that procedures be implemented to ensure cases with errors are addressed and resolved within a timely manner. Public Health generally agrees with the recommendations.

Due to issues around Medi-Cal eligibility, ADAP recently implemented an enhanced Third-Party-Payer screening process. This involved revising all third-party-payer screening activities and included mandatory trainings for all ADAP enrollment workers. The process also requires the contractor to submit weekly files of clients designated as Medi-Cal pending. ADAP staff checks the Medi-Cal Eligibility Data System (MEDS) to verify the status of the Medi-Cal application. If the client is identified

as having Medi-Cal, the contractor is notified and Medi-Cal is retroactively billed and ADAP is credited for the medications. Medi-Cal eligibility is sometimes granted retroactively, however, and ADAP is unable to back-bill Medi-Cal for more than four months of medication costs. ADAP provides full drug coverage while a client is pursuing Medi-Cal coverage. The program monitors the progress of clients through the Medi-Cal application process and gives an initial 120 day eligibility grace period. Once the 120 days have expired, additional grace periods are allowed on a case-by-case basis.

ADAP is currently formalizing and finalizing a monthly data exchange with the California Department of Health Care Services (Health Care Services). This data exchange will allow ADAP staff to monitor any changes in client status with respect to Medi-Cal eligibility. Once the monthly exchange is implemented, ADAP will closely monitor clients for full Medi-Cal eligibility.

ADAP generally agrees with the findings regarding the frequency of enrollment site visits and delays in getting the site visit reports completed in a timely manner. However, the requirement to visit enrollment sites every 5 years is an internal goal that was established by ADAP in 2001, and is not included in the site agreements between the program and the enrollment sites.

Public Health recognizes the need to increase enrollment site monitoring and is currently developing a plan prioritizing sites that require a monitoring visit. The enrollment site monitoring tools are also being updated to standardize and simplify the reporting required after completing a site visit. Included in these updates is the requirement to complete the site visit report within 30 days of the actual visit.

During site visits, coordinators often find issues surrounding correct documentation required for eligibility for the program. We believe that it is inaccurate, however, to assume that this discovery correlates to approximately 10% to 20% of ADAP clients actually being *ineligible* for the program. The issues of non-compliance with documentation requirements could be as simple as the enrollment worker using one month's paycheck stub for income determination rather than three months of pay, or using a bank statement as proof of residency rather than a utility bill. ADAP has established eligibility guidelines and all enrollment workers are required to attend an annual training on the enrollment process. Errors in documentation requirements discovered during site visits will continue to be emphasized during enrollment worker trainings and followed up with ongoing training as needed.

Reference Number:	2007-5-3
Federal Catalog Number:	93.566
Federal Program Title:	Refugee and Entrant Assistance—State Administered Programs
Federal Award Numbers and Years:	G-06AACA9115;2006 G-07AACA9115;2007
Category of Finding:	Eligibility
State Administering Department:	Department of Health Care Services (Health Care Services)

Criteria

TITLE 45—PUBLIC WELFARE, SUBTITLE A—DEPARTMENT OF HEALTH AND HUMAN SERVICES, PART 92—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE, LOCAL, AND TRIBAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 92.20, Standards for Financial Management Systems

(b)(3) *Internal control.* Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes.

TITLE 45—PUBLIC WELFARE, CHAPTER IV—OFFICE OF REFUGEE RESETTLEMENT, ADMINISTRATION FOR CHILDREN AND FAMILIES, DEPARTMENT OF HEALTH AND HUMAN SERVICES, PART 400—REFUGEE RESETTLEMENT PROGRAM

General Eligibility

- Clients must have either refugee, asylee, entrant, or Amerasian documented status (45 CFR section 400.43). Those meeting this status will be collectively referred to as "refugees".

- A client's eligibility period generally begins on the date he/she arrived in the U.S. (45 CFR section 400.204(a)). (See CA Medical Eligibility Manual rule below.)

Refugee Medical Assistance (RMA) Eligibility Criteria

- Eligibility for RMA is limited to newly arrived refugees who meet one of the following sets of conditions:

  —They are not eligible for Medicaid or the State's Children's Insurance Program (SCHIP), but currently receive Refugee Cash Assistance (RCA) (45 CFR section 400.100(d)); or

  —They meet all of the following criteria:

  (i) They have met the same time eligibility requirement stated above for RCA (45 CFR section 400.100(b)).

  (ii) They are determined ineligible for Medicaid or SCHIP (45 CFR section 400.100(a)(1)).

  (iii) They meet one of the following financial eligibility requirements:

  (A) In a State with a Medicaid medically needy program, they meet the State's Medicaid medically needy financial eligibility standard established at 200 percent of the national poverty level (45 CFR section 400.101(a)).

  (B) In a State without a Medicaid medically needy program, they meet the State's AFDC payment standards and methodologies in effect as of July 16, 1996, or a financial eligibility standard established at 200 percent of the national poverty level (45 CFR section 400.101(b)).

  (C) They did not meet either of these standards, but spent their resources down to the applicable standard using an appropriate method for deducting incurred medical expenses. States must allow applicants for RMA to do this (45 CFR section 400.103).

  —They are not full-time students in institutions of higher education, unless the State has approved their enrollment as part of the refugee's employability plan under 45 CFR section 400.79 or a plan for an unaccompanied minor in accordance with 45 section CFR 400.100(a).

- Earnings from employment do not affect refugees' eligibility for RMA. They remain eligible for RMA through the remainder of the time eligibility period after receiving earnings from employment. Refugees who become ineligible for Medicaid due to employment earnings and have resided in the U.S. less than the time eligibility period will become eligible for RMA for the remainder of the time eligibility period (45 CFR section 400.104).

  States may not require that a refugee actually receive or apply for RCA as a condition for eligibility for RMA (45 CFR section 400.100(d)).

- *Benefit Level*—In providing medical assistance services to eligible refugees, a State must provide at least the same services in the same manner and to the same extent as under the State's Medicaid program (45 CFR section 400.105). A State may provide additional services beyond the scope of the State's Medicaid program to eligible refugees if the State provides these services through public facilities to its indigent residents (45 CFR section 400.106).

CALIFORNIA MEDICAL ELIGIBILITY PROCEDURES MANUAL—Section 50257, No. 285, 24a—Federal Regulations

> The refugee will continue to receive RMA/EMA until the end of the eight-month eligibility period. Every eligible Refugee is guaranteed eight months of medical assistance.

Condition

During procedures performed over eligibility, we noted that no program review had been performed over the counties' determination of eligibility of applicants for Refugee Medical Assistance funding. As a result, 16 out of 60 tested individuals were found to have been improperly found eligible by the respective county of application for the Refugee Medical Assistance program. Furthermore in this same sample of 60, an additional four recipients' files were missing and four recipients' files were not complete. Thus, eligibility determination for these eight recipients could not be determined.

Questioned Costs

Not determined.

Recommendations

Health Care Services should enhance its current policies and procedures to implement a process of continual review of the counties' eligibility determination of applicants for Refugee Medical Assistance (RMA) funding. Health Care Services should also put other applicable procedures in place to insure the proper eligibility determination of applicants for the RMA funding so as to prevent applicants who do not meet the federal eligibility requirements from being improperly determined eligible in the respective county of application.

Department's View and Corrective Action Plan

Health Care Services agrees that some of the cases reviewed were made eligible in error or remained eligible past the eight-month RMA time-eligibility limit in error. We do not concur that ". . . no program review had been performed over the counties' determination of eligibility of applicants for Refugee Medical Assistance funding." Health Care Services reviewed RMA eligibility determinations in 2004. Further reviews were suspended pending negotiations with the Office of Refugee Resettlement on the protocol for a full case review for the October 2002-September 2005 period and further annual reviews. We would also like to point out that the audit does not acknowledge that eligibility in California is done at the County Welfare Departments, not at the state level. Many cases cited in error were due to missing information. Because of county concerns on Health Insurance Portability and Accountability Act violations and confidentiality of protected health information, many counties are reluctant to copy and send case files by mail. Therefore, it is not clear that the audit results are accurate as the county case files were not comprehensively reviewed. In the future we will request that audits be conducted on site where comprehensive case files are located.

Health Care Services' corrective action plan will include the following:

- Obtain final federal approval of our proposed methodology to conduct a three-year review of RMA eligibility determinations between October 2002 and September 2005 and complete that review.

- Complete the 2008 annual RMA case review.

- Contact counties included in the present 60-case sample to correct all cases found to be eligible in error.
- Issue a follow-up *All County Welfare Directors Letter* to all counties to address issues identified in the present 60-case sample on a statewide basis.
- Implement Medi-Cal Eligibility Data System changes needed to ensure that RMA eligibility does not extend beyond the eight-month RMA eligibility period.

Reference Number:	2007-5-4
Federal Catalog Number:	93.778
Federal Program Title:	Medicaid Cluster: Medical Assistance Program (Medi-Cal)
Federal Award Numbers and Years:	05-0605CA5028;2006 05-0705CA5028;2007
Category of Finding:	Eligibility
State Administering Department:	Department of Health Care Services (Health Care Services)

Criteria

TITLE 42—PUBLIC HEALTH, CHAPTER IV—CENTERS FOR MEDICARE AND MEDICAID SERVICES, DEPARTMENT OF HEALTH AND HUMAN SERVICES, PART 435—ELIGIBILITY IN THE STATES, DISTRICT OF COLUMBIA, THE NORTHERN MARIANA ISLANDS, AND AMERICAN SAMOA, Subpart E—General Eligibility Requirements, Section 435.406, Citizenship and Alienage

(a) The agency must provide Medicaid to otherwise eligible residents of the United States who are—

(1) Citizens:

(i) Under a declaration required by section 1137(d) of the Act that the individual is a citizen or national of the United States; and

(ii) The individual has provided satisfactory documentary evidence of citizenship or national status, as described in Section 435.407.

(iii) Individuals must declare their citizenship and the State must document the individual's citizenship in the individual's eligibility file on initial applications and initial redeterminations effective July 1, 2006.

Title 42—Public Health—Chapter IV—Centers for Medicaid Services, Department of Health and Human Services, PART 435—ELIGIBILITY IN THE STATES, DISTRICT OF COLUMBIA, THE NORTHERN MARIANA ISLANDS, AND AMERICAN SAMOA, Subpart E—General Eligibility Requirements, Section 435.407 Types of acceptable documentary evidence of Citizenship.

(a) Primary evidence of citizenship and identity. The following evidence must be accepted as satisfactory documentary evidence of both identity and citizenship:

(1) A U.S. passport. The Department of state issue this. A U.S. passport does not have to be currently valid to be accepted as evidence of U.S. citizenship, as long as it was originally issued without limitation. Note: Spouses and children were sometimes included

on one passport through 1980. U.S. passports issued after 1980 show only one person. Consequently, the citizenship and identity of the included person can be established when one of these passports is presented. Exception: Do not accept any passport as evidence of U.S. citizenship when it was issued with a limitation. However, such a passport may be used as proof of identity.

(2) A Certificate of Naturalization (DHS Forms N-550 or N-570.) Department of Homeland Security issued for naturalization.

(3) A Certificate of U.S. Citizenship (DHS Forms N-560 or N-561.) Department of Homeland Security issues certificates of citizenship to individuals who derive citizenship through a parent.

Condition

As a result of the Deficit Reduction Act of 2005, the federal government increased requirements as to the nature of acceptable documentation for Medi-Cal beneficiaries to verify citizenship/residency in the United States. Effective July 1, 2006, Medi-Cal beneficiaries are required to provide documented evidence of citizenship, including birth certificates, documentation of naturalization, or U.S. passports. Beneficiaries who fail to provide this information are only eligible for restricted benefits. However, certain beneficiaries are exempted from this requirement. These beneficiaries include beneficiaries who receive Social Security Income, children in the foster care system, and undocumented immigrants (as they are only eligible for restricted benefits).

Although the new documentation guidelines were required to be implemented by July 1, 2006, the State of California did not implement this requirement during the fiscal year ended June 30, 2007. Based on the results of the audit work performed over the eligibility case files selected, 12 of the 120 case files had at least one nonexempt beneficiary who lacked appropriate citizenship documentation, but received full-scope Medi-Cal benefits during the fiscal year ended June 30, 2007.

Questioned Costs

Not determined.

Recommendation

Health Care Services should implement the citizenship documentation requirements of 42 CFR 435.406 and 42 CFR 435.407, and take appropriate corrective action on all eligibility cases where individuals cannot produce the appropriate citizenship documentation.

Department's View and Corrective Action Plan

Health Care Services has implemented the Deficit Reduction Act of 2005 (DRA) evidence of citizenship requirements. Prior to issuance of All County Welfare Directors letter 07-12, Health Care Services implemented a process to verify citizenship for persons born in California using an automated birth record match. In addition, Health Care Services has conducted extensive outreach to inform Medi-Cal applicants and beneficiaries about the DRA citizenship and identity requirements and will continue to work with county welfare departments to ensure compliance.

Reference Number:	2007-5-5
Federal Catalog Number:	93.778
Federal Program Title:	Medicaid Cluster: Medical Assistance Program (Medi-Cal)
Federal Award Numbers and Years:	05-0605CA5028;2006 05-0705CA5028;2007
Category of Finding:	Eligibility
State Administering Department:	Department of Health Care Services (Health Care Services)

Criteria

TITLE 42—PUBLIC HEALTH, CHAPTER IV—CENTERS FOR MEDICARE AND MEDICAID SERVICES, DEPARTMENT OF HEALTH AND HUMAN SERVICES, PART 431—STATE ORGANIZATION AND GENERAL ADMINISTRATION, Subpart A—Single State Agency, Section 431.10, Single State Agency,

(c) Determination of Eligibility

(1) The plan must specify whether the agency that determines eligibility for families and for individuals under 21 is:

(i) The Medicaid Agency; or

(ii) The single State agency for the financial assistance program under Title IV-A (in the 50 States or the District of Columbia), or under Title XVI (AABD) in Guam, Puerto Rico, or the Virgin Islands.

(2) The plan must specify whether the agency that determines eligibility for aged, blind, or disabled is:

(i) The Medicaid Agency; or

(ii) The single State agency for the financial assistance program under Title IV-A (in the 50 States or the District of Columbia), or under Title XVI (AABD) in Guam, Puerto Rico, or the Virgin Islands, or

(iii) The Federal agency administering the supplemental social security income program under Title XVI (SSI). In this case, the plan must also specify whether the Medicaid agency or the Title IV-A agency determines eligibility for any of the groups whose eligibility is not determined by the federal agency.

TITLE 42—PUBLIC HEALTH, CHAPTER IV—CENTERS FOR MEDICARE AND MEDICAID SERVICES, DEPARTMENT OF HEALTH AND HUMAN SERVICES, PART 435—ELIGIBILITY IN THE STATES, DISTRICT OF COLUMBIA, THE NORTHERN MARIANA ISLANDS, AND AMERICAN SAMOA, Subpart J—Eligibility in the States and the District of Columbia, Section 435.916, Periodic Redeterminations of Medicaid Eligibility

"The agency must redetermine the eligibility of Medicaid recipients, with respect to circumstances that may change, at least every 12 months."

SOCIAL SECURITY ACT, TITLE XIX—GRANTS TO STATES FOR MEDICAL ASSISTANCE PROGRAM, Section 1925.

- Initial 6-Month Extension: (1) Requirement—Notwithstanding any other provision of this title, each State plan approved under this title must provide that each family which was receiving aid pursuant to a plan of the State approved under part A of title IV in at least 3 of the 6 months immediately preceding the month in which such family becomes ineligible for such aid, because of hours of, or income from, employment of the caretaker relative (as defined in subsection (e)) or because of section 402(a)(8)(B)(ii)(II) (providing for a time-limited earned income disregard), shall, subject to paragraph (3) and without any reapplication for benefits under the plan, remain eligible for assistance under the plan approved under this title during the immediately succeeding 6-month period in accordance with this subsection.

- Additional 6-Month Extension: (1) Requirement.—Notwithstanding any other provision of this title, each State plan approved under this title shall provide that the State shall offer to each family, which has received assistance during the entire 6-month period under subsection (a) and which meets the requirement of paragraph (2)(B)(i), in the last month of the period the option of extending coverage under this subsection for the succeeding 6-month period, subject to paragraph (3)."

Condition

States are required to operate a Medicaid Eligibility Quality Control (MEQC) system in accordance with requirements established by the Centers for Medicare and Medicaid Services (CMS). The MEQC system redetermines eligibility for individual sampled cases of beneficiary eligibility determined by state Medicaid agencies, or their designees. The State of California had been granted a waiver from the traditional MEQC program described in regulation. This waiver differs from the traditional MEQC program by performing special studies, targeted reviews, or other activities that are designed to ensure program integrity or improve program administration. The Health Care Services' MEQC process reviewed 3,267 cases from July 2006 to June 2007. Of the 3,267 cases sampled, Health Care Services determined that 247 cases were ineligible, resulting in a 7.6 percent error rate.

We evaluated the accuracy of the MEQC system by obtaining a listing of all eligibility case reviews performed by Health Care Services during the fiscal year and choosing 60 cases to reperform its MEQC review in 10 different counties. Our sample of 60 Medicaid recipients included 56 who were deemed eligible and four who were deemed ineligible by the MEQC review process. The results of our review over the MEQC process are as follows:

Our reexamination noted that one of the 56 Medicaid recipients deemed eligible by the MEQC process was actually ineligible for Medi-Cal benefits. We noted a family failed to submit its annual redetermination of eligibility, which was due in August 2005. Although the beneficiaries appear to have been discontinued in the county's consortium system, California Work Opportunity and Responsibility to Kids (CalWORKS) Information Network (CalWIN), they remained active in the Medicaid Eligibility Database System (MEDS), the state Medi-Cal database until August 2006. We note there was no evidence in the family's case file to substantiate that a redetermination was performed, and as such, the beneficiaries were ineligible from September 2005 through August 2006. We further note that the MEQC reviewer, who reviewed the case for eligibility in August 2006, did not note this case as ineligible. This indicates a potential interface error between the CalWIN and the MEDS, as the termination processed in the county system was not transmitted to the state system, which showed the beneficiaries as eligible for benefits.

One of 60 beneficiaries failed to provide a signed annual redetermination due in May 2006, resulting in the beneficiary also being ineligible from June 2006 until December 2006, when benefits were terminated by the county.

Additionally, we selected 60 case files from the general population of the State's Medi-Cal beneficiaries in 10 different counties to reperform the counties' eligibility determination.

We noted that one of the 60 cases tested from the general population of Medicaid beneficiaries was erroneously transferred to Transitional Medi-Cal (TMC). TMC is provided to Medicaid beneficiaries eligible under Section 1931(b) of the Social Security Act (1931(b)) or CalWORKS beneficiaries when an income increase reported causes them to exceed the income limitations for Medicaid. Beneficiaries are eligible for TMC for a year after their initial earnings increase, at which point, if they are above the Medicaid income limitation, their benefits would be discontinued. The beneficiaries in this case had not reported an increase in earnings, and therefore should have continued to receive benefits under the 1931(b) program. In the consortium system, Los Angeles Eligibility Automated Determination, Evaluation, and Reporting System (LEADER), the beneficiary was eligible under the 1931(b) program. However, MEDS indicated the beneficiary as eligible under the TMC program for the same period reviewed. This indicates a potential interface error between LEADER and MEDS. Even though the TMC and Section 1931(b) are full scope, no share of cost programs, the beneficiary could have been erroneously discontinued from Medicaid benefits.

Recommendations

Health Care Services should investigate the interfaces between the county eligibility systems and MEDS so that changes in the beneficiaries' status processed through the county eligibility systems are transmitted to the state database accurately.

Health Care Services should also strengthen its internal controls over the MEQC process. We further recommend procedures be implemented to ensure the cases with errors are addressed and resolved within a timely manner.

Questioned Costs

Not determined.

Department's View and Corrective Action Plan

Health Care Services agrees with the audit findings.

- The first finding relates to an MEQC case in which a family failed to submit their annual redetermination. The family was discontinued by the CalWIN automated system, but remained active on MEDS. This is a CalWIN/MEDS interface issue which will be addressed by Medi-Cal Policy and automated systems staff.

- The second finding relates to an MEQC case in which beneficiaries did not comply with the annual redetermination requirement and were therefore ineligible for Medi-Cal beginning the month after the 12-month certification period. The benefits received until the county completed actions to terminate were erroneously received. Because the cause of the erroneously issued benefits was an agency caused error, no overpayment actions can be taken against the beneficiaries. As a result, there are no further corrective actions that can be taken for this specific case situation.

- The third finding relates to a case sampled from MEDS. According to the auditor, LEADER correctly showed the beneficiaries as being eligible for Medi-Cal under Section 1931 (b). However, MEDS incorrectly showed the beneficiaries as eligible under the Transitional Medi-Cal (TMC) program. Both programs are full-scope with zero share of cost. The primary issue is an apparent interface problem between LEADER and MEDS. This LEADER/MEDS interface issue will be addressed by Medi-Cal Policy and automated systems staff.

Health Care Services has already strengthened its internal MEQC controls. Specifically, since 2000 Health Care Services has implemented the following:

- Corrective Action Reviews, which monitor county efforts to correct MEQC issues (i.e., dollar errors and procedural errors). Historically, counties have addressed over 97 percent of these issues.

- Central Control Unit, or quality control for quality controllers. At the conclusion of each base period, Program Review Section (PRS) supervisory staff reviews random samples of PRS staff MEQC cases, discusses findings and issues, and seeks to promote consistency in documentation and findings.

In addition, as of January 1, 2007, we added language to each of our Focused Review (FR) reports that specifically documents the requirement that counties take remedial action on each and every adverse FR finding. Major counties have excellent track records of addressing issues and taking corrective action.

Reference Number:	2007-5-6
Federal Catalog Number:	93.778
Federal Program Title:	Medicaid Cluster: Medical Assistance Program (Medi-Cal)
Federal Award Numbers and Years:	05-0605CA5028;2006 05-0705CA5028;2007
Category of Finding:	Eligibility
State Administering Department:	Department of Health Care Services (Health Care Services)

Criteria

SOCIAL SECURITY ACT, TITLE XIX—GRANTS TO STATES FOR MEDICAL ASSISTANCE PROGRAMS, Section 1920

- A State plan approved under Section 1902 may provide for making ambulatory prenatal care available to a pregnant woman during a presumptive eligibility period

- The State agency shall provide qualified providers with:

  (A) such forms as are necessary for a pregnant woman to make application for medical assistance under the State plan, and

  (B) information on how to assist such women in completing and filing such forms.

- A qualified provider that determines under subsection (b)(1)(A) that a pregnant woman is presumptively eligible for medical assistance under a State plan shall:

  (A) notify the State agency of the determination within 5 working days after the date on which determination is made, and

  (B) inform the woman at the time the determination is made that she is required to make application for medical assistance under the State plan by not later than the last day of the month following the month during which the determination is made.

Condition

The presumptive eligibility component of this program grants immediate and temporary Medi-Cal coverage for California residents who are pregnant but do not have health insurance or Medi-Cal coverage for prenatal care. Health Care Services grants the right to enroll recipients under

this program to qualified providers. Because the program provides immediate and temporary care prior to the approval of Medi-Cal eligibility, recipients enrolled in presumptive eligibility are not considered Medi-Cal eligible, and therefore, are not entered into Health Care Services' eligibility systems. Recipients presumed to be eligible are assigned a pre-numbered ID card (obtained from Health Care Services by the provider) that begins with a county ID # and presumptive eligibility aid code. The paper documentation, including the application and presumptive eligibility identification card, are retained by the provider. The provider is required by the state plan to submit to Health Care Services a weekly enrollment summary of all presumptive eligibility IDs issued to Health Care Services for filing. Health Care Services is to keep the documents for a period of three years. Since the supporting documentation for presumptive eligibility is retained by Health Care Services, the State's fiscal intermediary, Electronic Data Systems (EDS), does not perform procedures over recipients presumed to be eligible. The EDS mainframe processing is set to bypass the eligibility check if it recognizes the special sequencing of the presumptive eligibility ID number.

Consistent with the prior year, Health Care Services is unable to reconcile the presumptive eligibility number against the enrollment listing filed with Health Care Services because of staffing limitations. However, Health Care Services is pursuing an automated process to post the presumptive eligibility ID to the Medi-Cal eligibility system so that records for these recipients can be accessed to authenticate, reconcile, and prevent duplicate issuances of the presumptive eligibility number during the claims adjudication process.

Recommendations

Health Care Services should strengthen its internal control process to track and obtain the enrollment presumptive eligibility ID numbers issued to prevent unauthorized use of ID numbers. Further, Health Care Services should perform procedures to authenticate the existence of the recipient, prevent duplicate issuances, and reconcile the presumptive eligibility number against the recipient enrollment listing filed at Health Care Services during the claims adjudication process.

Questioned Costs

Not determined.

Department's View and Corrective Action Plan

Health Care Services partially agrees.

Health Care Services is unable to reconcile the presumptive eligibility number against the enrollment listing filed with it at this time without an automated system. However, state law only allows this automated system to be funded with health care foundations funding (Senate Bill 24, Chapter 895, Statutes of 2003).

Health Care Services is pursuing an automated process to post the presumptive eligibility ID to the Medi-Cal eligibility system so that the records for these recipients can be accessed to authenticate, reconcile, and prevent duplicate issuances of the presumptive eligibility number during the claims adjudication process. The consultant hired by Health Care Services is set to release its final report by the end of January 2008. After the report is final, Health Care Services will pursue funding through the health care foundations to conduct an independent feasibility study and accomplish this automation, as required by Senate Bill 24, Chapter 895, Statutes of 2003.

Reference Number:	2007-7-16
Federal Catalog Numbers:	93.575 & 93.596
Federal Program Titles:	Child Care Development Fund Cluster—Child Care and Development Block Grant & Child Care Mandatory and Matching Funds of the Child Care and Development Fund
Federal Award Numbers and Years:	G996005;2004 G994231;2004 G994232;2004
Category of Finding:	Earmarking
State Administering Department:	Department of Education (Education)

Criteria

TITLE 45—PUBLIC WELFARE, SUBTITLE A—DEPARTMENT OF HEALTH AND HUMAN SERVICES, PART 98—CHILD CARE AND DEVELOPMENT FUND, Subpart G—Financial Management, Section 98.67, Fiscal Requirements

(c) Fiscal control and accounting procedures shall be sufficient to permit:

(1) Preparation of reports required by the Secretary under this subpart and under subpart H; and

(2) The tracing of funds to a level of expenditure adequate to establish that such funds have not been used in violation of the provisions of this part.

Condition

Education does not have appropriately designed controls in place to monitor required program earmarking requirements. In addition, calculations are not performed on required earmarks to ascertain if Education has complied within the required limitations. In order to audit compliance with earmarking requirements, we obtained expenditure information from Education's California State Accounting and Reporting System (CALSTARS) general ledger reports and performed the calculations to ensure that they met requirements for the grant that closed out during the current fiscal year. Based on the expenditure information provided, the award for the fiscal year ended September 30, 2005, appeared to fall within the required limitations; however, there is no properly designed controls in place to monitor actual compliance with earmarking requirements.

We noted three specific earmarks in Education's grant agreement for child care quality improvement activities, infant and toddler quality improvement, and child care resource and referral and school-aged activities. We noted that the earmark for infant and toddler quality improvement was underspent by $236,772 from the required $11,233,568 indicated on the agreement. We also noted the earmark for child care resource and referral and school-aged child care activities was underspent by $23,525 from the required $1,991,783 indicated on the agreement.

Education believes a formal calculation of the earmarking is not necessary since it deems the established budget alone ensures compliance. However, since actual expenditures are not always expended exactly according to budget (for example, local educational agencies not expending full grant awards), without a formal calculation being prepared, there is no evidence to support that the final actual program expenditures met the required earmarking limitations.

Questioned Costs

Not applicable.

Recommendation

Education should enhance its current policies and procedures to include an actual calculation of required earmarks to be performed to ensure compliance with specified earmarking requirements.

Department's View and Corrective Action Plan

Education does not concur with this condition. Earmarks are part of the Discretionary Grant. The obligation period is October 1, 2004 to September 30, 2006, with a liquidation period until September 30, 2007. Since the liquidation period ended outside of the 2006–07 transaction year that was audited, the final expenditure entries, including FIFO entries, had not been made to fully spend the total amount calculated and budgeted for earmarks.

Auditor's Comment on Department's View

We believe that whether or not the grant was closed, Education should monitor earmarking and other compliance requirements during the grant period.

Reference Number:	2007-7-17
Federal Catalog Number:	93.994
Federal Program Title:	Maternal and Child Health Services Block Grant to the States
Federal Award Number and Year:	B04MC07784;2006
Category of Finding:	Earmarking
State Administering Department:	Department of Public Health (Public Health)

Criteria

TITLE 42—THE PUBLIC HEALTH AND WELFARE, CHAPTER 7—SOCIAL SECURITY, SUBCHAPTER V—MATERNAL AND CHILD HEALTH SERVICES BLOCK GRANT, Section 705, Application for Block Grant Funds

(a)(3) Except as provided under subsection (b), provides that the State will use:

- (a) At least 30% of such payment amounts for preventive and primary care services for children, and
- (b) At least 30% of such payment amounts for services for children with special health care needs (as specified in section 701(a)(1)(D) of this title).

Condition

During procedures performed over program earmarking requirements, we noted that the Maternal and Child Health Services Block Grant (MCAH) did not track the 30 percent spending requirement for (a) preventive and primary care for children, or (b) children with special health care needs during the fiscal year ended June 30, 2007. This finding was carried forward from the prior year audit due to the corrective action plan not being fully implemented to address the issue.

The amounts actually spent for these activities cannot be determined due to inadequate support for earmarking requirements; therefore, we are unable to assess Public Health's compliance with federal earmarking requirements.

Questioned Costs

Not determined.

Recommendation

Public Health should continue to implement its corrective action and develop accounting information that will properly track and provide timely reporting of grant fund expenditures for two categories—(a) preventive and primary care for children and (b) children with special health care needs—as prescribed by the MCAH's earmarking requirements.

Department's View and Corrective Action Plan

Public Health is continuing its efforts with the two-part corrective action plan to fully respond to the audit finding and ensure there is complete documentation of California's expenditure of Title V funds in accordance with the "30-30" expenditure requirements.

Part 1 of the Corrective Action Plan: Identify Title V subrecipient agreements that are entirely comprised of only one of the Title V components. Track expenditures for those agreements in accordance with 30/30 earmarking requirements. Estimated full implementation for Part 1: October 1, 2007. Status: Complete.

Part 2 of the Corrective Action Plan: Identify Title V subrecipient agreements that are comprised of more than one of the three Title V components. In collaboration with the affected subrecipients, develop and implement an expenditure tracking mechanism to fully track the two components required to be tracked by Title V requirements. Estimated full implementation for Part 2: July 1, 2008.

- Public Health/MCAH Action Workgroup consisting of key Public Health and MCAH Directors has been formed and teleconferenced on June 19, 2007 and July 10, 2007 to discuss county-based options to document 30/30 Title V earmarking requirements for Preventive and Primary Care Services for Children and for Children with Special Health Care Needs. Status: The Workgroup teleconferenced again on October 10, 2007 to review current findings and discuss time survey methodology again.

- Two options to document 30/30 earmarking are being tested for feasibility: 1) One week per quarter activity survey and/or 2) Use of existing secondary documentation collected during the Counties' quarterly Title XIX time surveys. Status Option 1): The Workgroup teleconferenced on October 10, 2007 and finalized plans to develop a time survey methodology pilot to validate documentation of the 30/30 expenditures. Draft time survey specification was presented to the MCAH action committee on October 17, 2007 for comment prior to implementing the pilot. Estimated completion date for the time survey pilot is March 31, 2008. Status Option 2): On August 8, 2007, MCAH queried 4 pilot Local Health Jurisdictions (LHJ) for secondary documentation to determine if sufficient secondary data is available to track the two components in subrecipient agreements. Formal conclusions could not be drawn based on the information received on August 17, 2007.

Reference Number:	2007-8-8
Federal Catalog Number:	93.566
Federal Program Title:	Refugee and Entrant Assistance—State Administered Programs
Federal Award Numbers and Years:	G-06AACA9115;2006 G-07AACA9115;2007
Category of Finding:	Period of Availability
State Administering Department:	Department of Public Health (Public Health)

Criteria

TITLE 45—PUBLIC WELFARE, SUBTITLE A—DEPARTMENT OF HEALTH AND HUMAN SERVICES, PART 92—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE, LOCAL, AND TRIBAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 92.23, Period of Availability of Funds

(a) *General.* Where a funding period is specified, a grantee may charge to the award only costs resulting from obligations of the funding period unless carryover of unobligated balances is permitted, in which case the carryover balances may be charged for costs resulting from obligations of the subsequent funding period.

Condition

During our procedures performed over period of availability, we noted three exceptions out of 30 sample items tested where the service period did not coincide with the federal fiscal year recorded. The three invoices were related to services provided in federal fiscal year 2007, but they were expensed to federal fiscal year 2006:

- Payment for $9,663 with services provided in October 2006 was recorded to the federal fiscal year 2006 award where the last day of obligation was September 30, 2006.
- Payment for $197 with services provided in October 2006 was recorded to the federal fiscal year 2006 award where the last day of obligation was September 30, 2006.
- Payment for $1,862 with services provided in October 2006 was recorded to the federal fiscal year 2006 award where the last day of obligation was September 30, 2006.

Public Health did not have adequate controls in place to prevent or detect items being posted in the incorrect period, which caused expenditures to be charged to the incorrect award year.

Questioned Costs

$11,722 of the $231,975 sampled were recorded in the improper period

Recommendation

Public Health should enhance its current policies and procedures to ensure that payments made to subrecipient contractors are recorded in the corresponding federal fiscal award year when the services are provided.

Department's View and Corrective Action Plan

The Department of Health Care Services agrees that three payments were processed in the same draw and that the entire draw amount was posted incorrectly to the California State Accounting and Reporting System (CALSTARS) as a lump sum to the wrong work phase and reported incorrectly as federal fiscal year (FFY) 2006 instead of FFY 2007. As of July 1, 2007, effective with the creation of the California Department of Public Health, the funding process for Refugee program expenditures completely changed. Health Care Services' Medicaid Local Assistance Payments Unit and the Support Accounting Services Unit are now paying the Refugee program expenditures initially from its General Fund. Subsequently, a representative of the Support Accounting Services Unit will analyze CALSTARS reports and bill Public Health according to an interagency agreement. Public Health will then prepare a claim schedule and draw federal funds to reimburse Health Care Services' General Fund for the Refugee program expenditures. The billing and reimbursement processes are still being developed. Several key people are aware of this audit finding and will work as a team to incorporate in the new procedures processes to ensure that the correct information is posted to CALSTARS and documented properly in any required reports.

Reference Number:	2007-8-9
Federal Catalog Numbers:	93.575 & 93.596
Federal Program Titles:	Child Care Development Fund Cluster—Child Care and Development Block Grant & Child Care Mandatory and Matching Funds of the Child Care and Development Fund
Federal Award Numbers and Years:	G996005;2006 G994231;2006 G994232;2006
Category of Finding:	Period of Availability
State Administering Department:	Department of Education (Education)

Criteria

TITLE 45—PUBLIC WELFARE, SUBTITLE A—DEPARTMENT OF HEALTH AND HUMAN SERVICES, PART 98—CHILD CARE AND DEVELOPMENT FUND, Subpart G—Financial Management, Section 98.67, Fiscal Requirements

(c) Fiscal control and accounting procedures shall be sufficient to permit:

(1) Preparation of reports required by the Secretary under this subpart and under subpart H; and

(2) The tracing of funds to a level of expenditure adequate to establish that such funds have not been used in violation of the provisions of this part.

TITLE 45—PUBLIC WELFARE, SUBTITLE A—DEPARTMENT OF HEALTH AND HUMAN SERVICES, PART 92—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE, LOCAL, AND TRIBAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 92.23, Period of Availability of Funds

(a) *General.* Where a funding period is specified, a grantee may charge to the award only costs resulting from obligations of the funding period unless carryover of unobligated balances is permitted, in which case the carryover balances may be charged for costs resulting from obligations of the subsequent funding period.

Condition

During our procedures performed over the period of availability, we selected a sample of adjusting journal entries (entries) made during the fiscal year to ascertain if underlying obligations for those entries occurred within the appropriate period of availability. We noted that all of the six entries sampled were prepared and posted into Education's California State Accounting and Reporting System (CALSTARS) by the same employee, resulting in a lack of segregation of duties. Additionally, there was no evidence of review or approval of these six entries.

We requested the supporting documentation of the underlying transactions for those entries recorded that carried back or forward expenditures between award years and noted that Education does not maintain support in the level of detail (specified transactions identified with claims schedules) so that transactions can be sampled and tested for appropriateness of the period recorded. Rather, the support for the entries consists of pools of funds (voluminous listing of claims schedules that significantly exceed the amount of the entry); however no specified claims schedules or underlying transactions are identified as the specific transactions that are being adjusted.

Previous correspondence between Education and the U.S. Department of Education regarding exceptions noted in prior-year audits indicated that unambiguous support should be maintained to support the first-in, first-out (FIFO) close-out journal entries: "The FIFO method depends upon clear documentation of the transactions falling within the Tydings period. To the extent that a recipient relies on principles of FIFO accounting, the recipient must also establish that such a method has been consistently used from year to year and must document clearly and unambiguously that the transactions giving rise to the obligations in question arose before the relevant Tydings cut-off date."

Education does not require journal entries to be reviewed and approved, nor does it require segregation of duties between the preparer and the recorder of the entry. Without appropriately designed controls in place, there is risk that Education could incorrectly adjust expenditures between grant award years. We also noted Education's current policies and procedures do not require that detailed transaction supporting documentation be maintained to support FIFO amounts adjusted. Without this unambiguous detailed documentation that identifies specific transactions to support that they were incurred during the proper period, a reviewer cannot ascertain if the transactions are being transferred between the appropriate grant award years.

Questioned Costs

Not applicable.

Recommendations

Education should strengthen its policies and procedures to ensure appropriate segregation of duties are maintained and adjusting FIFO entries are reviewed and approved. Education should also ensure appropriate supporting documentation is maintained to adequately support adjusting transactions between federal funding years.

Department's View and Corrective Action Plan

Education does not agree that the journal entries referred to in this condition need to be reviewed and approved; these transactions are adjusting entries in the Payment Management System (PMS) and do not constitute a cash withdrawal from the federal system. Reconciliations, such as carryover worksheets, are completed by staff and reviewed by management. These reconciliations summarize all activity associated with each grant.

The supporting documentation provided for the FIFO entries encompassed all expenditures that were incurred prior to the close of the performance period of the grant. We have agreed that we will enhance our documentation to identify specific detailed information where applicable.

It should also be noted that this grant does not have a Tydings period as stated in the third paragraph of the condition section of this finding.

Auditor's Comment on Department's View

Education's response is not supported by the test work performed and resulting finding described above. Specifically, there was no readily available unambiguous detailed documentation supporting the FIFO entries.

Reference Number:	2007-8-10
Federal Catalog Numbers:	93.575 & 93.596
Federal Program Titles:	Child Care Development Fund Cluster—Child Care and Development Block Grant & Child Care Mandatory and Matching Funds of the Child Care and Development Fund
Federal Award Numbers and Years:	G999005;2005 G999005;2007
Category of Finding:	Period of Availability
State Administering Department:	Department of Education (Education)

Criteria

TITLE 45—PUBLIC WELFARE, SUBTITLE A—DEPARTMENT OF HEALTH AND HUMAN SERVICES, PART 98—CHILD CARE AND DEVELOPMENT FUND, Subpart G—Financial Management, Section 98.60, Availability of Funds

(d) The following obligation and liquidation provisions apply to States and Territories:

(1) Discretionary Fund allotments shall be obligated in the fiscal year in which funds are awarded or in the succeeding fiscal year. Unliquidated obligations as of the end of the succeeding fiscal year shall be liquidated within one year.

Condition

During our procedures performed over the period of availability, we noted Education records subrecipient contractor payments essentially on a cash basis into the program year (work phase) that is open at the time the payment request is submitted. This method of recording contractor payments increases the risk that material amounts would be recorded in the improper period. In our sample of 60 payments made, we noted 15 that were not obligated during the period of availability.

- One payment was charged to a federal award for a contract that was obligated subsequent to the last day available to obligate program funds. The contract advance for $513,559 was charged to the 2005 award (0501CACCDF) and was obligated on December 8, 2006; however the last day to obligate was September 30, 2006.

- Of payments charged to a federal award, 14 were obligated before the first day available to obligate program funds. These 14 contract advances, totaling $14,430,685, were obligated between July 2006 and September 2006; however, they were charged against the 2007 award (0701CACCDF) where the first day to obligate was October 1, 2006.

Additionally, we noted four advances that were made to one contractor before the contracts were executed. Two of those payments were made 10 and 11 days before the contract was executed, while the other two payments made to the same contractor were made 65 and 90 days before the contract was executed.

Questioned Costs

$14,944,244 of the $38,365,580 sampled payments made to contractors outside of the federal program obligation period

Recommendation

Education should enhance its current policies and procedures to ensure that payments made to subrecipient contractors are recorded in the grant award that corresponds with the obligation period.

Department's View and Corrective Action Plan

Education does not concur with this condition. Service contracts for the Child Development Program are conditional obligations of the State of California at the time they are mailed to the providers; these contracts include a condition regarding the availability of funding. Since all contracts have conditional language regarding availability of funding, the obligation for the October through June portion of the contract would not be an obligation to the State until Federal Funds are available for obligation.

Per California *Education Code*, Section 8447(b), contracts and funding terms and conditions shall be issued to child care contractors no later than June 1 of each year. This requirement ensures continuity of the program and reflects availability of both current and prior year federal funds to fulfill the obligations. The contracts are for the state fiscal year starting July 1 and ending June 30; therefore, all of the contracts referenced in this condition were mailed in June. However, the first three months of the contracts (July, August, and September) pertain to current fiscal year state funds and prior year federal funds; whereas, the last nine months (October through June) pertain to both current state and federal fiscal year funds. Education will review its existing contract language regarding the conditions of obligation, and, if necessary, add clarifying language.

Furthermore, Education notes that payments are not made until the contractor has signed the contract and returned it to the department. The payments to the four contracts specified as paid prior to the contracts being obligated, were processed after the contractor signed and returned them to Education.

Auditor's Comment on Department's View

Education's response is not supported by the test work performed and resulting finding described above. Specifically, we noted instances where payments were made and charged to a federal grant prior to the execution of subcontractor contracts.

Reference Number:	2007-12-23
Category of Finding:	Reporting
State Administering Department:	Department of Public Health (Public Health)
Federal Catalog Number:	93.566
Federal Program Title:	Refugee and Entrant Assistance—State Administered Programs
Federal Award Numbers and Years:	G-06AACA9115;2006 G-07AACA9115;2007

Federal Catalog Number:	93.889
Federal Program Title:	National Bioterrorism Hospital Preparedness Program
Federal Award Numbers and Years:	U3RHS03890;2004 U3RHS05953;2005 U3RHS007572;2006

Criteria

TITLE 45—PUBLIC WELFARE, SUBTITLE A—DEPARTMENT OF HEALTH AND HUMAN SERVICES, PART 92—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE, LOCAL, AND TRIBAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 92.20, Standards for Financial Management Systems

(b)(3) *Internal control.* Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes.

Condition

During procedures performed over reporting, we noted that there is no evidence of review or approval of the SF-272, Federal Cash Transactions Report. Public Health's current policies and procedures do not require that evidence of reviews and approvals be documented. Without appropriately designed controls in place, there is increased risk of inaccurate reporting.

Further, Public Health did not prepare and submit two of its four quarterly Financial Status Reports for the grant award U3RHS05953 as required by the special terms and conditions section in the grant extension letter. Public Health indicated these reports were not filed because it was not aware of the requirement.

Questioned Costs

Not determined.

Recommendation

Public Health should enhance its current policies and procedures to implement segregation-of-duties controls to reduce the risk of material inaccurate reporting. For example, someone other than the preparer should review and approve the required reports.

Department's View and Corrective Action Plan

Public Health agrees with the finding. The report was prepared by an Accounting Administrator I—Specialist. It was past practice to rely on the expertise and integrity of the staff member at this level to perform the function without being reviewed. The accounting department has, however, implemented immediate corrective action to have the quarterly SF-272, Federal Cash Transactions Report, reviewed and approved at a second level before sending the final report to Payment Management System.

As for timely preparation of quarterly Financial Status Reports (FSR), the accounting staff responsible for this grant was not aware of the requirement to file the quarterly reports for the extension period of this grant. The requirement was not discovered until a later date; therefore, two of the reporting periods were missed. However, the third quarter was reported on a timely basis on March 23, 2007 for the period of December 1, 2006 through February 28, 2007. At that time, a change in the accounting staff occurred and the information regarding this quarterly requirement was not passed on to the new employee. As a result, the fourth quarter report was not filed. The final FSR was filed on November 30, 2007. Public Health is current in preparing the FSRs.

While the accounting staff will be provided ongoing instructions regarding grant requirement for reporting, it should be noted that the federal granting agency has changed its requirements regarding quarterly reports for extensions on the National Bioterrorism Hospital Preparedness Program grant. The next budget period for this grant has received an extension period to August 31, 2008 and no quarterly reports are required.

Reference Number:	2007-12-24
Federal Catalog Number:	93.767
Federal Program Title:	State Children's Insurance Program
Federal Award Numbers and Years:	05-05A5CA5021;2005 05-06A5CA5021;2006 05-07A5CA5021;2007
Category of Finding:	Reporting
State Administering Department:	Department of Health Care Services (Health Care Services)

Criteria

TITLE 45—PUBLIC WELFARE, SUBTITLE A—DEPARTMENT OF HEALTH AND HUMAN SERVICES, PART 92—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE, LOCAL AND TRIBAL GOVERNMENTS, Subpart C—Post Award Requirements, Section 92.20, Standards for Financial Management Systems

(b)(1) *Financial reporting.* Accurate, current and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant or subgrant.

(b)(2) *Accounting records.* Grantees and subgrantees must maintain records which adequately identify the source and application of funds provided for financially assisted activities. These records must contain information pertaining to grant or subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income.

Condition

This was a carryover finding from the prior year. During the current year, the program has started addressing the finding that Health Care Services does not ensure that amounts reported on its Children's Medical Services (CMS)—21 report, Quarterly Children's Health Insurance Program Statement of Expenditures for Title XXI, are classified correctly. Although the total amounts spent on the program reported by Health Care Services are accurate, we were unable to verify the accuracy of detailed expenditures reported by line item or category of service. Health Care Services states that it does not receive enough information from its fiscal intermediary to be able to reconcile and accurately report program expenditures by category of service as required.

Questioned Costs

Not determined.

Recommendation

Health Care Services should continue to actively work with the contractor (Electronic Data Systems—EDS) to redesign the CMS-21 accounting system to include the capability to accurately report all program expenditures by category of service.

Department's View and Corrective Action Plan

Health Care Services agrees with the recommendation. It has been meeting with EDS staff for the past several months and has determined the underlying issues with the Children's Medical Services (CMS) 21 report. The manual processes utilized by the accounting section for the CMS 21 reporting do not provide enough flexibility to categorize the EDS financial reports by category of service. The Fiscal Intermediary—Information Technology Management Branch (FI-ITMB), accounting section and EDS have determined that an automated CMS 21 reporting process will be created that will provide program expenditures by category of service. The accounting section and FI-ITMB have written a System Development Notice (SDN) to eliminate and automate the manual processes used to generate the CMS 21 report. The SDN will ensure that accounting receives the data in a format that will allow reconciliation of program expenditures and accurate reporting by category of services as required.

Reference Number:	2007-12-25
Federal Catalog Numbers:	93.575 & 93.596
Federal Program Titles:	Child Care Development Fund Cluster—Child Care and Development Block Grant & Child Care Mandatory and Matching Funds of the Child Care and Development Fund
Federal Award Numbers and Years:	G996005;2006 G994231;2006 G994232;2006
Category of Finding:	Reporting
State Administering Department:	Department of Education (Education)

Criteria

TITLE 45—PUBLIC WELFARE, SUBTITLE A—DEPARTMENT OF HEALTH AND HUMAN SERVICES, PART 98—CHILD CARE AND DEVELOPMENT FUND, Subpart G—Financial Management, Section 98.67, Fiscal Requirements

(c) Fiscal control and accounting procedures shall be sufficient to permit:

(1) Preparation of reports required by the Secretary under this subpart and under subpart H; and

(2) The tracing of funds to a level of expenditure adequate to establish that such funds have not been used in violation of the provisions of this part.

Condition

During procedures performed over reporting where Education reported its compliance with various matching, level-of-effort and earmarking requirements, we noted Education utilizes a manual process to compile the data which is reported on the U.S. Department of Health and Human Services Administration for Children and Families Child Care and Development Fund ACF—696 Financial Report. We reviewed a sample of items reported on three of the reports submitted for the quarter ended September 30, 2006, and noted the following exceptions:

- In our review of the final report for 2004, we noted that Education did not maintain supporting documentation for the allocation to nondirect services (local administration and ORC expenditures) of $87,420,654, which was reported in the Discretionary Fund. Per further inquiry with Education's staff, the data is generated from Education's PARIS system at a point in time and cannot be recreated. Without supporting documentation Education cannot support expenditures reported. Education indicated it has implemented a policy to retain the documentation for the point in time to support the amounts reported as of December 31, 2006.

- Education had overreported the amounts expended in the Discretionary Fund's Direct and Non-Direct Services line items when we traced the amounts reported to the California State Accounting and Reporting System (CALSTARS) general ledger. The following indicates the differences noted:

  —Fiscal Year 2004 report indicated $490.9 million; however, the general ledger supported $292.6 million. The financial reporting worksheet that was used to compile the report did not indicate any outstanding encumbrances for these line items.

  —Fiscal Year 2005 report indicated $592.4 million; however, the general ledger supported $364.7 million. The financial reporting worksheet provided that was used to compile the report did not indicate any outstanding encumbrances for these line items.

  —Fiscal Year 2006 report indicated $68.9 million; however, the general ledger supported $103.3 million. The financial reporting worksheet used to compile this report indicated $191.7 million in unliquidated obligations, but we were unable to trace that amount to supporting documentation.

  These differences totaled $391.6 million in reported expenditures that were not supported by the general ledger. These differences appear to have been caused by errors in manually compiling the data for reports.

- In our procedures performed of the amounts reported as Transferred from TANF to the Discretionary Fund, we noted Education had reported the total approved amount of TANF funds to be transferred, but this did not match the totals of expenditures that were recorded in the CALSTARS general ledger. The fiscal year 2005 report indicated $412.6 million; however, the general ledger only supported $364.7 million of expenditures. Education asserted the difference was due to the final close-out accounting entries (FIFO entries) not having been posted in the general ledger to allocate the expenditures that had been made among its three open grants. We therefore reviewed the other two fiscal year grants open to ascertain if their combined expenditures were sufficient to support all three reported amounts. Those two fiscal years contained overreported expenditures

of $12.6 million and underreported expenditures of $13.5 million for fiscal years 2004 and 2005, respectively. These combined differences among all three fiscal years amounted to $47 million of unsupported expenditures reported.

We noted Education's procedure for recording these TANF transfers consisted of posting the entire approved transfer amount for the entire grant period in the general ledger by debiting the general ledger account where the expenditures are captured for reporting and crediting the expense account where the expenditures post that are at the beginning of the grant period. As expenditures are incurred they are posted to offset the credit expense balance. Education indicated that this methodology assists it with the budgeting process for the TANF transferred amounts; however, these offsetting negative expenditure accounts may have been overlooked in the report preparation.

Questioned Costs

Not applicable.

Recommendation

Education should enhance its current policies and procedures to ensure accuracy of data reported and investigate a more automated process to compile reporting data and perform a detailed review to reduce the risk of material inaccurate reporting.

Department's View and Corrective Action Plan

Education does not concur with this condition. Education did not over report the Direct and Non-Direct Services amounts on the ACF-696. The program cost accounts (PCAs) totaled by the auditors do not include all the activity within the PCAs that Education used to compile the amounts reported on the ACF-696. For example, the amounts on the ACF-696 include services related to Migrant, Stage II and Stage III, and Alternative Payments; however, the auditors did not include the associated CalSTARS PCA amounts in their analysis. Also, based on the information provided by the auditors, Education believes that the auditors did not match the correct work phases to the federal grant and ACF-696 reports.

Auditor's Comments on Department's View

The spreadsheet documentation we were provided totaled the reported amounts on the ACF-696. We traced PCA expenditure totals indicated on the spreadsheet to the CALSTARS general ledger and noted our exceptions. If there were additional programs or PCAs that were not included in the spreadsheet documentation that was provided to us, as indicated in Education's response, Education did not provide such additional information to us to resolve the exceptions.

Reference Number:	2007-12-26
Federal Catalog Number:	93.778
Federal Program Title:	Medicaid Cluster: Medical Assistance Program
Federal Award Numbers and Years:	05-0605CA5048;2006 05-0705CA5048;2007
Category of Finding:	Reporting
State Administering Department:	Department of Health Care Services (Health Care Services)

Criteria

Title 42—Public Health, CHAPTER IV—CENTERS FOR MEDICARE AND MEDICAID SERVICES, DEPARTMENT OF HEALTH AND HUMAN SERVICES, PART 431—STATE ORGANIZATION AND GENERAL ADMINISTRATION, Subpart A—Single State Agency, Section 431.17, Maintenance of Records

(b) Content of records. A State plan must provide that the Medicaid agency will maintain or supervise the maintenance of the records necessary for the proper and efficient operation of the plan. The records must include:

(2) Statistical, fiscal, and other records necessary for reporting and accountability as required by the Secretary.

Condition

The federal expenditures noted in the quarterly Centers for Medicare and Medicaid Services (CMS) CMS-64, *Quarterly Statement of Expenditures for the Medical Assistance Program* reports are not traceable to individual claims.

This is a repeat finding from the prior year.

Recommendation

Health Care Services should implement an audit trail such that funding sources for individual claims may be identified.

Questioned Costs

Not determined.

Department's View and Corrective Action Plan

The expenditures in the CMS-64 reports are not traceable to individual claims. This is correct. Health Care Services agrees with the recommendation that the CMS-64 system (system) should have an audit trail to individual claims.

The purpose of the system is to meet the report summary needs for the Health Care Services accounting section. The system was designed to calculate the federal financial participation (FFP) for programs administered by Health Care Services. It does this by importing the California Medicaid Management Information System (CA-MMIS) weekly checkwrite data into CMS-64, which is organized by service and aid categories codes.

The Fiscal Intermediary Contract Oversight Division will submit a Systems Development Notice (SDN) to redesign the system to incorporate the capability to trace summary reports that are submitted to CMS and the California State Accounting and Reporting System (CALSTARS), back to individual claims. It will be a significant design change to both mainframe and non-mainframe applications. The requirements gathering phase for the SDN (SDN 07018) was anticipated to be complete by September 30, 2007. However, this date has been postponed until January 31, 2008, due to the allocation of resources to the National Provider Identification (NPI) project, which was implemented on December 17, 2007. The contractor, Electronic Data Systems (EDS) will receive this SDN approximately February 4, 2008, to begin the redesign of the CMS-64 Accounting System. The revised implementation date is March 2009.

Reference Number:	2007-13-19
Federal Catalog Numbers:	93.575 & 93.596
Federal Program Titles:	Child Care Development Fund Cluster—Child Care and Development Block Grant & Child Care Mandatory and Matching Funds of the Child Care and Development Fund
Federal Award Numbers and Years:	G996005;2006 G994231;2006 G994232;2006
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Education (Education)

Criteria

TITLE 31—MONEY AND FINANCE, SUBTITLE V—GENERAL ASSISTANCE ADMINISTRATION, CHAPTER 75—REQUIREMENTS FOR SINGLE AUDITS, Section 7502, Audit Requirements; Exemptions

(f)(2) Each pass-through entity shall:

(B) monitor the subrecipient's use of Federal awards through site visits, limited scope audits, or other means;

(C) review the audit of a subrecipient as necessary to determine whether prompt and appropriate corrective action has been taken with respect to audit findings, as defined by the Director, pertaining to Federal awards provided to the subrecipient by the pass-through entity; and

(D) require each of its subrecipients of Federal awards to permit, as a condition of receiving Federal awards, the independent auditor of the pass-through entity to have such access to the subrecipient's records and financial statements as may be necessary for the pass-through entity to comply with this chapter.

TITLE 45—PUBLIC WELFARE, SUBTITLE A—DEPARTMENT OF HEALTH AND HUMAN SERVICES, PART 74—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR AWARDS AND SUBAWARDS TO INSTITUTIONS OF HIGHER EDUCATION, HOSPITALS, OTHER NONPROFIT ORGANIZATIONS, AND COMMERCIAL ORGANIZATIONS, Subpart C—Post-Award Requirements, Section 74.51, Monitoring and Reporting Program Performance

(a) Recipients are responsible for managing and monitoring each project, program, subaward, function or activity supported by the award. Recipients shall monitor subawards to ensure the subrecipients have met the audit requirements as set forth in Section 74.26.

Condition

During procedures performed over subrecipient monitoring, we noted the Child Care Development Fund program Local Educational Agencies (LEAs) are monitored by Education's Consolidated Program Monitoring Unit (CPM) and the non-LEA contractors are monitored by the Contract Monitoring Review (CMR).

1. We selected a sample of schools that had been monitored by the CPM process and noted the following regarding its policies and procedures:

- The monitoring procedures contained limited fiscal procedures and do not cover all major functions and activities of the program. Procedures performed may be limited to reviewing that the school has a policy rather than selecting a sample of transactions to test the effectiveness of that policy.

- There was no documented signoff of approval for the procedures performed and conclusions reached for the monitoring visit on the Cross-Program Instrument (CP) by someone other than the preparer. We noted instances where the team leader performed the monitoring procedures and signed off on the overall conclusions on the Notification of Findings.

We also noted the CPM's policies and procedures (CPM protocols) do not require segregation of duties for the CP and Notification of Findings to be reviewed by someone other than the preparer; since the team leaders are also performing portions of the actual procedures, they do not constitute an independent review. Nonsegregation of duties increases the risk of errors or potential fraud. The current CPM protocols do not require the CPM team to maintain documentation other than the checkmarks on the instrument that indicate completion, nor do they require evidence of Education's internal reviews and approvals of the conclusions reached and approvals of the Notifications of Findings issued. By not maintaining adequate documentation of the procedures performed or ensuring that appropriate reviews and approvals are performed, Education is not able to adequately support conclusions reached during its monitoring visits.

In our sample of 60 schools from 27 districts that were monitored between November 2006 and May 2007, we noted 58 of those 60 schools were issued Notification of Findings reports. We reviewed the support for the follow-up that had been performed on those findings to ascertain if it was conducted in a timely manner. Education requires them to respond with a proposed resolution or corrective action plan within 45 days of receipt of the Notification of Findings.

—For the 58 schools required to submit a proposed corrective action plan within 45 days, we noted that 34 corrective action plans were submitted between 46 and 94 days after the receipt of the Notification of Findings.

—In reviewing the timeliness of the resolution of these proposed corrective action plans we noted the following:

—Of the 58 schools 18 had been fully resolved in a timely manner.

—Of the 58 schools 25 had not been resolved by the proposed completion date; however, there was documented evidence of continued follow-up by Education.

—Of the 58 schools 15 were past the proposed corrective action completion date and remained unresolved, and there was no evidence of recent follow-up performed.

There do not appear to be effective sanctions imposed by Education on its LEAs for untimely implementation of correction action plans. Per review of the CPM protocols policy, Education's resolution process includes mailing follow-up letters after 45 days, 145 days, 225 days, and 365 days. The sanction threatened to be imposed is for an additional monitoring visit to be performed the subsequent year. Without significant repercussions the LEAs do not have incentive to implement corrective actions in a timely manner.

2. During the year ending June 30, 2007, Education performed CMR visits on 194 of its contractors. We selected a sample of contractors that had been monitored and reviewed the documentation retained to support the review's findings and conclusions. We noted that the CMR visits consist of one consultant that performs the site visit, prepares the monitoring report, and issues the findings. Education's policies and procedures do not require an independent review or approval of the work performed by the consultant to ensure consistency and quality control.

Questioned Costs

Not applicable.

Recommendation

Education should enhance its current policies, procedures, and monitoring instruments to help ensure that adequate evidence is maintained for monitoring visits performed and that LEA-proposed corrective actions from those visits are implemented in a timely manner.

Department's View and Corrective Action Plan

To strengthen existing controls, Education conducted the following actions:

Monitoring protocols specify the standard for writing findings—Current CPM protocols require all compliance reviewers to "Identify the evidence analyzed to determine compliance or noncompliance." Additionally, on January 9, 2008, Education's Categorical Program Monitoring Unit (CPMU) manager advised reviewers to specifically identify the documents, interviews and observations used as evidence of non-compliance and also initiated review of the Notifications of Findings for each monitoring visit. This review verifies that the documentation of the procedures performed (e.g., program and fiscal samples tested, interviews and observations performed, etc.) support the conclusions reached. Signed verification documents are maintained with the Notification of Findings.

On December 18, 2007, a meeting between representatives of Education and the California Comprehensive Center at West Ed resulted in an agreement to develop a Web-based computerized tracking system to support categorical program monitoring. This new system will facilitate more timely follow-up and corrective action by the appropriate Education program manager when a LEA fails to resolve findings of non-compliance within the time period allowed.

Reference Number:	2007-13-20
Federal Catalog Number:	93.778
Federal Program Title:	Medicaid Cluster: Medical Assistance Program (Medi-Cal)
Federal Award Numbers and Years:	05-0605CA5028;2006 05-0705CA5028;2007
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Health Care Services (Health Care Services)

Criteria

TITLE 31—MONEY AND FINANCE, SUBTITLE V—GENERAL ASSISTANCE ADMINISTRATION, CHAPTER 75—REQUIREMENTS FOR SINGLE AUDITS, Section 7502, Audit Requirements; Exemptions

(f)(2) Each pass-through entity shall:

(A) provide such subrecipients the program names (and any identifying numbers) from which such assistance is derived, and the Federal requirements which govern the use of such awards and the requirements of this chapter.

Condition

Health Care Services is required to disclose the program information to its subrecipients (program name, identifying numbers) and to provide them with the federal program regulations with which they must comply. Of the sample of 30 agreements passing through federal funds to subrecipients selected for testing, none contained the identifying Catalog of Federal Domestic Assistance (CFDA) number of the federal program that Health Care Services passed through to the subrecipient.

It appears Health Care Services does not have adequate controls in place to monitor compliance with required disclosures in subgrant agreements, which resulted in the required disclosures not being made. Without proper disclosure of federal requirements to subrecipients, there is increased risk that subrecipients may not comply with the proper terms and conditions of the Medi-Cal program.

Recommendation

Health Care Services should ensure that the identifying number of the federal program is included in its subgrant agreements.

Questioned Costs

Not determined.

Department's View and Corrective Action Plan

Health Care Services agrees with the finding and will revise all contracts to include the identifying number of the federal program passed through to the subrecipient.

Reference Number:	2007-13-21
Federal Catalog Number:	93.778
Federal Program Title:	Medicaid Cluster: Medical Assistance Program (Medi-Cal)
Federal Award Numbers and Years:	05-0605CA5028;2006 05-0705CA5028;2007
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Health Care Services (Health Care Services)

Criteria

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133, *AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS* (OMB Circular A-133), Subpart D—Federal Agencies and Pass-Through Entities, Section 405, Management Decision

(a) General. The management decision shall clearly state whether or not the audit finding is sustained, the reasons for the decision, and the expected auditee action to repay disallowed costs, make financial adjustments, or take other action. If the auditee has not completed corrective action, a timetable for follow-up should be given. Prior to issuing the management decision, the Federal agency or pass-through entity may request additional information or documentation from the auditee, including a request for auditor assurance related to the documentation, as a way of mitigating disallowed costs. The management decision should describe any appeal process available to the auditee.

(c) Pass-through entity. As provided in Section .400(d)(5), the pass-through entity shall be responsible for making the management decision for audit findings that relate to Federal awards it makes to subrecipients.

(d) Time requirements. The entity responsible for making the management decision shall do so within six months of receipt of the audit report. Corrective action should be initiated within six months after receipt of the audit report and proceed as rapidly as possible.

(e) Reference numbers. Management decisions shall include the reference numbers the auditor assigned to each audit finding in accordance with Section .510(c).

Condition

During our procedures performed over the subrecipient monitoring requirement, we noted that Health Care Services did not issue management decisions within six months of the receipt of the State Controller's Office 2005–06 Fiscal Year Audit Finding Resolution Report, which noted three counties with OMB Circular A-133 report findings related to Medi-Cal.

Adequate controls do not appear to be in place to ensure findings noted on OMB Circular A-133 audit reports are addressed in a timely manner. Without timely resolution of OMB Circular A-133 audit findings in subrecipient audit reports, there is an increased period where subrecipients may not be complying with Medi-Cal program requirements.

Recommendation

Health Care Services should design and implement internal controls to ensure that management decisions are issued by the department within six months of the State's receipt of the subrecipient's OMB Circular A-133 audit reports.

Questioned Costs

Not determined.

Department's View and Corrective Action Plan

Health Care Services agrees with the audit finding and recommendation. Formal written procedures have been developed to ensure management decisions are issued by the Health Care Services within six months of the State's receipt of the subrecipient's A-133 audit report. The procedures are as follows:

- Received reports are logged. Logged details include the fiscal period, date received, date issued and the auditor assigned to the review.

- The auditor reviews the report for fiscal or program findings that require referral and follow-up for corrective action. If there are no findings, the audit reports are filed.

- The reports with findings that are Health Care Services funded are forwarded via a transmittal memo to the program(s) associated with the finding. The transmittal letter identifies the findings in need of follow-up and corrective action. The memo also instructs the program to follow-up on the findings and contact the State Controller's Office once a corrective action plan is submitted by the agency.

As part of its operating responsibilities, Health Care Services will follow up on the corrective action and submit a status report on its implementation with a target date of July 13, 2008. The status report will include a plan of corrective action, implementation dates of those actions, and the individuals responsible for implementation. A copy of the status report will be provided to the Bureau of State Audits upon completion.

Reference Number:	2007-13-22
Federal Catalog Number:	93.994
Federal Program Title:	Maternal and Child Health Services Block Grant to the States
Federal Award Number and Year:	B04MC07784;2006
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Public Health (Public Health)

Criteria

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133, *AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS* (OMB Circular A-133), Subpart D—Federal Agencies and Pass-Through Entities, Section 405, Management Decision

(a) General. The management decision shall clearly state whether or not the audit finding is sustained, the reasons for the decision, and the expected auditee action to repay disallowed costs, make financial adjustments, or take other action. If the auditee has not completed corrective action, a timetable for follow-up should be given. Prior to issuing the management decision, the Federal agency or pass-through entity may request additional information or documentation from the auditee, including a request for auditor assurance related to the documentation, as a way of mitigating disallowed costs. The management decision should describe any appeal process available to the auditee.

(c) Pass-through entity. As provided in section .400(d)(5), the pass-through entity shall be responsible for making the management decision for audit findings that relate to Federal awards it makes to subrecipients.

(d) Time requirements. The entity responsible for making the management decision shall do so within six months of receipt of the audit report. Corrective action should be initiated within six months after receipt of the audit report and proceed as rapidly as possible.

Condition

During procedures performed over the subrecipient monitoring requirement, we noted that program staff did not issue the management decision within six months of the receipt of the State Controller's Office 2005–06 Fiscal Year Audit Finding Resolution Report, which noted one county with OMB Circular A-133 audit findings related to the program.

Adequate controls do not appear to be in place to ensure findings noted on OMB Circular A-133 audit reports are addressed in a timely manner. Without timely resolution, there is an increased period where subrecipients may not be complying with program requirements.

Questioned Costs

Not determined.

Recommendation

Public Health should implement processes and controls to ensure that required management decisions are issued within six months of the State's receipt of the subrecipient's OMB Circular A-133 audit report.

Department's View and Corrective Action Plan

Public Health's Maternal, Child and Adolescent Health (MCAH) Program acknowledges requirements to issue a management decision within six months upon the State's receipt of A-133 reports for fiscal year ending June 30, 2006. In this instance, the MCAH program was unable to prepare a timely management decision because of the delayed notification of the 2005–06 fiscal year State Controller's Office (SCO) Audit Finding Resolution Report from the California Department of Health Care Services (Health Care Services) Audits and Investigations. The MCAH Program, in conjunction with Health Care Services Audits and Investigations, has established a process that would ensure that the Health Care Services submits the appropriate SCO finding directly to the MCAH Program to allow time to issue a management decision letter in a timely manner. To further ensure that a management decision is issued by the required deadline, the MCAH Program is currently investigating to determine if SCO can forward a copy of its Audit Finding Resolution Report directly to the MCAH Program as appropriate.

Reference Number:	2007-14-12
Federal Catalog Number:	93.777
Federal Program Title:	Medicaid Cluster: State Survey and Certification of Health Care Providers and Supplies. (Medi-Cal)
Federal Award Numbers and Years:	05-0605CA50001;2006 05-0705CA5001;2007
Category of Finding:	Special Tests and Provisions
State Administering Department:	Department of Health Care Services (Health Care Services)

Criteria

TITLE 42—PUBLIC HEALTH, CHAPTER IV—CENTERS FOR MEDICARE AND MEDICAID SERVICES, DEPARTMENT OF HEALTH AND HUMAN SERVICES, PART 431—STATE ORGANIZATION AND GENERAL ADMINISTRATION, Subpart C—Administrative Requirements: Provider Relations, Section 431.107, Required Provider Agreement,

(b) Agreements. A State plan must provide for an agreement between the Medicaid agency and each provider or organization furnishing services under the plan in which the provider or organization agrees to:

(1) Keep any records necessary to disclose the extent of services the provider furnishes to recipients;

(2) On request, furnish to the Medicaid agency, the Secretary, or the State Medicaid fraud control unit (if such a unit has been approved by the Secretary under Sec. 455.300 of this chapter), any information maintained under paragraph (b)(1) of this section and any information regarding payments claimed by the provider for furnishing services under the plan;

(3) Comply with the disclosure requirements specified in part 455, subpart B of this chapter; and

(4) Comply with the advance directives requirements for hospitals, nursing facilities, providers of home health care and personal care services, hospices, and HMOs specified in part 489.

Condition

The determination of the eligibility for Medi-Cal providers in the State of California is split between Health Care Services' Provider Enrollment Division (PED) and the Licensing and Certification (L&C) program of the Department of Public Health (Public Health). The PED enrolls providers, including doctors, pharmacies, and medical groups. L&C is responsible for determining the eligibility of facility providers (for example, hospitals and long-term care facilities) within the State of California.

Of the 50 providers selected, the PED did not retain federally required provider agreements and its related disclosures for 33 providers. The breakdown of the providers is as follows:

- Of the 16 nonfacility providers, 10 selected for testing did not have a provider agreement.
- Of the 34 facility providers, 23 did not have a provider agreement.

Provider Enrollment

Prior to 1999, the PED did not require its Medi-Cal providers to submit a provider agreement with the federally required disclosures. The PED has since updated its provider enrollment process to require these agreements and disclosures. Additionally, the PED commenced reenrolling providers in 1999. More recently, the PED has commenced a focused reenrollment of providers who were enrolled prior to 1999 to ensure compliance with federal disclosure requirements. These providers are required to submit a reenrollment application package updated to current federal standards (including the provider agreement) to retain eligibility for Medi-Cal. The PED has implemented this plan alphabetically by county. With over 150,000 providers actively enrolled in the Medi-Cal program, this reenrollment effort is expected to take some time to complete given the available staff. The PED has also updated its requirements for all providers such that when they make changes to their critical information (for example, service address or reporting a change in ownership), they are required to submit a new application package which includes all required documentation for current federal standards. All 10 of the PED no-facility provider exceptions without provider agreements represented pre-1999 providers who had not been reenrolled or did not make any changes to their information since 1999.

One of the 10 exceptions is located outside of the State of California, in Arizona, and is required to submit a complete application package that includes the federally mandated disclosure information. We have determined this to be an exception, as California did not retain a provider agreement for this provider.

Another of the 10 provider exceptions is licensed and certified to receive Medi-Cal funds from the Department of Mental Health (Mental Health), as it is a mental health facility. However, Mental Health was not able to produce files for this provider supporting that the State retained a provider agreement.

Licensing and Certification Program

Facilities that apply for eligibility to receive Medi-Cal funds and opt to apply for Medi-Cal-only eligibility or to be dually certified, may receive funding for the Medicaid and Medicare-related services provided. Certification for Medicare funds is determined by the federal Department of Health and Human Services' Center for Medicare and Medicaid Services (CMS), and the State of California relies on CMS's assessment as the determination that the facility meets the requirements to receive federal funding. L&C relies on CMS's certification of the facility for Medicare funds in certifying the provider for Medicaid. As such, L&C does not retain provider agreements for dually certified facilities but rather retains a record of CMS's approval for Medicare in the provider's records. Although the risk of a provider not substantially meeting the requirements for eligibility to receive Medicaid funds is less as periodic health and safety surveys are performed on these providers and the federal government has approved these providers for Medicare funding, the State is not in compliance with requirements to retain a provider agreement for each provider receiving Medicaid funds. Of the 35 facility providers tested, 23 were dually certified facilities that did not have provider agreements.

This finding is consistent with those of prior years.

Recommendation

Health Care Services and Public Health should strengthen their controls to retain all provider agreements and continue efforts to ensure that they obtain the appropriate certifications, agreements, and disclosures.

Questioned Costs

Not determined.

Department's View and Corrective Action Plan

Health Care Services concurs with this recommendation. Health Care Services continues its plan to re-enroll all Medi-Cal providers as a continuous process, to verify and update their original enrollment information to ensure compliance with current state and federal regulations.

The Provider Enrollment Division continues to work in conjunction with the Audits and Investigations Division to re-enroll providers identified as high-risk using an on-going risk assessment analysis and the annual Medi-Cal Payment Error Study. Several re-enrollment phases in progress and near completion include optometrists in Los Angeles County, physicians and physician groups.

As appropriately noted in the audit findings, the 10 providers without the required agreements were enrolled prior to the requirements implemented in 1999. Health Care Services continues to focus on the re-enrollment of identified pre-1999 providers, which will include the 10 providers cited in the report.

Licensing and Certification (L&C), which resides in the newly created California Department of Public Health as of July 1, 2007, in partnership with the Provider Enrollment Division, has completed the final draft of the new provider agreement that will meet the requirements under 42 CFR 431.107 for health facilities. This agreement is in final stages of legal review, and once this has been completed, L&C, under the directive of Health Care Services, Medi-Cal (the Single State Medicaid agency), will collect and maintain the new provider agreement for all health facilities that participate in Medi-Cal. It is estimated that this process will be completed by June 2008.

Reference Number:	2007-14-13
Federal Catalog Number:	93.777
Federal Program Title:	Medicaid Cluster: State Survey and Certification of Health Care Providers and Supplies (Medi-Cal)
Federal Award Numbers and Years:	05-0605CA50001;2006 05-0705CA5001;2007
Category of Finding:	Special Tests and Provisions
State Administering Department:	Department of Health Care Services (Health Care Services)

Criteria

TITLE 42—PUBLIC HEALTH, CHAPTER IV—CENTERS FOR MEDICARE AND MEDICAID SERVICES, DEPARTMENT OF HEALTH AND HUMAN SERVICES, PART 440—SERVICES: GENERAL PROVISIONS, Subpart, Subpart A—Definitions, Section 440.120, Prescribed Drugs, Dentures, Prosthetic Devices, and Eyeglasses

(a)(3) Prescribed drugs are to be dispensed by the licensed pharmacist or practitioner on a written prescription that is recorded and maintained in the pharmacist's or practitioner's records.

TITLE 42—PUBLIC HEALTH, CHAPTER IV—CENTERS FOR MEDICARE AND MEDICAID SERVICES, DEPARTMENT OF HEALTH AND HUMAN SERVICES, PART 440—SERVICES: General Provisions, Subpart, Subpart A—Definitions, Section 440.50, Physicians' Services and Medical and Surgical Services of a Dentist

(a) "Physicians' services," whether furnished in the office, the recipient's home, a hospital, a skilled nursing facility, or elsewhere, means services furnished by a physician—

(1) Within the scope of practice of medicine or osteopathy as defined by State law; and

(2) By or under the personal supervision of an individual licensed under State law to practice medicine or osteopathy.

(b) "Medical and surgical services of a dentist" means medical and surgical services furnished, on or after January 1, 1988, by a doctor of dental medicine or dental surgery if the services are services that—

(1) If furnished by a physician, would be considered physician's services.

(2) Under the law of the State where they are furnished, may be furnished either by a physician or by a doctor of dental medicine or dental surgery; and

(3) Are furnished by a doctor of dental medicine or dental surgery who is authorized to furnish those services in the State in which he or she furnished the services.

TITLE 42—PUBLIC HEALTH, CHAPTER IV—CENTERS FOR MEDICARE AND MEDICAID SERVICES, DEPARTMENT OF HEALTH AND HUMAN SERVICES, PART 440—SERVICES: GENERAL PROVISIONS, Subpart, Subpart A—Definitions, Section 440.160, Inpatient Psychiatric Services for Individuals Under the Age of 21

(a)(2) A psychiatric facility which is accredited by the Joint Commission on Accreditation of Healthcare Organizations, the Council on Accreditation of Services for Families and Children, the Commission on Accreditation of Rehabilitation Facilities, or by any other accrediting organization, with comparable standards, that is recognized by the State.

Condition

We sampled 50 providers, of which 13 did not have documentation of an active license during fiscal year 2006–07. All 13 provider exceptions were providers enrolled under the Provider Enrollment Division (PED).

Health Care Services' PED does not have a procedure in place to discontinue a provider number once a provider's license has expired. As such, providers may continue to receive Medi-Cal funds even if the provider does not have an active license. All 13 providers without active licenses related to "allied" providers under the purview of the PED. This indicates a lack of controls, as there is no review of current license status, as well as a compliance finding as the 13 providers did not have active licenses for at least part of the fiscal year ended June 30, 2007.

One of the 13 provider exceptions noted is located outside of the State of California, in the State of Arizona, and although it is a facility provider, is required to submit a provider application, including all relevant disclosures and evidence of an active license to the PED for review and approval. The provider had a change of ownership effective 2001; an application package from the change was remitted to Health Care Services, including a copy of the active license at that point in time. However, the license has since expired, and Health Care Services does not have any evidence indicating that the provider has

a current, active license. As the State did not review the license status and there is no evidence that the provider had an active license during the fiscal year ended June 30, 2007, this indicates a deficiency in internal controls as well as noncompliance with federal requirements.

Another of the 13 provider exceptions was for a mental health facility, and therefore the State Department of Mental Health (Mental Health) is responsible for licensing the facility. However, Mental Health was not able to produce files for this provider supporting its certification, provider agreement, or license.

Recommendation

Health Care Services should strengthen its controls to verify that provider licenses are current and active.

Questioned Costs

Not determined.

Department's View and Corrective Action Plan

Health Care Services concurs with the recommendation to strengthen its controls to verify that provider licenses are current and active. As a condition for participation or continued participation, providers agree to comply with all program requirements stipulated in their Medi-Cal Provider Agreement. By law, the provider is required to keep its application for enrollment in the Medi-Cal program current by informing Health Care Services, Provider Enrollment Division (PED), within 35 days of any changes to the information contained in its application for enrollment.

Accordingly, provider licensing information is verified and updated when providers submit a new application to report a new, additional, or change in location. In addition, state law requires a new application be submitted when there is a change in business entity. Health Care Services continually verifies provider information to ensure compliance with state and federal requirements in its ongoing re-enrollment efforts.

Lastly, Health Care Services' Office of Legal Services (OLS) is notified of actions taken against provider licenses that have been disciplined, revoked, or suspended by the respective licensing boards or the Federal Medicaid/Medicare program. The OLS provides written notice to Medi-Cal providers of suspension or ineligibility, a copy of which is sent to the PED to update the Provider Master File by coding the provider "suspended" and adding the provider to the Suspended and Ineligible list. The PED utilizes this list and the Office of Inspector General's List of Excluded Individuals/Entities in the review of each application for all provider types. Health Care Services is currently involved in identifying improvements in this process to ensure that immediate action is taken to remove suspended physicians from Medi-Cal. One potential improvement is to participate in database file matches with the California Medical Board that would allow for automated updates to physician records. This process has been explored in the past and will be revisited.

Current staffing levels do not allow for specific focus on the status of provider licenses, however, the statutory program requirements noted above enable Health Care Services to monitor physician providers on an ongoing basis.

Reference Number:	2007-14-14
Federal Catalog Number:	93.778
Federal Program Title:	Medicaid Cluster: Medical Assistance Program (Medi-Cal)
Federal Award Numbers and Years:	05-0605CA5028;2006 05-0705CA5028;2007
Category of Finding:	Special Tests and Provisions
State Administering Department:	Department of Health Care Services (Health Care Services)

Criteria

TITLE 45—PUBLIC WELFARE, SUBTITLE A—DEPARTMENT OF HEALTH AND HUMAN SERVICES, PART 92—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE, LOCAL, AND TRIBAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 92.42, Retention and Access Requirements for Records

Applicability. (1) This section applies to all financial and programmatic records, supporting documents, statistical records, and other records of grantees or subgrantees which are: (i) Required to be maintained by the terms of this part, program regulations or the grant agreement, or (ii) Otherwise reasonably considered as pertinent to program regulations or the grant agreement.

Length of retention period. (1) Except as otherwise provided, records must be retained for three years from the starting date specified in paragraph (c) of this section.

TITLE 42—PUBLIC HEALTH, CHAPTER IV—CENTERS FOR MEDICARE AND MEDICAID SERVICES, DEPARTMENT OF HEALTH AND HUMAN SERVICES, PART 456—UTILIZATION CONTROL, SUBPART A—GENERAL PROVISIONS, Section 456.3, Statewide Surveillance and Utilization Control Program

The Medicaid agency must implement a statewide surveillance and utilization control program that—

(a) Safeguards against unnecessary or inappropriate use of Medicaid services and against excess payments;

(b) Assesses the quality of those services;

(c) Provides for the control of the utilization of all services provided under the plan in accordance with subpart B of this part; and

(d) Provides for the control of the utilization of inpatient services in accordance with subparts C through I of this part.

Condition

Of our sample of 60 audits and fraud investigations performed, the Medical Review Branch was unable to provide work papers for three audits. The audit files contain audit procedures and work papers to substantiate the performance of the audit. Adequate controls do not appear to be in place to ensure the retention of documentation of audit files, resulting in a lack of evidence of the performance of the audits, as well as the findings noted and conclusions reached.

Recommendation

Health Care Services should strengthen its internal controls over document retention for audits and reviews performed by the Medical Review Branch.

Questioned Costs

Not determined.

Department's View and Corrective Action Plan

Health Care Services agrees that internal controls over document retention for audits and reviews performed by Medical Review Branch (MRB) should be strengthened. Of the files requested three could not be located; all three files originated from one section and one unit within the section and is an isolated issue. To ensure consistency throughout the branch, MRB has implemented a Quality Assurance Review Committee. The committee randomly selects files throughout the branch and reviews the file for quality and consistency with Medi-Cal and branch policy. It is branch policy to maintain case files for three years at the field office and then for an additional four years at an archive facility.

U.S. DEPARTMENT OF HOMELAND SECURITY

Reference Number:	2007-3-16
Category of Finding:	Cash Management
State Administering Departments:	Governor's Office of Emergency Services (Emergency Services) Governor's Office of Homeland Security (Homeland Security)
Federal Catalog Number:	97.004
Federal Program Title:	State Domestic Preparedness Equipment Support Program
Federal Award Numbers and Years:	TE-CX-0133;2002, TE-TX-0167;2003 MU-T3-0035;2003, GE-T4-0045;2004 GE-T5-0015;2005, GE-T6-0071;2006

Federal Catalog Number:	97.008
Federal Program Title:	Urban Areas Security Initiative
Federal Award Numbers and Years:	EU-T3-0023;2003 TU-T4-0014;2004

Federal Catalog Number:	97.036
Federal Program Title:	Disaster Grants—Public Assistance (Presidentially Declared Disasters)
Federal Award Numbers and Years:	FEMA-1577-DR;2005 FEMA-1628-DR;2006 FEMA-1646-DR;2006

Federal Catalog Number:	97.039
Federal Program Title:	Hazard Mitigation Grant
Federal Award Numbers and Years:	FEMA-1008-DR;1994,FEMA-1044-DR;1995, FEMA-1046-DR:1995,FEMA-1203-DR;1998, FEMA-1498-DR;2003,FEMA-1505-DR;2004

Criteria

TITLE 31—MONEY AND FINANCE: TREASURY, CHAPTER II—FISCAL SERVICE, DEPARTMENT OF THE TREASURY, PART 205—RULES AND PROCEDURES FOR EFFICIENT FEDERAL-STATE FUNDS TRANSFERS, Subpart A—Rules Applicable to Federal Assistance Programs Included in a Treasury-State Agreement, Section 205.11, What Requirements Apply to Funding Techniques?

(a) A State and a Federal Program Agency must minimize the time elapsing between the transfer of funds from the United States Treasury and the State's payout of funds for Federal assistance program purposes, whether the transfer occurs before or after the payout of funds.

U.S. OFFICE OF MANAGEMENT AND BUDGET Circular A-102 (OMB CIRCULAR A-102) paragraph 2a, states "Agency methods and procedures for transferring funds shall minimize the time elapsing between the transfer to recipients of grants and cooperative agreements and the recipient's need for the funds."

(1) Such transfers shall be made consistent with program purposes, applicable law and Treasury regulations contained in 31 CFR Part 205, Federal Funds Transfer Procedures.

(2) Where letters-of-credit are used to provide funds, they shall be in the same amount as the award.

Condition

During our procedures performed over cash management requirements and Emergency Services' payment processes to its subrecipients, we reviewed a sample of subrecipient reimbursement requests for any reimbursement amounts due back to subrecipients to ascertain if Emergency Services was minimizing the time between the subrecipient expenditure of program funds and its subsequent reimbursement. We reviewed the dates the reports were received by Emergency Services, or if no date received is indicated by Emergency Services, the date the request was signed by the subrecipient was used and compared those dates received to the dates payments were actually disbursed to the subrecipients.

We noted that Emergency Services has a policy of preparing and sending the reimbursement request to the State Controller's Office (Controller's Office) within 30 days, allowing the Controller's Office 15 days to process the reimbursement request, which is consistent with the Controller's Office's policy. Based on this information, we believe that reimbursement requests should be processed within 45 days. We further note that Emergency Services currently does not reject inaccurate subgrantee reimbursement requests and alternatively, does not maintain a log of communications with the subgrantee in order to track the date the reimbursement request is considered to be received as accurate for processing.

State Domestic Preparedness Equipment Support Program

In our sample of 29 reimbursement requests, which totaled $8,272,873, we noted 15 requests totaling $2,808,348 were not processed within 45 days and three totaling $3,810,519 where the date of the reimbursement could not be determined as the date was not included on the documents. The following summarizes the results of the items selected to ascertain if the reimbursement payments were being made in a timely manner:

- Ten reimbursement requests were processed within a range of eight to 28 days.
- Eighteen reimbursement requests totaling $6,414,995 were processed within a range of 31 to 115 days from the date of receipt of the request to the date submitted to the Controller's Office.
- For one request totaling $173,200, we could not determine the date it was submitted to the Controller's Office as the date was missing from the *Report to State Controller of Remittance to State Treasurer, Transaction Code 30* (TC 30).
- Fifteen reimbursement payments were made more than 45 days after the request was submitted. These untimely disbursements ranged from 48 to 134 days from the date of the subrecipient reimbursement requests.
- Ten requests were not processed by the Controller's Office within 15 days.

As a result of the timing of these disbursements to the subrecipients, it does not appear that Emergency Services minimized the time between the receipt of the request and disbursement to the subrecipient.

Urban Areas Security Initiative

In our sample of 30 reimbursement requests totaling $19,340,214, we noted 19 requests totaling $16,644,566 were not processed within 45 days and six requests totaling $859,730, where the date of the reimbursement could not be determined as the date was not included on the documents. The following summarizes the results of the items selected to ascertain if the reimbursement payments were being made in a timely manner:

- Ten reimbursement requests were processed within a range of 16 to 29 days.
- Sixteen reimbursement requests totaling $9,956,226 were processed in 31 to 145 days.
- The date the reimbursement request was submitted to the Controller's Office could not be determined in four items totaling $3,111,428, as the information was not included on the TC 30.
- It took more than 45 days to make reimbursement payments for 19 of the 30 requests. These untimely disbursements ranged from 47 to 124 days after the date of the subrecipient reimbursement requests.
- For six of the 30 items the reimbursement date to the subrecipient could not be determined as the information was missing.
- Eleven of the 30 reimbursement requests were not processed by the Controller's Office within 15 days.

As a result of the timing of these disbursements to its subrecipients, it does not appear that Emergency Services minimized the time between the receipt of the request and disbursement to the subrecipient.

Disaster Grants—Public Assistance (Presidentially Declared Disasters)

In our sample of 30 reimbursement requests totaling $8,640,966, we noted that 18 requests totaling $3,992,724 were not processed within 45 days and three totaling $1,195,844 where the date of the reimbursement could not be determined as the date was not included on the documents. The following summarizes the results of the items selected to ascertain if the reimbursement payments were being made in a timely manner:

- Three requests were processed within a range of 21 to 26 days.
- Twenty-four requests totaling $6,302,272 were processed in 34 to 342 days.
- Eighteen of the 30 reimbursement payments were made more than 45 days after the request. These untimely disbursements ranged from 46 to 342 days from the date of the requests.
- We could not determine the date the reimbursement request was submitted to the Controller's Office for three requests totaling $1,195,843, as the date was missing from the TC 30.
- All 30 reimbursement requests were processed by the Controller's Office within 15 days.

As a result of the timing of these disbursements to its subrecipients, it does not appear that Emergency Services minimized the time between the receipt of the request and disbursement to the subrecipient.

Hazard Mitigation Grant

In our sample of 30 reimbursement requests totaling $15,753,659, we noted 18 totaling $10,895,880 were not processed within 45 days. The following summarizes the results of the samples selected to ascertain if the reimbursement payments were being made in a timely manner:

- Six requests were processed within a range of 16 to 30 days.
- Twenty-four requests totaling $14,963,858 were processed in 31 to 92 days.
- Eighteen payments were made more than 45 days after the request. These untimely disbursements ranged from 47 to 98 days from the date of the subrecipient reimbursement requests.
- All 30 requests were processed by the Controller's Office within 15 days.

As a result of the timing of these disbursements to its subrecipients, it does not appear that Emergency Services minimized the time between the receipt of the request and disbursement to the subrecipient.

Questioned Costs

Not determined.

Recommendation

Emergency Services should develop a process to track and monitor the timing of disbursement from the date of the reimbursement request and implement controls to ensure the reasonableness of the timing of disbursement is consistent with the applicable federal guidelines to reduce the risk of potential noncompliance.

Department's View and Corrective Action Plan

Emergency Services noted the findings identified for each program regarding disbursements not being made to sub-grantees within 45 days of the request for reimbursement. It attempts to comply with the guiding principle specified by OMB Circular A-102, 2a, which states that "Agency methods and procedures for transferring funds shall minimize the time elapsing between the transfer to recipients of grants and cooperative agreements and the recipient's need for funds." Emergency Services prioritizes timely payment of subgrantees' requests for reimbursement, however, it must initially assure that all issues related to the amount for reimbursement have been resolved, and that the reimbursement requests are compliant with grant requirements prior to payment.

Emergency Services' Grants Accounting Unit has worked cooperatively with Homeland Security and other Grant Program Units for several years, to minimize the review and processing times associated with payment of reimbursement requests of subgrantees. However, prior to requesting payment from the State Controller's Office, and subsequent to receipt of payment requests from the various program units, Emergency Services Accounting performs a cursory review of the reimbursement requests. If errors are found, Emergency Services places a courtesy telephone call to the subgrantee, in an attempt to resolve the errors. While errors that cannot be resolved with a call are returned to the program unit or the subgrantee for correction, on some occasions, this process causes the request for reimbursement to remain in our system longer than the 10-15 days we are allowed to process payments.

Furthermore, OMB Circular A-102 refers to 31 CFR, Part 205, in specifying timeliness guidelines for the Federal Funds Transfer Process, which generally provides that State Agencies must minimize the time between the deposit of federal funds in the State's account and the disbursement of funds for program purposes. KPMG's testing clearly shows that Emergency Services was in compliance with the cash management requirements specified by 31 CFR, Part 205.

KPMG has assigned a number of "reasonable" days to the entire reimbursement process, however, the number is established arbitrarily and does not indicate a clear compliance requirement according to the criteria of the federal regulations (except in the case of VOCA Grants, which are subject to the California Prompt Payment Act). Emergency Services does not agree with a finding of noncompliance based on an arbitrarily number of days, not specified in federal regulations pertaining to cash management.

Reference Number:	2007-9-5
Category of Finding:	Procurement, Suspension and Debarment
State Administering Department:	Governor's Office of Emergency Services (Emergency Services)
Federal Catalog Number:	97.036
Federal Program Title:	Disaster Grants—Public Assistance (Presidentially Declared Disasters)
Federal Award Numbers and Years:	FEMA-845-DR;1989,FEMA-919-DR;1991, FEMA-935-DR;1992,FEMA-942-DR;1992, FEMA-943-DR;1992,FEMA-947-DR;1992, FEMA-979-DR;1993,FEMA-1005-DR;1993, FEMA-1008-DR;1994,FEMA-1044-DR;1995, FEMA-1046-DR;1995,FEMA-1155-DR;1996, FEMA-3120-EM;1996,FEMA-1203-DR;1998, FEMA-1342-DR;2000,FEMA-1498-DR;2003, FEMA-1505-DR;2004,FEMA-1529-DR;2004, FEMA-1577-DR;2005,FEMA-1585-DR;2005, FEMA-3248-EM;2005,FEMA-1628-DR;2006, FEMA-1646-DR;2006

Federal Catalog Number:	97.039
Federal Program Title:	Hazard Mitigation Grant
Federal Award Numbers and Years:	FEMA-845-DR;1989,FEMA-979-DR;1993, FEMA-1005-DR;1993,FEMA-1008-DR;1994, FEMA-1044-DR;1995,FEMA-1155-DR;1996, FEMA-1203-DR;1998,FEMA-1267-DR;1999, FEMA-1342-DR;2000,FEMA-1498-DR;2003, FEMA-1505-DR;2004,FEMA-1529-DR;2004, FEMA-1577-DR;2005,FEMA-1585-DR;2005, FEMA-3248-EM;2005,FEMA-1628-DR;2006, FEMA-1646-DR;2006

Criteria

TITLE 44—EMERGENCY MANAGEMENT AND ASSISTANCE, CHAPTER I—FEDERAL EMERGENCY MANAGEMENT AGENCY, DEPARTMENT OF HOMELAND SECURITY, PART 13—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 13.35, Subawards to Debarred and Suspended Parties

> Grantees and subgrantees must not make any award or permit any award (subgrant or contract) at any tier to any party which is debarred or suspended or is otherwise excluded from or ineligible for participation in Federal assistance programs under Executive Order 12549, *Debarment and Suspension.*

Condition

During procedures performed over suspension and debarment of subrecipients, we noted Emergency Services utilizes a Project Application for Federal Assistance Form (Form 89) for its subrecipients participating in both the Public Assistance Program (PA) and Hazard Mitigation Grant Program (HMGP). The latest revision of Form 89 implemented in January 2005 includes the appropriate required language for the subrecipient to certify that it has not been suspended or debarred from participating in a federally funded program.

Disaster Grants—Public Assistance (Presidentially Declared)

In our samples selected, we noted the PA Program did not require one of the 12 subrecipients who received grant awards prior to January 2005 to complete an updated Form 89 that contained the required certification, nor did it review the federal excluded parties list system (EPLS) Web site to verify that the subrecipient was neither suspended nor debarred. The prior noncompliant Form 89 was carried forward into the subrecipient's new projects. Consequently, there are no signed certifications on file for this subrecipients of the PA Program to comply with the suspension and debarment requirement.

Hazard Mitigation Grant

In our samples selected, we noted HMGP did not require 18 of the 30 subrecipients who received grant awards prior to January 2005 to complete an updated Form 89 that contained the required certifications, nor did it review the Federal EPLS Web site to verify whether the subrecipients were either suspended or debarred. The prior noncompliant Form 89 was carried forward into the subrecipients' new projects. Consequently, there are no signed certifications on file for those subrecipients of the HMGP to comply with the suspension and debarment requirement.

Questioned Costs

Not determined.

Recommendation

Emergency Services should ensure adequate policies, procedures, and documentation exist to support verification that subrecipients are not suspended or debarred before awarding program funds by querying the EPLS, collecting a certification from the other party, or adding a clause or condition to the covered transaction with that party.

Department's View and Corrective Action Plan

Emergency Services agrees with the finding. The Hazard Mitigation Branch has revised the Form 89 to include the language regarding suspension and debarment. Subgrantees who received grants prior to January 2005 are required to submit the revised form before any payments will be made, thus assuring that OES obtains updated form 89s for subgrantees who received grant awards prior to January 2005.

Reference Number:	2007-12-27
Federal Catalog Number:	97.004
Federal Program Title:	State Domestic Preparedness Equipment Support Program
Federal Award Numbers and Years:	TE-TX-0167;2003 MU-T3-0035;2003 GE-T4-0045;2004
Category of Finding:	Reporting
State Administering Department:	Governor's Office of Emergency Services (Emergency Services)

Criteria

TITLE 28—JUDICIAL ADMINISTRATION, CHAPTER I—DEPARTMENT OF JUSTICE, PART 66—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 66.20, Standards for Financial Management Systems

(a) A State must expend and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contractors, must be sufficient to:

(1) Permit preparation of reports required by this part and the statutes authorizing the grant, and

(2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

OFFICE OF JUSTICE PROGRAMS, *FINANCIAL GUIDE 2006*, PART III, CHAPTER 19

Awards are subject to conditions of fiscal, program and general administration to which the recipient expressly agrees. Accordingly, the audit objective is to review the recipient's administration of funds and required non-Federal contributions for the purpose of determining whether the recipient has submitted financial reports (which may include Financial Status Reports, Cash Reports, and Claims for Advances and Reimbursements), which contain accurate and reliable financial data, and are presented in accordance with the terms of applicable agreements.

Condition

During procedures performed over reporting, we could not trace certain amounts per the financial Status Report (FSR) to supporting documentation or accounting records for five reports out of the total population of 21 FSRs. We noted that total expenditures reported on the FSRs are correct; however, the Total Unliquidated Obligations amounts are incorrectly reported. We note these errors do not result in an error of expenditures reported to the federal funding agency. We inquired of the accounting manager at Emergency Services, noting the amount is generally calculated but there is no general rule for the calculation. Per the accounting manager, the amount usually includes the local funding, encumbrance, state administrative cost, reimbursement submitted by the subgrantees but not yet drawn or submitted into Accounting, or a net between the Total Federal Share and Total Federal Funds authorized for this funding period.

The accounting manager stated staff received no training on preparing the report and are in the process of learning how to prepare it. Emergency Services could be materially misstating the unliquidated obligations on its reports.

Questioned Costs

Not determined.

Recommendation

Emergency Services should establish processes and procedures to ensure that the Financial Status Reports (SF-269) can be accurately traced to accounting records.

Department's View and Corrective Action Plan

Emergency Services basically agrees with the findings. While we did locate inaccurate posting in some reports, we were able to trace the numbers in others. We feel this is primarily due to a posting error. Emergency Services has established a process and procedure to assure that each FSR has the corresponding fiscal reports attached as documentation to support the quarterly calculations.

Reference Number:	2007-13-23
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Governor's Office of Emergency Services (Emergency Services)
Federal Catalog Numbers:	97.036 & 97.039
Federal Program Titles:	Disaster Grants—Public Assistance (Presidentially Declared Disasters), Hazard Mitigation Grant
Federal Award Numbers and Years:	FEMA-845-DR;1989FEMA-3120-EM;1996 FEMA-919-DR;1991FEMA-1203-DR;1998 FEMA-935-DR;1992FEMA-1342-DR;2000 FEMA-1498-DR;2003FEMA-942-DR;1992 FEMA-1505-DR;2004FEMA-943-DR;1992 FEMA-1529-DR;2004FEMA-947-DR;1992 FEMA-1577-DR;2005FEMA-979-DR;1993 FEMA-1585-DR;2005FEMA-1005-DR;1993 FEMA-1008-DR;1994FEMA-3248-EM;2005 FEMA-1044-DR;1995FEMA-1628-DR;2006 FEMA-1046-DR;1995FEMA-1646-DR;2006 FEMA-1155-DR;1996

Federal Catalog Number:	97.039
Federal Program Title:	Hazard Mitigation Grant
Federal Award Numbers and Years:	FEMA-845-DR;1989FEMA-1155-DR;1996 FEMA-1203-DR;1998FEMA-1267-DR;1999 FEMA-1342-DR;2000FEMA-1498-DR;2003 FEMA-1505-DR;2004FEMA-1529-DR;2004 FEMA-979-DR;1993FEMA-1577-DR;2005 FEMA-1005-DR;1993FEMA-1585-DR;2005 FEMA-1008-DR;1994FEMA-3248-EM;2005 FEMA-1044-DR;1995FEMA-1628-DR;2006 FEMA-1046-DR;1995FEMA-1646-DR;2006

Criteria

TITLE 31—MONEY AND FINANCE, SUBTITLE V—GENERAL ASSISTANCE ADMINISTRATION, CHAPTER 75—REQUIREMENTS FOR SINGLE AUDITS, Section 7502, Audit Requirements; Exemptions

(f)(2) Each pass-through entity shall:

(B) monitor the subrecipient's use of Federal awards through site visits, limited scope audits, or other means;

(C) review the audit of a subrecipient as necessary to determine whether prompt and appropriate corrective action has been taken with respect to audit findings, as defined by the Director, pertaining to Federal awards provided to the subrecipient by the pass-through entity; and

TITLE 44—EMERGENCY MANAGEMENT AND ASSISTANCE, CHAPTER I—FEDERAL EMERGENCY MANAGEMENT AGENCY, DEPARTMENT OF HOMELAND SECURITY, PART 13—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 13.40, Monitoring and Reporting Program Performance

(a) *Monitoring by grantees.* Grantees are responsible for managing the day-to-day operations of grant and subgrant supported activities. Grantees must monitor grant and subgrant supported activities to assure compliance with applicable Federal requirements and that performance goals are being achieved. Grantee monitoring must cover each program, function or activity.

Condition

Emergency Services did not adequately monitor its subrecipients of funds for its Public Assistance and Hazard Mitigation Grant programs for the fiscal year ended June 30, 2007. According to the chief of its Grants Management Branch, there is a backlog in performing the reviews and preparing management letters due to lack of staffing. Emergency Services has not reviewed an estimated 200 Public Assistance Program and 50 Hazard Mitigation Grant program audit reports submitted by subrecipients dating back to 2003. In addition, Emergency Services has not followed up with subrecipients who have not submitted their single audit reports. Further, Emergency Services does not have processes or controls in place to accurately track whether subrecipients' audit reports have been submitted or reviewed.

Emergency Services states that it lacks sufficient staff to adequately monitor the receipt of the reports, review them, issue management decisions on the findings contained in them, and ensure that the subrecipients have taken timely and appropriate corrective action on all audit findings. Without performing these procedures, Emergency Services cannot ensure that subrecipients are complying with federal program requirements.

Questioned Costs

Not determined.

Recommendation

Emergency Services should develop a process to review, respond, and resolve findings noted in subrecipient's U.S. Office of Management and Budget Circular A-133 audit reports, and ensure appropriate corrective action is taken within six months after receipt of the audit reports in accordance with federal guidelines.

Department's View and Corrective Action Plan

Emergency Services agrees with these findings. It has completed review of the backlog of A-133 Audit Reports, and the workload is current at this time. This includes the initial desk review of the audit reports, follow-up contacts with the sub-recipient for corrective action and issuance of management decision memos. Current workload is within the six-month requirement.

Emergency Services has developed procedures to determine the sub-grantees who have exceeded the $500,000 threshold for total funding, and who have completed the required audit.

AUDITEE'S SECTION

Schedule of Federal Assistance

Prepared by Department of Finance

STATE OF CALIFORNIA
SCHEDULE OF FEDERAL ASSISTANCE
FISCAL YEAR ENDED JUNE 30, 2007

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Department of Agriculture		
Plant and Animal Disease, Pest Control, and Animal Care	10.025	$ 96,227
Wildlife Services	10.028	15,815
Market Protection and Promotion	10.163	168,129
Farm Labor Housing Loans and Grants	10.405	1,103,410
Special Supplemental Nutrition Program for Women, Infants, and Children	10.557	794,664,653
Child and Adult Care Food Program	10.558	252,989,267
State Administrative Expenses for Child Nutrition	10.560	20,124,186
Commodity Supplemental Food Program	10.565	13,049,205 *
WIC Farmers' Market Nutrition Program (FMNP)	10.572	2,188,351
Team Nutrition Grants	10.574	50,666
Senior Farmers Market Nutrition Program	10.576	548,066
Child Nutrition Discretionary Grants Limited Availability	10.579	26
Cooperative Forestry Assistance	10.664	6,718,695
Schools and Roads - Grants to States	10.665	66,141,300
National Forest - Dependent Rural Communities	10.670	82,213
Forest Legacy Program	10.676	19,690
Forest Land Enhancement Program	10.677	191,588
Forest Stewardship Program	10.678	153,967
Forest Health Protection	10.680	40,459
Environmental Quality Incentives Program	10.912	182,153
Other - U.S. Department of Agriculture	10.999	36,220,159
Total Excluding Clusters		1,194,748,223
Food Stamp Cluster		
Food Stamps	10.551	2,509,373,002 *
State Administrative Matching Grants for Food Stamp Program	10.561	472,018,646
Total Food Stamp Cluster		2,981,391,648
Child Nutrition Cluster		
School Breakfast Program	10.553	263,118,359
National School Lunch Program	10.555	1,138,052,205 *
Special Milk Program for Children	10.556	638,042
Summer Food Service Program for Children	10.559	14,861,783

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Total Child Nutrition Cluster		1,416,670,390
Emergency Food Assistance Cluster		
Emergency Food Assistance Program (Administrative Costs)	10.568	6,954,064
Emergency Food Assistance Program (Commodities)	10.569	29,436,782 *
Total Emergency Food Assistance Cluster		36,390,846
Total U.S. Department of Agriculture		5,629,201,107
Department of Commerce		
Anadromous Fish Conservation Act Program	11.405	261,789
Interjurisdictional Fisheries Act of 1986	11.407	106,790
Coastal Zone Management Administration Awards	11.419	7,591,067
Coastal Zone Management Estuarine Research Reserves	11.420	1,676,770
Marine Sanctuary Program	11.429	16,065
Pacific Coast Salmon Recovery-Pacific Salmon Treaty Program	11.438	11,311,097
Unallied Management Projects	11.454	660,185
Habitat Conservation	11.463	287,706
Coastal Services Center	11.473	68,023
Other - U.S. Department of Commerce	11.999	181,839
Total Excluding Clusters		22,161,332
Research & Development Cluster		
Coastal Zone Management Estuarine Research Reserves	11.420	142,135
Total U.S. Department of Commerce		22,303,467
Department of Defense		
Planning Assistance to States	12.110	2,529,605
State Memorandum of Agreement Program for the Reimbursement of Technical Services	12.113	9,935,424
Military Construction, National Guard	12.400	1,318,694
National Guard Military Operations and Maintenance (O&M) Projects	12.401	53,237,307
National Guard Civilian Youth Opportunities	12.404	3,764,426
Community Economic Adjustment Planning Assistance	12.607	373,857

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Other - U.S. Department of Defense	12.999	1,617,183
Total U.S. Department of Defense		72,776,496
Department of Housing and Urban Development		
Manufactured Home Construction and Safety Standards	14.171	163,359
Community Development Block Grants/State's Program	14.228	49,190,791
Emergency Shelter Grants Program	14.231	6,989,877
Permanent Housing for Handicapped Homeless	14.235	2,607,970 **
HOME Investment Partnerships Program	14.239	130,725,082 **
Housing Opportunities for Persons with AIDS	14.241	3,054,716
Equal Opportunity in Housing	14.400	1,769,395
Section 8 Rental Voucher Program	14.855	3,713,509
Lead-Based Paint Hazard Control in Privately-Owned Housing	14.900	1,055,291
Total U.S. Department of Housing and Urban Development		199,269,990
Department of Interior		
Distribution of Receipts to State and Local Governments	15.227	54,438,358
National Fire Plan - Wildland Urban Interface Community Fire Assistance	15.228	571,059
Small Reclamation Projects	15.503	78,435
Anadromous Fish Conservation	15.600	10,527
Endangered Species Conservation	15.612	13,634
Coastal Wetlands Planning, Protection and Restoration Act	15.614	346,002
Cooperative Endangered Species Conservation Fund	15.615	3,051,408
Clean Vessel Act	15.616	1,462,838
Sportfishing & Boating Safety Act	15.622	1,752,643
Wildlife Conservation and Restoration	15.625	992,848
Landowner Incentive	15.633	87,766
State Wildlife Grants	15.634	1,698,456
Migratory Bird Conservation	15.647	86,231
Earthquake Hazards Reduction Program	15.807	286,858
U.S. Geological Survey-Research and Data Collection	15.808	449,279
Historic Preservation Fund Grants-In - Aid	15.904	808,816
Outdoor Recreation-Acquisition, Development and Planning	15.916	6,403,275
Support	15.975	657,166

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Other - U.S. Department of the Interior	15.999	5,819,529
Total Excluding Clusters		79,015,128
Fish and Wildlife Cluster		
Sport Fish Restoration	15.605	9,697,652
Wildlife Restoration	15.611	3,791,477
Total Fish and Wildlife Cluster		13,489,129
Research & Development Cluster		
Wildlife Restoration	15.611	149,899
Coastal Wetlands Planning, Protection and Restoration Act	15.614	7,241
U.S. Geological Survey-Research and Data Collection	15.808	77,500
Total Research & Development Cluster		234,640
Total U.S. Department of Interior		92,738,897

Department of Justice

Prisoner Reentry Initiative Demonstration (Offender Reentry)	16.202	275,092
Juvenile Accountability Incentive Block Grants	16.523	4,412,407
Juvenile Justice and Delinquency Prevention - Allocation to States	16.540	5,722,033
Title V - Delinquency Prevention Program	16.548	1,756,942
Part E - State Challenge Activities	16.549	245,358
State Justice Statistics Program for Statistical Analysis Centers	16.550	28,315
National Criminal History Improvement Program (NCHIP)	16.554	1,963,960
National Institute of Justice Research, Evaluation, and Development Project Grants	16.560	1,921,775
Crime Laboratory Improvement-Combined Offender DNA Index System Backlog Reduction	16.564	1,826,870
Crime Victim Assistance	16.575	40,648,120
Crime Victim Compensation	16.576	13,968,664
Edward Byrne Memorial Formula Grant Program	16.579	13,260,542
Edward Byrne Memorial State and Local Law Enforcement Assistance Discretionary Grants Program	16.580	2,185,806
Crime Victim Assistance/Discretionary Grants	16.582	113,088
Drug Court Discretionary Grant Program	16.585	127,152
Violent Offender Incarceration and Truth in Sentencing Incentive Grants	16.586	7,776,730

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Violence Against Women Formula Grants	16.588	11,456,806
Rural Domestic Violence and Child Victimization Enforcement Grant Program	16.589	259,730
Residential Substance Abuse Treatment for State Prisoners	16.593	2,290,107
Bulletproof Vest Partnership Program	16.607	851,083
Community Prosecution and Project Safe Neighborhoods	16.609	1,496,571
Regional Information Sharing Systems	16.610	5,259,265
Public Safety Partnership and Community Policing Grants	16.710	5,887,845
Enforcing Underage Drinking Laws Program	16.727	818,338
Protecting Inmates and Safeguarding Communities Discretionary Grant Program	16.735	1,278
Edward Byrne Memorial Justice Assistance Grant Program	16.738	21,876,819
Anti-Gang Initiative	16.744	25,281
Other - U.S. Department of Justice	16.999	1,044,629
Violence Against Women	See Note 4c	77,079
Total U.S. Department of Justice		147,577,686
Department of Labor		
Labor Force Statistics	17.002	8,203,833
Compensation and Working Conditions	17.005	807,300
Support	17.203	1,952,437
Unemployment Insurance	17.225	5,097,508,274
Senior Community Service Employment Program	17.235	7,307,058
Trade Adjustment Assistance	17.245	23,866,218
Welfare-to-Work Grants to State and Localities	17.253	408
WIA Pilots, Demonstrations, and Research Projects	17.261	4,323,941
Work Incentives Grant	17.266	1,811,198
Occupational Safety and Health - State Program	17.503	25,558,752
Consultation Agreements	17.504	5,107,024
Mine Health and Safety Grants	17.600	572,149
Disability Employment Policy Development	17.720	206,858
Total Excluding Clusters		5,177,225,449
Employment Services Cluster		
Employment Service/Wagner-Peyser Funded Activities	17.207	88,560,188
Disabled Veterans' Outreach Program (DVOP)	17.801	10,269,963
Local Veterans' Employment Representative Program	17.804	6,076,805

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Total Employment Services Cluster		104,906,956
WIA Cluster		
WIA Adult Program	17.258	133,585,874
WIA Youth Activities	17.259	128,155,791
WIA Dislocated Workers	17.260	185,203,732
Total WIA Cluster		446,945,397
Total U.S. Department of Labor		5,729,077,802
Department of Transportation		
Boating Safety Financial Assistance	20.005	2,946,374
Airport Improvement Program	20.106	308,007
Motor Carrier Safety	20.217	8,633,202
National Motor Carrier Safety	20.218	2,297,851
Border Enforcement Grants	20.233	784,683
Federal Transit - Metropolitan Planning Grants	20.505	41,586,946
Formula Grants for Other than Urbanized Areas	20.509	17,990,430
Pipeline Safety	20.700	690,967
Interagency Hazardous Materials Public Sector Training and Planning Grants	20.703	961,669
Others-Department of Transportation	20.999	61,139
Total Excluding Clusters		76,261,268
Highway Planning and Construction Cluster		
Highway Planning and Construction	20.205	2,694,823,949
Federal Transit Cluster		
Federal Transit - Capital Investment Grants	20.500	10,134,281
Highway Safety Cluster		
State and Community Highway Safety	20.600	98,159,783
Research & Development Cluster		
Highway Planning and Construction	20.205	12,857,396
Formula Grants for Other than Urbanized Areas	20.509	236,053
Total Research & Development Cluster		13,093,449

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Total U.S. Department of Transportation		2,892,472,730
Equal Employment Opportunity Commission		
Employment Discrimination - State and Local Fair Employment Practices Agency Contracts	30.002	2,445,250
General Services Administration		
Donation of Federal Surplus Personal Property	39.003	9,517,529 ***
National Foundation on the Arts and the Humanities		
Promotion of the Arts-State and Regional Program	45.007	1,080,500
Grants to States	45.310	15,564,282
Total National Foundation on the Arts and Humanities		16,644,782
Department of Veterans Affairs		
Veterans State Domiciliary Care	64.014	9,466,334
Veterans State Nursing Home Care	64.015	12,260,872
Veterans State Hospital Care	64.016	74,274
Burial Expenses Allowance for Veterans	64.101	115,200
Veterans Housing - Guaranteed and Insured Loans	64.114	75,066,898 ****
All-Volunteer Force Educational Assistance	64.124	66,272
Other-U.S. Department of Veterans Affairs	64.999	1,463,206
Total U.S. Department of Veteran's Affairs		98,513,057
Environmental Protection Agency		
Air Pollution Control Program Support	66.001	9,901,031
State Indoor Radon Grants	66.032	165,232

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Compliance Assistance Support for Services to the Regulated Community and Other Assistance Providers	66.305	8,232
Water Pollution Control State and Interstate Program Support	66.419	2,770,732
State Underground Water Source Protection	66.433	176,566
Surveys, Studies, Investigations, Demonstrations, and Training Grants and Cooperative Agreements - Section 104(b)(3) of the Clean Water Act	66.436	589,441
Targeted Watersheds Grants	66.439	157,319
Water Quality Management Planning	66.454	614,688
National Estuary Program	66.456	202,215
Capitalization Grants for Clean Water State Revolving Funds	66.458	331,647,801 **
Nonpoint Source Implementation Grants	66.460	13,919,604
Regional Wetland Program Development Grants	66.461	22,723
Water Quality Cooperative Agreements	66.463	131,521
Capitalization Grants for Drinking Water State Revolving Funds	66.468	115,414,080
State Grants to Reimburse Operators of Small Water Systems for Training and Certification Costs	66.471	389,728
Beach Monitoring and Notification Program Implementation Grants	66.472	516,905
Water Protection Grants to the States	66.474	724,029
Wetland Program Grants - State/Tribal Environmental Outcome Wetland Demonstration Program	66.479	200,943
Environment Protection-Consolidated Research	66.500	90,000
Safe Drinking Water Research and Demonstration	66.506	6,784,341
Office of Research and Development Consolidated Research/Training	66.511	301,614
Surveys, Studies, Investigations and Special Purpose Grants	66.606	71,251
Environmental Information Exchange Network Grant Program and Related Assistance	66.608	69,254
Consolidated Pesticide Enforcement Cooperative Agreements	66.700	1,218,367
Toxic Substances Compliance Monitoring Cooperative Agreements	66.701	26,352
TSCA Title IV State Lead Grants Certification of Lead-Based Paint Professionals	66.707	318,654
Pollution Prevention Grants Program	66.708	55,981
Hazardous Waste Management State Program Support	66.801	7,280,843
Superfund State, Political Subdivision, and Indian Tribe Site-Specific Cooperative Agreements	66.802	936,741

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
State and Tribal Underground Storage Tanks Program	66.804	326,194
Leaking Underground Storage Tank Trust Fund Program	66.805	3,233,176
Solid Waste Management Assistance Grants	66.808	2,876
Superfund State and Indian Tribe Core Program Cooperative Agreements	66.809	69,242
State and Tribal Response Program Grants	66.817	1,558,199
Brownfields Assessment and Cleanup Cooperative Agreements	66.818	27,869
Environmental Education Grants	66.951	46,939
Total Excluding Clusters		499,970,681
Research & Development Cluster		
Pollution Prevention Grants Program	66.708	33,824
Surveys, Studies, Investigations, Training Demonstrations and Educational Outreach	66.716	116,782
Total Research & Development Cluster		150,606
Total U.S. Environmental Protection Agency		500,121,286
Office of State and Tribal Programs, Nuclear Regulatory Commission		
Radiation Control-Training Assistance and Advisory Counseling	77.001	128,677
Department of Energy		
State Energy Program	81.041	3,262,483
Weatherization Assistance for Low-Income Persons	81.042	6,039,341
Environmental Restoration	81.092	245,409
Office of Environmental Cleanup and Acceleration	81.104	39,423
Other - U.S. Department of Energy	81.999	347,866
Total Excluding Clusters		9,934,522
Research & Development Cluster		
Other - U.S. Department of Energy	81.999	1,109,794
Total U.S. Department of Energy		11,044,316

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Federal Emergency Management Agency		
Community Assistance Program State Support Services Element (CAP-SSSE)	83.105	443,463
State Disaster Preparedness Grants	83.505	64,377
Flood Mitigation Assistance	83.536	83,015
Pre-Disaster Mitigation	83.557	3,093
State and Local All Hazards Emergency Operations Planning	83.562	118,622
Total Federal Emergency Management Agency		712,570
Department of Education		
Adult Education State Grant Program	84.002	95,251,701
Title I Grants to Local Educational Agencies	84.010	1,436,386,109
Migrant Education State Grant Program	84.011	126,479,789
Title I Program for Neglected and Delinquent Children	84.013	4,176,970
Federal Family Education Loan Program	84.032	27,222,936,663 **
Vocational Education Basic Grants to States	84.048	117,735,226
CA Advisory Council on Vocational Education	84.053	1,193
Leveraging Educational Assistance Partnership	84.069	10,622,475
Rehabilitation Services - Vocational Rehabilitation Grants to States	84.126	259,134,653
Rehabilitation Services Service Projects	84.128	1,146,413
Independent Living State Grants	84.169	114,557
Rehabilitation Services Independent Living Services for Older Individual Who are Blind	84.177	2,716,515
Special Education Grants for Infants and Families with Disabilities	84.181	53,558,527
Byrd Honors Scholarships	84.185	6,140,063
Safe and Drug-Free Schools and Communities State Grants	84.186	38,031,959
Supported Employment Services for Individuals with Sever Disabilities	84.187	3,482,272
Education for Homeless Children and Youth	84.196	8,501,309
Even Start State Educational Agencies	84.213	19,063,262
Assistive Technology	84.224	951,269

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Rehabilitation Services Demonstration and Training Programs	84.235	336,421
Tech-Prep Education	84.243	13,411,821
Rehabilitation Training State Vocational Rehabilitation Unit In-Service Training	84.265	416,789
Eisenhower Professional Development State Grants	84.281	6,197,752
Charter Schools	84.282	24,766,678
Twenty-First Century Community Learning Centers	84.287	109,158,530
State Grants for Innovative Programs	84.298	18,149,954
Education Technology State Grants	84.318	40,922,162
Special Education-State Personnel Development	84.323	2,106,424
Advanced Placement Program	84.330	2,638,046
Grants to States for Incarcerated Youth Offenders	84.331	2,089,765
Comprehensive School Reform Demonstration	84.332	16,047,276
Reading First State Grants	84.357	121,932,968
Rural Education	84.358	1,249,625
Literacy Through School Libraries	84.364	16,653
English Language Acquisition Grants	84.365	137,973,518
Mathematics and Science Partnerships	84.366	18,889,989
Improving Teacher Quality State Grants	84.367	373,606,938
Grants for State Assessments and Related Activities	84.369	33,696,936
Statewide Data Systems	84.372	15,969
Hurricane Education Recovery	84.938	4,692,375
Total Excluding Clusters		30,334,747,512
Special Education Cluster		
Special Education -Grants to States	84.027	1,103,380,487
Special Education - Preschool Grants	84.173	39,709,610
Total Special Education Cluster		1,143,090,097
Total U.S. Department of Education		31,477,837,609

Department of Health and Human Services

Special Programs for the Aging - Title VII, Chapter 3 - Programs for Prevention of Elder Abuse, Neglect, and Exploitation	93.041	526,724
Special Programs for the Aging - Title VII, Chapter 2 - Long Term Care Ombudsman Services for Older Individuals	93.042	1,573,784

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Special Programs for the Aging - Title III, Part D - Disease Prevention and Health Promotion Services	93.043	2,243,811
Special Programs for the Aging - Title IV - and Title II - Discretionary Projects	93.048	319,737
National Family Caregiver Support	93.052	16,378,783
Food and Drug Administration - Research	93.103	1,055,980
Maternal and Child Health Federal Consolidated Programs	93.110	123,369
Environmental Health	93.113	1,474
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	93.116	6,822,062
Emergency Medical Services for Children	93.127	121,612
Primary Care Services Resource Coordination and Development	93.130	211,255
Injury Prevention and Control Research and State and Community Based Programs	93.136	2,581,228
Projects for Assistance in Transition from Homelessness (PATH)	93.150	8,264,299
Health Program for Toxic Substances and Disease Registry	93.161	667,097
Grants to States for Loan Repayment Program	93.165	767,399
Disabilities Prevention	93.184	384,244
Consolidated Knowledge Development and Application (KD&A) Program	93.230	81,202
Traumatic Brain Injury State Demonstration Grant Program	93.234	65,090
State Rural Hospital Flexibility Program	93.241	339,666
Substance Abuse and Mental Health Services - Projects of Regional and National Significance	93.243	4,533,264
Universal Newborn Hearing Screening	93.251	76,954
Rural Access to Emergency Devices Grant	93.259	10,380
Immunization Grants	93.268	167,025,339
Substance Abuse and Mental Health Services - Access to Recovery	93.275	10,184,764
Centers for Disease Control and Prevention - Investigations and Technical Assistance	93.283	57,084,276
Small Rural Hospital Improvement Grant Program	93.301	431,400
Promoting Safe and Stable Families	93.556	50,296,729
Temporary Assistance for Needy Families	93.558	3,227,916,893
Child Support Enforcement	93.563	540,119,839
Child Support Enforcement Research	93.564	1,811
Refugee and Entrant Assistance - State Administered Programs	93.566	25,476,262

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Low-Income Home Energy Assistance	93.568	134,536,733
Community Services Block Grant	93.569	57,730,822
Community Services Block Grant Formula and Discretionary Awards Community Food and Nutrition	93.571	118,803
Refugee and Entrant Assistance - Discretionary Grants	93.576	2,506,295
US Repatriation	93.579	13,233
Refugee and Entrant Assistance - Targeted Assistance Grants	93.584	4,030,135
Empowerment Zones Program	93.585	243,406
State Court Improvement Program	93.586	1,450,168
Community-Based Child Abuse Prevention Grants	93.590	3,879,933
Grants to States for Access and Visitation Programs	93.597	994,393
Chafee Education and Training Vouchers Program (ETV)	93.599	8,633,514
Head Start	93.600	228,716
Mentoring Children of Prisoners	93.616	197,130
Voting Access for Individuals with Disabilities - Grants to States	93.617	721,707
Developmental Disabilities Basic Support and Advocacy Grants	93.630	6,216,482
Children's Justice Grants to States	93.643	2,198,483
Child Welfare Services - State Grants	93.645	31,541,529
Social Services Research and Demonstration	93.647	38,841
Adoption Opportunities	93.652	348,626
Foster Care - Title IV-E	93.658	1,202,437,057
Adoption Assistance	93.659	330,901,331
Social Services Block Grant	93.667	579,095,483
Child Abuse and Neglect State Grants	93.669	2,833,703
Family Violence Prevention and Services/Grants for Battered Women's Shelters - Grants to States and Indian Tribes	93.671	7,516,015
Chafee Foster Care Independence Program	93.674	24,130,006
State Children's Insurance Program	93.767	1,068,602,008
Medicare - Supplementary Medical Insurance	93.774	3,615,922
Centers for Medicare and Medicaid Services (CMS) Research, Demonstrations and Evaluations	93.779	3,158,440
Reimbursement of State Costs for Provision of Part D Drugs	93.794	48,600,965
Bioterrorism-Hospital Preparedness Program	93.889	38,765,571
Grants to States for Operation of Offices of Rural Health	93.913	143,533
HIV Care Formula Grants	93.917	124,500,896
Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems	93.938	901,089

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
HIV Prevention Activities - Health Department Based	93.940	14,327,867
Human Immunodeficiency Virus (HIV) / Acquired Immunodeficiency Virus Syndrome (AIDS) Surveillance	93.944	2,468,070
Trauma Care Systems Planning and Development	93.952	11,996
Block Grants for Community Mental Health Services	93.958	55,285,527
Block Grants for Prevention and Treatment of Substance Abuse	93.959	229,093,458
Preventive Health Services - Sexually Transmitted Diseases Control Grants	93.977	4,723,294
Preventive Health Services - Sexually Transmitted Diseases Research, Demonstrations, and Public Information and Education Grants	93.978	195,187
Health Program for Refugees	93.987	269,931
Cooperative Agreements for State-Based Diabetes Control Program and Evaluation of Surveillance Systems	93.988	1,358,713
Preventive Health and Health Services Block Grant	93.991	7,835,579
Maternal and Child Health Services Block Grant to the States	93.994	35,994,635
Other-Department of Health and Human Services	93.999	15,919,592
Substance Abuse & Mental Health Services (SAMHSA)	See Note 4c	520,000
Total Excluding Clusters		8,184,521,545
Aging Cluster		
Special Programs for the Aging - Title III, Part B - Grants for Supportive Services & Senior Centers	93.044	35,627,266
Special Programs for the Aging - Title III, Part C - Nutrition Services	93.045	55,178,865
Nutrition Services Incentive Program	93.053	11,942,662
Total Aging Cluster		102,748,793
Child Care Cluster		
Child Care and Development Block Grant	93.575	579,818,117
Child Care Mandatory and Matching Funds of the Child Care and Development Fund	93.596	410,087,004
Total Child Care Cluster		989,905,121
Medicaid Cluster		
State Medicaid Fraud Control Units	93.775	19,960,987
Hurricane Katrina Relief	93.776	427,739
State Survey and Certification of Health Care Providers and Suppliers	93.777	35,913,045

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Medical Assistance Program	93.778	19,478,089,739
Total Medicaid Cluster		19,534,391,510
Research & Development Cluster		
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	93.116	237,848
Substance Abuse and Mental Health Services - Projects of Regional and National Significance	93.243	161,000
Centers for Medicare and Medicaid Services (CMS) Research, Demonstrations and Evaluations	93.779	616,500
Total Research & Development Cluster		1,015,348
Total U.S. Department of Health and Human Services		28,812,582,317
Corporation for National and Community Service		
CalServe America	94.001	3,320
State Commissions	94.003	1,463,540
Learn and Serve America - School and Community Based Programs	94.004	3,616,474
AmeriCorps	94.006	29,657,803
Total Excluding Clusters		34,741,138
Foster Grandparent/Senior Companion Cluster:		
Foster Grandparent Program	94.011	1,466,499
Total U.S. Corporation for National and Community Service		36,207,636
Social Security Administration		
Social Security - Disability Insurance	96.001	180,851,156
Department of Homeland Security		
Pilot Demonstration or Earmarked Projects	97.001	31,728
State Domestic Preparedness Equipment Support Program	97.004	306,453,528

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Urban Areas Security Initiative	97.008	122,462,358
Pre-Disaster Mitigation (PDM) Competitive Grants	97.017	15,658,589
Flood Mitigation Assistance	97.029	758,042
Disaster Unemployment Assistance	97.034	180,402
Disaster Grants - Public Assistance (Presidentially Declared Disasters)	97.036	206,144,547
Hazard Mitigation Grant	97.039	33,496,293
Emergency Management Performance Grants	97.042	8,425,888
Fire Management Assistance Grant	97.046	3,437,729
Pre-Disaster Mitigation Disaster Resistant Universities	97.063	219,657
Map Modernization Management Support	97.070	69,403
Rail and Transit Security Grant Program	97.075	5,658,873
Buffer Zone Protection Plan (BZPP)	97.078	4,274,510
Total Department of Homeland Security		707,271,548
Office of National Drug Control Policy		
High Intensity Drug Trafficking Area	See Note 4a	5,369,574
Miscellaneous Grants and Contracts		
Shared Revenue-Flood Control Lands	99.002	311,712
Shared Revenue-Grazing Land	99.004	170,553
U.S. Department of the Interior-Fire Prevention/Suppression Agreement	99.014	634,000
U.S. Department of the Interior-Fire Prevention/Suppression Agreement	99.015	564,347
U.S. Department of Agriculture and Various Other U.S. Department-Fire Prevention/Suppression	99.016	7,172,642
Miscellaneous Federal Receipts	99.099	35,844
Miscellaneous Federal Receipts	99.999	1,999,324
Total Miscellaneous		10,888,422

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Total Federal Awards Received		**$ 76,655,553,902**

* Amount includes value of commodities or food stamps.
** Amount includes loans and/or loan guarantees outstanding as of June 30, 2007.
*** Amount includes donated property.
**** Amount includes insurance in effect as of June 30, 2007.

Notes to the Schedule of Federal Assistance

Fiscal Year Ended June 30, 2007

1. GENERAL

The accompanying State of California Schedule of Federal Assistance presents the total amount of federal financial assistance received by the State of California for the fiscal year ended June 30, 2007. This schedule does not include expenditures of federal awards received by the University of California, the California State University system, and the California Housing Finance Agency, a component unit of the State. These entities engaged other auditors to perform an audit in accordance with the U.S. Office of Management and Budget, Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (OMB Circular A-133).

The $76,655,553,902 in total federal assistance consists of the following:

Cash assistance received	$46,351,957,296
Non-cash federal awards	2,809,663,331
Loans and/or loan guarantees outstanding	27,418,866,377
Insurance in-force	75,066,898
Total	$76,655,553,902

2. BASIS OF ACCOUNTING

OMB Circular A-133 requires the auditee to prepare a schedule of expenditures of federal awards for the period covered by the auditee's financial statements. Further, at a minimum, the schedule shall provide total federal wards expended for each individual federal program and Catalog of Federal Domestic Assistance (CFDA) number or other identifying number when the CFDA information is not available.

However, although the state accounting system separately identifies revenues for each federal award, it does not separately identify expenditures. As a result, the State prepares its Schedule of Federal Assistance on a cash receipts basis. The schedule shows the amount of cash and non-cash federal assistance received, loans and loan guarantees outstanding, and insurance in force for the year ended June 30, 2007.

3. UNEMPLOYMENT INSURANCE

Of the $5,097,508,274 in total unemployment insurance funds (federal catalog number 17.225) received by the Employment Development Department during fiscal year 2006–07, $4,726,282,730 was State unemployment insurance funds that were drawn down from the Unemployment Trust Fund in the U.S. Treasury.

4. OTHER

a. The California Department of Justice (DOJ) receives cash reimbursements from local law enforcement agencies under the Office of National Drug Control Policy's High Intensity Drug Trafficking Area program. During the period July 1, 2006 through June 30, 2007, the DOJ received the following cash reimbursements from pass-through entities:

Federal Agency/Program	Pass-through Entity	Grant Number	Amount
Office of National Drug Control Policy			
High Intensity Drug Trafficking Area			
	LA Clear/LA Police Chief's Association/City of Hawthorne	I5PLAP534	$ 862,556
	LA Clear/LA Police Chief's Association/City of Hawthorne	I6PLAP534	1,448,924
	NC HIDTA/LA Police Chief's Association	2002-CPOT Hard Target	15,200
	NC HIDTA/LA Police Chief's Association	2005-RTTAC	518
	NC HIDTA/LA Police Chief's Association	I5PSFP501	7,534
	NC HIDTA/LA Police Chief's Association	I6PSFP501	448,534
	NC HIDTA/LA Police Chief's Association	I7PSFP501	29,401
	CV HIDTA/LA Police Chief's Association/Stanislaus County	I4PCVP501Z	31,897
	CV HIDTA/LA Police Chief's Association/Stanislaus County	I5PCVP501Z	548,351
	CV HIDTA/LA Police Chief's Association/Stanislaus County	I6PCVP501Z	148,896
	INCH/LA Police Chief's Association/Riverside County	I6PLAP540Z	39,081
	INCH/LA Police Chief's Association/Riverside County	I76PLAP540Z	25,713
	NV HIDTA/LA Police Chief's Association/Las Vegas Metro PD	I2PNVP501Z	5,128
	NV HIDTA/LA Police Chief's Association/Las Vegas Metro PD	I5PNVP501Z	10,152
	NV HIDTA/LA Police Chief's Association/Las Vegas Metro PD	I6PNVP501Z	73,738
	CA Border Alliance Group/City of San Diego	I5PSCP575	7,525
	CA Border Alliance Group/City of San Diego	I6PSCP501Z	1,548,516
	Northwest HIDTA/Washington State	SLA 97-04-05	31,000
	Northwest HIDTA/Washington State	SLA 97-04-06	11,625
	Criminal Information Sharing Alliance	DCA100-03-1-0001	65,044
	Institute of Intergovernmental Research	2003RSCX1002	10,241
		Total	$5,369,574

(b) The State was also loaned Federal Excess Personal Property (FEPP) from the U.S. Forest Service during the period July 1, 2006 to June 30, 2007. According to the California Department of Forestry and Fire Protection, the amount loaned from July 1, 2006 to June 30, 2007, was $1,676,544. The U.S. Forest Service and the State maintain the FEPP program at federal acquisition costs of the property.

(c) The following trial courts of the Judicial Council of California received federal awards from local government agencies. During the period July 1, 2006 through June 30, 2007, the trial courts received the following awards:

Program	Pass-through Entity	Grant Number	Amount
Violence Against Women	Contra Costa County	49002	$ 77,079
Substance Abuse & Mental Health Services (SAMHSA)	Riverside County	5-H79-T17507-02	520,000
		Total	$597,079

Summary Schedule of Prior Audit Findings

Prepared by Department of Finance

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

Reference Number:	**2006-12-10**
Federal Program:	All Programs
State Administering Department:	Department of Finance
Fiscal Year Initially Reported:	1995-96
Audit Finding:	Reporting. Because of limitations in its automated accounting systems, the State has not complied with the provision of OMB Circular A-133 requiring a schedule showing total expenditures for each federal program.
Status of Corrective Action:	Remains uncorrected. The Department of Finance has received approval for a new integrated statewide financial management system, the Financial Information System for California. The Legislature did not provide funding to proceed with the project as planned for the state's fiscal year 2007-08, but did provide resources to develop and provide specific information to it no later than April 2008. The project team is in the process of developing the information requested by the Legislature for its consideration. It is anticipated that the new system will have the capability to provide total expenditures for each federal program. [1]

Reference Number:	**2006-3-1**
Federal Program:	84.298
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2001-02
Audit Finding:	Cash Management. The Department of Education (Education) does not have adequate procedures to ensure that subrecipients of the Innovative Education Program demonstrate the ability to minimize the time between receipt and disbursement of federal funds.
Status of Corrective Action:	Partially corrected. Education continues to explore procedural improvements that will reduce the time in which federal funds are distributed to and expended by funding recipients. To facilitate this process, Education plans to seek additional guidance from the U.S. Department of Education's Risk Management Team and form a task force specifically to strengthen existing cash management policies and processes.

Reference Number:	**2006-7-1**
Federal Program:	84.181
State Administering Department:	Department of Developmental Services
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Level of Effort – Maintenance of Effort. The Department of Developmental Services does not have a system in place to demonstrate that it maintains funding under the Early Start Program for early intervention services for children and their families at a level that is at least equal to the funding for the prior year.
Status of Corrective Action:	Fully corrected. [2]

Reference Number:	**2006-7-2**
Federal Program:	84.298
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2003-04
Audit Finding:	Level of Effort – Supplement Not Supplant. The Department of Education (Education) does not have a system in place for monitoring the State's compliance with the requirement that it use revenues from Innovative Education to supplement, rather than supplant, existing funds for grant-related activities.
Status of Corrective Action:	Partially corrected. Education is discussing methods to resolve the lack of documentation that shows compliance with the supplement-not-supplant requirements.

Reference Number:	**2006-13-1**
Federal Program:	84.181
State Administering Department:	Department of Developmental Services
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Suprecipient Monitoring. The Department of Developmental Services (Developmental Services) did not completely fulfill its subrecipient monitoring responsibilities for its Early Start Program. Specifically, Developmental Services did not provide the Catalog of Federal Domestic Assistance (CFDA) title and number, the award number, and the name of the Federal agency when awarding program funds through a contract.

Status of Corrective Action:	Partially corrected. Developmental Services revised all grant contract formats to include identification of the federal award information. The information that is included on each subrecipient contract includes the CFDA title and number, award name and number and the name of the federal agency. In addition, Developmental Services Contract Section has implemented a procedure to require that all requests for contracts include the applicable federal award information. The Developmental Services contracts with Family Resource Centers have been amended to include the required federal award information. All other Developmental Services contracts are in the process of being amended to include the federal award information. It is anticipated that all affected contracts will be amended by the end of January 2008. [3]

Reference Number:	**2006-14-7**
Federal Program:	84.032
State Administering Department:	California Student Aid Commission
Fiscal Year Initially Reported:	2001-02
Audit Finding:	Special Tests and Provisions. Student Aid's auxiliary organization administers the loan program. However, the auxiliary organization has not developed adequate internal controls over its information systems to provide reasonable assurance that it keeps current, complete, and accurate records of each loan. Specifically, we found weaknesses in the auxiliary organization's controls over entity-wide security planning and management, and its restriction of access to data files. We also found weaknesses in the operating agreement between Student Aid and its auxiliary organization.
Status of Corrective Action:	Partially corrected. Entity-wide Security Planning and Management EdFund has an entity-wide security program plan. Many elements of the plan are in place while others are continuing to be addressed. A significant number of the high-risk and moderately high-risk findings identified in the June 2005 risk assessment have been mitigated, although, some remain to be addressed. EdFund is in the process of expanding its dedicated information security team by providing additional resources to better strengthen this function. Data Maintenance The auxiliary is strengthening its electronic access controls specific to the limited number of employees designated by

management to have system access to perform their job responsibilities, which include data maintenance. Data maintenance is used for exception processing and these transactions are not part of the normal workflow. New data maintenance processes were established during federal FY 2005-2006 and EdFund subsequently conducted an internal audit in 2007. The internal audit noted areas where certain controls could be further strengthened such as in monitoring and evaluating transactions to help identify solutions that will reduce the number of transactions performed. The audit also identified improvements that could be made to expand quality control reviews, better document approvals and track transactions. A follow up review will be conducted in January 2008 to evaluate the implementation and/or progress of the corrective actions cited in the internal audit report. [4]

Fully corrected. Operating Agreement
A new Operating Agreement between the California Student Aid Commission and EdFund, the Commission's auxiliary organization, became effective July 1, 2007. The agreement requires the auxiliary to maintain strong control over its information systems including an annual audit of information technology controls relevant to the Operating Fund and Federal Fund financial statements (Article VIII Section 8.2 B). The audit will be performed only if the expenses associated there with are approved by the California Department of Finance.

Reference Number:	**2006-2-2**
Federal Program:	93.778
State Administering Department:	Department of Health Services
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Allowable Costs/Cost Principles. The Department of Health Care Services (Health Care Services), formerly the Department of Health Services, contracts with Electronic Data Systems (EDS) to authorize Medicaid payments. EDS authorized Medicaid payments to some skilled nursing facilities more than once for the same services.
Status of Corrective Action:	Partially corrected. Health Care Services has completed the review of all claim types and has determined that duplicate payments were authorized by the contractor beyond those identified in the audit. The permanent update to the Edit Criteria for Medical, Outpatient, and Vision claim types is being implemented. All overpayments will be collected from providers through the Erroneous Payment Correction process. Remains uncorrected/agree with finding. Health Care Services believes the cost and effort required to implement

the recommended new field to document and track the reasons for overriding claims exceeds the benefit. Currently all transactions applied to a claim are documented in CA-MMIS reports that are reviewed and retained for 10 years. The EDS Quality Management Department performs monthly audits of claims processing, which includes override transactions. To create a new field to record the basis for overriding a suspended claim would require CA-MMIS system changes of approximately 1,600 hours to design, code, test, capture and update claim history. In addition, edit criteria sheets would need to be updated and examiner staff would require training. The final negative impact would be a significant reduction to claim examiners' productivity when determining the correct override code and inputting this code into the system. [5]

Reference Number:	**2006-3-16**
Federal Program:	93.563
State Administering Department:	Department of Child Support Services
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Cash Management. The Department of Child Support Services did not have procedures in place to ensure that it limits the advances of federal funds to its subgrantee – the Judicial Council of California – to the minimum amounts needed for the enforcement program.
Status of Corrective Action:	Fully corrected. [6]

Reference Number:	**2006-13-16**
Federal Program:	93.044; 93.045; 93.053
State Administering Department:	Department of Aging
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Subrecipient Monitoring. The Department of Aging (Aging) is not adequately fulfilling all its monitoring responsibilities for the Area Agencies on Aging. Specifically, Aging was able to conduct eight onsite program reviews and 11 onsite compliance reviews for fiscal year 2005-06. However, as of December 14, 2006, Aging had not completed the final reports for seven of its eight onsite program reviews and had yet to complete the draft reports for 11 onsite compliance reviews.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2006-14-2**
Federal Program:	10.557
State Administering Department:	Department of Health Services
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Special Tests and Provisions – Review of Food Instruments to Enforce Price Limitations and Detect Errors. The Department of Public Health, formerly the Department of Health Services, is not in compliance with the recordkeeping requirements of the WIC Program by not retaining copies or having the ability to obtain copies of the redeemed food instruments for the three-year retention period. The WIC Program obtained a waiver from the United States Department of Agriculture, which allowed the State Agency to destroy redeemed food instruments prior to the end of the regulated three-year retention period. However, this is contingent upon the ability to retrieve copies of these destroyed food instruments (up to three years after redemption) routinely and timely through existing banking records. The WIC Program is only able to retrieve copies of the food instruments redeemed up to one year ago.
Status of Corrective Action:	Fully corrected.[7]

Reference Number:	**2006-13-2**
Federal Program:	16.575
State Administering Department:	Governor's Office of Emergency Services
Fiscal Year Initially Reported:	2001-02
Audit Finding:	Subrecipient Monitoring. The Governor's Office of Emergency Services (Emergency Services) did not adequately monitor its subrecipients of funds for the Crime Victim Assistance Program for the fiscal year ending June 30, 2006. Emergency Services has not reviewed an estimated combined 1,575 audit reports submitted by subrecipients dating back to 2002 and does not have processes or controls in place to accurately track whether subrecipients' audit reports have been submitted or reviewed.
Status of Corrective Action:	Partially corrected. This Single Audit finding was issued based on a significant backlog of A-133 Audit reviews. Emergency Services' proposed corrective action was to hire an Audit Coordinator and eliminate the backlog by June 30, 2007. Unfortunately, this position was redirected to other Emergency Services priorities to avoid financial

penalties to the State of California as the result of new legislation. However, the backlog has been dramatically reduced (less than 50 reports are currently outstanding), and we expect the backlog will be completely eliminated by no later than October 1, 2007.[8]

Reference Number:	**2006-1-5**
Federal Program:	84.332
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Activities Allowed/Allowable Costs. The Department of Education (Education) cannot demonstrate support for the proper approval of grants. Education has a formal control process for approving awarding grants to Local Educational Agencies (LEAs). This process consists of multiple levels of Education approval, which are documented on a *Summary Cover Memo* (Form EXE-100f), as appropriate, to approve the award to the LEA. These approved *Summary Cover Memos* are not retained as evidence of the controls in place over the grant award approval process.
Status of Corrective Action:	Fully corrected.[9]

Reference Number:	**2006-1-6**
Federal Program:	84.332
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Activities Allowed/Allowable Costs. The Department of Education (Education) does not retain documentation to support the review and approval of proposed grant activities. The program department has a formal control process for the approval of the Local Educational Agencies' (LEAs) application for use of program funds. This process consists of a review of the proposed activities by two program consultants. Evidence of the review is indicated on a reviewer's score sheet. These program funds were issued to LEAs in grouping cycles entitled cohorts. During the fiscal year ended June 30, 2006 funds were paid for cohorts 3, 4, and 5. The program department did not retain these reviewer score sheets for cohorts 3 or 4, nor were we able to obtain any other documented evidence to support the review and approval of applications for allowable activities.
Status of Corrective Action:	Fully corrected.[10]

Reference Number:	**2006-3-3**
Federal Program:	84.010; 84.011; 84.027; 84.173; 84.318; 84.332; 84.365; 84.367; 84.369
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Cash Management. The Department of Education (Education) requests cash advances from the federal government and then requests payments to be made to the Local Educational Agencies (LEAs) by the State Controller's Office (SCO). Education has a control process in place to reconcile and follow up on a monthly basis any outstanding LEA payment requests submitted to the SCO from advanced federal funds that remain unpaid after 60 days. The practice of only following up on items after 60 days past due would not enable Education to determine whether or not it is in compliance with Federal requirements for minimizing the time elapsing between the request for advance from the Federal government and the payment being made to the subrecipient. Without appropriately designed controls in place, Education risks payments not being made in accordance with Federal guidelines.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2006-3-4**
Federal Program:	84.010
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Cash Management. The Department of Education (Education) cannot demonstrate support for proper approvals of payments made to Local Educational Agencies. The original copy of the approved *Claims Schedule* is sent to the State Controller's Office to be paid, however a copy of the approved *Claims Schedule* is not retained as evidence of the review and approval process for the claim. An unsigned copy of the *Claims Schedule* is retained along with the other documentation as support for the payment.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2006-3-5**
Federal Program:	84.010
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2001-02
Audit Finding:	Cash Management. The Department of Education (Education) does not have a process in place for assessing the cash needs of its subrecipients. Education requests advance funds from the Federal government and makes three predetermined payment advances to Local Educational Agencies (LEAs) during the fiscal year. Education does not require periodic expenditure reporting or input by the LEAs during the award period and relies upon expenditures reported in the annual two-part consolidated application, the year-end expenditure report. The timing of the payments made to LEAs does not take the LEAs' cash needs into consideration as no expenditure data or input was obtained from the LEAs during the award year. As a result of this condition, Education disbursed over $1.7 billion during the fiscal year ending June 30, 2006 with no assurances that these subrecipients minimized the time between the receipt and disbursement of federal funds, which would not comply with Federal guidelines.
Status of Corrective Action:	Partially corrected. Education continues to explore procedural improvements that will reduce the time in which federal funds are distributed to and expended by funding recipients. To facilitate this process, Education plans to seek additional guidance from the U. S. Department of Education's Risk Management Team and form a task force specifically to strengthen existing cash management policies and processes. The task force will focus on improvements for: (1) determining optimal funding distributions on a program-by-program basis; (2) assessing recipient cash needs, and (3) ensuring that federal funds are timely and appropriately expended by funding recipients through Education's monitoring processes.[11]

Reference Number:	**2006-3-6**
Federal Program:	84.318
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2002-03
Audit Finding:	Cash Management. The Department of Education (Education) does not have a process in place for assessing the cash needs of its subrecipients. Education requests

advance funds from the Federal government and makes two predetermined payment advances to Local Educational Agencies (LEAs) during the fiscal year with final payment to be made after the receipt of the year-end final expenditure report. Education does not require periodic expenditure reporting or input by the LEAs during the award period but requires the year-end final expenditure report, which is due to Education approximately 60 days after the end of the State Fiscal year.

The timing of the payments made to LEAs does not take the LEAs' cash needs into consideration as no expenditure data or input was obtained from the LEAs during the award year. As a result of this condition, Education disbursed over $81 million during the fiscal year ending June 30, 2006 with no assurances that these subrecipients minimized the time between the receipt and disbursement of federal funds, which would not comply with Federal guidelines.

Status of Corrective Action:

Partially corrected. For the Enhancing Education Through Technology (EETT) competitive grant, Education now requires a Mid-Year Certification of Expenditure Report for all EETT grantees. Before a second payment is issued, the grantee must spend a minimum of 80 percent of the previous payment in accordance with the grant regulations. The grantee must record the amount of actual expenditures, which is compared to the 80 percent calculation before the next payment is issued.

However, to fully implement the Mid-Year Certification of Expenditure Report for the EETT Formula grant with 1,000 awards, Education is seeking the necessary staffing resources and system applications to effectively monitor grantees' cash needs. [12]

Reference Number: **2006-3-7**

Federal Program: 84.332

State Administering Department: Department of Education

Fiscal Year Initially Reported: 2005-06

Audit Finding: Cash Management. The Department of Education (Education) does not have a process in place for assessing the cash needs of its subrecipients. Education requests advance funds from the Federal government and makes two predetermined payment advances to Local Educational Agencies (LEAs) during the fiscal year with final payment to be made after the receipt of the year-end final expenditure report. Education does not require periodic expenditure reporting or input by the LEAs during the award period but requires the year-end final expenditure report, which is due to Education approximately 60 days after the end of the State fiscal year.

	The timing of the payments made to LEAs does not take the LEAs' cash needs into consideration as no expenditure data or input was obtained from the LEAs during the award year. As a result of this condition, Education disbursed over $28 million during the fiscal year ending June 30, 2006 with no assurances that these subrecipients minimized the time between the receipt and disbursement of federal funds, which would not comply with Federal guidelines
Status of Corrective Action:	Partially corrected. Education continues to explore procedural improvements that will reduce the time in which federal funds are distributed to and expended by funding recipients. To facilitate this process, Education plans to seek additional guidance from the U. S. Department of Education's Risk Management Team and form a task force specifically to strengthen existing cash management policies and processes. The task force will focus on improvements for: (1) determining optimal funding distributions on a program-by-program basis; (2) assessing recipient cash needs, and (3) ensuring that federal funds are timely and appropriately expended by funding recipients through Education's monitoring processes.

Reference Number:	**2006-3-8**
Federal Program:	84.365
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2002-03
Audit Finding:	Cash Management. The Department of Education (Education) does not have an adequate process in place for assessing the cash needs of its subrecipients. In our sample of 64 LEA advance payment considerations, we noted 10 LEAs that had sufficient expenditures when compared to the advances made but did not receive the scheduled advance. In the same sample, we also noted one LEA was paid a cash advance before it had submitted the required expenditure report to support it had expended the earlier advance. As a result of these exceptions noted, Education disbursed approximately $152 million during fiscal year ending June 30, 2006 with no assurances that these subrecipients minimized the time between the receipt and disbursement of federal funds, which would not comply with Federal guidelines.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2006-3-9**
Federal Program:	84.367
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2002-03
Audit Finding:	Cash Management. The Department of Education (Education) does not have an adequate process in place for assessing the cash needs of its subrecipients. Education's procedures do not take the current year Local Educational Agencies' (LEAs) cash needs into consideration as the only expenditure data taken into consideration was the prior year. No current year expenditure data was obtained from the LEAs during the award year to monitor and minimize the time elapsing between the expenditure and receipt of program funds. As a result of this condition, Education disbursed approximately $324 million during the fiscal year ending June 30, 2006 with no assurances that subrecipients minimized the time between the receipt and disbursement of federal funds, which would not comply with Federal guidelines.
Status of Corrective Action:	Partially corrected. Education continues to explore procedural improvements that will reduce the time in which federal funds are distributed to and expended by funding recipients. To facilitate this process, Education plans to seek additional guidance from the U. S. Department of Education's Risk Management Team and form a task force specifically to strengthen existing cash management policies and processes. The task force will focus on improvements for: (1) determining optimal funding distributions on a program-by-program basis; (2) assessing recipient cash needs, and (3) ensuring that federal funds are timely and appropriately expended by funding recipients through Education's monitoring processes.[13]

Reference Number:	**2006-3-10**
Federal Program:	84.010; 84.332; 84.367
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Cash Management. The Department of Education (Education) does not appear to be adequately monitoring the cash management compliance of its subrecipients, in that potential material amounts of interest earned on cash advances paid by Education without an adequate assessment of immediate cash needs, are not being returned.

Under the Comprehensive School Reform program Education did not notify the Local Educational Agencies (LEAs) of the requirement to return interest earned on advances nor did they request this information in their year end report entitled *Summary of Expenditures for Fiscal year 2005-2006.* In addition, there were no processes or controls in place to collect and return the interest earned over $100 to the federal Department of Education.

Under the Title I Grants to LEAs and Improving Teacher Quality programs, Education did notify the LEAs of the requirement to return interest earned on advances, however they did not require the interest earned to be reported on the Consolidated Application nor are they any processes or controls in place to collect and return the interest earned over $100 to the federal Department of Education. In one subrecipients' A-133 audit report the interest earned on a Title I program alone was $1.8 million during the fiscal year ended June 30, 2005, which was not returned to Education or the federal government.

By not implementing appropriately designed processes, controls, and enforcement procedures, Education cannot adequately ensure its subrecipients' compliance with cash management requirements.

Status of Corrective Action: Partially corrected. Education is and will continue to work on the funding handbook to provide guidance to program staff on the requirement to collect interest over $100. Additionally, Education is formulating a task force to improve its cash management processes. [14]

Reference Number: **2006-5-5**

Federal Program: 84.367

State Administering Department: Department of Education

Fiscal Year Initially Reported: 2005-06

Audit Finding: Eligibility. The Department of Education (Education) has a formal process for calculating the award entitlements made to its subrecipients, however this calculation is performed by one individual and there is no evidence of the review and approval of the calculation by a supervisor to help ensure the accuracy of the calculations. Absence of segregation of duties and proper reviews and approvals increase the risk that material errors may occur within the entitlement calculations.

Status of Corrective Action: Partially corrected. Education will document its review and approval beginning with the Fall 2007 entitlement calculations for the 2007-08 program year. [15]

Reference Number:	**2006-7-4**
Federal Program:	84.010; 84.186; 84.318; 84.365; 84.367
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Level of Effort – Maintenance of Effort Condition 1: Expenditures for debt service, principal and interest were included as part of the expense for free public education, but should be omitted in accordance with the Federal Education Code. In addition, only the equipment replacement portion of capital outlay was being omitted instead of the entire capital outlay, thereby including expenditures for buildings, improvements, and equipment that should also be omitted. Condition 2: Education was using unadjusted Local Educational Agencies (LEAs) expenditure figures to calculate compliance with the maintenance of effort requirements instead of using the final audited expenditures. There is no policy or procedure in place to review and reconcile the LEAs' unaudited financial trial balance to the final audited financial statement or review the subsequent year unaudited financial trial balance in the following September for any material adjustments to the fund balance for prior year audit adjustments. By using unaudited figures, there is a risk that material adjustments or omissions may not be adequately reflected and computed in the maintenance of effort calculation. Condition 3: Education does not prepare timely the maintenance of effort (MOE) calculations for its LEAs. Education has not yet finalized its State fiscal year 2005 calculations, which compare the expenditures for the State fiscal years ending June 30, 2003 to June 30, 2004, even though it received the required expenditure data that is used to perform the calculation on or before September 15, 2004. Education does not have policies or procedures that require Education to send the final calculations to each LEA annually. By not timely performing and providing these calculations to its LEAs, Education is not providing information required by its LEAs in completing their annual A-133 audits.
Status of Corrective Action:	Partially corrected. Condition 1: Education continues to disagree with this finding. Expenditures for capital outlay and debt service are excluded from the "current expense of education," which is Education's starting point for the MOE calculation. Equipment replacement expenditures are initially included

in the "current expense of education" figure, so Education manually excludes these costs from the calculation. Therefore, while they may appear to be treated differently, capital outlay, debt service and equipment replacement costs are all excluded from the calculation.

Condition 2: Education does not currently have authority to require LEAs to submit audited data electronically, thus making this finding difficult to implement. Education is looking into alternative methods it could use to proxy audited data, such as building an additional audit procedure into the K-12 audit guide, but that outcome is still undetermined.

Condition 3: Education acknowledges the late calculation of MOE, and is in the process of revising the timeliness for calculating MOE and adjusting allocations. Education has completed the 2005-06 MOE calculation and is actively working on completing the 2006-07 and 2007-08 calculations. These calculations will be used to adjust 2007-08 entitlements as required. [16]

Reference Number:	**2006-7-5**
Federal Program:	84.027
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2003-04
Audit Finding:	Level of Effort – Maintenance of Effort. The Department of Education (Education) was unable to obtain clarification with the U.S. Department of Education on which funds should be included in its maintenance of effort (MOE) determination, thus it cannot be concluded whether or not Education has met this requirement. For fiscal year 2003-04, the most recent year for which complete information is available, Education included only those expenditures authorized under certain General Fund appropriations specific to Education and certain special Education programs. Using this method, Education determined it had met its MOE requirement. Due to these conditions, it cannot be concluded that Education has included all of the information to demonstrate its compliance with the requirement. For example, Special Education expenses incurred by other State departments, such as Mental Health expenditures were not included. Education has also included the amount of local property taxes required to be allocated for Special Education instead of the actual expenditures made during the fiscal year, where unexpended allocations could cause noncompliance.

Status of Corrective Action:	Fully corrected.

Reference Number:	**2006-7-7**
Federal Program:	84.027
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Earmarking – Formula Subgrants to Local Educational Agencies (LEAs). The federal Department of Education Grant Award Document includes specific earmarking requirements for each state, including California. The earmarking amount was indicated as $830,013,772; however, per review of expenditure data compiled by the Department of Education we noted the total expenditures to be only $829,260,041, thus under the requirement of grants to LEAs by $773,731.
Status of Corrective Action:	Partially corrected. The process of designating the earmark is done annually in September. Education anticipates following the new review process with 2007 documents. [17]

Reference Number:	**2006-8-1**
Federal Program:	84.318; 84.369
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Period of Availability. The Department of Education (Education) liquidated grant awards after the allowable period. Items that were required to be liquidated by December 29, 2005 were paid in January 2006. Liquidations of program encumbrances/expenditures made after the period allowable are no longer allowable costs.
Status of Corrective Action:	Fully corrected. [18]

Reference Number:	**2006-9-2**
Federal Program:	84.011; 84.027; 84.173; 84.332
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Procurement, Suspension, and Debarment. The Department of Education's (Education) agreements made with subcontractors did not include nonsuspension and debarment certification language. Education also does not

	require Special Education Local Plan Area (SELPA) or Local Educational Agencies (LEAs) to sign the General Assurances and Federal Funds Conditions attachment and return the signed copy to it. Further, grant awards did not include any language regarding suspension or debarment and Education does not require participating LEAs to sign nonsuspension and debarment certification forms. Finally, Education did not verify the nonsuspension or debarment of the LEAs on the Excluded Parties List System (EPLS). By not obtaining signed self-certifications of nonsuspension or debarment and not performing any independent checks on the EPLS website, Education is not in compliance with Federal suspension and debarment requirements. Education runs the risk that it will enter into an agreement with a suspended or debarred LEA or contractor, which would result in all expenditures paid under that agreement being disallowed.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2006-9-4**
Federal Program:	84.369
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Procurement, Suspension, and Debarment. The Department of Education (Education) did not retain evidence of review and approval of material program contracts and therefore cannot demonstrate that appropriate approvals are in place.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2006-12-5**
Federal Program:	84.027; 84.173
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Reporting. The Department of Education's (Education) California Special Education Management Information System (CASEMIS) contains build-in edit checks to identify errors or any potentially duplicate participants. However, there is no ability to evidence that each edit check is successfully performed or other audit trail to show successful completion of all edit checks. Also, there is inadequate evidence of control totals to ensure that there were no duplicate students contained in the CASEMIS

	system. The absence of evidence of system controls being performed effectively increases the risk of inaccurate reporting.
Status of Corrective Action:	Fully corrected. [19]

Reference Number:	**2006-12-6**
Federal Program:	84.011
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Reporting. The Department of Education (Education) did not maintain copies of supporting documentation used to prepare the annual Consolidated State Performance Report for Funding Year 2004-05. Education was unable to provide supporting documentation for all of the sampled items, which related to population data. By not maintaining documentation to support required reporting, Education is not in compliance with Federal reporting requirements. There is no documented evidence of Education's review and approval of the data compiled by a subcontractor for the Consolidated State Performance Report or the data compiled by a subcontractor for the Migrant Child Count Report. The absence of appropriate reviews and approvals of the compilation of required reporting increases the risk of inaccuracies going undetected.
Status of Corrective Action:	Partially corrected. Education has strengthened its policies and procedures for reviewing and documenting information utilized for the Consolidated State Performance Report and child counts. Education will develop an on-going monitoring and re-interview process by December 30, 2007 which will be revised as needed after USDE publishes regulations to standardize processes validating child counts. [20]

Reference Number:	**2006-12-7**
Federal Program:	84.318
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Reporting. The Department of Education (Education) did not maintain the original documentation used to support items of data reported in the annual Consolidated State Performance Report for Funding Year 2003, which was submitted in 2006. However, Education was able to recreate the documentation to support the information reports for all but two of the 42 items tested. By not

maintaining documentation to support required reporting, Education is not in compliance with Federal reporting requirements.

In addition, Education did not maintain documented evidence of the review and approval of the report by a department official. The absence of appropriate reviews and approvals of the compilation of required reporting increases the risk of inaccuracies going undetected.

Status of Corrective Action: Fully corrected.

Reference Number: **2006-12-8**

Federal Program: 84.332

State Administering Department: Department of Education

Fiscal Year Initially Reported: 2005-06

Audit Finding: Reporting. The Department of Education's (Education) reporting approval process includes a top level review and approval from a department official, but it appears there was no detailed level review tracing the report data to the supporting documentation. Supporting documentation did not match the reported data for three of 25 sampled items reported on Education's annual Consolidated State Performance Report and the Comprehensive School Reform Demonstration Program 2005 Evaluation Report. Although these differences appeared to be immaterial in the current year reports, differences in future years could be material without a performed detail review.

Status of Corrective Action: Fully corrected. [21]

Reference Number: **2006-12-9**

Federal Program: 84.365

State Administering Department: Department of Education

Fiscal Year Initially Reported: 2005-06

Audit Finding: Reporting. The Department of Education (Education) does not maintain supporting documentation used to create its annual Consolidated State Performance Report for Funding Year 2004-05, which was submitted during 2006. Education was able to recreate supporting documentation for three of the 50 items sampled. However, one of the unsupported items is data reporting the total number of participating students identified as Limited English Proficiency. Based on other data, the number reported does not appear reasonable.

	There is no documented evidence of the review and approval by a department official of the data compiled by a subcontractor used in this report. The absence of appropriate reviews and approvals of the compilation of required reporting increases the risk of material inaccuracies going undetected.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2006-13-4**
Federal Program:	84.011
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Subrecipient Monitoring. The Department of Education (Education) does not have controls to ensure that award information was properly identified to the Local Educational Agencies. In one instance, the *Grant Award Notification* did not contain the name of the Federal agency. In another instance, Education incorrectly identified the CFDA number. This incorrect program identification information would cause subrecipients to follow incorrect program regulations.
Status of Corrective Action:	Fully corrected. [22]

Reference Number:	**2006-13-5**
Federal Program:	84.010; 84.011; 84.318; 84.332; 84.365; 84.367
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Subrecipient Monitoring. The Department of Education (Education) does not have policies or procedures for assessing Local Educational Agencies (LEAs) subrecipients as high risk either on the individual program level or the overall LEA level. Identification of higher risk LEAs is a critical component in determining the extent of during-the-award monitoring procedures to be performed.
Status of Corrective Action:	Partially corrected. Education is continuing to develop policies and procedures for gaining adequate knowledge for making informed assessments of LEAs performance on a program-specific basis. [23] Fully corrected. Education has begun disseminating summary reports of A-133 audit findings to program staff.

Reference Number:	**2006-13-6**
Federal Program:	84.010; 84.011; 84.365; 84.367
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Subrecipient Monitoring. The Department of Education (Education) does not have adequate controls over its subrecipient monitoring. Documentation of the monitoring visit performed by the Consolidated Program Monitoring (CPM) unit is evidenced by the Cross-Program Instrument (CP). However, the CPM does not retain detail work paper documentation of the samples tested, interviews performed, etc., to support the conclusions reached. The monitoring procedures contained limited fiscal procedures and should be enhanced to cover all major functions and activities of the program. There was no documented signoff of approval for the procedures performed and conclusions reached for the monitoring visit on the CP by someone other than the preparer. By not maintaining adequate documentation of the procedures performed or ensuring that appropriate reviews and approvals are performed, Education is not able to adequately support conclusions reached during its monitoring visits.
Status of Corrective Action:	Partially corrected. Education has strengthened categorical program monitoring (CPM) procedures during monitoring visits to ensure sufficient documentation is reviewed and cited in order to reach compliance findings. Monitoring visits are evidenced by: (1) the Notification of Findings (NOF), and (2) individual program instruments. The NOF is a summary of findings for the entire CPM team. It is derived from the more detailed instrument that each team member uses on-site and retains as his/her record of findings in addition to a copy of the NOF. While more detailed notation is made on the program instruments, the NOF is discussed by the team and signed by each program reviewer prior to submitting the report to the LEA. Furthermore, either the CPM office administrator or the School and District Accountability Division (SDAD) director also reviews and signs off on the NOF reports. The past year, training was provided on writing findings. This included a template for an approved structure when writing findings and citing evidence reviewed.

Comprehensive training for CPM reviewers for the 2007-2008 CPM cycle will be provided in September 2007, and again in January 2008.

Fiscal reviews are part of the CPM process at different levels. While CPM reviews are mostly program-oriented reviews, they also include an appropriate-use-of-program-funds review. Additionally, more in depth fiscal audits can be requested by individual programs as needed. [24]

Reference Number:	**2006-13-7**
Federal Program:	84.318
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Subrecipient Monitoring. The Department of Education (Education) has formal subrecipient monitoring procedures; however, they include very limited procedures over fiscal requirements. Documentation of the monitoring visit is evidenced by the *Enhancing Education Through Technology Site Visitation Form* (Form). There was no documented signoff of approval for the procedures performed and conclusion reached for the monitoring visit on the Form by someone other than the preparer. The program does not retain detail work paper documentation of the samples tested, interviews performed, etc., to support the conclusion reached. The monitoring visit exit correspondence indicates that the site visit was not an audit and that fiscal certification criteria would be assessed during the annual district audit or by appropriate oversight agencies, thus reliance is placed on A-133 subrecipient audits and any Federal Agency audits to ensure compliance with fiscal requirements. By not performing monitoring procedures over fiscal requirements, Education risks material noncompliance of subrecipients going undetected on a timely basis.
Status of Corrective Action:	Partially corrected. Education will explore incorporating audit procedures in the annual CPA school district audit guide to address this issue. The ETO will utilize their email listserv and annual Request for Applications (RFA) to distribute technical advice to LEAs. Finally the ETO will explore the possibility of performing additional monitoring in the 2007-08 fiscal year. While Education recognizes the importance of monitoring pass-through funding to the LEAs, with 1,000 awards, a comprehensive review is difficult to perform with limited resources. Education also plans to provide technical advice to the LEAs and auditors of those LEAs via e-mail and conference training.

Education continues to work with the California Technology Assistance Project (CTAP) regional assistance agencies to monitor, review and resolve funding issues, as CTAP is funded to assist Education in connecting with funded LEAs. [25]

Reference Number:	**2006-13-8**
Federal Program:	84.332
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Subrecipient Monitoring. The Department of Education (Education) does not have adequate controls to ensure that award information was properly identified to the Local Educational Agencies (LEAs). The *Grant Award Notification Form* did not contain any of the following: CFDA number, name of federal agency or CFR references for requirements imposed by laws, regulations or provisions. The Standard Account Code Structure program identification incorrectly identified the CFDA number for the Comprehensive School Reform Demonstration program funds. Education did not perform comprehensive monitoring of its subrecipients' activities to assess if they were in compliance with the laws, regulations and provisions of grant award agreements or if its performance goals were being achieved. Education did not perform any site visits or limited scope audits nor was the Comprehensive School Reform Demonstration program part of Education's consolidated program monitoring reviews performed on its subgrantees. Education did not require its subrecipients to provide annual programmatic reporting to assess if the subrecipients had met the goals and objectives. However, Education did require the submission of one annual financial expenditure report, which was reviewed before the final payment was made to the subrecipients.
Status of Corrective Action:	Fully corrected. [26]

Reference Number:	**2006-13-9**
Federal Program:	84.027; 84.173
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Subrecipient Monitoring. The Department of Education's (Education) Focused Monitoring and Technical Assistance

	Unit does not perform timely follow up on monitoring visit findings of noncompliance with program regulations. Without timely follow-up, the period of noncompliance for subrecipients may be extended causing noncompliance in subsequent grant periods.
Status of Corrective Action:	Fully corrected. [27]

Reference Number:	**2006-13-10**
Federal Program:	84.010; 84.011; 84.027; 84.173; 84.318; 84.332; 84.365; 84.367
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Subrecipient Monitoring. The Department of Education (Education) does not have adequate segregation of duties over the input and review of information entered into a database used to track subrecipient audit findings. In addition, no formal reports are generated from the database for review by Education management and the audit findings and their resolutions are not formally communicated to the respective Education program departments or the Consolidated Performance Monitoring Unit.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2006-14-3**
Federal Program:	84.010
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Special Tests and Provisions – Comparability. The Department of Education (Education) does not require Local Educational Agencies (LEAs) to supply supporting documentation for any revised or supplemental information submitted by the LEAs in response to Comparability Report calculations that do not meet mandated criteria. Education does not have procedures to assess the accuracy of data used in the comparability calculations.
Status of Corrective Action:	Fully corrected. [28]

Reference Number:	**2006-14-4**
Federal Program:	84.010

State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Special Tests and Provisions – Identifying Schools and Local Educational Agencies (LEAs) Needing Improvement. The Department of Education (Education) does not have proper controls in place to assess the accuracy and completeness of data compiled by its computer systems. Education uses two separate computer systems to process data used to assess compliance with program requirements. Neither system programs produce logs or other evidence of the results of the processing of records. No formal documented processes exist to evidence that this review is performed. Test results of changes to the computer systems implemented due to changes in the requirements to assess LEAs needing improvement are not retained and the system(s) do not generate logs or other material to confirm either valid or invalid data. No formal change review process exists for this process.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2006-14-5**
Federal Program:	84.011
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Special Tests and Provisions – Subgrant Process. The Department of Education (Education) does not have documented evidence of the review and approval performed by an Education official of data compiled by a subcontractor for the Migrant Education – State Grant Program. Without evidence of controls and monitoring performed over the subcontractor, Education risks that materially inaccurate data may be compiled and reported without being detected.
Status of Corrective Action:	Partially corrected. Education has strengthened its policies and procedures for the sub grant approval process by (1) requiring the vendor to provide summary reports by Region and (2) reviewing and validating regional summary reports used in calculating the sub grant reports. Education will develop a statewide on-going monitoring and re-interview process by December 30, 2007 and revise as needed when the USDE regulations are published. [29]

Reference Number:	**2006-1-1**
Federal Program:	93.778
State Administering Department:	Department of Health Services
Fiscal Year Initially Reported:	1996-97
Audit Finding:	Allowable Costs/Cost Principles. The Department of Health Care Services, formerly the Department of Health Services, does not have proper internal controls over its fee-for-services claims to ensure current wholesale prices are used and claims are supported.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2006-1-2**
Federal Program:	93.778
State Administering Department:	Department of Health Services
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Allowable Costs/Cost Principles. The Department of Health Care Services (Health Care Services), formerly the Department of Health Services, does not have proper internal control procedures to prevent, deter, and detect potential overpayments to providers and follow existing policies and procedures to ensure payments are made for allowable services and to eligible recipients.
Status of Corrective Action:	Partially corrected. Health Care Services has initiated and implemented several corrective action steps outlined in the 2006 Medi-Cal Payment Error Study (MPES) to strengthen the internal control procedures, prevent, deter, and detect potential overpayments to providers. Health Care Services increased the number of claims examined in the random claims review process focusing on provider type identified in the MPES as vulnerable providers, and also, increased the number of provider letters informing them of their billing practices. Monthly Medi-Cal Eligibility Quality Control (MEQC) reviews identifying error trends by category and county and target future focused reviews of selected counties examining specific problem areas are performed. Corrective action is taken for the counties, which failed to comply with eligibility requirements. Health Care Services has also partnered with other agencies and/or other parts of Health Care Services in the anti-fraud effort. In September 2007, Health Care Services will be conducting joint visits with the Medical Board and the Board of Pharmacy.

Currently an independent top-to-bottom evaluation of the Health Care Services' anti-fraud program is in the final stages of completion. This evaluation, ordered by the Governor, is to identify any gaps in Health Care Services efforts to protect the fiscal integrity of Medi-Cal and is intended to ensure that Health Care Services is taking every appropriate action to prevent Medi-Cal fraud and payment error. [30]

Reference Number:	**2006-1-4**
Federal Program:	93.778
State Administering Department:	Department of Health Services
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Activities Allowed. Business users (who do not have any system administration responsibilities) have full, unrestricted administrative access to the Centers for Medicare and Medicaid Services 64 (CMS-64) database. Administrative users have the ability to change data and disable any controls on the system, thereby removing traceability of the actions of the user.
Status of Corrective Action:	Remains uncorrected/disagree with finding. System Development Notice (SDN) 07006 was submitted to EDS to initiate changes needed to the CMS-64 system. The SDN has been staffed and work is underway. EDS anticipates completion, testing, and implementation of the new interface screens by December 31, 2007. [31]

Reference Number:	**2006-2-1**
Federal Program:	93.283
State Administering Department:	Department of Health Services
Fiscal Year Initially Reported:	2004-05
Audit Finding:	Allowable Costs/Cost Principles. The Department of Public Health (Public Health), formerly the Department of Health Services, did not ensure that employees who worked full-time on the Breast and Cervical Cancer Control Program consistently completed the required payroll certifications. Public Health also did not ensure that employees who worked full-time on Public Health Preparedness and Response for Bioterrorism Program consistently completed the required payroll certifications.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2006-3-2**
Federal Program:	93.283
State Administering Department:	Department of Health Services
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Cash Management. The Department of Public Health (Public Health), formerly the Department of Health Services, did not require subrecipients to return interest earned on advances from the Federally funded program. Subrecipients are notified that any interest earned on cash advances is to be used for purposes of the program only. Interest earned on program advances does not fall under the program income regulations unless specifically provided in the Federal awarding agency regulations or terms and conditions of the award.
Status of Corrective Action:	Remains uncorrected/disagree with finding. Public Health continues to disagree with the auditor's findings, as there has been no change in state/federal requirements on this issue. The audit findings refer to federal regulations applicable to these grants, but ignore threshold criteria applicable to financial administration of the grant. Specifically, federal regulations on financial administration of the grant require that states, "must expend and account for grant funds in accordance with state laws and procedures for expending and accounting for its own funds (42 CFR 92 20 (a))". Therefore, by federal rule, California is required to comply with its own laws applicable to this grant. Health & Safety Code Section 101317 (f) requires local health departments that receive these funds to deposit them in a special local public health preparedness trust fund established solely for local preparedness purposes before transferring or expending the funds for any of the allowed uses, and further states that interest accrued to the benefit of the fund shall be expended for the same purpose as other moneys in the fund. [32]

Reference Number:	**2006-3-11**
Federal Program:	93.283
State Administering Department:	Department of Health Services
Fiscal Year Initially Reported:	2004-05
Audit Finding:	Cash Management. The Department of Public Health (Public Health), formerly the Department of Health Services, does not have procedures in place to ensure that the Public Health Preparedness and Response to Bioterrorism program's subrecipients can demonstrate the

ability to minimize the time between receipt and disbursement of federal program funds.

Status of Corrective Action: Public Health continues to disagree with the auditor's findings, as there have been no changes in state or federal requirements related to these issues. The basis for Public Health's disagreement is: (1) Public Health is required by federal regulation to comply with state law, which expressly requires quarterly payments; (2) there is no guidance or criteria upon which to base a finding that a quarterly payment is inconsistent with the federal timely disbursement requirement; and (3) federal regulations provide for, contemplate, and acknowledge alternative methods of disbursing grant funds and circumstances under which a grantee would not be able to meet the requirement to minimize the time between receipt and disbursement of funds.

Public Health concludes that both the State and federal requirements for grant financial funding apply. Both contain timely administration of payment criteria, which are not inconsistent. State disbursement requirements are quarterly. Federal requirements must ensure a procedure to limit any time lags between receipt and disbursement of funds. It is unclear how a quarterly disbursement is inconsistent or noncompliant with a procedure that minimizes the time between receipt of grant funds and disbursements. Without specific criteria, there is nothing upon which to base a finding that these timeframes are inconsistent. Moreover, with the federal regulation requiring states administer grant funds in accordance with state requirements, doing anything other than quarterly disbursements (or whatever methodology required by state law) would violate this federal requirement. Assuming the state is disbursing funds in accordance with state law (including but not limited to H&S 101317), and has a procedure in place that minimizes the lapse in time between receipt and disbursement of grant funds, then it is reasonable to conclude that the grant funds are being administered in accordance with federal requirements. [33]

Reference Number: **2006-3-12**

Federal Program: 93.575; 93.596

State Administering Department: Department of Education

Fiscal Year Initially Reported: 2005-06

Audit Finding: Cash Management. The Department of Education does not follow up on outstanding payment requests timely. We noted Education requests cash advances from the federal government and then requests payments to be made to the Local Educational Agencies (LEAs) by the State Controller's Office (SCO).

Education has a control process in place to reconcile and follow up on a monthly basis any outstanding LEA payment requests submitted to the SCO from advanced federal funds that remain unpaid after 60 days. The practice of only following up on items after 60 days past due would not enable Education to determine whether or not it is in compliance with Federal requirements for minimizing the time elapsing between the request for advance from the Federal government and the payment being made to the subrecipient.

Without appropriately designed controls in place, Education risks payments not being made in accordance with Federal guidelines which could cause Education to be required to switch from the advance basis to a reimbursement basis from the awarding agency.

Status of Corrective Action: Fully corrected.

Reference Number: **2006-3-13**

Federal Program: 93.994

State Administering Department: Department of Health Services

Fiscal Year Initially Reported: 2005-06

Audit Finding: Cash Management. The Department of Public Health (Public Health), formerly the Department of Health Services, advanced funds on July 29, 2005 from the Maternal, Child, and Adolescent Health (MCAH) program to pay for services provided under the California Child Services Medical Therapy Program, which are not allowable under MCAH regulations. These cash advances were not paid to the MCAH program by the Medicaid Program until May 3, 2006. The MCAH regulations prohibit the use of the grant funds to pay for rehabilitation services to individuals under 16 years of age, if these services are available through the Medicaid Program. The approximately 9 months from when these cash advances were drawn down from the MCAH letter of credit in July 2005 until they were reimbursed by the Medicaid Program in May 2006 were not for the immediate cash needs of the MCAH program in accordance with cash management requirements.

Status of Corrective Action: Fully corrected.

Reference Number: **2006-3-14**

Federal Program: 93.575; 93.596

State Administering Department: Department of Education

Fiscal Year Initially Reported:	2005-06
Audit Finding:	Cash Management. The Department of Education's (Education) control processes over sub grant claim payments made to subrecipients could be improved. Education's control processes include a signed approval by the Division Director that is documented on a *Request for Payment of a Non-Formula Grant* (Form AO-401 rev.01/02). An approved authorized agent did not sign 11 of 50 *Request for Payment of a Non-Formula Grant* forms reviewed. Education has adopted an informal process where an Administrator I would sign his or her own name and add "for the director," however this practice is not authorized in the Education Administrative Manual. Claim Schedules are prepared by the Fiscal Services Division Accounting Office (Accounting Office) upon receipt of the approved *Request for Payment of a Non-Formula Grant* form. The Claim Schedule is then reviewed and approved by a supervisor. The original copy of the approved *Claims Schedule* is sent to the State Controller's Office to be paid, however a copy is not retained as evidence of the review and approval process for the claim. By not retaining the signed copy as evidence of review and approval, Education cannot demonstrate support for approvals for payments made to Local Educational Agencies and subrecipient contractors.
Status of Corrective Action:	Fully corrected. [34]

Reference Number:	**2006-5-1**
Federal Program:	93.778
State Administering Department:	Department of Health Services
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Eligibility. The Department of Health Care Services (Health Care Services), formerly the Department of Health Services, does not have proper internal controls to track and obtain the enrollment of presumptive eligibility ID numbers issued to prevent unauthorized use of ID numbers.
Status of Corrective Action:	Remains uncorrected/agree with finding. Although SB 24 (2002) recognizes the presumptive eligibility's (PE) technological limitations by creating a Prenatal Gateway to enroll pregnant women simultaneously in PE and Medi-Cal, it prevented any expenditure of state General Fund money on planning, designing or developing automated solutions to these issues. Currently, the four foundations including the California Healthcare Foundation are conducting a feasibility study to design a new and more advanced

system. The resources needed to complete automation design and development to implement a new system has not been estimated yet. California lawmakers should consider a policy change that would provide PE the funding necessary to establish modern tracking systems. This would be the first step in detecting and controlling fraud within the program. [35]

Reference Number:	**2006-5-2**
Federal Program:	93.778
State Administering Department:	Department of Health Services
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Eligibility. The Department of Health Care Services, formerly the Department of Health Services, does not have adequate internal controls over the Medicaid Eligibility Quality Control (MEQC) system to ensure recipients required eligibility re-determinations and notifications of deceased beneficiaries are processed timely.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2006-5-4**
Federal Program:	93.778
State Administering Department:	Department of Health Services
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Eligibility. The Department of Health Care Services (Health Care Services), formerly the Department of Health Services, performs limited follow up on errors noted through its focused reviews. While all errors are communicated to the counties once they have been encountered, Health Care Services only performs corrective action reviews on the focused reviews with less than 90% accuracy within 12 months of the initial review.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2006-7-8**
Federal Program:	93.994
State Administering Department:	Department of Health Service
Fiscal Year Initially Reported:	2005-06

Audit Finding:	Earmarking. Department of Public Health's, formerly the Department of Health Services, Maternal and Child Health Program (MCH) did not track the 30% spending requirement for (a) preventive and primary care for children or (b) children with special health care needs during the fiscal year ended June 30, 2006.
Status of Corrective Action:	Partially corrected. MCH is implementing a two part corrective action plan to fully respond to the audit finding and ensure there is complete documentation of California's expenditure of Title V funds in accordance with the "30-30" expenditure requirements. Part 1 of Corrective Action Plan: Identify Title V sub-recipient agreements that are entirely comprised of only one of the Title V components. Track expenditures for those agreements in accordance with 30-30 earmarking requirements. Estimated full implementation for Part 1: 10/1/07. Part 2 of Corrective Action Plan: Identify Title V sub-recipient agreements that are comprised of more than one of the three Title V components. In collaboration with the affected sub-recipients, develop and implement an expenditure tracking mechanism to fully track the two components required to be tracked by Title V requirements. Estimated full implementation for Part 2: 7/1/08. [36]

Reference Number:	**2006-8-2**
Federal Program:	93.268
State Administering Department:	Department of Health Services
Fiscal Year Initially Reported:	2004-05
Audit Finding:	Period of Availability. The Department of Public Health (Public Health), formerly the Department of Health Services, did not always have the appropriate controls in place to ensure that it charged the Immunization Grants program only for costs resulting from obligations incurred during the funding period.
Status of Corrective Action:	Partially corrected. Public Health communicated to staff the correct definition of encumbering funds. To ensure compliance with federal requirements, a monthly document is generated titled Status of Contracts. This document contains the name of each subrecipient, the funding award amount, contract term, and the status of the contract. Each subrecipient that does not have an executed contract is listed in bold to differentiate them from the remainder of the list. This document is monitored by contract staff and management staff to ensure that each contract is executed during the period of availability.

In addition, each subrecipient has been notified of the consequences of not returning signed contracts by the deadline. The first notification occurred by conference call. Each subrecipient was told they must return signed contracts by the July 1, 2006 deadline. In June 2006, a written communication was also disseminated to subrecipients providing them with a deadline for submission of signed contracts and explaining that noncompliance could result in loss of funding.

Despite these efforts three counties were unable to return their contracts by December 31, 2006 due to internal authorization processes. County immunization programs depend upon this funding to provide immunization services to the public in their jurisdiction. Due to the impact of removing funding, the immunization Branch processed the contracts.

As a result, contract monitoring has been improved. More frequent contacts will be made with counties who have not submitted their contracts by August 31, 2007. Monthly reminders will be sent to those counties and additional written communication will be sent in October 2007 to those who still have not returned their signed contracts, reminding them that they will lose funding if the contracts are not signed as soon as possible.

Reference Number:	**2006-8-3**
Federal Program:	93.575; 93.596
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Period of Availability. The Department of Education (Education) should enhance it current policies and procedures to ensure that payments made to subrecipient contractors are recorded in the corresponding Federal fiscal award year when the services are provided and any liquidations of obligations are made in a timelier manner. Education records subrecipient contract payments essentially on a cash basis into the program year (e.g., work phase) that is open at the time the payment request is submitted. If the contract payment relates to the prior year work phase but it has been closed, they record the encumbrance in the next year work phase that is open. This method of recording contract encumbrances increases the risk that material encumbrances would be recorded and thus reported in the improper period, which could also cause non-compliance with liquidation guidelines.
Status of Corrective Action:	Fully corrected. [37]

Reference Number:	**2006-8-4**
Federal Program:	93.575; 93.596
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Period of Availability. The Department of Education (Education) does not maintain support for adjusting journal entries that were recorded to transfer expenditures of funds between different grant award years. The journal entry approval process consists of a review of the totals of pools of funds that it believes meet the criteria to be transferred to a different fiscal year. Without unambiguous detailed support that identifies specific transactions to support that they were incurred during the proper period transferred, the reviewer cannot verify that transactions are being transferred between the appropriate grant award years.
Status of Corrective Action:	Fully corrected. [38]

Reference Number:	**2006-12-2**
Federal Program:	93.767
State Administering Department:	Department of Health Services
Fiscal Year Initially Reported:	2003-04
Audit Finding:	Reporting. The Department of Health Care Services (Health Care Services), formerly the Department of Health Services, does not ensure that amounts reported on its Quarterly Children's Health Insurance Program Statement of Expenditures for Title XXI CMS-21 report are classified correctly. Although the total amounts spent on the program reported by Health Care Services are accurate, we were unable to verify the accuracy of detailed expenditures reported by line item or category of service.
Status of Corrective Action:	Partially corrected. Health Care Services is actively working with a contractor to redesign the CMS-21 Accounting System to include the capability to accurately report all program expenditures by category of service. The new reporting requirements would ensure that Accounting receives the data in a format that will adequately identify the source and application of funds and allow reconciliation of program expenditures. This will be accomplished through System Development Notice (SDN) 07040. The target implementation date is December 2009. [39]

Reference Number:	**2006-12-3**
Federal Program:	93.575; 93.596
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Reporting. The Department of Education (Education) performs a manual process to compile the data that is reported on the U.S. Department of Health and Human Services Administration for Children and Families Child Care and Development Fund ACF-696 Financial Report. One error in the computation was noted and there was one instance where Education did not maintain supporting documentation for a number reported. By not maintaining supporting documentation for required reporting, Education is not in compliance with Federal reporting requirements.
Status of Corrective Action:	Fully corrected. [40]

Reference Number:	**2006-12-4**
Federal Program:	93.778
State Administering Department:	Department of Health Services
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Reporting. The federal expenditures noted in the Quarterly Statement of Expenditures for the Medical Assistance Program CMS-64 reports are not traceable to individual claims.
Status of Corrective Action:	Remains uncorrected/agree with finding. The system changes needed for the CMS-64 Accounting System will be accomplished through a System Development Notice (SDN) that will be submitted to the Medi-Cal Fiscal Intermediary. The requirements gathering phase for the SDN (SDN 07018) will be completed by September 30, 2007. Electronic Data Systems (EDS) will receive this SDN in October of 2007 to begin the redesign of the CMS-64 Accounting System. The expected implementation date is January 2009. [41]

Reference Number:	**2006-13-12**
Federal Program:	93.917
State Administering Department:	Department of Health Services
Fiscal Year Initially Reported:	2002-03

Audit Finding:	Subrecipient Monitoring. The Department of Public Health (Public Health), formerly the Department of Health Services, does not ensure that all subrecipients comply with Federal A-133 single audit requirement. Public Health was unable to locate the A-133 audit report for one of four community-based organizations (CBOs) selected for testing the Care Services Program. We also found that one of the 15 CBOs from the Case Management Program had not submitted their A-133 report.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2006-13-13**
Federal Program:	93.268
State Administering Department:	Department of Health Services
Fiscal Year Initially Reported:	2004-05
Audit Finding:	Subrecipient Monitoring. The Department of Public Health (Public Health), formerly the Department of Health Services, does not have adequate controls in place to identify and obtain A-133 reports from subrecipients expending $500,000 or more in federal funds. Without an effective system to identify subrecipients required to have audits and to track the timely receipt of these required audit reports, Public Health has reduced assurance that its subrecipients are spending federal assistance according to applicable laws and regulations.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2006-13-14**
Federal Program:	93.575; 93.596
State Administering Department:	Department of Education
Fiscal Year Initially Reported:	2003-04
Audit Finding:	Subrecipient Monitoring. The Department of Education (Education) does not have adequate controls over its subrecipient monitoring. Documentation of the monitoring visit performed by the Consolidated Program Monitoring (CPM) unit is evidenced by the Cross-Program Instrument (CP). However, the CPM does not retain detail work paper documentation of the samples tested, interviews performed, etc., to support the conclusions reached. The monitoring procedures contained limited fiscal

procedures and should be enhanced to cover all major functions and activities of the program.

There was no documented signoff of approval for the procedures performed and conclusions reached for the monitoring visit on the CP by someone other than the preparer.

Education did not follow up timely on audit findings reported for non-Local Educational Agency (LEA) contractors.

By not maintaining adequate documentation of the procedures performed or ensuring that appropriate reviews and approvals are performed, Education is not able to adequately support conclusions reached during its monitoring visits. Timely follow-up of findings decreases the risk that those findings will be repeated in future years.

Status of Corrective Action:

Partially corrected. Education strengthened its policies and procedures over subrecipient monitoring with improved documentation retention that supports its conclusions made. Consultants now retain the working papers to produce the Summary of Findings. Education ensures that identical child development records are retained for LEA and non-LEA reviews and is developing standardized report forms for reviews using Environmental Rating Scales.

A permanent database to track agency responses to audit findings and Education's follow up activities is expected to be operational during FY 2007-08.

Agencies found to be non-compliant receive extensive technical assistance, including further onsite, hands-on training. Education conducts subsequent follow-up reviews to determine if LEAs have successfully implemented the corrective actions.

Education will explore incorporating a system of secondary reviews in the categorical monitoring review of non-LEA contractors. [42]

Reference Number: **2006-13-15**

Federal Program: 93.575; 93.596

State Administering Department: Department of Education

Fiscal Year Initially Reported: 2005-06

Audit Finding: Subrecipient Monitoring. The Department of Education (Education) does not appear to have adequate segregation of duties or an independent review process over the input and review of information entered into a database used to

track subrecipients' A-133 audit findings. In addition, the database does not generate a formal report that summarizes the status of Local Educational Agencies' audit findings that require Education management decisions. The audit findings and their resolutions are not formally communicated to the respective Education program departments or the Consolidated Performance Monitoring Unit.

Status of Corrective Action: Fully corrected.

Reference Number: **2006-14-1**

Federal Program: 93.777

State Administering Department: Department of Health Services

Fiscal Year Initially Reported: 1997-98

Audit Finding: Special Tests and Provisions, Provider Eligibility. The Department of Health Care Services (Health Care Services), formerly the Department of Health Services, does not always have the required provider agreements, disclosures, and certifications on file.

Status of Corrective Action: Partially corrected. As part of Health Care Services' re-enrollment plan, all Medi-Cal providers will continue to be re-enrolled, on a continuous process, to verify and update their original enrollment information and to ensure compliance with current state and federal regulations. The Provider Enrollment Division (formerly Provider Enrollment Branch) continues to work in conjunction with Audits and Investigations to re-enroll providers identified as high risk using an on-going risk assessment analysis and the annual Medi-Cal Payment Error Study (MPES) to prioritize these providers for re-enrollment. Health Care Services completed the re-enrollment process of 540 Optometrists in Los Angeles County and currently continues to re-enroll physician groups.

Licensing and Certification (L&C), now part of the California Department of Public Health, has completed the review of the current long-term care provider agreements in relation to the provisions of the Medi-Cal Provider Agreement (DHS 6208). The L&C will now be completing the legal review process and will also be partnering with the California Department of Health Care Services (the Single State Medicaid Agency) in finalizing the Medi-Cal provider agreements that will be consistently applicable to all health facilities statewide. [43]

Reference Number: **2006-7-3**

Federal Program: 97.004

State Administering Department:	Governor's Office of Homeland Security & Governor's Office of Emergency Services
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Earmarking. The Governor's Office of Homeland Security and Emergency Services did not adequately monitor the level of administrative expenditures of funds for the State Domestic Preparedness Equipment Support Program for the fiscal year ended June 30, 2006 and the grant exceeded its earmarking limit by approximately $7.6 million.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2006-9-1**
Federal Program:	97.039
State Administering Department:	Governor's Office of Emergency Services
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Procurement, Suspension, and Debarment. The Hazard Mitigation Grant Program (HMGP) utilizes a Project Application for Federal Assistance Form (Form 89) which was revised in January 2005. The HMGP did not require 18 of the 30 subrecipients that received grant awards prior to January 2005 to complete an updated Form 89. The prior noncompliant Form 89 was carried forward into the subrecipients' new projects.
Status of Corrective Action:	Fully corrected. [44]

Reference Number:	**2006-12-1**
Federal Program:	97.036; 97.039
State Administering Department:	Governor's Office of Emergency Services
Fiscal Year Initially Reported:	1999-2000
Audit Finding:	Reporting. The Governor's Office of Emergency Services (Emergency Services) is required to report total recipient and subrecipient nonfederal expenditures and administrative expenses on quarterly Federal Status Reports (FSR-). In our sample of FSR's selected for the Hazard Mitigation Grant Program, we noted four of the 18 did not contain all the required expenditure information. We also noted in our sample of FSR's selected for the Public Assistance Grants Program, one of the 23 did not report recipient share of outlays. In addition, none of the FSR

samples selected reported subrecipient nonfederal expenditures and administrative expenses.

Status of Corrective Action: Partially corrected – Public Assistance 97.036 Emergency Services is currently reviewing the internal grant tracking system information for the subrecipient non-federal share for Public Assistance. It is much more complex due to the cost share variances not only between disasters, but down to individual project levels.

Emergency Services disagrees with the portion of the finding referencing FEMA-3248-EM; 2005 for Public Assistance. This is a 100% federally declared event and there is no required cost share for the recipient or sub-recipient.

Fully corrected – Hazard Mitigation 97.039

Reference Number: **2006-13-3**

Federal Program: 97.036; 97.039

State Administering Department: Governor's Office of Emergency Services

Fiscal Year Initially Reported: 2001-02

Audit Finding: Subrecipient Monitoring. The Governor's Office of Emergency Services (Emergency Services) did not adequately monitor its subrecipients of funds for the Public Assistance or Hazard Mitigation Grant Program for the fiscal year ending June 30, 2006. Emergency Services has not reviewed an estimated combined 1,575 audit reports submitted by subrecipients dating back to 2002 and does not have processes or controls in place to accurately track whether subrecipients' audit reports have been submitted or reviewed.

Status of Corrective Action: Partially corrected. This Single Audit finding was issued based on a significant backlog of A-133 Audit reviews. Emergency Services' proposed corrective action was to hire an Audit Coordinator and eliminate the backlog by June 30, 2007. Unfortunately, this position was redirected to other Emergency Services priorities to avoid financial penalties to the State of California as the result of new legislation. However, the backlog has been dramatically reduced (less than 50 reports are currently outstanding), and we expect the backlog will be completely eliminated by no later than October 1, 2007. [45]

Reference Number: **2006-13-17**

Federal Program: 66.458

State Administering Department: State Water Resources Control Board

Fiscal Year Initially Reported:	2005-06
Audit Finding:	Subrecipient Monitoring. Subrecipients were not notified of all required federal award information pertaining to the federal award. Additionally, single audits were not completed or not properly completed by certain subrecipients in accordance with the OMB Circular A-133.
Status of Corrective Action:	Fully corrected.

Endnotes—Auditor Comments

[1] Please refer to reference number 2007-12-15 for additional information.

[2] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-7-9.

[3] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-13-6.

[4] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-14-4.

[5] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-2-5.

[6] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-3-3.

[7] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-14-6.

[8] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-13-11.

[9] Education reports this finding as fully corrected because it did not receive any new federal funding for this program during fiscal year 2006–07. However, KPMG found that Education did not make any procedural changes to address the finding.

[10] Education reports this finding as fully corrected because it did not receive any new federal funding for this program during fiscal year 2006–07. However, KPMG found that Education did not make any procedural changes to address the finding.

[11] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-3-7.

[12] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-3-7.

[13] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-3-7.

[14] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-3-8.

[15] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-5-1.

[16] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-7-12.

[17] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-7-14.

[18] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference numbers 2007-8-6 and 2007-8-7.

[19] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-12-21.

[20] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-12-20.

[21] Education reports this finding as fully corrected because it did not receive any new federal funding for this program during fiscal year 2006–07. However, KPMG found that Education did not make any procedural changes to address the finding.

[22] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-13-12.

[23] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-13-18.

[24] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-13-13.

[25] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-13-17.

[26] Education reports this finding as fully corrected because it did not receive any new federal funding for this program during fiscal year 2006–07. However, KPMG found that Education did not make any procedural changes to address the finding.

[27] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-13-14.

[28] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-14-8.

[29] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-14-10.

[30] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-2-10.

[31] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-1-11.

[32] This finding is no longer valid. KPMG determined that the advances this federal program receives are not subject to interest liability.

[33] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-3-12.

[34] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-3-14.

[35] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-5-6.

[36] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-7-14.

[37] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-8-10.

[38] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-8-9.

[39] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-12-23.

[40] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-12-24.

[41] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-12-25.

[42] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-13-19.

[43] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-14-2.

[44] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-9-5.

[45] We reported a similar finding in our audit of fiscal year 2006–07. Please refer to reference number 2007-13-23.

We conducted this audit to comply with Section 8546.3 of the California Government Code. The Independent Auditor's Report provides the opinions we expressed on the State of California's internal control and on compliance and other matters.

Respectfully submitted,

ELAINE M. HOWLE
State Auditor

Date: June 26, 2008

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For questions regarding the contents of this report, please contact Margarita Fernández, Chief of Public Affairs, at (916) 445-0255.

DEPARTMENT OF FINANCE
OFFICE OF THE DIRECTOR

ARNOLD SCHWARZENEGGER, GOVERNOR
STATE CAPITOL ■ ROOM 1145 ■ SACRAMENTO CA ■ 95814-4998 ■ WWW.DOF.CA.GOV

June 6, 2008

Ms. Elaine M. Howle, State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Dear Ms. Howle:

Thank you for the opportunity to respond to the internal control and state and federal compliance audit report for the fiscal year ended June 30, 2007. This report was the result of your examination of the state's general purpose financial statements and administration of federal programs for the fiscal year ended June 30, 2007, and will be part of the Single Audit Report covering this period. We accept the reported findings and recommendations and recognize that compliance findings resulted in 28 qualified, 1 adverse, and 1 disclaimer opinion for the 43 major programs. We also recognize that there are areas where internal controls and administration of federal awards needs to be improved.

California provides its citizens with numerous state and federal programs and activities and is much more complex and vast than most economic entities in the world. Moreover, such operations must exist within a system of internal and administrative control that safeguards assets and resources and produces reliable financial information. Attaining these objectives and overseeing the financial and business practices of the state continues to be an important part of the Department of Finance's (Finance) leadership.

In meeting our responsibility for financial leadership and oversight, Finance provides internal audit related education and training to departments as well as oversight of departmental internal audit units by issuing audit guidelines and conducting quality assurance reviews. Further, we have an ongoing process of issuing audit memos to departments that establish statewide policy and provide technical advice on various audit related issues. An audit memo concerning the results of the fiscal year 2006-07 Single Audit will be issued to remind all departments of the new internal auditing standards and processes included in the Omnibus Audit Accountability Act of 2006.

The head of each state department is responsible for establishing and maintaining a system of internal accounting and administrative control within their department. This responsibility includes documenting the system, communicating system requirements to employees, and assuring that the system is functioning as prescribed and is modified for changing conditions.

Moreover, all levels of state management must be involved in assessing and strengthening their systems of internal accounting and administrative controls to minimize fraud, errors, abuse, and waste of government funds. In 2006 the state implemented changes to the Financial Integrity and State Manager's Accountability Act (FISMA) reporting requirements. As a result, each agency must conduct an internal review of its controls and prepare a report of the findings. A certification letter alone does not meet the FISMA requirements. Finance will continue to provide education and guidance to assist agencies in meeting the FISMA requirements. The state is committed to sound and effective fiscal oversight.

Individual departments have separately responded to the report's findings and recommendations. Accordingly, their viewpoints and corrective action plans are included in the report. We will monitor the findings and reported corrective actions to identify potential changes in statewide fiscal procedures.

Finance is committed to ensuring the proper financial operations and business practices of the state, as well as ensuring that internal controls exist for the safeguarding and effective use of assets and resources. We will take the single audit findings into consideration during the performance of audit work in those departments that received a qualified or adverse opinion on a major program.

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

Sincerely,

Original signed by:

MICHAEL C. GENEST
Director