State of California:

Financial Report
Year Ended June 30, 2008

March 2009 Report 2008-001

CALIFORNIA
STATE AUDITOR

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Elaine M. Howle
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CALIFORNIA STATE AUDITOR

Bureau of State Audits

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March 24, 2009 2008-001

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

Dear Governor and Legislative Leaders:

The Bureau of State Audits presents its Independent Auditor's Report on the State of California's basic financial statements for the year ended June 30, 2008. These financial statements are presented on a basis in conformity with general accepted accounting principles (GAAP). The financial statements show that the State's General Fund had revenues and other financing sources that were approximately $2.3 billion less than expenditures and other financing uses. The General Fund ended the fiscal year with a fund deficit of approximately $4.2 billion. The GAAP basis government-wide statements include all liabilities owed by the State while the budgetary basis statements used to report on the State's budget do not reflect all liabilities.

We conducted the audit to comply with the California Government Code 8546.4.

Respectfully submitted,

Elaine M. Howle

ELAINE M. HOWLE, CPA
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, 2008, 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 86 percent, 53 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 90 percent, 81 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 91 percent, 93 percent, and 12 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, 2008, 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

February 25, 2009

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, 2008. 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 weakening of the State's economy had a significant impact on state revenues in the 2007-08 fiscal year. General revenues rose by only 1.0%, the smallest increase since 2001, primarily in personal income, corporate, and sales tax revenues. However, expenses for the State's governmental activities grew by 8.2%—one of the highest rates of growth since 2001—resulting in a decrease in governmental activities' net assets. Total expenses for the State's business-type activities also exceeded revenues for the year, primarily because unemployment benefits exceeded employers' contributions. The net assets for the 2007-08 fiscal year for both governmental and business-type activities decreased by 25.3% from last year.

Net Assets — The primary government's net assets as of June 30, 2008, were $35.0 billion. After the total net assets are reduced by $84.3 billion for investment in capital assets (net of related debt) and by $17.0 billion for restricted net assets, the resulting unrestricted net assets totaled a negative $66.3 billion. Restricted net assets are dedicated for specified uses and are not available to fund current activities. Almost two-thirds of the negative $66.3 billion consists of $40.1 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 $11.9 billion (25.3%) during the year ended June 30, 2008. Net assets of governmental activities decreased by $10.3 billion (29.2%), while net assets of business-type activities decreased by $1.6 billion (13.6%).

Fund Highlights

Governmental Funds — As of June 30, 2008, the primary government's governmental funds reported a combined ending fund balance of $12.7 billion, a decrease of $5.3 billion from the previous fiscal year. After the total fund balance is reduced by $21.6 billion in reserves, the unreserved fund balance totaled a negative $8.9 billion.

Proprietary Funds — As of June 30, 2008, the primary government's proprietary funds reported combined ending net assets of $10.3 billion, a decrease of $1.5 billion from the previous fiscal year. After the total net assets are reduced by $218 million for investment in capital assets (net of related debt) and expendable restrictions of $6.9 billion, the unrestricted net assets totaled $3.2 billion.

Noncurrent Assets and Liabilities

As of June 30, 2008, the primary government's noncurrent assets totaled $127.7 billion, of which $102.2 billion is related to capital assets. State highway infrastructure assets of $58.5 billion represent the largest portion of the State's capital assets.

The primary government's noncurrent liabilities totaled $107.1 billion, which consists of $55.5 billion in general obligation bonds, $29.6 billion in revenue bonds, and $22.0 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 94250-5872.

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 for 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 and other postemployment benefit 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 activities.

Government-wide Financial Analysis

Net Assets

The primary government's combined net assets (governmental and business-type activities) decreased 25.3%, from $46.8 billion as restated at June 30, 2007, to $35.0 billion a year later.

The primary government's $84.3 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 $17.0 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, 2008, governmental activities showed an unrestricted net assets deficit of $69.3 billion and business-type activities showed unrestricted net assets of $3.0 billion.

A large portion of the negative unrestricted net assets of governmental activities comprises $40.1 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, 2007 and 2008
(amounts in millions)

	Governmental Activities		Business-type Activities		Total	
	2008	2007*	2008	2007*	2008	2007*
ASSETS						
Current and other assets	$ 48,376	$ 51,048	$ 32,207	$ 34,234	$ 80,583	$ 85,282
Capital assets	95,360	91,818	6,841	6,267	102,201	98,085
Total assets	**143,736**	**142,866**	**39,048**	**40,501**	**182,784**	**183,367**
LIABILITIES						
Noncurrent liabilities	81,475	72,970	25,642	25,849	107,117	98,819
Other liabilities	37,204	34,519	3,494	3,438	40,698	37,957
Total liabilities	**118,679**	**107,489**	**29,136**	**29,287**	**147,815**	**136,776**
NET ASSETS						
Investment in capital assets net of related debt	84,255	81,353	50	208	84,305	81,561
Restricted	10,149	10,543	6,853	8,575	17,002	19,118
Unrestricted	(69,347)	(56,519)	3,009	2,431	(66,338)	(54,088)
Total net assets	**$ 25,057**	**$ 35,377**	**$ 9,912**	**$ 11,214**	**$ 34,969**	**$ 46,591**

* Not restated

Changes in Net Assets

The expenses of the primary government totaled $209.4 billion for the year ended June 30, 2008. Of this amount, $87.4 billion (41.7%) was funded with program revenues (charges for services or program-specific grants and contributions), leaving $122.0 billion to be funded with general revenues (mainly taxes). The primary government's general revenues of $110.1 billion were less than the unfunded expenses. As a result, the total net assets decreased by $11.9 billion, or 25.3%.

Of the total decrease, net assets for governmental activities decreased by $10.3 billion, while those for business-type activities decreased by $1.6 billion. The decrease in governmental activities is primarily due to increased spending for health and human services, education, 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, 2007 and 2008
(amounts in millions)

	Governmental Activities		Business-type Activities		Total	
	2008	2007	2008	2007	2008	2007
REVENUES						
Program revenues:						
Charges for services	$ 20,296	$ 18,822	$ 19,828	$ 20,614	$ 40,124	$ 39,436
Operating grants and contributions	45,850	43,440	—	—	45,850	43,440
Capital grants and contributions	1,207	1,165	189	183	1,396	1,348
General revenues:						
Taxes	109,205	108,016	—	—	109,205	108,016
Investment and interest	639	730	—	—	639	730
Miscellaneous	282	334	—	—	282	334
Total revenues	**177,479**	**172,507**	**20,017**	**20,797**	**197,496**	**193,304**
EXPENSES						
Program expenses:						
General government	12,230	13,314	—	—	12,230	13,314
Education	65,130	61,542	—	—	65,130	61,542
Health and human services	74,310	69,980	—	—	74,310	69,980
Resources	6,333	5,317	—	—	6,333	5,317
State and consumer services	1,129	1,215	—	—	1,129	1,215
Business and transportation	13,068	9,763	—	—	13,068	9,763
Correctional programs	10,504	8,945	—	—	10,504	8,945
Tax relief	957	948	—	—	957	948
Interest on long-term debt	4,185	2,596	—	—	4,185	2,596
Electric Power	—	—	5,362	5,865	5,362	5,865
Water Resources	—	—	1,009	952	1,009	952
Public Building Construction	—	—	372	335	372	335
State Lottery	—	—	3,173	3,471	3,173	3,471
Unemployment Programs	—	—	10,623	9,136	10,623	9,136
Nonmajor enterprise	—	—	984	1,148	984	1,148
Total expenses	**187,846**	**173,620**	**21,523**	**20,907**	**209,369**	**194,527**
Excess (deficiency) before transfers	**(10,367)**	**(1,113)**	**(1,506)**	**(110)**	**(11,873)**	**(1,223)**
Transfers	55	30	(55)	(30)	—	—
Change in net assets	(10,312)	(1,083)	(1,561)	(140)	(11,873)	(1,223)
Net assets, beginning of year (restated)	**35,369**	**36,460**	**11,473**	**11,354**	**46,842**	**47,814**
Net assets, end of year	**$ 25,057**	**$ 35,377**	**$ 9,912**	**$ 11,214**	**$ 34,969**	**$ 46,591**

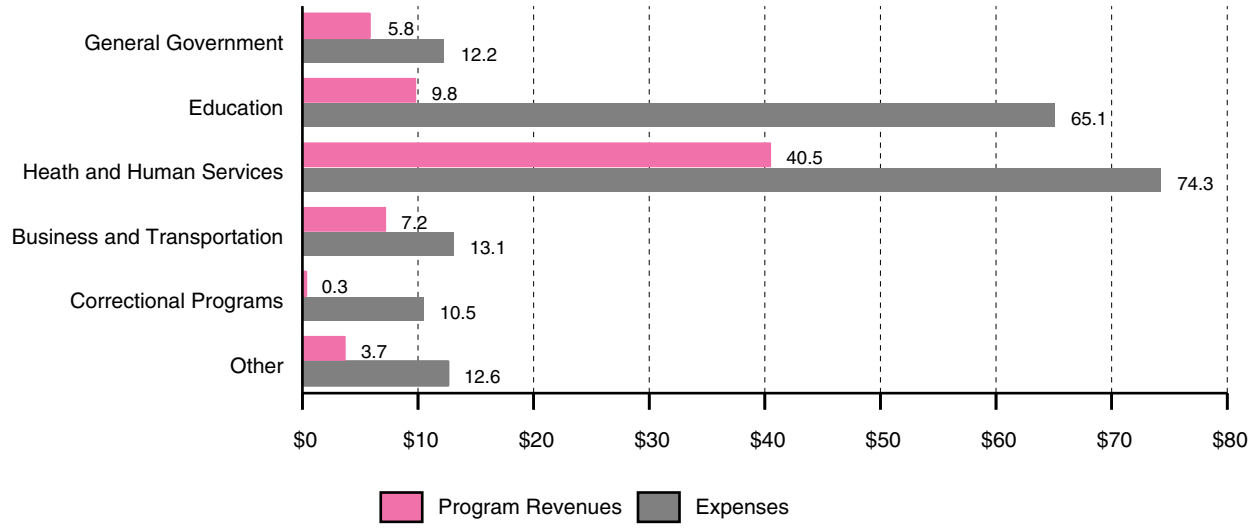
Governmental Activities

Governmental activities expenses totaled $187.8 billion. Program revenues, including $47.0 billion received in federal grants, funded $67.3 billion (35.8%) of that amount, leaving $120.5 billion to be funded with general revenues (mainly taxes). However, general revenues and transfers for governmental activities totaled only $110.2 billion, so governmental activities' total net assets decreased by $10.3 billion, or 29.2%, during the year ended June 30, 2008. 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, 2008
(amounts in billions)



For the year ended June 30, 2008, total state tax revenues collected for governmental activities increased by only 1.1% over the prior year, resulting in the weakest growth rate since the recession of 2001. Personal income and insurance taxes increased, but were offset by decreases in sales and use, corporation, and other taxes. The largest increase occurred in personal income taxes.

Overall expenses for governmental activities increased by $14.2 billion (8.2%) over the prior year. The largest increases in expenses were a $4.3 billion increase in health and human services spending, a $3.6 billion increase in education spending, and a $3.3 billion increase in business and transportation spending. The increase in health and human services spending was mainly due to increased services provided by the Medical Assistance program and other public health programs, most of which are funded through federal grants. The increase in education spending was primarily due to cost of living adjustments, increased funding for child care, and increased funding for enrollment growth in higher education. The increase in business and transportation expenses was the result of increased capital outlay and local assistance spending for transportation projects funded from bonds authorized by Proposition 1B, passed by voters in November 2006.

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, 2008
(as a percent)

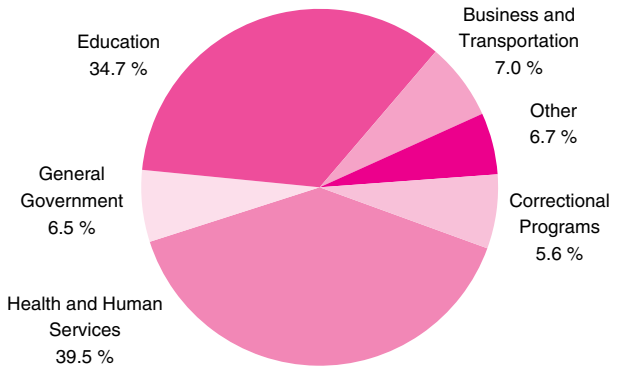
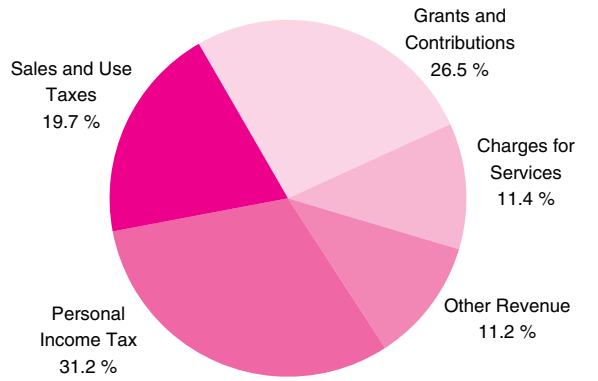


Chart 3

Revenues by Source
Year ended June 30, 2008
(as a percent)



Business-type Activities

Business-type activities expenses and transfers totaled $21.6 billion. The program revenues of $20.0 billion, primarily generated from charges for services, were not sufficient to cover these expenses. Consequently, business-type activities' total net assets decreased by $1.6 billion, or 13.6%, during the year ended June 30, 2008. Most of the decrease was due to a $1.8 billion 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, 2007 and 2008
(amounts in billions)

Fund Financial Analysis

The State's weakening economy had the greatest effect on 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, it was the lowest increase the State has experienced since 2001. The expenditures of the governmental funds increased at a much higher rate than revenues. Most of the proprietary funds had revenues that exceeded their expenses for the year ended June 30, 2008. However, the total net assets of proprietary funds decreased because the Unemployment Programs Fund incurred a higher increase in benefit payments caused by California's rising unemployment.

Governmental Funds

The governmental funds' Balance Sheet reported $52.0 billion in assets, $39.3 billion in liabilities, and $12.7 billion in fund balance as of June 30, 2008. The largest change in account balances was a $5.2 billion decrease in cash and pooled investments. The State's budget shortfall, weakening revenues, increasing expenditures, and limited access to the credit markets caused it to significantly deplete its cash reserves. Within the total fund balance, $21.6 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 ($7.6 billion), noncurrent interfund receivables and loans receivable ($5.0 billion), continuing appropriations ($8.1 billion), and debt service ($899 million). The unreserved balance of the governmental funds is a negative $8.9 billion.

The Statement of Revenues, Expenditures, and Changes in Fund Balances of the governmental funds shows $177.3 billion in revenues, $197.4 billion in expenditures, and a net $14.8 billion in receipts from other financing sources. The ending fund balance of the governmental funds for the year ended June 30, 2008, was $12.7 billion, a $5.3 billion decrease over the previous year's restated ending fund balance of $18.0 billion. Personal income taxes, which account for 50.6% of tax revenues and 31.1% of total governmental fund revenues, increased by $1.9 billion over the previous fiscal year. The slowing of California's economy and the housing market downturn have taken a toll on real estate-related profits and capital gains. Payroll withholding provided most of the increase in personal income tax revenue; but with the loss of more than 22,000 jobs in the second quarter of 2008 and declining investment and capital gain revenues, this increase was significantly smaller than increases in the previous four years and the smallest increase since the recession of 2001. Sales and use taxes, which account for 31.9% of tax revenues and 19.6% of total governmental fund revenues, decreased by $687 million. The State's taxable sales have been negatively impacted by the decline in California's real estate market and its effect on sales of building materials, home furnishings, and related household items. Higher gasoline prices had a negative impact on consumer spending on vehicles.

The State's major governmental funds are the General Fund, the Federal Fund, and the Transportation Fund. The General Fund ended the fiscal year with a fund deficit of $4.2 billion. The Federal Fund and the Transportation Fund ended the fiscal year with fund balances of $43 million and $5.4 billion, respectively. The nonmajor governmental funds ended the year with a total fund balance of $11.4 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 $14.2 billion, liabilities of $18.4 billion, and fund balance reserves of $2.1 billion, leaving the General Fund with an unreserved fund deficit of $6.3 billion. The largest change in asset accounts was in cash and pooled investments, which decreased from $6.0 billion to $1.8 billion; cash reserves were used for current-year expenditures, as revenue collections were so far below expectations.

The largest change in liability account balances was a decrease in interfund payables (from $3.4 billion to $2.2 billion). The decrease in interfund payables is attributable to a change in accounting for the liability for unclaimed property. Rather than reporting the liability as an interfund payable to the Unclaimed Property Fund, the General Fund is now reporting this liability to the depositors in the unclaimed property liability account.

As shown on the Statement of Revenues, Expenditures, and Changes in Fund Balances of the governmental funds, the General Fund had $97.8 billion in revenues, $99.0 billion in expenditures, and a net $1.1 billion disbursement from other financing sources (uses) for the year ended June 30, 2008. The largest source of General Fund revenue was $94.7 billion in taxes, comprised primarily of personal income taxes ($54.2 billion) and sales and use taxes ($26.6 billion).

Total General Fund tax revenues increased by $1.0 billion, or 1.1%, resulting in the lowest tax revenue growth rate since 2001. Revenues from personal income and insurance taxes increased, but were offset by decreases in sales and use, corporation, and other taxes. The largest increase in revenues came from personal income taxes, which increased by $1.9 billion (3.6%). Sales and use taxes decreased by $804 million (2.9%), to $26.6 billion.

General Fund expenditures increased by $2.8 billion, to $99.0 billion. The programs with the largest increases were education, which increased by $1.8 billion, to $51.1 billion, and correctional programs, which increased by $884 million, to $9.7 billion. The General Fund's ending fund balance (including reserves) for the year ended June 30, 2008, was a negative $4.2 billion, a decrease of $2.3 billion over the previous year's ending fund balance of negative $1.9 billion. The increase in education expenditures consists mainly of cost-of-living adjustments, increased funding for child care, and increased funding for enrollment growth in higher education. The increased expenditures in correctional programs was mainly for inmate medical services, in order to comply with recent court orders and implementation of new parole programs to reduce recidivism.

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 $34.9 billion (76.0%) of the total $46.0 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—$6.4 billion (13.9%)—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 $5 million increase in fund balance from the prior year.

Transportation Fund: This fund accounts for fuel taxes, bond proceeds, and other revenues used primarily for highway and passenger rail construction. Expenditures increased by 70.5%, while revenues increased by 51.9% from the prior year. The increase in revenues and expenditures is the result of combining the Transportation Safety Fund and certain other nonmajor governmental funds with the Transportation Construction Fund into the newly named Transportation Fund. Fund expenditures of $12.4 billion exceeded revenues by $4.2 billion; however, there were receipts of $2.8 billion in other financing sources, so the fund balance decreased by only $1.3 billion over the previous year's restated fund balance.

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. However, the dramatic increase in California's unemployment rate had an equally dramatic effect on the Unemployment Programs Fund net assets, which decreased by $1.8 billion.

As shown on the Statement of Net Assets of the proprietary funds, total assets of the enterprise funds were $39.5 billion as of June 30, 2008. Of this amount, current assets totaled $11.6 billion and noncurrent assets totaled $27.9 billion. The largest change in asset account balances was a $1.2 billion decrease in cash and pooled investments, mainly in the Unemployment Programs Fund. The total liabilities of the enterprise funds were $29.5 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 small.

Total net assets of the enterprise funds were $9.9 billion as of June 30, 2008. Total net assets consisted of three segments: expendable restricted net assets of $6.9 billion, investment in capital assets (net of related debt) of $50 million, and unrestricted net assets of $3.0 billion. The Unemployment Programs Fund had the largest net assets, with $3.8 billion (38.6% of the enterprise funds' total net assets). The expendable restricted net assets of the Unemployment Programs Fund decreased by $1.8 billion.

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 $18.3 billion, operating expenses of $19.1 billion, and net disbursements from other transactions of $809 million. The largest sources of operating revenue were unemployment and disability insurance receipts of $8.5 billion in the Unemployment Programs Fund and power sales of $4.3 billion collected by the Electric Power Fund. The largest operating expenses were distributions to beneficiaries of $10.4 billion by the Unemployment Programs Fund and power purchases (net of recoverable costs) of $4.3 billion by the Electric Power Fund. The ending net assets of the enterprise funds for the year ended June 30, 2008, were $9.9 billion, or $1.6 billion less than the previous year's restated ending fund balance of $11.5 billion.

The large decrease in the cash and pooled investments account and the net assets of the Unemployment Programs Fund were the result of the fund's reserves being used to cover the increased demand for unemployment benefits. Several years ago, a legislative change nearly doubled the maximum unemployment weekly benefit, but there was no corresponding increase to the tax rate schedule or the taxable wage base that would have generated additional revenue to cover the increased benefit. This imbalanced financing structure caused a brief insolvency in the Unemployment Programs Fund in 2004, but as the economy improved and unemployment decreased, the fund was able to build a modest reserve. However, as unemployment began to dramatically increase during the 2007-08 fiscal year, the fund's unemployment insurance receipts for the year once again fell short of the amount needed to pay the current-year unemployment benefits.

Since June 30, 2008, the condition of the Unemployment Programs Fund deteriorated more quickly than anticipated, as California's unemployment rate rose to 10.1% in January 2009, and the State had to obtain a federal loan to cover the deficit projected for the first quarter of 2009. The State anticipates requesting another loan to cover the second quarter of 2009. It is estimated that proposed changes to the financing structure, including increases to the tax rates and the taxable wage base, will restore solvency to the fund by the end of 2010.

Internal Service Funds: Total net assets of the internal service funds were $419 million as of June 30, 2008. These net assets consist of two segments: investment in capital assets (net of related debt) of $169 million and unrestricted net assets of $250 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 $3.1 billion. The pension and other employee benefit trust funds ended the fiscal year with net assets of $408.8 billion. The State's only investment trust fund, the Local Agency Investment Fund, ended the fiscal year with net assets of $25.2 billion. Agency funds act as clearing accounts and thus do not have net assets.

For the year ended June 30, 2008, the fiduciary funds' combined net assets were $437.1 billion, a $17.8 billion decrease from prior year net assets. The net assets of the private purpose trust funds and the investment trust fund increased by $407 million and $5.4 billion, respectively, while the net assets of the pension and other employee benefit trust funds decreased by $23.6 billion. The decrease in net assets for these funds was mainly attributable to a decline in investment income that actually resulted in a net loss for the year and a decrease in the fair value of their investments of over $41.5 billion.

General Fund Budget Highlights

The original General Fund budget of $103.6 billion was increased by $349 million. This increase is mainly composed of increased resources spending due to additional fire protection needs, reductions to various education programs due to fiscal emergency measures, and a shift in funding from general government to correctional programs as a result of arbitration settlements. During the 2007-08 fiscal year, General Fund actual expenditures were $102.8 billion, $1.2 billion less than the final budgeted amounts.

Table 3

General Fund Original and Final Budgets
Year ended June 30, 2008
(amounts in millions)

	Original	Final	Increase/ (Decrease)
Budgeted amounts			
State and consumer services	$ 597	$ 604	$ 7
Business and transportation	1,433	1,433	0
Resources	1,191	1,650	459
Health and human services	29,885	29,940	55
Correctional programs	9,829	10,225	396
Education	50,854	50,455	(399)
General government:			
Tax relief	984	983	(1)
Debt service	3,524	3,543	19
Other general government	5,307	5,120	(187)
Total	**$ 103,604**	**$ 103,953**	**$ 349**

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, 2008, amounted to $102.2 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 and bridges.

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, 2008
(amounts in millions)

	Governmental Activities	Business-type Activities	Total
Land	$ 16,059	$ 53	$ 16,112
State highway infrastructure	58,548	—	58,548
Collections – nondepreciable	22	—	22
Buildings and other depreciable property	22,253	8,714	30,967
Less: accumulated depreciation	(9,261)	(3,802)	(13,063)
Construction in progress	7,739	1,876	9,615
Total	**$ 95,360**	**$ 6,841**	**$ 102,201**

The budget authorized $2.5 billion for the State's capital outlay program in the 2007-08 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 $2.5 billion authorized, $75 million was from the General Fund; $458 million was from lease-revenue bonds; $1.7 billion was from proceeds of various general obligation bonds; and $267 million was from reimbursements, federal funds, and special funds. The major capital projects authorized include:

- $1.4 billion for numerous construction projects within the University of California, the California State University, and the California Community Colleges;
- $164 million for the Department of Forestry and Fire Protection to replace 16 wildland fire protection facilities, including two conservation camps, and increased funding for continuing projects, as well as to address critical infrastructure deficiencies and health and safety issues at emergency response facilities; and

- $156 million for the Department of Corrections and Rehabilitation to construct waste-water and potable water treatment projects and other projects that address critical infrastructure deficiencies and health and safety issues.

In addition to the funding contained in the budget, legislation authorized $7.3 billion in lease–revenue bonds for the Department of Corrections and Rehabilitation for the construction of infill beds, secure reentry facilities, local jail beds, and healthcare facilities. Legislation also appropriated $300 million from the General Fund to make infrastructure improvements at existing state prisons.

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

Modified Approach for Infrastructure Assets

The State uses the modified approach to report the cost of its infrastructure assets (state roadways and bridges). Under the modified approach, the State does not report depreciation expense for roads and bridges but capitalizes all costs that add to the capacity and efficiency of State-owned roads and bridges. All maintenance and preservation costs are expensed and not capitalized. Under the modified approach, the State maintains an asset management system to demonstrate that it is preserving the infrastructure at or above established condition levels. The State is responsible for maintaining 49,477 lane miles and 12,183 bridges.

During the 2007-08 fiscal year, the actual amount spent on preservation was 15.2% 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, 2008, the primary government had total bonded debt outstanding of $89.1 billion. Of this amount, $58.3 billion (65.4%) represents general obligation bonds, which are backed by the full faith and credit of the State. Included in the $58.3 billion of general obligation bonds is $10.5 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 $2.9 billion and the long-term portion is $55.4 billion. The remaining $30.8 billion (34.6%) 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 $29.6 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, 2008
(amounts in millions)

	Governmental Activities	Business-type Activities	Total
Government-wide noncurrent liabilities			
General obligation bonds	$ 53,682	$ 1,772	$ 55,454
Revenue bonds	7,676	21,949	29,625
Certificates of participation and commercial paper	1,578	67	1,645
Capital lease obligations	4,131	—	4,131
Other noncurrent liabilities	14,408	1,854	16,262
Total noncurrent liabilities	**81,475**	**25,642**	**107,117**
Current portion of long-term obligations	4,392	1,722	6,114
Total long-term obligations	**$ 85,867**	**$ 27,364**	**$ 113,231**

The primary government's total long-term obligations increased during the year ended June 30, 2008. The largest change in governmental activities' long-term obligations is an increase of $5.4 billion in general obligation bonds payable mainly attributed to the sale of $3.2 billion of Economic Recovery bonds and $1.1 billion of Highway Safety, Traffic Reduction, Air Quality, and Port Security (Proposition 1B) bonds. General obligation bonds also increased by a net $925 million that represents the unamortized bond premiums and refunding losses that had previously not be included in the financial statements.

Note 10, Long-term Obligations, and Notes 11 through 16 include additional information on the State's long-term obligations.

In February 2009, Standard & Poor's reduced the State's general obligation bond credit rating from "A+" to "A" due to the State's inability to reach an agreement on the mid-year budget revision and its rapidly eroding cash position. The current ratings from the other two rating services are "A1" from Moody's Investors Service and "A+" from Fitch. These ratings have remained unchanged for almost three years.

Economic Condition and Future Budgets

Economic Condition and Outlook

The current negative economic climate dominates the headlines across California and the nation. According to the National Bureau of Economic Research, the national recession is now official and had actually begun in December of 2007. The problems began in real estate as housing sales began to decline in 2005. Housing prices began to decline in 2006; prices are now down 21.3% from first-quarter-of-2006 peak levels. The decline in the real estate market began to put stress on the overall economy during 2007—first in the financial markets as the mortgage credit crisis began to show in mid-2007, and second in the labor market as unemployment started to rise at the end of 2007. In 2008, the problems intensified, and now California's economic woes have

spread far beyond real estate and financial markets to the entire state economy. Growth in the fourth quarter of 2008 was -6.2%, the worst in at least 25 years.

Over the past 16 years, credit expanded dramatically, with over $20 trillion in new debt issued during this period. As the overall U.S. economy slowed, the extent of the credit crisis became obvious. In early 2008, Bear Stearns announced that it incurred a loss in the fourth quarter of 2007—the first in its history; investors lost confidence and share prices plummeted, and the company was finally purchased by JP Morgan. In July 2008, IndyMac Bank was seized by federal regulators following a run on deposits fueled by concerns over excessive exposure to the subprime mortgage market. IndyMac was the second-largest independent mortgage originator in the nation and the seventh-largest savings and loan institution in the country; its demise represents the largest thrift failure since 1984. A series of buyouts and failures of prominent financial firms followed, including those of Merrill Lynch, Washington Mutual, Wachovia, Lehman Brothers, and California's Downey Savings and Loan. In September 2008, the federal government rescued insurance giant AIG with a bailout package that has now reached $160 billion.

The federal government has been using a variety of tools in an attempt to bolster the financial markets. In late September of 2008, the U.S. Treasury unveiled the $700 billion Troubled Asset Relief Program (TARP), to purchase troubled assets and provide relief to banks that have seen an enormous erosion of balance sheets. Between September 2007 and December 2008, the Federal Reserve cut the federal funds rate by 50 basis points, to a historically low 0-to-0.25%, in order to improve credit conditions and promote a return to moderate economic growth. The Federal Reserve has also been buying debt from the non-financial market and, now that benchmark lending rates are near zero, it is considering buying up government treasury bonds to try to keep long-term interest rates low.

The situation was not much better outside the financial sector in 2008. What began as a decline in construction and financial activities spread to most other sectors by the end of the year. California, a center of much of the housing sector chaos, has led the nation in the downturn. Unemployment here has risen substantially since mid-2007, and by November 2008, the seasonally adjusted unemployment rate in California had reached 8.4%—its highest level in 14 years. In November 2008, 1.56 million Californians were unemployed and civilian employment had declined by more than 220,000 since November 2007. California's job market was hit harder than the nation's as a whole; the national unemployment rate was 7.2%, with 11.1 million people unemployed as of December 2008. Since the official start of the national recession in December 2007, the U.S. has shed roughly 2.96 million jobs.

The real estate markets are still in decline, due to loose lending practices coupled with a large discrepancy in the ratio of incomes to home prices; many banks made loans for homes that borrowers simply couldn't afford. In 2008, defaults and foreclosures in California were at their highest levels in over a decade. Between January and September 2008, 191,000 homes had been foreclosed upon and 311,000 were in default status. With layoffs on the rise, the newly unemployed may add to the number of foreclosures. In the third quarter of 2008, non-residential building permits were down 41% from the fourth quarter of 2007.

By September 2008, median home prices for both existing single-family homes and new single-family homes declined further and sat 40.2% and 21.5%, respectively, below their fourth-quarter-of-2006 levels. In the third quarter of 2008, home sales showed signs of responding to the decline in prices—there were nearly twice as many sales of existing homes and condos as in the first quarter. However, economists believe that sales of foreclosed properties were made primarily to speculators. Thus, these properties represent a "shadow inventory" that will reenter the market when prices increase—prolonging the downturn and delaying recovery.

The troubles do not appear to be easing as we enter 2009; the weakened economy has created severe budget problems for California. With greater numbers of people out of work and losing their homes, major revenue

sources for the State, such as personal income tax and sales and use taxes, have been negatively impacted. Reassessment of property values in the face of declining home prices will likely affect the property tax rolls as well. Economists forecast that the California unemployment rate, already at 10.1% in January 2009, will continue to rise through 2009. Home prices will continue to fall throughout the next two years and likely into 2011. Economists expect that, as in the third and fourth quarters of 2008, the Gross Domestic Product will contract in the first three quarters of 2009.

California's 2008-09 Budget

California's 2008-09 Budget Act was enacted on September 23, 2008, almost three months after the fiscal year began. The total spending plan adopted for the State was $144.5 billion—$103.4 billion from the General Fund, $28.2 billion from special funds, and $12.9 billion from bond funds. The General Fund's available resources were projected to be $106.0 billion and the adopted budget included a reserve for economic uncertainty of $1.7 billion. General Fund revenues come predominately from taxes, with personal income taxes expected to provide 55% of total revenue. California's major taxes (personal income, sales and use, and corporation taxes) were projected to supply approximately 94% of the General Fund's resources in the 2008-09 fiscal year.

Not long after the 2008-09 budget was enacted, it became clear that the sinking economy and the turmoil in the financial markets were causing General Fund revenue to decline. In early October 2008, just weeks after the budget was enacted, the State Controller announced that revenues were deteriorating faster than expected and the General Fund receipts in the first quarter of the fiscal year were already $1.1 billion lower than expected. By late December 2008 it was estimated that General Fund revenues would be $14.8 billion lower than projected at the time the budget was enacted. At the same time, the worldwide financial crisis and its impact on credit markets, including the municipal bond market, resulted in a dramatic decline in the normal volume of bond and note transactions. As a result, the State did not obtain all of the financing that it needed. The declining General Fund revenues and limited credit market access was starting to create a cash shortage. In response to the expected cash shortage, the State Controller implemented a payment deferral plan in February 2009 to preserve cash for education, debt service, and other payments required by the State Constitution, federal law, and court rulings.

In light of the deteriorating economic conditions and the situation's urgency, the Governor called a special session of the Legislature and proposed a variety of spending reductions and revenue increases to bring spending in the 2008-09 fiscal year closer in line with available revenues. On February 20, 2009, an unprecedented 17-month budget package covering the remainder of the 2008-09 fiscal year and the 2009-10 fiscal year was enacted. This budget package contains $11.4 billion in solutions for the 2008-09 fiscal year that include: $6.7 billion in expenditure reductions, primarily in K-12 education; $2.8 billion in federal funds from the recent economic stimulus law; $1.5 billion in revenue from increased rates for the sales and use tax and the vehicle license fee; and $268 million from internal borrowing. Even with these solutions, the budget package shows that the General Fund will end the 2008-09 fiscal year with a $2.3 billion deficit.

California's 2009-10 Budget

The 17-month budget package enacted on February 20, 2009, provides the fiscal blueprint intended to solve the estimated $41.6 billion budget shortfall that was predicted in the 2009-10 Governor's proposed budget released on January 9, 2009. This enacted budget projects total General Fund revenue of $97.7 billion and expenditures of $92.2 billion. The $5.5 billion difference between revenue and expenditures is expected to cover the anticipated year-end deficit of $2.3 billion in the 2008-09 fiscal year and to build up reserve accounts of $3.2 billion by the end of the 2009-10 fiscal year.

The enacted budget package includes more than $30.3 billion in solutions for the 2009-10 fiscal year. The solutions include $9.0 billion in expenditure reductions. The largest reductions are related to K-12 education, which will experience both reductions to core program funding and the deferral of payments to future years. Expenditure reductions also include furloughing state workers, eliminating inflationary adjustments for many programs, and making other reductions in services. The solutions also include $11.0 billion in revenue from temporary tax increases. Most of the higher taxes are the result of increased rates for the sales and use tax, vehicle license fee, and personal income tax. The solutions also include the receipt of $5.2 billion—a conservative estimate—in federal funds from the recent economic stimulus law. Finally, the solutions include $5.1 billion in borrowing against future Lottery profits through securitization bonds and internal sources.

As part of the 2009-10 fiscal year budget package, several statewide propositions will be placed on the May 2009 ballot for voter approval before certain budget provisions can be executed. These propositions include policy changes and reforms intended to provide immediate and long-term benefits to the economy. The 2009-10 budget depends on access to about $6 billion related to three propositions on the May 2009 ballot—$5.0 billion from borrowing from future Lottery profits (Proposition 1C), up to $608 million from redirecting dedicated childhood development funds (Proposition 1D), and about $230 million from redirecting dedicated mental health funds (Proposition 1E). If the voters reject these measures, the 2009-10 budget will not be in balance under current revenue projections. The Governor and the Legislature would need to agree to billions of dollars of additional spending cuts, tax increases, or other budgetary solutions to bring the budget back into balance.

According the Legislative Analyst's Office (LAO), California's nonpartisan fiscal and policy advisor, even with the adoption of the 2009-10 budget package and the passage of all the propositions on the May 2009 ballot, the State is expected to face budget shortfalls in the future. The LAO expects the State's economic recovery from the recession to be relatively slow and it concludes that many of the solutions adopted as part of the 2009-10 budget are short-term in nature. Consequently, based on the LAO's current projections, the State will need to adopt billions of dollars in additional spending reductions, tax increases, or other solutions in the coming years.

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.

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Basic Financial Statements

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Government-wide Financial Statements

Statement of Net Assets

June 30, 2008
(amounts in thousands)

	Primary Government			
	Governmental Activities	Business-type Activities	Total	Component Units
ASSETS				
Current assets:				
Cash and pooled investments	$ 18,721,824	$ 4,112,921	$ 22,834,745	$ 2,906,555
Amount on deposit with U.S. Treasury	—	2,666,360	2,666,360	—
Investments	2,275,363	735,986	3,011,349	10,612,860
Restricted assets:				
Cash and pooled investments	—	1,920,995	1,920,995	22,196
Investments	—	—	—	38,983
Due from other governments	—	57,496	57,496	—
Net investment in direct financing leases	—	363,790	363,790	—
Receivables (net)	12,119,452	521,050	12,640,502	3,738,970
Internal balances	119,243	(119,243)	—	—
Due from primary government	—	—	—	241,952
Due from other governments	10,138,518	199,586	10,338,104	552,171
Due from component units	62,831	—	62,831	—
Prepaid items	104,337	11,476	115,813	2,232
Inventories	89,195	29,529	118,724	158,165
Recoverable power costs (net)	—	511,000	511,000	—
Other current assets	205,793	261,617	467,410	228,129
Total current assets	43,836,556	11,272,563	55,109,119	18,502,213
Noncurrent assets:				
Restricted assets:				
Cash and pooled investments	—	1,068,560	1,068,560	126,140
Investments	—	560,124	560,124	39,696
Loans receivable	—	454,214	454,214	—
Investments	—	1,449,565	1,449,565	37,761,542
Net investment in direct financing leases	—	6,307,555	6,307,555	—
Receivables (net)	1,697,616	17,194	1,714,810	952,625
Loans receivable	2,767,302	3,826,070	6,593,372	8,435,986
Recoverable power costs (net)	—	5,934,000	5,934,000	—
Deferred charges	71,429	1,303,971	1,375,400	42,469
Capital assets:				
Land	16,059,470	52,848	16,112,318	831,366
State highway infrastructure	58,547,500	—	58,547,500	—
Collections – nondepreciable	21,631	29	21,660	288,859
Buildings and other depreciable property	22,253,110	8,713,588	30,966,698	30,281,005
Less: accumulated depreciation	(9,260,938)	(3,801,680)	(13,062,618)	(13,409,120)
Construction in progress	7,738,896	1,876,245	9,615,141	3,143,052
Other noncurrent assets	3,000	13,476	16,476	408,229
Total noncurrent assets	99,899,016	27,775,759	127,674,775	68,901,849
Total assets	**$ 143,735,572**	**$ 39,048,322**	**$ 182,783,894**	**$ 87,404,062**

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	$ 16,602,662	$ 700,672	$ 17,303,334	$ 1,993,402
Due to primary government	—	—	—	62,831
Due to component units	236,389	5,563	241,952	—
Due to other governments	7,553,049	135,954	7,689,003	6
Dividends payable	—	—	—	3,100
Deferred revenue	—	60,565	60,565	1,032,779
Tax overpayments	4,998,235	—	4,998,235	—
Deposits	293,727	4,731	298,458	545,989
Contracts and notes payable	4,301	—	4,301	11,589
Unclaimed property liability	800,570	—	800,570	—
Advance collections	765,976	25,296	791,272	115,142
Interest payable	844,804	205,637	1,050,441	150,698
Securities lending obligations	—	—	—	3,842,568
Benefits payable	—	509,667	509,667	1,942,713
Current portion of long-term obligations	4,392,297	1,721,700	6,113,997	1,686,317
Other current liabilities	711,772	124,255	836,027	1,906,072
Total current liabilities	37,203,782	3,494,040	40,697,822	13,293,206
Noncurrent liabilities:				
Benefits payable	—	6,761	6,761	16,432,739
Lottery prizes and annuities	—	1,235,904	1,235,904	—
Compensated absences payable	1,911,923	26,574	1,938,497	219,976
Certificates of participation, commercial paper, and other borrowings	1,577,832	67,204	1,645,036	66,444
Capital lease obligations	4,131,270	—	4,131,270	2,326,650
General obligation bonds payable	53,681,605	1,771,903	55,453,508	—
Revenue bonds payable	7,676,096	21,948,885	29,624,981	15,722,332
Other noncurrent liabilities	12,496,318	584,623	13,080,941	3,056,331
Total noncurrent liabilities	81,475,044	25,641,854	107,116,898	37,824,472
Total liabilities	**118,678,826**	**29,135,894**	147,814,720	**51,117,678**
NET ASSETS				
Investment in capital assets, net of related debt	84,255,048	49,510	84,304,558	10,979,069
Restricted:				
Nonexpendable – endowments	—	—	—	3,570,528
Expendable:				
Endowments and gifts	—	—	—	7,442,272
Business and transportation	1,159,766	144,081	1,303,847	1,444,265
Resources	1,360,505	1,618,308	2,978,813	—
Health and human services	3,005,273	109,789	3,115,062	—
Education	1,184,946	395,812	1,580,758	1,648,330
General government	3,353,405	756,683	4,110,088	998,964
Unemployment programs	84,753	3,828,948	3,913,701	—
Workers' compensation liability	—	—	—	4,488,663
Total expendable	10,148,648	6,853,621	17,002,269	16,022,494
Unrestricted	(69,346,950)	3,009,297	(66,337,653)	5,714,293
Total net assets	**25,056,746**	**9,912,428**	34,969,174	**36,286,384**
Total liabilities and net assets	**$ 143,735,572**	**$ 39,048,322**	$ 182,783,894	**$ 87,404,062**

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

Statement of Activities

Year Ended June 30, 2008
(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	$ 12,229,890	$ 4,399,159	$ 1,394,832	$ —
Education	65,130,420	3,343,205	6,462,741	—
Health and human services	74,309,784	5,191,548	35,383,450	—
Resources	6,333,252	2,648,952	331,868	—
State and consumer services	1,129,063	692,348	52,941	—
Business and transportation	13,068,043	3,987,958	1,989,722	1,207,101
Correctional programs	10,504,182	27,702	233,859	—
Tax relief	957,190	4,967	—	—
Interest on long-term debt	4,184,631	—	—	—
Total governmental activities	187,846,455	20,295,839	45,849,413	1,207,101
Business-type activities:				
Electric Power	5,362,000	5,362,000	—	—
Water Resources	1,009,214	1,009,214	—	—
Public Building Construction	371,904	384,816	—	—
State Lottery	3,173,060	3,242,828	—	—
Unemployment Programs	10,622,582	8,829,018	—	—
High Technology Education	16,916	20,600	—	—
State University Dormitory Building Maintenance and Equipment	699,018	640,208	—	—
State Water Pollution Control Revolving	13,056	71,404	—	189,064
Housing Loan	132,101	130,139	—	—
Other enterprise programs	122,921	137,476	—	—
Total business-type activities	21,522,772	19,827,703	—	189,064
Total primary government	**$ 209,369,227**	**$ 40,123,542**	**$ 45,849,413**	**$ 1,396,165**
Component units:				
University of California	$ 21,140,587	$ 10,385,989	$ 7,867,138	$ 245,305
State Compensation Insurance Fund	2,983,819	2,274,908	—	—
California Housing Finance Agency	571,294	506,194	118,001	—
Public Employees' Benefit Fund	936,963	1,826,740	—	—
Nonmajor component units	2,008,714	1,245,046	549,307	4,797
Total component units	**$ 27,641,377**	**$ 16,238,877**	**$ 8,534,446**	**$ 250,102**

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, 2007

Net assets, June 30, 2008

* 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**
$ (6,435,899)		$ (6,435,899)	
(55,324,474)		(55,324,474)	
(33,734,786)		(33,734,786)	
(3,352,432)		(3,352,432)	
(383,774)		(383,774)	
(5,883,262)		(5,883,262)	
(10,242,621)		(10,242,621)	
(952,223)		(952,223)	
(4,184,631)		(4,184,631)	
(120,494,102)		(120,494,102)	
	$ —	—	
	—	—	
	12,912	12,912	
	69,768	69,768	
	(1,793,564)	(1,793,564)	
	3,684	3,684	
	(58,810)	(58,810)	
	247,412	247,412	
	(1,962)	(1,962)	
	14,555	14,555	
	(1,506,005)	(1,506,005)	
(120,494,102)	**(1,506,005)**	(122,000,107)	
			$ (2,642,155)
			(708,911)
			52,901
			889,777
			(209,564)
			(2,617,952)
55,355,266	—	55,355,266	—
34,856,824	—	34,856,824	—
11,207,468	—	11,207,468	—
2,190,870	—	2,190,870	—
5,594,970	—	5,594,970	—
639,059	—	639,059	1,526,701
282,287	—	282,287	—
—	—	—	2,610,292
54,994	(54,994)	—	—
110,181,738	**(54,994)**	110,126,744	**4,136,993**
(10,312,364)	(1,560,999)	(11,873,363)	1,519,041
35,369,110 *	**11,473,427** *	46,842,537	**34,767,343** *
$ 25,056,746	**$ 9,912,428**	$ 34,969,174	**$ 36,286,384**

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, 2008
(amounts in thousands)

	General	Federal	Transportation	Nonmajor Governmental	Total
ASSETS					
Cash and pooled investments	$ 1,832,914	$ 422,134	$ 3,163,666	$ 12,384,457	$ 17,803,171
Investments	—	—	—	2,275,363	2,275,363
Receivables (net)	9,917,756	1,535	519,599	1,255,410	11,694,300
Due from other funds	1,364,683	6,347	1,947,593	1,526,757	4,845,380
Due from component units	62,831	—	—	—	62,831
Due from other governments	805,230	9,100,071	16,058	202,678	10,124,037
Interfund receivables	76,429	—	1,645,803	602,684	2,324,916
Loans receivable	103,082	46,011	—	2,558,184	2,707,277
Other assets	38,496	—	123,827	43,470	205,793
Total assets	**$ 14,201,421**	**$ 9,576,098**	**$ 7,416,546**	**$ 20,849,003**	**$ 52,043,068**
LIABILITIES					
Accounts payable	$ 1,545,539	$ 1,101,076	$ 513,274	$ 4,095,945	$ 7,255,834
Due to other funds	4,983,375	6,202,681	308,494	1,764,661	13,259,211
Due to component units	163,561	—	2,565	64,689	230,815
Due to other governments	3,303,179	2,169,403	813,403	1,874,888	8,160,873
Interfund payables	2,231,795	—	—	28,876	2,260,671
Tax overpayments	4,989,995	—	—	8,240	4,998,235
Deposits	3,967	—	11,136	272,236	287,339
Advance collections	37,984	37,498	13,633	281,076	370,191
Interest payable	6,719	8,178	—	229,116	244,013
Unclaimed property liability	800,570	—	—	—	800,570
General obligation bonds payable	—	—	—	421,405	421,405
Other liabilities	303,606	14,510	308,609	438,611	1,065,336
Total liabilities	**18,370,290**	**9,533,346**	**1,971,114**	**9,479,743**	**39,354,493**
FUND BALANCES					
Reserved for:					
Encumbrances	933,269	—	3,994,383	2,715,777	7,643,429
Interfund receivables	76,429	—	1,645,803	602,684	2,324,916
Loans receivable	103,082	46,011	—	2,558,184	2,707,277
Continuing appropriations	1,000,369	—	4,668,623	2,381,810	8,050,802
Debt service	—	—	—	898,808	898,808
Unreserved, reported in:					
General Fund	(6,282,018)	—	—	—	(6,282,018)
Special revenue funds	—	(3,259)	(4,863,377)	3,049,346	(1,817,290)
Capital projects funds	—	—	—	(837,349)	(837,349)
Total fund balances (deficits)	**(4,168,869)**	**42,752**	**5,445,432**	**11,369,260**	**12,688,575**
Total liabilities and fund balances	**$ 14,201,421**	**$ 9,576,098**	**$ 7,416,546**	**$ 20,849,003**	

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		**$ 12,688,575**
Amounts reported for governmental activities in the Statement of Net Assets are different from those in the Governmental Funds Balance Sheet because:		
• Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds.		95,145,200
• Other long-term assets are not available to pay for current-period expenditures and, therefore, are not reported.		1,715,295
• 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.		418,703
• Bond discounts, premiums, and deferred issue costs are amortized over the life of the bonds and are included in the governmental activities in the Statement of Net Assets.		(328,225)
• General obligation bonds totaling $55,689,667 and revenue bonds totaling $8,326,429 are not due and payable in the current period and, therefore, are not reported in the funds.		(64,016,096)
• Certain long-term liabilities are not due and payable in the current period; therefore, adjustments to these liabilities are not reported in the funds:		
Compensated absences adjustments	(1,961,773)	
Certificates of participation and commercial paper adjustments	(1,736,089)	
Capital lease adjustments	(4,367,363)	
Other long-term obligations	(12,501,481)	
		(20,566,706)
Net assets of governmental activities		**$ 25,056,746**

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, 2008
(amounts in thousands)

	General	Federal	Transportation	Nonmajor Governmental	Total
REVENUES					
Personal income taxes	$ 54,214,285	$ —	$ —	$ 982,777	$ 55,197,062
Sales and use taxes	26,598,820	—	1,157,373	7,008,458	34,764,651
Corporation taxes	11,201,468	—	—	—	11,201,468
Insurance taxes	2,190,870	—	—	—	2,190,870
Other taxes	494,427	—	3,253,041	1,928,426	5,675,894
Intergovernmental	—	47,037,796	—	1,931,210	48,969,006
Licenses and permits	792	—	3,038,550	2,287,512	5,326,854
Charges for services	190,992	—	502,309	332,268	1,025,569
Fees	796,517	—	18,964	5,235,921	6,051,402
Penalties	52,724	453	55,370	640,684	749,231
Investment and interest	581,535	—	90,099	919,391	1,591,025
Escheat	282,287	—	—	—	282,287
Other	1,169,661	—	106,661	2,988,688	4,265,010
Total revenues	**97,774,378**	**47,038,249**	**8,222,367**	**24,255,335**	177,290,329
EXPENDITURES					
Current:					
General government	2,238,325	1,021,975	147,356	8,381,014	11,788,670
Education	51,091,244	6,399,901	101,412	6,775,055	64,367,612
Health and human services	29,147,545	34,938,163	137,851	9,879,149	74,102,708
Resources	1,468,516	331,483	146,482	4,177,128	6,123,609
State and consumer services	539,094	52,966	92,358	554,979	1,239,397
Business and transportation	11,454	2,912,887	11,155,136	668,029	14,747,506
Correctional programs	9,695,223	233,796	—	43,488	9,972,507
Tax relief	957,190	—	—	—	957,190
Capital outlay	268,686	—	—	1,455,388	1,724,074
Debt service:					
Bond and commercial paper retirement	1,455,885	50,985	576,615	6,887,048	8,970,533
Interest and fiscal charges	2,101,880	20,960	21,537	1,250,056	3,394,433
Total expenditures	**98,975,042**	**45,963,116**	**12,378,747**	**40,071,334**	197,388,239
Excess (deficiency) of revenues over (under) expenditures	(1,200,664)	1,075,133	(4,156,380)	(15,815,999)	(20,097,910)
OTHER FINANCING SOURCES (USES)					
General obligation bonds and commercial paper issued	—	—	2,092,485	12,101,275	14,193,760
Refunding debt issued	—	—	41,705	1,756,980	1,798,685
Payment to refund long-term debt	(45,321)	—	(41,705)	(1,756,980)	(1,844,006)
Premium on bonds issued	147,463	—	—	147,976	295,439
Capital leases	268,686	—	—	—	268,686
Transfers in	3,995,696	—	1,416,585	6,001,851	11,414,132
Transfers out	(5,427,191)	(1,070,105)	(694,532)	(4,144,936)	(11,336,764)
Total other financing sources (uses)	**(1,060,667)**	**(1,070,105)**	**2,814,538**	**14,106,166**	14,789,932
Net change in fund balances	(2,261,331)	5,028	(1,341,842)	(1,709,833)	(5,307,978)
Fund balances, July 1, 2007	**(1,907,538)**	**37,724**	**6,787,274 ***	**13,079,093 ***	17,996,553
Fund balances (deficits), June 30, 2008	**$ (4,168,869)**	**$ 42,752**	**$ 5,445,432**	**$ 11,369,260**	$ 12,688,575

* 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		**$ (5,307,978)**
Amounts reported for governmental activities in the Statement of Activities are different from those in 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.		3,512,032
• Revenues in the Statement of Activities that do not provide current financial resources are deferred and not reported as revenues in the funds.		188,768
• 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	(5,979,756)	
Revenue bond adjustments	197,952	
Certificates of participation and commercial paper adjustments	(378,038)	
		(6,159,842)
• 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	(21,606)	
Lease adjustments	(31,802)	
Other long-term obligations	(2,516,902)	
		(2,570,310)
• 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.		24,966
Change in net assets of governmental activities		**$ (10,312,364)**

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

Statement of Net Assets

Proprietary Funds

June 30, 2008
(amounts in thousands)

	Electric Power	Water Resources
ASSETS		
Current assets:		
Cash and pooled investments	$ —	$ 485,283
Amount on deposit with U.S. Treasury	—	—
Investments	—	—
Restricted assets:		
Cash and pooled investments	1,846,000	—
Investments	—	—
Due from other governments	—	—
Net investment in direct financing leases	—	—
Receivables (net)	—	109,775
Due from other funds	27,000	5,016
Due from other governments	—	26,968
Prepaid items	—	—
Inventories	—	19,035
Recoverable power costs (net)	511,000	—
Other current assets	261,000	—
Total current assets	2,645,000	646,077
Noncurrent assets:		
Restricted assets:		
Cash and pooled investments	1,015,000	37,521
Investments	450,000	74,135
Loans receivable	—	—
Investments	—	—
Net investment in direct financing leases	—	—
Receivables	—	—
Interfund receivables	—	91,517
Loans receivable	—	24,105
Recoverable power costs (net)	5,934,000	—
Deferred charges	—	1,194,268
Capital assets:		
Land	—	—
Collections – nondepreciable	—	—
Buildings and other depreciable property	—	4,587,682
Less: accumulated depreciation	—	(1,878,224)
Construction in progress	—	365,297
Other noncurrent assets	—	—
Total noncurrent assets	7,399,000	4,496,301
Total assets	**$ 10,044,000**	**$ 5,142,378**

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**
$ —	$ 270,476	$ 1,604,136	$ 1,753,026	**$ 4,112,921**	$ 918,653
—	—	2,666,360	—	**2,666,360**	—
—	280,980	—	455,006	**735,986**	—
—	—	—	74,995	**1,920,995**	—
—	—	—	—	**—**	—
—	—	—	57,496	**57,496**	—
342,481	—	—	21,309	**363,790**	—
108,498	159,097	213,598	41,715	**632,683**	53,406
22,633	3,131	14,650	16,496	**88,926**	360,264
—	—	34,485	138,133	**199,586**	14,481
—	10,537	—	939	**11,476**	88,920
—	6,842	—	3,652	**29,529**	89,195
—	—	—	—	**511,000**	—
—	—	—	617	**261,617**	—
473,612	731,063	4,533,229	2,563,384	**11,592,365**	1,524,919
—	—	—	16,039	**1,068,560**	—
24,146	—	—	11,843	**560,124**	—
—	—	—	454,214	**454,214**	—
—	1,392,758	—	56,807	**1,449,565**	—
5,969,611	—	—	337,944	**6,307,555**	—
—	—	17,194	—	**17,194**	—
—	—	—	2,126	**93,643**	—
—	—	—	3,801,965	**3,826,070**	—
—	—	—	—	**5,934,000**	—
62,656	5,526	—	41,521	**1,303,971**	—
—	6,469	—	46,379	**52,848**	231
—	—	—	29	**29**	—
—	104,553	11,640	4,009,713	**8,713,588**	605,896
—	(60,546)	(4,646)	(1,858,264)	**(3,801,680)**	(409,883)
1,061,445	—	—	449,503	**1,876,245**	18,225
—	—	—	13,476	**13,476**	—
7,117,858	1,448,760	24,188	7,383,295	**27,869,402**	214,469
$ 7,591,470	**$ 2,179,823**	**$ 4,557,417**	**$ 9,946,679**	**$ 39,461,767**	**$ 1,739,388**

(continued)

Statement of Net Assets (continued)

Proprietary Funds

June 30, 2008
(amounts in thousands)

	Electric Power	Water Resources
LIABILITIES		
Current liabilities:		
Accounts payable	$ 469,318	$ 91,143
Due to other funds	—	14,060
Due to component units	—	—
Due to other governments	—	118,972
Deferred revenue	—	—
Deposits	—	—
Contracts and notes payable	—	—
Advance collections	—	—
Interest payable	60,000	28,581
Benefits payable	—	—
Current portion of long-term obligations	510,000	152,925
Other current liabilities	—	—
Total current liabilities	1,039,318	405,681
Noncurrent liabilities:		
Interfund payables	—	—
Benefits payable	—	—
Lottery prizes and annuities	—	—
Compensated absences payable	—	—
Certificates of participation, commercial paper, and other borrowings	—	19,352
Capital lease obligations	—	—
General obligation bonds payable	—	531,700
Revenue bonds payable	8,999,000	2,558,734
Other noncurrent liabilities	5,682	421,480
Total noncurrent liabilities	9,004,682	3,531,266
Total liabilities	**10,044,000**	**3,936,947**
NET ASSETS		
Investment in capital assets, net of related debt	—	127,858
Restricted – Expendable:		
Construction	—	1,077,573
Debt service	—	—
Security for revenue bonds	—	—
Lottery	—	—
Unemployment program	—	—
Other purposes	—	—
Total expendable	—	1,077,573
Unrestricted	—	—
Total net assets	**—**	**1,205,431**
Total liabilities and net assets	**$ 10,044,000**	**$ 5,142,378**

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
$ 26,246	$ 31,384	$ 72	$ 57,317	$ 675,480	$ 235,897
116,896	238,016	51,076	16,463	436,511	363,225
—	—	—	5,563	5,563	5,574
2,035	—	14,792	155	135,954	20,075
—	—	—	60,565	60,565	—
—	—	—	4,731	4,731	6,388
—	—	—	—	—	14,880
18,962	3,046	—	3,288	25,296	395,785
66,529	—	—	50,527	205,637	—
—	—	509,667	—	509,667	—
365,284	494,641	—	198,850	1,721,700	17,525
—	—	116,534	7,721	124,255	4,107
595,952	767,087	692,141	405,180	3,905,359	1,063,456
—	—	—	2,126	2,126	95,737
—	—	—	6,761	6,761	—
—	1,235,904	—	—	1,235,904	—
—	5,347	12,897	8,330	26,574	48,286
—	—	—	47,852	67,204	—
—	—	—	—	—	7,474
—	—	—	1,240,203	1,771,903	—
6,695,964	—	—	3,695,187	21,948,885	—
—	6,402	16,438	134,621	584,623	105,732
6,695,964	1,247,653	29,335	5,135,080	25,643,980	257,229
7,291,916	**2,014,740**	**721,476**	**5,540,260**	29,549,339	**1,320,685**
—	50,476	6,993	(135,817)	49,510	168,855
268,831	—	—	328,321	1,674,725	—
30,723	—	—	61,760	92,483	—
—	—	—	511,710	511,710	—
—	165,083	—	—	165,083	—
—	—	3,828,948	—	3,828,948	—
—	—	—	580,672	580,672	—
299,554	165,083	3,828,948	1,482,463	6,853,621	—
—	(50,476)	—	3,059,773	3,009,297	249,848
299,554	**165,083**	**3,835,941**	**4,406,419**	9,912,428	**418,703**
$ 7,591,470	**$ 2,179,823**	**$ 4,557,417**	**$ 9,946,679**	$ 39,461,767	**$ 1,739,388**

(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, 2008
(amounts in thousands)

	Electric Power	Water Resources
OPERATING REVENUES		
Unemployment and disability insurance	$ —	$ —
Lottery ticket sales	—	—
Power sales	4,323,000	215,430
Student tuition and fees	—	—
Services and sales	—	773,845
Investment and interest	—	—
Rent	—	—
Other	—	—
Total operating revenues	**4,323,000**	**989,275**
OPERATING EXPENSES		
Lottery prizes	—	—
Power purchases (net of recoverable power costs)	4,289,000	323,236
Personal services	—	216,752
Supplies	—	—
Services and charges	34,000	233,374
Depreciation	—	79,136
Distributions to beneficiaries	—	—
Interest expense	—	—
Amortization of deferred charges	—	—
Other	—	—
Total operating expenses	**4,323,000**	**852,498**
Operating income (loss)	—	136,777
NONOPERATING REVENUES (EXPENSES)		
Investment and interest income	1,039,000	—
Interest expense and fiscal charges	(1,039,000)	(156,716)
Lottery payments for education	—	—
Other	—	19,939
Total nonoperating revenues (expenses)	**—**	**(136,777)**
Income (loss) before contributions and transfers	—	—
Capital contributions	—	—
Transfers in	—	—
Transfers out	—	—
Change in net assets	—	—
Total net assets, July 1, 2007	**—**	**1,205,431**
Total net assets, June 30, 2008	**$ —**	**$ 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**
$ —	$ —	$ 8,483,142	$ —	**$ 8,483,142**	$ —
—	3,049,621	—	—	**3,049,621**	—
—	—	—	—	**4,538,430**	—
—	—	—	561,762	**561,762**	—
—	—	122,034	102,923	**998,802**	2,460,764
28,481	—	—	184,836	**213,317**	—
356,333	—	—	40,011	**396,344**	—
2	—	—	16,928	**16,930**	—
384,816	**3,049,621**	**8,605,176**	**906,460**	**18,258,348**	**2,460,764**
—	1,619,473	—	—	**1,619,473**	—
—	—	—	—	**4,612,236**	—
—	48,431	150,813	185,712	**601,708**	730,888
—	10,491	—	—	**10,491**	11,270
33,566	312,253	67,512	414,339	**1,095,044**	1,611,762
—	9,070	673	99,696	**188,575**	40,973
—	—	10,403,584	—	**10,403,584**	—
331,355	—	—	239,850	**571,205**	588
6,983	—	—	1,180	**8,163**	—
—	—	—	33,681	**33,681**	—
371,904	**1,999,718**	**10,622,582**	**974,458**	**19,144,160**	**2,395,481**
12,912	1,049,903	(2,017,406)	(67,998)	**(885,812)**	65,283
—	192,357	223,842	71,109	**1,526,308**	3,334
—	(104,014)	—	(8,422)	**(1,308,152)**	(480)
—	(1,069,328)	—	—	**(1,069,328)**	—
—	850	—	21,126	**41,915**	(20,797)
—	**(980,135)**	**223,842**	**83,813**	**(809,257)**	**(17,943)**
12,912	69,768	(1,793,564)	15,815	**(1,695,069)**	47,340
—	—	—	189,064	**189,064**	—
—	—	—	1,441	**1,441**	397
(7,514)	—	—	(48,921)	**(56,435)**	(22,771)
5,398	69,768	(1,793,564)	157,399	**(1,560,999)**	24,966
294,156	**95,315**	**5,629,505**	**4,249,020** *	**11,473,427**	**393,737**
$ 299,554	**$ 165,083**	**$ 3,835,941**	**$ 4,406,419**	**$ 9,912,428**	**$ 418,703**

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

Statement of Cash Flows

Proprietary Funds

Year Ended June 30, 2008
(amounts in thousands)

	Electric Power	Water Resources
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers/employers	$ 4,423,000	$ 1,018,049
Receipts from interfund services provided	—	—
Payments to suppliers	(4,539,000)	(502,787)
Payments to employees	—	(216,752)
Payments for interfund services used	—	—
Payments for Lottery prizes	—	—
Claims paid to other than employees	—	—
Other receipts (payments)	32,000	(24,020)
Net cash provided by (used in) operating activities	**(84,000)**	**274,490**
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Changes in interfund payables and loans payable	—	—
Proceeds from bonds	2,000	—
Receipts of bond charges	867,000	—
Retirement of general obligation bonds	—	—
Retirement of revenue bonds	(470,000)	—
Retirement of notes payable and commercial paper	—	—
Interest paid on operating debt	(447,000)	—
Transfers in	—	—
Transfers out	—	—
Lottery payments for education	—	—
Net cash provided by (used in) noncapital financing activities	**(48,000)**	**—**
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Changes in interfund payables and loans payable	—	—
Acquisition of intangible assets	—	—
Acquisition of capital assets	—	(115,158)
Proceeds from sale of capital assets	—	—
Proceeds from notes payable and commercial paper	—	19,900
Principal paid on notes payable and commercial paper	—	(133,910)
Retirement of general obligation bonds	—	(50,355)
Proceeds from revenue bonds	—	668,604
Retirement of revenue bonds	—	(601,320)
Interest paid	—	(141,252)
Grants received	—	—
Net cash provided by (used in) capital and related financing activities	**—**	**(353,491)**
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investments	—	(151,303)
Proceeds from maturity and sale of investments	150,000	179,961
Change in interfund receivables and loans receivable	—	1,823
Earnings (loss) on investments	185,000	59,104
Net cash provided by (used in) investing activities	**335,000**	**89,585**
Net increase (decrease) in cash and pooled investments	203,000	10,584
Cash and pooled investments at July 1, 2007	**2,658,000**	**512,220**
Cash and pooled investments at June 30, 2008	**$ 2,861,000**	**$ 522,804**

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
$ 676,400	$ 3,130,700	$ 8,559,351	$ 745,076	$ 18,552,576	$ 2,690,771
—	—	—	5,935	5,935	20,646
(32,429)	(107,968)	(67,506)	(450,463)	(5,700,153)	(1,562,386)
—	(38,380)	(136,341)	(176,608)	(568,081)	(670,882)
—	(9,840)	—	(1,311)	(11,151)	(112,247)
—	(2,010,557)	—	—	(2,010,557)	—
—	(213,042)	(10,336,686)	(2)	(10,549,730)	(6,731)
(280,990)	32,633	80,186	(406,406)	(566,597)	(166,178)
362,981	**783,546**	**(1,900,996)**	**(283,779)**	**(847,758)**	**192,993**
—	—	—	(20)	(20)	(406)
—	—	—	191,200	193,200	—
—	—	—	—	867,000	—
—	—	—	(87,066)	(87,066)	—
—	—	—	(80,964)	(550,964)	—
—	—	—	(5,500)	(5,500)	—
—	—	—	(9,794)	(456,794)	(26)
—	—	—	1,441	1,441	397
(7,514)	—	—	(48,921)	(56,435)	(22,771)
—	(1,149,396)	—	—	(1,149,396)	—
(7,514)	**(1,149,396)**	**—**	**(39,624)**	**(1,244,534)**	**(22,806)**
—	—	—	1,114	1,114	—
—	—	—	(71)	(71)	(2,951)
(654,124)	(24,056)	(218)	(269,180)	(1,062,736)	(32,652)
—	105	2,027	15,679	17,811	430
—	—	—	139,322	159,222	—
—	—	—	(132,390)	(266,300)	(3,556)
—	—	—	—	(50,355)	—
492,726	—	—	442,120	1,603,450	—
(342,582)	—	—	(127,494)	(1,071,396)	—
—	—	—	(115,929)	(257,181)	(1,042)
—	—	—	189,951	189,951	—
(503,980)	**(23,951)**	**1,809**	**143,122**	**(736,491)**	**(39,771)**
—	(218,891)	—	(200,048)	(570,242)	—
636	506,594	788,675	3,328	1,629,194	—
—	—	—	—	1,823	—
—	21,738	223,842	74,939	564,623	3,528
636	**309,441**	**1,012,517**	**(121,781)**	**1,625,398**	**3,528**
(147,877)	(80,360)	(886,670)	(302,062)	(1,203,385)	133,944
147,877	**350,836**	**2,490,806**	**2,146,122**	**8,305,861**	**784,709**
$ —	**$ 270,476**	**$ 1,604,136**	**$ 1,844,060**	**$ 7,102,476**	**$ 918,653**

(continued)

Statement of Cash Flows (continued)

Proprietary Funds

Year Ended June 30, 2008
(amounts in thousands)

	Electric Power	Water Resources
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES		
Operating income (loss)	$ —	$ 136,777
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:		
Interest expense on operating debt	—	—
Depreciation	—	79,136
Accretion of capital appreciation bonds	—	—
Provisions and allowances	—	—
Accrual of deferred charges	—	20,591
Amortization of discounts	—	—
Amortization of deferred charges	—	—
Other	—	(24,020)
Change in assets and liabilities:		
Receivables	—	41,234
Due from other funds	—	—
Due from other governments	—	(11,587)
Prepaid items	—	—
Inventories	—	(6,428)
Net investment in direct financing leases	—	—
Recoverable power costs (net)	(63,000)	—
Other current assets	—	—
Loans receivable	—	—
Interfund receivable	—	—
Accounts payable	(21,000)	5,217
Due to other funds	—	14,060
Due to component units	—	—
Due to other governments	—	19,510
Deposits	—	—
Contracts and notes payable	—	—
Advance collections	—	—
Interest payable	—	—
Other current liabilities	—	—
Deferred revenue	—	—
Benefits payable	—	—
Lottery prizes and annuities	—	—
Compensated absences payable	—	—
Capital lease obligations	—	—
Other noncurrent liabilities	—	—
Total adjustments	(84,000)	137,713
Net cash provided by (used in) operating activities	**$ (84,000)**	**$ 274,490**
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	150,000	—

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**
$ 12,912	$ 1,049,903	$ (2,017,406)	$ (67,998)	**$ (885,812)**	$ 65,283
—	—	—	115,929	**115,929**	588
—	9,070	673	99,696	**188,575**	40,973
1,675	—	—	1,127	**2,802**	—
—	(2,661)	—	(2,115)	**(4,776)**	—
(4,063)	—	—	—	**16,528**	—
(6,289)	—	—	91	**(6,198)**	—
6,983	7,502	—	5,159	**19,644**	—
(1,232)	1,394	—	17,926	**(5,932)**	—
31,613	68,842	(51,450)	(10,839)	**79,400**	72,609
(3,899)	4	16,017	13,150	**25,272**	(71,345)
—	—	(3,765)	(1,814)	**(17,166)**	2,362
—	—	—	(361)	**(361)**	(19,710)
—	(528)	—	30	**(6,926)**	(10,135)
327,407	—	—	16,704	**344,111**	—
—	—	—	—	**(63,000)**	—
—	(1,906)	—	(10,780)	**(12,686)**	177
—	—	—	(444,437)	**(444,437)**	—
—	—	—	83	**83**	—
(186)	7,101	6	(3,588)	**(12,450)**	65,575
(1,883)	1	6,255	(20,034)	**(1,601)**	(212,792)
—	—	—	—	**—**	51,958
1,138	—	174	(1,100)	**19,722**	(6)
—	—	—	863	**863**	46
—	—	—	—	**—**	(214)
(75)	477	—	(818)	**(416)**	151,300
(1,120)	—	—	2,330	**1,210**	—
—	5,037	31,093	3,366	**39,496**	767
—	—	—	2,090	**2,090**	—
—	—	102,927	(1,785)	**101,142**	—
—	(360,829)	—	—	**(360,829)**	—
—	185	(1,958)	2,092	**319**	4,002
—	—	—	—	**—**	6,753
—	(46)	16,438	1,254	**17,646**	44,802
350,069	(266,357)	116,410	(215,781)	**38,054**	127,710
$ 362,981	**$ 783,546**	**$ (1,900,996)**	**$ (283,779)**	**$ (847,758)**	**$ 192,993**
					(concluded)
$ —	$ 104,014	$ —	$ —	**$ 104,014**	$ —
—	25,617	—	—	**25,617**	—
—	69,768	—	—	**219,768**	—

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, 2008
(amounts in thousands)

	Private Purpose Trust	Pension and Other Employee Benefit Trust	Investment Trust Local Agency Investment	Agency
ASSETS				
Cash and pooled investments	$ 398,273	$ 2,150,090	$ 25,356,255	$ 3,847,162
Investments, at fair value:				
Short-term	—	5,069,194	—	—
Equity securities	58,995	216,048,653	—	—
Debt securities	—	92,115,314	—	—
Real estate	—	42,306,465	—	—
Other	3,051,256	52,351,622	—	—
Securities lending collateral	—	62,254,367	—	—
Total investments	3,110,251	470,145,615	—	—
Receivables (net)	7,062	8,138,167	—	980,883
Due from other funds	22	445,269	—	8,691,264
Due from other governments	—	7	—	88,701
Prepaid Items	—	—	—	14,506
Loans receivable	—	—	—	68,964
Other assets	299,658	391,566	—	255
Total assets	**3,815,266**	**481,270,714**	**25,356,255**	**$ 13,691,735**
LIABILITIES				
Accounts payable	3,118	4,444,115	79	$ 5,380,232
Due to other funds	370,510	1,322	346	—
Due to other governments	—	191	194,917	6,056,796
Tax overpayments	—	—	—	11,037
Benefits payable	—	1,677,734	—	292,394
Deposits	299,658	—	—	967,189
Advance collections	—	—	—	65,998
Securities lending obligations	—	62,254,367	—	—
Interfund payables	—	—	—	60,025
Other liabilities	611	4,133,183	—	858,064
Total liabilities	**673,897**	**72,510,912**	**195,342**	**$ 13,691,735**
NET ASSETS				
Held in trust for pension benefits, pool participants, and other purposes	**$ 3,141,369**	**$ 408,759,802**	**$ 25,160,913**	

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, 2008
(amounts in thousands)

	Private Purpose Trust	Pension and Other Employee Benefit Trust	Investment Trust Local Agency Investment
ADDITIONS			
Contributions:			
Employer	$ —	$ 12,269,903	$ —
Plan member	—	6,775,528	—
Total contributions	—	19,045,431	—
Investment income:			
Net appreciation (depreciation) in fair value of investments	(221,204)	(29,456,876)	—
Interest, dividends, and other investment income	121,923	12,745,177	935,886
Less: investment expense	(9,792)	(5,963,993)	—
Net investment income	(109,073)	(22,675,692)	935,886
Receipts from depositors	1,365,444	—	32,477,787
Other	—	235,768	—
Total additions	**1,256,371**	**(3,394,493)**	**33,413,673**
DEDUCTIONS			
Distributions paid and payable to participants	—	18,965,204	934,201
Refunds of contributions	—	286,772	—
Administrative expense	24	531,889	1,685
Payments to and for depositors	849,774	408,283	27,053,132
Total deductions	**849,798**	**20,192,148**	**27,989,018**
Change in net assets	406,573	(23,586,641)	5,424,655
Net assets, July 1, 2007	**2,734,796**	**432,346,443** *	**19,736,258**
Net assets, June 30, 2008	**$ 3,141,369**	**$ 408,759,802**	**$ 25,160,913**

* Restated

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

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Discretely Presented Component Units Financial Statements

Statement of Net Assets

Discretely Presented Component Units – Enterprise Activity

June 30, 2008
(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	$ 258,676	$ 320,463	$ 1,223,832	$ 442,244	$ 661,340	$ 2,906,555
Investments	6,777,015	3,111,416	488,613	15,490	220,326	10,612,860
Restricted assets:						
Cash and pooled investments	—	—	—	—	22,196	22,196
Investments	—	—	—	—	38,983	38,983
Receivables (net)	1,995,922	931,529	397,234	61,324	352,961	3,738,970
Due from primary government	236,273	—	—	4,622	1,057	241,952
Due from other governments	402,846	—	—	70,791	78,534	552,171
Prepaid items	—	—	641	—	1,591	2,232
Inventories	157,920	—	—	—	245	158,165
Other current assets	135,698	19,565	121	—	72,745	228,129
Total current assets	9,964,350	4,382,973	2,110,441	594,471	1,449,978	18,502,213
Noncurrent assets:						
Restricted assets:						
Cash and pooled investments	—	—	—	—	126,140	126,140
Investments	—	—	—	—	39,696	39,696
Investments	16,497,768	17,302,321	215,715	2,688,464	1,057,274	37,761,542
Receivables (net)	701,305	—	—	—	251,320	952,625
Loans receivable	—	—	8,110,363	—	325,623	8,435,986
Deferred charges	—	—	41,058	—	1,411	42,469
Capital assets:						
Land	664,306	57,768	—	—	109,292	831,366
Collections – nondepreciable	284,875	—	—	—	3,984	288,859
Buildings and other depreciable property	28,143,711	523,126	1,471	—	1,612,697	30,281,005
Less: accumulated depreciation	(12,500,229)	(246,256)	(632)	—	(662,003)	(13,409,120)
Construction in progress	3,000,551	80,138	—	—	62,363	3,143,052
Other noncurrent assets	272,927	—	40,065	—	95,237	408,229
Total noncurrent assets	37,065,214	17,717,097	8,408,040	2,688,464	3,023,034	68,901,849
Total assets	**$ 47,029,564**	**$ 22,100,070**	**$ 10,518,481**	**$ 3,282,935**	**$ 4,473,012**	**$ 87,404,062**

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	$ 1,407,375	$ 98,190	$ 46,239	$ 341,483	$ 100,115	$ 1,993,402
Due to primary government	—	—	—	62,831	—	62,831
Due to other governments	—	—	6	—	—	6
Dividends payable	—	3,100	—	—	—	3,100
Deferred revenue	968,686	—	—	—	64,093	1,032,779
Deposits	362,702	—	182,006	—	1,281	545,989
Contracts and notes payable	—	—	—	—	11,589	11,589
Advance collections	—	114,524	—	—	618	115,142
Interest payable	—	—	148,813	—	1,885	150,698
Securities lending obligations	3,513,191	329,377	—	—	—	3,842,568
Benefits payable	—	1,942,713	—	—	—	1,942,713
Current portion of long-term obligations	1,355,328	71,176	114,212	19,698	125,903	1,686,317
Other current liabilities	1,505,364	132,945	5,816	76,998	184,949	1,906,072
Total current liabilities	9,112,646	2,692,025	497,092	501,010	490,433	13,293,206
Noncurrent liabilities:						
Benefits payable	—	14,134,000	—	2,298,739	—	16,432,739
Compensated absences payable	208,763	—	—	—	11,213	219,976
Certificates of participation, commercial paper, and other borrowings	2,270	—	—	—	64,174	66,444
Capital lease obligations	2,098,791	—	—	—	227,859	2,326,650
Revenue bonds payable	6,736,011	—	8,505,841	—	480,480	15,722,332
Other noncurrent liabilities	2,239,467	370,606	70,444	1,896	373,918	3,056,331
Total noncurrent liabilities	11,285,302	14,504,606	8,576,285	2,300,635	1,157,644	37,824,472
Total liabilities	**20,397,948**	**17,196,631**	**9,073,377**	**2,801,645**	**1,648,077**	51,117,678
NET ASSETS						
Investment in capital assets, net of related debt	10,034,663	414,776	839	—	528,791	10,979,069
Restricted:						
Nonexpendable	2,868,331	—	—	—	702,197	3,570,528
Expendable:						
Endowments and gifts	7,433,816	—	—	—	8,456	7,442,272
Education	887,164	—	—	—	596,405	1,483,569
Indenture	—	—	505,370	—	—	505,370
Employee benefits	—	—	—	616,025	—	616,025
Workers' compensation liability	—	4,488,663	—	—	—	4,488,663
Statute	—	—	938,895	—	258,448	1,197,343
Other purposes	—	—	—	—	289,252	289,252
Total expendable	8,320,980	4,488,663	1,444,265	616,025	1,152,561	16,022,494
Unrestricted	5,407,642	—	—	(134,735)	441,386	5,714,293
Total net assets	**26,631,616**	**4,903,439**	**1,445,104**	**481,290**	**2,824,935**	36,286,384
Total liabilities and net assets	**$ 47,029,564**	**$ 22,100,070**	**$ 10,518,481**	**$ 3,282,935**	**$ 4,473,012**	$ 87,404,062

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, 2008
(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	$ 12,401,378	$ 690,208	$ 26,576	$ —	$ 541,685	$ 13,659,847
Scholarships and fellowships	427,588	—	—	—	40,353	467,941
Supplies	2,101,594	—	—	—	9,193	2,110,787
Services and charges	391,966	75,863	65,688	936,963	1,270,168	2,740,648
Department of Energy laboratories	1,039,330	—	—	—	—	1,039,330
Depreciation	1,093,620	40,436	182	—	63,901	1,198,139
Distributions to beneficiaries	—	1,756,083	—	—	—	1,756,083
Interest expense and fiscal charges	400,369	—	392,647	—	32,433	825,449
Amortization of deferred charges	—	260,786	10,617	—	86	271,489
Grants provided	527,572	—	75,584	—	—	603,156
Other	2,757,170	160,443	—	—	50,895	2,968,508
Total operating expenses	**21,140,587**	**2,983,819**	**571,294**	**936,963**	**2,008,714**	**27,641,377**
PROGRAM REVENUES						
Charges for services	10,385,989	2,274,908	506,194	1,826,740	1,245,046	16,238,877
Operating grants and contributions	7,867,138	—	118,001	—	549,307	8,534,446
Capital grants and contributions	245,305	—	—	—	4,797	250,102
Total program revenues	**18,498,432**	**2,274,908**	**624,195**	**1,826,740**	**1,799,150**	**25,023,425**
Net (expense) revenue	(2,642,155)	(708,911)	52,901	889,777	(209,564)	(2,617,952)
GENERAL REVENUES						
Investment and interest income (loss)	275,632	1,311,092	(3,746)	(30,188)	(26,089)	1,526,701
Other	2,222,464	119,703	3,036	—	265,089	2,610,292
Total general revenues	**2,498,096**	**1,430,795**	**(710)**	**(30,188)**	**239,000**	**4,136,993**
Change in net assets	(144,059)	721,884	52,191	859,589	29,436	1,519,041
Net assets (deficit), July 1, 2007	**26,775,675**	**4,181,555**	**1,392,913**	**(378,299)**	**2,795,499 ***	**34,767,343**
Net assets (deficit), June 30, 2008	**$ 26,631,616**	**$ 4,903,439**	**$ 1,445,104**	**$ 481,290**	**$ 2,824,935**	**$ 36,286,384**

* 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). The provisions of the following Governmental Accounting Standards Board (GASB) Statements have been implemented for the year ended June 30, 2008:

GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*;

GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*; and

GASB Statement No. 50, *Pension Disclosures; an amendment of GASB Statements No. 25 and No. 27*.

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 $527 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 94250-5872.

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, Resources, Environmental and Capital Outlay 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 $71 million between the authorities and other programs reported in the same fund have been eliminated from the 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 moneys and the administration of the plans. CalPERS administers the following seven 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 State Peace Officers' and Firefighters' Defined Contribution Plan Fund, the public employee Replacement Benefits Fund, and the public employee 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 94229-2703.

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 three pension and other employee benefit trust funds: the State Teachers' Retirement Fund; the Teachers' Health Benefits Fund; and the Pension2 Program, formally known as 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 95851-0275.

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, 10th Floor, Oakland, California 94607-5200.

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, 2007, may be obtained from the State Compensation Insurance Fund, P.O. Box 420807, San Francisco, California 94142-0807.

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 94229-2703.

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 94250-5872.

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 nonprofit 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, 2007);

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, 2007);

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 provided financing for projects to increase power supplies, reduce demand for energy, and improve the efficiency and environmental performance of power plants. The last remaining program expired in 2007 and all other activities were transferred to other state agencies, so this is the last year for which this component unit will be reported.

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, 2008, CADA had total assets of $29.9 million, total liabilities of $18.0 million, and total net assets of $11.9 million. Total revenues for the fiscal year were $10.5 million and expenses were $8.3 million, resulting in a change in net assets of $2.2 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 95814-5958.

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 94250-5872.

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 accountability 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 Fund* accounts for fuel taxes, including the State's diesel, motor vehicle, and fuel use taxes; bond proceeds; automobile registration fees; and other revenues that are used for transportation purposes, including highway and passenger rail construction and transportation safety programs.

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:

- The activity's debt is secured solely by fees and charges of the activity;
- There is a legal requirement to recover costs; or
- 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, and administrative services related to water delivery. 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.

The California State University (CSU), an agency that accounts for its lease activities in the State University Dormitory Building Maintenance and Equipment Fund, a nonmajor enterprise fund, has entered into 30-year capital lease agreements with certain of its auxiliary organizations that are accounted for as a nonmajor discretely presented component unit. These agreements lease existing and newly constructed facilities to the auxiliary organizations. A portion of the proceeds from certain revenue bonds issued by CSU were used to finance the construction of these facilities.

G. Deferred Charges

The deferred charges account in the enterprise funds primarily represents operating and maintenance costs and unrecovered capital costs that will be recognized in the Water Resources Fund as expenses over the remaining life of long-term state water supply contracts. 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 and are amortized over the life of the bonds.

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 recorded 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 12,183 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 net other postemployment benefit obligation, 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, discounts, and loss on refundings 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, discount, or loss. Bond premiums and discounts for governmental activities are reported as other financing sources (uses) in the fund financial statements. However, in the government-wide financial statements, the bonds payable for governmental activities is reported net of the applicable unamortized premium, discount and loss on refunding.

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 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, 2008, the government-wide

financial statements show restricted net assets for the primary government of $17.0 billion, of which $8.3 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** decreased by $8 million. This decrease is reported in two **nonmajor governmental funds** and comprises a $6 million net decrease in the separate financial statements of the trial courts as a result of error corrections for overstated revenue and unreconciled amounts the courts found when migrating to a centralized accounting system and a $2 million decrease from an error the Department of Public Health made when reversing a transfer accrual. In addition, the Transportation Safety Fund and several other funds previously included in other nonmajor special revenue funds were combined with the Transportation Construction Fund to create the newly-named Transportation Fund. As a result, the beginning fund balance of the Transportation Fund increased by $908 million and the beginning fund balance of the **nonmajor governmental funds** decreased by $908 million.

The beginning net assets of the **nonmajor enterprise funds** increased by $260 million from the inclusion of the net investment in direct financing leases between the California State University and its auxiliary organizations, a nonmajor component unit.

The beginning net assets of the **pension and other employee benefit trust funds** decreased by $69 million as a result of overstated member contributions in the Volunteer Firefighters' Length of Service Award Fund.

The beginning net assets of the **discretely presented component units – enterprise activity** increased by $12 million as a result of error corrections in the separately audited financial statements of the California State University auxiliary organizations. The corrections included adjustments for depository and other liabilities, notes payable, receivables, and endowment investments.

2. Government-wide Financial Statements

The beginning net assets of the **governmental activities**, **business-type activities**, and the **component units** were restated as described in the previous section for governmental funds and discretely presented component units – enterprise activity, respectively.

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, 2008, increased spending authority for the General Fund and the Transportation 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 is 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, 2008, the discretely presented component units accounted for approximately 3.7% 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, 2008, totaling approximately $10.3 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, 2008, the State Treasurer's Office had on deposit with a fiscal agent amounts totaling $31 million related to principal and interest payments to bondholders. Additionally, $13 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. The State Treasurer's Office performs a quarterly fair market valuation of the pooled investment program portfolio. In addition, the State Treasurer's Office performs a monthly fair market valuation of all securities held against carrying cost. These valuations are posted to the State Treasurer's Office website at www.treasurer.ca.gov. As of June 30, 2008, the weighted average maturity of the securities in the pooled investment program administered by the State Treasurer's Office was approximately 163 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, 2008, 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. Most of the $412 million in interest revenue received by the General Fund from the pooled investment program in the 2007-08 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, 2008, structured notes and asset-backed securities comprised approximately 14.7% of the pooled investments. A significant portion of the structured notes consisted of federal agency floating-rate debentures. For the federal agency and corporate floating-rate securities 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 portion representing the asset-backed securities consists of mortgage backed securities, Small Business Administration (SBA) pools, and asset-backed commercial paper. The mortgage-backed securities are called real estate mortgage investment conduits (REMICs), and are securities backed by pools of mortgages. The REMICs in the State's portfolio have a fixed principal payment schedule. A lesser portion of the asset-backed securities consisted of floating-rate SBA notes. For floating-rate SBA 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. The bulk of the asset-backed portfolio holdings were asset-backed commercial paper (ABCP) which represented 3.6% of pooled investments.

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[1]	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[2]
Corporate Bonds/Notes	5 years	N/A	N/A	A-/A3/A-[3]
Repurchase Agreements	1 year	N/A	N/A	N/A
Reverse Repurchase Agreements	1 year	10%[1]	N/A	N/A

[1] 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, except for commercial paper.

[2] 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.

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

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

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, 2008
(amounts in thousands)

	Interest Rates[1]	Maturity	Fair Value at Year End	Weighted Average Maturity (in years)
Pooled investments				
U.S. Treasury bills and notes	1.79 - 2.51	3 days - 1.38 years	$ 4,167,418	0.76
U.S. agency bonds and discount notes	2.00 - 5.37	18 days - 2.00 years	19,629,101	0.63
Small Business Administration loans	2.55 - 3.38	0.25 year	547,472	0.25 [2]
Mortgage-backed securities [3]	3.92 - 14.25	17 days - 7.13 years	1,118,704	3.29
Certificates of deposit	2.25 - 3.07	1 day - 149 days	14,042,931	0.14
Commercial paper	2.08 - 3.00	1 day - 149 days	9,327,169	0.07
Corporate bonds and notes	2.62 - 5.50	7 days - 1.70 years	1,136,398	0.33
Total pooled investments			**49,969,193** [4]	
Other primary government investments				
U.S. Treasuries and agencies			2,062,358	4.68
Commercial paper			900,820	N/A [5]
Guaranteed investment contracts			400,404	14.31
Corporate debt securities			601,643	1.77
Other			1,102,854	0.75
Total other primary government investments [6]			**5,068,079**	
Funds outside primary government included in pooled investments				
Less: investment trust funds			25,356,255	
Less: other trust and agency funds			3,438,677	
Less: discretely presented component units			2,616,669	
Total primary government investments			**$ 23,625,671**	

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

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

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

4 Total pooled investments does not include certain assets of the State's pooled investment program. The other assets include $9.4 billion of time deposits and $10.7 billion of internal loans to State funds which are reported as cash in the respective funds.

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

6 Total other primary government investments include approximately $47 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, 2008
(amounts in thousands)

Pooled investments	Fair Value at Year End	% of Total Pooled Investments
Mortgage-backed		
Federal National Mortgage Association Collateralized Mortgage Obligations	$ 1,118,457	2.238 %
Government National Mortgage Association Pools	184	0.000
Federal Home Loan Mortgage Corporation Participation Certificate Pools	63	0.000

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, 2008
(amounts in thousands)

Credit Rating as of Year End		
Short-term	**Long-term**	**Fair Value**
Pooled investments[1]		
A-1+/P-1/F-1+	AAA/Aaa/AAA	$ 38,790,866 [2]
A-1/P-1/F-1	AA/Aa/AA	4,972,209
A-2/P-2/F-2	A/A/A	343,902
B/N.P./B	BB/Ba/BB	28,622
Not rated		1,118,520
Not applicable		4,715,074
Total pooled investments		$ **49,969,193** [3]
Other primary government investments		
A-1+/P-1/F-1+	AAA/Aaa/AAA	$ 1,138,071
A-1/P-1/F-1	AA/Aa/AA	530,376
A-2/P-2/F-2	A/A/A	1,061,464
A-3/P-3/F-3	BBB/Baa/BBB	4,803
Not rated		557,954
Not applicable		1,775,411
Total other primary government investments		**$ 5,068,079**

1 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.

2 This amount includes $8.1 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.

3 Total pooled investments does not include certain assets of the State's pooled investment program. The other assets include time deposits of $9.4 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 $10.7 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, 2008
(amounts in thousands)

POOLED INVESTMENTS

Issuer	Investment Type	Reported Amount	% of Total Pooled Investments
Federal Home Loan Bank	U.S. agency securities	$ 10,432,122	20.88 %
Federal Home Loan Mortgage Corp.	U.S. agency securities	8,100,656	16.21
General Electric Capital/GE Company	Corporate Bonds/Commercial Paper	2,501,395	5.01

OTHER PRIMARY GOVERNMENT INVESTMENTS

Issuer	Investment Type	Reported Amount	% of Total Agency Investments
Golden State Tobacco Securitization Corporation			
Briarwood	Commercial paper	$ 63,540	13.44 %
Coral	Commercial paper	86,703	18.35
Crimson	Commercial paper	72,883	15.42
Curzon	Commercial paper	64,617	13.67
Hannover	Commercial paper	75,318	15.94
Morrigan	Commercial paper	75,386	15.95
Sapphire	Commercial paper	28,023	5.93
Department of Water Resources			
Federal National Mortgage Association	U.S. agency securities	$ 73,934	61.01 %

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, 2008, $16 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 negative $100 million as of June 30, 2008. 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, 2008, CalPERS had an approximately negative $100 million net exposure to loss from forward foreign currency exchange transactions related to the approximately $53.5 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, 364 days, 499 days, and 57 days. In accordance with CalPERS' investment guidelines, the cash collateral was invested in short-term investment funds that, at June 30, 2008, had durations of 1 day, 21 days, 22 days, and 2 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, 2008, had a 20-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, 2008, 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, 2008
(amounts in thousands)

Investment Type	Fair Value
Equity securities	$ 216,107,648
Debt securities*	97,184,508
Investment contracts	944,970
Mutual funds	7,677,438
Real estate	42,306,465
Inflation linked	4,659,829
Insurance contracts	281,756
Private equity	40,588,117
Securities lending collateral	62,254,367
Other	1,250,768
Total investments	**$ 473,255,866**

* 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 20% (0.80 to 1.20) of the average effective duration of the relevant Lehman Brothers benchmark. The permissible range of deviation for the average 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 the average maturity of the portfolio shall be managed such that it will not exceed 180 days.

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, 2008
(amounts in thousands)

	Fair Value at Year End	Effective Duration[1]
California Public Employees' Retirement Fund [2]		
U.S. Treasuries and agencies	$ 7,508,022	10.27
Mortgages	27,276,700	5.43
Corporate	17,879,260	8.71
Asset-backed	1,091,790	6.61
Private placement	5,494	4.64
International	5,656,320	7.41
SWAPS	128,672	1.33
Commingled	3,220	2.17
No effective duration [3]	2,039,109	N/A
Total	**$ 61,588,587**	
Deferred Compensation Plan Fund		
Investment contracts	$ 944,970	4.25
Scholarshare Program Trust Fund		
Investment contracts	$ 281,756	2.38
California State Teachers' Retirement System		
Long-term fixed-income investments		
U.S. Government and agency obligations	$ 6,671,318	4.53
Corporate	6,313,843	5.92
High yield	2,415,903	3.66
Debt core plus	4,178,269	5.21
Asset-backed securities	89,670	4.16
Commercial mortgage-backed securities	1,692,192	4.57
Mortgage-backed securities	9,472,130	4.03
Total	**$ 30,833,325**	

	0-30 days	31-90 days	91-120 days
Short-term fixed-income investments			
Money market securities	$ 1,015,846	$ 48,030	$ —
Corporate bonds	—	—	—
Corporate floating-rate notes	112,584	245,687	17,000
U.S. Government and agency obligations			
Noncallables	19,995	84,927	14,539
Discount notes	99,907	74,671	—
Callable	37,000	126,997	13,997
Municipals	—	12,747	—
U.S. Treasury	95,778	74,824	—
Asset-backed securities	138,357	20,845	19,000
Total	**$ 1,519,467**	**$ 688,728**	**$ 64,536**

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

121-180 days	181-365 days	366+ days	Fair Value at Year End
$ —	$ —	$ —	$ 1,063,876
—	2,340	—	2,340
—	—	—	375,271
50,424	25,075	44,951	239,911
24,695	—	—	199,273
34,029	11,998	—	224,021
—	—	—	12,747
—	48,874	14,951	234,427
—	14,499	—	192,701
$ 109,148	**$ 102,786**	**$ 59,902**	**$ 2,544,567**

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, at the time of purchase, at least 95% of the corporate securities comprising the credit portion of the internally managed fixed income portfolio be rated Baa3/BBB-/BBB- or better by two out of the three nationally recognized statistical rating organizations (NRSROs), such as Moody's Investors Service, Inc, Standard and Poor's Rating Service, or Fitch Ratings. The rating used to determine the quality of the individual securities will be the highest of the ratings supplied by two NRSROs. Furthermore, the total position of the outstanding debt of any one private mortgage-backed and asset-backed securities issuer shall be limited to 10% of the market value of the portfolio. Obligations of other issuers are held to a 5% per issuer limit (at the time of purchase) of the market value of any individual portfolio. The investment guidelines also include an allocation to high yield and core plus assets which 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, 2008
(amounts in thousands)

Credit Rating as of Year End		
Short-term	**Long-term**	**Fair Value**
A-1+/P-1/F-1+	AAA/Aaa/AAA	$ 59,220,214
A-1/P-1/F-1	AA/Aa/AA	12,019,201
A-2/P-2/F-2	A/A/A	12,672,840
A-3/P-3/F-3	BBB/Baa/BBB	11,975,570
B/NP/B	BB/Ba/BB	1,569,379
B/NP/B	B/B/B	1,883,699
C/NP/C	CCC/Caa/CCC	497,194
C/NP/C	CC/Ca/CC	3,787
C/NP/C	C/C/C	576
D/NP/D	D/D/D	9,358
Not rated		10,900,457
Not applicable		18,758,104
Total fixed-income securities		**$ 129,510,379**

3. Concentration of Credit Risk

The Deferred Compensation Plan Fund held $945 million in investment contracts of Dwight Asset Management Company; this amount represented 13.6% of the fund's total investments as of June 30, 2008. The Scholarshare Program Trust Fund held $282 million in investment contracts of TIAA-CREF Life Insurance Company; this amount represented 9.1% of the fund's total investments as of June 20, 2008.

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, 2008, were not exposed to custodial risk.

5. Foreign Currency Risk

At June 30, 2008, CalPERS and CalSTRS held $58.0 billion and $33.7 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 40% of total global equity assets invested in international equities and 8.5% 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 of 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, 2008
(amounts in thousands of U.S. dollars at fair value)

Currency	Cash	Equity	Alternative	Fixed Income	Real Estate	Currency Overlay	Total
Argentine Peso	$ 463	$ 4,587	$ —	$ 109	$ —	$ —	$ 5,159
Australian Dollar	27,057	4,266,697	58,373	124,905	13,316	38,854	4,529,202
Bermuda Dollar	—	1,573	—	—	—	—	1,573
Brazilian Real	6,961	1,444,084	—	30,929	—	(1,950)	1,480,024
British Pound Sterling	88,774	12,974,442	379,812	278,841	205,309	62,653	13,989,831
Canadian Dollar	18,507	4,781,284	137,484	32,266	—	46,217	5,015,758
Chilean Peso	491	56,091	—	—	—	—	56,582
Chinese Yuan	54	8,171	—	—	—	—	8,225
Columbian Peso	45	—	—	1,384	—	—	1,429
Czech Koruna	244	78,548	—	—	—	—	78,792
Danish Krone	14,594	609,120	625	61,215	—	(2,738)	682,816
Egyptian Pound	5,159	186,364	—	—	—	—	191,523
Euro	248,927	27,239,731	2,005,046	2,162,445	25,749	(11,464)	31,670,434
Hong Kong Dollar	21,537	3,302,581	—	—	24,928	16,736	3,365,782
Hungarian Forint	231	90,457	—	2,088	—	18,288	111,064
Iceland Krona	—	—	—	4,275	—	—	4,275
Indian Rupee	2,252	697,299	—	—	—	—	699,551
Indonesian Rupiah	498	306,905	—	—	—	358	307,761
Israeli Shekel	4,013	305,177	—	1	—	1,317	310,508
Japanese Yen	572,207	12,375,450	1,126,576	1,488,078	57,636	97,005	15,716,952
Malaysian Ringgit	6,176	300,426	—	—	—	(2,453)	304,149
Mexican Peso	3,996	542,373	—	62,399	—	(233)	608,535
Moroccan Dirham	87	797	—	—	—	—	884
New Russian Ruble	—	8,086	—	—	—	27,068	35,154
New Zealand Dollar	1,820	70,273	—	9,262	2,277	(224)	83,408
Norwegian Krone	29,833	839,065	—	—	—	31,954	900,852
Pakistan Rupee	29	7,602	—	—	—	—	7,631
Peruvian Nouveau Sol	12	454	—	—	—	7,122	7,588
Philippine Peso	378	48,317	—	—	—	(25)	48,670
Polish Zloty	1,311	120,472	—	30,645	—	—	152,428
Singapore Dollar	7,366	949,034	—	15,278	39,092	—	1,010,770
South African Rand	3,877	1,047,523	—	7,172	—	5,107	1,063,679
South Korean Won	3,420	1,840,313	—	9,488	—	—	1,853,221
Sri Lanka Rupee	16	413	—	—	—	—	429
Swedish Krona	32,514	1,271,945	—	160,212	—	(84)	1,464,587
Swiss Franc	17,181	4,180,492	306	—	1,514	356	4,199,849
Taiwan Dollar	38,892	1,365,473	—	—	—	—	1,404,365
Thailand Baht	2,867	271,583	—	3,985	—	(5,349)	273,086
Turkish New Lira	802	430,211	—	—	—	1,866	432,879
UAE Dirham	—	—	—	—	—	14,129	14,129
Total exposure to foreign currency risk	**$ 1,162,591**	**$ 82,023,413**	**$ 3,708,222**	**$ 4,484,977**	**$ 369,821**	**$ 344,510**	**$ 92,093,534**

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 it is obligated to pay a fee and a rebate to the borrower. The university receives the net investment income. As of June 30, 2008, the university had no exposure to borrowers because the amounts that 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, 2008, the securities in these pools had a weighted average maturity of 27 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, 2007, the aggregate fair value of the loaned securities and the cash collateral received in respect to these loans was $334 million and $329 million, 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, 2008
(amounts in thousands)

Investment Type	Fair Value
Equity securities	$ 3,945,363
Debt securities*	32,678,462
Investment contracts	517,365
Mutual funds	5,215,479
Real estate	566,167
Money market securities	423,743
Private equity	820,909
Mortgage loans	596,919
Externally held irrevocable trusts	283,058
Securities lending collateral	3,497,400
Invested for others	(1,424,024)
Other	1,332,240
Total investments	**$ 48,453,081**

* 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, 2008
(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	$ 946,865	1.00	$ 130,345	4.50
U.S. Treasury strips	29,659	8.00	—	—
U.S. TIPS	424,552	5.30	—	—
U.S. government-backed securities	3,637	6.30	4,406	3.80
U.S. government-backed asset-backed securities	—	—	2,240	3.90
Corporate bonds	3,259,085	2.60	61,324	4.00
Commercial paper	2,937,981	0.00	—	—
U.S. agencies	1,398,261	1.40	82,836	2.50
U.S. agencies asset-backed securities	137,200	4.40	2,101	3.30
Corporate asset-backed securities	241,409	3.80	11,947	0.60
Supranational/foreign	828,033	2.80	620	0.00
Government/Sovereign (foreign currency denominated)	189,068	6.60	—	—
Corporate (foreign currency denominated)	5,072	3.90	—	—
U.S. bond funds	40,243	4.70	168,668	4.60
Non-U.S. bond funds	—	—	49,544	5.10
Money market funds	26,895	0.00	357,418	1.80
Mortgage loans	586,387	0.00	10,532	5.40
Other	15	0.60	—	—
Total	**$ 11,054,362**		**$ 881,981**	

	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	$ 5,192,014	3.66	$ 219,777	11.80
Municipal securities	328,583	7.27	—	—
Public utilities	406,971	6.88	—	—
Corporate bonds	6,283,723	4.54	—	—
Commercial paper	173,911	0.10	—	—
Certificate of deposit	104,994	0.24	—	—
Special revenue	1,101,675	11.24	—	—
Other government	49,889	0.92	—	—
Mortgage-backed securities	6,449,987	22.55	—	—
Mutual funds	321,990	0.11	—	—
Total	**$ 20,413,737**		**$ 219,777**	

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, 2008
(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.	$ 339,991	4.30	$ 72,953	2.50
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.			8,048	1.70
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.	4,139	3.20	11,947	0.60
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.	609,359	0.20		
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.	1,500,966	1.60	506	3.50

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, comprising 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, 2008
(amounts in thousands)

Credit Rating as of Year End		
Short-term	**Long-term**	**Fair Value**
A-1+/P-1/F-1+	AAA/Aaa/AAA	$ 15,788,955
A-1/P-1/F-1	AA/Aa/AA	6,693,224
A-2/P-2/F-2	A/A/A	5,657,317
A-3/P-3/F-3	BBB/Baa/BBB	1,628,259
B/NP/B	BB/Ba/BB	108,070
B/NP/B	B/B/B	130,112
C/NP/C	CCC/Caa/CCC	408
Not rated		1,286,582
Total fixed-income securities		**$ 31,292,927**

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 $784 million in federal agency securities of the Federal National Mortgage Association; this amount represented 5.28% of the university's total investments as of June 30, 2008.

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, 2008
(amounts in thousands)

	Fair Value
Investment Type	
Domestic equity securities	$ 91,941
Foreign equity securities	1,212
U.S. Treasury bills, notes, and bonds	92,801
U.S. government-backed – asset-backed securities	2,226
U.S. agencies	2,224
Total exposure to custodial credit risk	**$ 190,404**

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, 2008
(amounts in thousands of U.S. dollars at fair value)

Currency	Equity	Fixed-Income	Total
Australian Dollar	$ 62,575	$ 808	$ 63,383
British Pound Sterling	224,191	13,685	237,876
Canadian Dollar	83,061	4,261	87,322
Danish Krone	10,595	1,527	12,122
Euro	418,975	99,699	518,674
Hong Kong Dollar	29,855	—	29,855
Japanese Yen	224,270	67,240	291,510
Malaysian Ringgit	—	854	854
New Zealand Dollar	741	—	741
Norwegian Krone	9,717	574	10,291
Polish Zloty	—	2,011	2,011
Singapore Dollar	16,800	729	17,529
South African Rand	2,406	—	2,406
South Korean Won	3,445	—	3,445
Swedish Krona	19,661	1,381	21,042
Swiss Franc	89,039	1,371	90,410
Thailand Baht	2,309	—	2,309
Other	19,052	—	19,052
Commingled currencies	1,152,735	29,683	1,182,418
Total exposure to foreign currency risk	**$ 2,369,427**	**$ 223,823**	**$ 2,593,250**

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, 2008
(amounts in thousands)

	Taxes	Reimbursement of Accrued Interest Expense	Lottery Retailers	Unemployment Programs	Other	Total
Current governmental activities						
General Fund	$ 9,352,420	$ —	$ —	$ —	$ 565,336	$ 9,917,756
Federal Fund	—	—	—	—	1,535	1,535
Transportation Fund	338,097	—	—	—	181,502	519,599
Nonmajor governmental funds	75,986	81	—	—	1,179,343	1,255,410
Internal service funds	—	—	—	—	53,406	53,406
Adjustment:						
Fiduciary funds	—	—	—	—	371,746	371,746
Total current governmental activities	**$ 9,766,503**	**$ 81**	**$ —**	**$ —**	**$ 2,352,868**	**$ 12,119,452**
Amounts not scheduled for collection during the subsequent year	**$ 1,402,964**	**$ —**	**$ —**	**$ —**	**$ 294,652**	**$ 1,697,616**
Current business-type activities						
Water Resources Fund	$ —	$ —	$ —	$ —	$ 109,775	$ 109,775
Public Building Construction Fund	—	108,498	—	—	—	108,498
State Lottery Fund	—	—	159,097	—	—	159,097
Unemployment Programs Fund	—	—	—	213,598	—	213,598
Nonmajor enterprise funds	—	—	—	—	41,715	41,715
Adjustment:						
Account reclassification	—	(107,888)	—	—	(3,745)	(111,633)
Total current business-type activities	**$ —**	**$ 610**	**$ 159,097**	**$ 213,598**	**$ 147,745**	**$ 521,050**
Amounts not scheduled for collection during the subsequent year	**$ —**	**$ —**	**$ —**	**$ 17,194**	**$ —**	**$ 17,194**

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, 2008
(amounts in thousands)

	Cash and Pooled Investments	Investments	Due From Other Governments	Loans Receivable	Total
Primary government					
Debt service	$ 1,185,560	$ 524,135	$ 57,496	$ 454,214	$ 2,221,405
Construction	15,866	—	—	—	15,866
Operations	1,781,301	—	—	—	1,781,301
Other	6,828	35,989	—	—	42,817
Total primary government	**2,989,555**	**560,124**	**57,496**	**454,214**	**4,061,389**
Discretely presented component units					
Nonmajor component units – debt service	148,336	78,679	—	—	227,015
Total discretely presented component units	**148,336**	**78,679**	**—**	**—**	**227,015**
Total restricted assets	**$ 3,137,891**	**$ 638,803**	**$ 57,496**	**$ 454,214**	**$ 4,288,404**

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.

The California State University (CSU), an agency that accounts for its lease activities in the State University Dormitory Building Maintenance and Equipment Fund, a nonmajor enterprise fund, has entered into 30-year capital lease agreements with certain of its auxiliary organizations that are accounted for as a nonmajor discretely presented component unit. These agreements lease existing and newly constructed facilities to the auxiliary organizations. A portion of the proceeds from certain revenue bonds issued by CSU were used to finance the construction of these facilities.

Table 18 summarizes the minimum lease payments to be received by the primary government.

Table 18

Schedule of Minimum Lease Payments to be Received by the Primary Government
(amounts in thousands)

Year Ending June 30	Primary Government Agencies	University of California	Nonmajor Component Unit	Local Agencies	Total
2009	$ 478,184	$ 168,319	$ 16,237	$ 70,844	$ 733,584
2010	462,093	160,894	16,156	70,030	709,173
2011	436,079	160,765	16,209	68,700	681,753
2012	425,917	160,851	16,425	64,641	667,834
2013	415,753	160,804	19,793	63,671	660,021
2014-2018	2,028,494	671,719	94,534	252,529	3,047,276
2019-2023	1,289,034	557,237	90,863	77,765	2,014,899
2024-2028	852,301	291,450	90,960	63,379	1,298,090
2029-2033	206,303	118,240	75,647	39,021	439,211
2034-2038	—	—	17,768	—	17,768
Total minimum lease payments	**6,594,158**	**2,450,279**	**454,592**	**770,580**	**10,269,609**
Less: unearned income	2,352,986	827,806	196,952	220,520	3,598,264
Net investment in direct financing leases	**$ 4,241,172**	**$ 1,622,473**	**$ 257,640**	**$ 550,060**	**$ 6,671,345**

NOTE 7: CAPITAL ASSETS

Table 19 summarizes the capital activity for the primary government, which includes $6.0 billion in capital assets related to capital leases.

Table 19

Schedule of Changes in Capital Assets – Primary Government
June 30, 2008
(amounts in thousands)

	Beginning Balance	Additions	Deductions	Ending Balance
Governmental activities				
Capital assets not being depreciated				
Land	$ 15,510,432	$ 605,961	$ 56,923	$ 16,059,470
State highway infrastructure	55,991,217	2,673,779	117,496	58,547,500
Collections	20,682	949	—	21,631
Construction in progress	7,876,896	3,010,934	3,148,934	7,738,896
Total capital assets not being depreciated	**79,399,227**	**6,291,623**	**3,323,353**	**82,367,497**
Capital assets being depreciated				
Buildings and improvements	16,323,278	1,023,890	94,722	17,252,446
Infrastructure	566,630	102,739	—	669,369
Equipment and other assets	4,118,772	428,319	215,796	4,331,295
Total capital assets being depreciated	**21,008,680**	**1,554,948**	**310,518**	**22,253,110**
Less accumulated depreciation for:				
Buildings and improvements	5,415,942	481,703	72,430	5,825,215
Infrastructure	173,550	23,662	—	197,212
Equipment and other assets	3,000,253	326,078	87,820	3,238,511
Total accumulated depreciation	**8,589,745**	**831,443**	**160,250**	**9,260,938**
Total capital assets being depreciated, net	**12,418,935**	**723,505**	**150,268**	**12,992,172**
Governmental activities, capital assets, net	**$ 91,818,162**	**$ 7,015,128**	**$ 3,473,621**	**$ 95,359,669**
Business-type activities				
Capital assets not being depreciated				
Land	$ 46,766	$ 6,082	$ —	$ 52,848
Collections	29	—	—	29
Construction in progress	1,176,650	734,015	34,420	1,876,245
Total capital assets not being depreciated	**1,223,445**	**740,097**	**34,420**	**1,929,122**
Capital assets being depreciated				
Buildings and improvements	7,327,428	54,055	4,162	7,377,321
Infrastructure	1,223,588	8	—	1,223,596
Equipment and other assets	110,630	4,272	2,231	112,671
Total capital assets being depreciated	**8,661,646**	**58,335**	**6,393**	**8,713,588**
Less accumulated depreciation for:				
Buildings and improvements	2,831,523	159,117	2,432	2,988,208
Infrastructure	715,764	19,721	—	735,485
Equipment and other assets	70,367	9,737	2,117	77,987
Total accumulated depreciation	**3,617,654**	**188,575**	**4,549**	**3,801,680**
Total capital assets being depreciated, net	**5,043,992**	**(130,240)**	**1,844**	**4,911,908**
Business-type activities, capital assets, net	**$ 6,267,437**	**$ 609,857**	**$ 36,264**	**$ 6,841,030**

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

Table 20

Schedule of Depreciation Expense – Primary Government
June 30, 2008
(amounts in thousands)

	Amount
Governmental activities	
General government	$ 72,471
Education	249,018
Health and human services	48,234
Resources	46,528
State and consumer services	42,892
Business and transportation	156,090
Correctional programs	175,237
Internal service funds (charged to the activities that utilize the fund)	40,973
Total depreciation expense – governmental activities	**831,443**
Business-type activities	
Enterprise	**188,575**
Total primary government	**$ 1,020,018**

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, 2008
(amounts in thousands)

	Beginning Balance	Additions	Deductions	Ending Balance
Capital assets not being depreciated				
Land	$ 762,229	$ 73,114	$ 3,977	$ 831,366
Collections	270,097	18,762	—	288,859
Construction in progress	3,966,242	49,061	872,251	3,143,052
Total capital assets not being depreciated	**4,998,568**	**140,937**	**876,228**	**4,263,277**
Capital assets being depreciated				
Buildings and improvements	18,509,061	2,868,489	53,501	21,324,049
Equipment and other depreciable assets	8,129,581	668,126	311,096	8,486,611
Infrastructure	433,245	38,049	949	470,345
Total capital assets being depreciated	**27,071,887**	**3,574,664**	**365,546**	**30,281,005**
Less accumulated depreciation for:				
Buildings and improvements	6,877,542	625,724	28,621	7,474,645
Equipment and other depreciable assets	5,474,912	555,465	298,100	5,732,277
Infrastructure	186,230	16,950	982	202,198
Total accumulated depreciation	**12,538,684**	**1,198,139**	**327,703**	**13,409,120**
Total capital assets being depreciated, net	**14,533,203**	**2,376,525**	**37,843**	**16,871,885**
Capital assets, net	**$ 19,531,771**	**$ 2,517,462**	**$ 914,071**	**$ 21,135,162**

NOTE 8: ACCOUNTS PAYABLE

Accounts payable are amounts due 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 fiduciary funds that were reclassified as external payables on the government-wide Statement of Net Assets.

Table 22

Schedule of Accounts Payable
June 30, 2008
(amounts in thousands)

	Education	Health and Human Services	Resources	Business and Transportation	General Government and Others	Total
Governmental activities						
General Fund	$ 55,000	$ 685,568	$ 248,662	$ 1,500	$ 554,809	$ 1,545,539
Federal Fund	142,580	581,721	58,212	124,040	194,523	1,101,076
Transportation Fund	218	26,294	21,917	369,789	95,056	513,274
Nonmajor governmental funds	1,175,322	1,018,088	246,053	1,205,702	450,780	4,095,945
Internal service funds	—	—	21,573	—	214,324	235,897
Adjustment:						
Fiduciary funds	3,396,563	4,449,341	28,709	162,048	1,074,270	9,110,931
Total governmental activities	**$ 4,769,683**	**$ 6,761,012**	**$ 625,126**	**$ 1,863,079**	**$ 2,583,762**	**$ 16,602,662**
Business-type activities						
Electric Power Fund	$ —	$ —	$ 469,318	$ —	$ —	$ 469,318
Water Resources Fund	—	—	91,143	—	—	91,143
Public Building Construction Fund	—	—	—	—	26,246	26,246
State Lottery Fund	—	—	—	—	31,384	31,384
Unemployment Program Fund	—	66	—	—	6	72
Nonmajor enterprise funds	42,885	484	250	10,382	3,316	57,317
Adjustment:						
Fiduciary funds	—	—	—	—	25,192	25,192
Total business-type activities	**$ 42,885**	**$ 550**	**$ 560,711**	**$ 10,382**	**$ 86,144**	**$ 700,672**

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 November 1, 2007, the State issued $7.0 billion of RANs to fund cash flow needs for the 2007-08 fiscal year. The RANs were repaid on June 30, 2008.

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, 2008 draws totaling $40 million were outstanding.

NOTE 10: LONG-TERM OBLIGATIONS

As of June 30, 2008, the primary government had long-term obligations totaling $113.2 billion. Of that amount, $6.1 billion is due within one year. The $6.1 billion includes $151 million in outstanding commercial paper that was scheduled to be repaid by general obligation bonds issued during the fiscal year. This commercial paper was not repaid until July 2008. The largest change in governmental activities long-term obligations is an increase of $6.1 billion in general obligation bonds payable mainly attributed to the sale of $3.2 billion of Economic Recovery bonds and $1.1 billion of Highway Safety, Traffic Reduction, Air Quality, and Port Security (Proposition 1B) bonds. Another reason for the increase in general obligation bonds payable is the inclusion for the first time of the net unamortized bond premiums and refunding losses that have accumulated to a material amount since the inception of GASB 34 in 2001. This increased the June 30, 2008 general obligation bonds payable by $914 million. Previously, the premiums and refunding losses were determined to be immaterial and were netted against debt service interest and fiscal charges in the governmental funds each year. Another reason for the increase in long-term obligations is the establishment of a $2.3 billion net other postemployment benefits obligation.

The other long-term obligations for governmental activities consist of $2.0 billion for net pension obligations, $300 million owed for lawsuits, the University of California unfunded pension liability of $63 million, and the Department of Technology Services notes payable of $37 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 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 $591 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, 2008.

Table 23

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

	Balance July 1, 2007	Additions	Deductions	Balance June 30, 2008	Due Within One Year	Noncurrent Liabilities
Governmental activities						
Loans payable	$ 925,855	$ —	$ 925,855	$ —	$ —	$ —
Compensated absences payable	1,999,193	955,912	930,304	2,024,801	112,878	1,911,923
Certificates of participation and commercial paper	1,358,051	5,564,500	5,188,003	1,734,548	158,257	1,576,291
Accreted interest	—	1,541	—	1,541	—	1,541
Certificates of participation and commercial paper payable	1,358,051	5,566,041	5,188,003	1,736,089	158,257	1,577,832
Capital lease obligations	4,346,179	268,686	238,455	4,376,410	245,140	4,131,270
General obligation bonds	50,269,442	10,427,945	5,187,584	55,509,803	2,674,480	52,835,323
Accreted interest	—	478	—	478	—	478
Premiums/discounts/other	727,383	250,118	63,250	914,251	68,447	845,804
General obligation bonds payable	50,996,825 *	10,678,541	5,250,834	56,424,532	2,742,927	53,681,605
Revenue bonds	8,535,255	55,944	264,770	8,326,429	151,580	8,174,849
Premiums/discounts/other	(525,471)	—	(10,874)	(514,597)	(15,844)	(498,753)
Revenue bonds payable	8,009,784 *	55,944	253,896	7,811,832	135,736	7,676,096
Proposition 98 funding guarantee	3,964,600	—	300,000	3,664,600	600,000	3,064,600
Workers' compensation	2,320,478	568,481	338,457	2,550,502	310,069	2,240,433
Mandated costs	2,066,878	568,317	78,931	2,556,264	27,899	2,528,365
Net other postemployment benefits obligation	—	2,296,829	—	2,296,829	—	2,296,829
Other long-term obligations	2,285,275	355,123	214,916	2,425,482	59,391	2,366,091
Total	**$ 78,273,118**	**$ 21,313,874**	**$ 13,719,651**	**$ 85,867,341**	**$ 4,392,297**	**$ 81,475,044**
Business-type activities						
Benefits payable	$ 10,054	$ —	$ 1,789	$ 8,265	$ 1,504	$ 6,761
Lottery prizes and annuities	2,012,977	1,753,742	2,036,174	1,730,545	494,641	1,235,904
Compensated absences payable	53,699	25,676	22,828	56,547	29,973	26,574
Certificates of participation and commercial paper	179,782	225,237	337,815	67,204	—	67,204
General obligation bonds	1,954,220	91,200	136,430	1,908,990	135,340	1,773,650
Premiums/discounts/other	(1,841)	94	—	(1,747)	—	(1,747)
General obligation bonds payable	1,952,379 *	91,294	136,430	1,907,243	135,340	1,771,903
Revenue bonds	22,990,594	3,430,462	3,444,196	22,976,860	1,036,791	21,940,069
Premiums/discounts/other	(54,659)	107,404	26,508	26,237	17,421	8,816
Revenue bonds payable	22,935,935 *	3,537,866	3,470,704	23,003,097	1,054,212	21,948,885
Other long-term obligations	546,567	54,314	10,228	590,653	6,030	584,623
Total	**$ 27,691,393**	**$ 5,688,129**	**$ 6,015,968**	**$ 27,363,554**	**$ 1,721,700**	**$ 25,641,854**

* 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
2009	$ 7,099	$ 2,539	$ 9,638
2010	6,883	2,758	9,641
2011	6,874	2,766	9,640
2012	6,909	2,732	9,641
2013	6,816	2,828	9,644
2014-2018	28,620	3,203	31,823
Total	**$ 63,201**	**$ 16,826**	**$ 80,027**

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
2009	$ 2,175	$ 158	$ 2,333
2010	2,270	67	2,337
Total	**$ 4,445**	**$ 225**	**$ 4,670**

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 October 01, 2007, authorizes the issuance of notes in an aggregate principal amount not to exceed $2.5 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, 2008, the enterprise fund commercial paper program had $19 million in outstanding notes.

During the year ended June 30, 2008, the primary government issued $5.2 billion in general obligation commercial paper, $400 million in general obligation refunding commercial paper, and $4.1 billion in long-term general obligation bonds to refund outstanding commercial paper. However, by June 30, 2008, only $4.0 billion of the $4.1 billion had been used to repay outstanding commercial paper. The remaining $151 million was used to repay commercial paper in July 2008. As of June 30, 2008, the general obligation commercial paper program had $1.7 billion in outstanding commercial paper notes, of which $151 million is considered a current liability for governmental activities. Of the $1.5 billion noncurrent liability, $10.5 million is for business-type activities and the remainder is for governmental 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, 2008, $37 million in outstanding BANs existed in anticipation of the primary government's issuing revenue bonds to the public. During the 2006-07 fiscal year, the primary government issued Stem Cell Research and Cures BANs to private individuals and philanthropic foundations to finance stem cell research. In October 2007, the primary government issued general obligation bonds to redeem the outstanding BANs. As of June 30, 2008, there were no outstanding Stem Cell Research and Cures BANs.

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, 2008, 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 $310 million as of June 30, 2008, are various unsecured financing agreements with commercial banks totaling $115 million.

NOTE 13: LEASES

The aggregate amount of lease commitments for facilities and equipment of the primary government in effect as of June 30, 2008, 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 $9 million from internal service funds and $4.4 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, 2008, amounted to approximately $798 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 $4.2 billion. This amount represents 97.0% 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 $527 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
2009	$ 235,583	$ 2,006	$ 526,328	$ 763,917
2010	161,845	2,047	497,725	661,617
2011	112,060	2,055	460,598	574,713
2012	68,207	2,085	442,625	512,917
2013	46,504	1,320	422,753	470,577
2014-2018	119,360	550	2,041,939	2,161,849
2019-2023	25,914	—	1,289,034	1,314,948
2024-2028	3,357	—	852,300	855,657
2029-2033	1,725	—	206,303	208,028
2034-2038	1,653	—	—	1,653
2039-2043	405	—	—	405
2044-2048	405	—	—	405
2049-2053	293	—	—	293
2054-2058	109	—	—	109
2059-2063	48	—	—	48
2064-2068	30	—	—	30
2069-2073	30	—	—	30
2074-2078	30	—	—	30
2079-2083	30	—	—	30
2084-2088	30	—	—	30
2089-2093	30	—	—	30
2094-2098	30	—	—	30
2099	3	—	—	3
Total minimum lease payments	**$ 777,681**	**10,063**	**6,739,605**	**$ 7,527,349**
Less: amount representing interest		1,016	2,372,242	
Present value of net minimum lease payments		**$ 9,047**	**$ 4,367,363**	

The aggregate amount of the major discretely presented component units' lease commitments for land, facilities, and equipment in effect as of June 30, 2008, was approximately $4.0 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, 2008, amounted to approximately $243 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
2009	$ 249,594	$ 104,619	$ 49,135	$ 403,348
2010	223,935	83,609	41,550	349,094
2011	216,713	63,166	31,985	311,864
2012	207,597	142,670	14,400	364,667
2013	199,668	27,365	10,684	237,717
2014-2018	891,719	51,886	13,019	956,624
2019-2023	722,612	3,456	—	726,068
2024-2028	419,965	3,766	—	423,731
2029-2033	245,219	4,297	—	249,516
2034-2038	—	4,894	—	4,894
2039-2043	—	1,652	—	1,652
Total minimum lease payments	**3,377,022**	**$ 491,380**	**$ 160,773**	**$ 4,029,175**
Less: amount representing interest	1,134,473			
Present value of net minimum lease payments	**$ 2,242,549**			

NOTE 14: COMMITMENTS

As of June 30, 2008, the primary government had commitments of $6.8 billion for certain highway construction projects. These commitments are not included as a reserve for encumbrances in the Federal Fund or the Transportation Fund because the future expenditures related to these commitments will be reimbursed with $2.9 billion from local governments and $3.9 billion from proceeds of approved federal grants. The ultimate liability will not accrue to the State. In addition, the primary government had commitments of $435 million for various education programs, $204 million for services provided under various public health programs, $352 million for terrorism and disaster prevention preparedness and response projects, and $44 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 $23.9 billion, that are not included as a liability on the Balance Sheet or the Statement of Net Assets. These commitments included $4.9 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 $8.1 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 fair value of $459 million as of June 30, 2008. Also, the Department of Water Resources entered into bilateral arrangements, with a fair value of $314 million, to hedge the price of natural gas. The $23.9 billion in commitments also included grant agreements, totaling approximately $8.8 billion, to reimburse other entities for construction projects for school building aid, parks, transportation related infrastructure, and other improvements, and to reimburse counties and cities for costs associated with various programs. Any

constructed assets 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 $23.9 billion in commitments includes contracts of $822 million for the construction of water projects and the purchase of power that are not included as a liability on the Statement of Net Assets of the Water Resources Fund. Included in this amount are certain power purchase, sale, and exchange contracts which are considered to be derivatives. These contracts had a fair value of $570 million as of June 30, 2008. The primary government also had commitments of $856 million for California State University construction projects, $368 million for the California State Lottery's gaming and telecommunication systems and services, and $86 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.

As of June 30, 2008, 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 $3.3 billion. The university also made commitments to make investments in certain investment partnerships pursuant to provisions in the partnership agreements. These commitments totaled $429 million as of June 30, 2008. The California Housing Finance Agency had outstanding commitments to provide $238 million for loans under its housing programs. The California Public Employees' Retirement System had capital commitments to private equity funds of $26.4 billion and commitments to purchase real estate equity of $17.1 billion 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, 2008, the State had $55.5 billion in outstanding general obligation bonds related to governmental activities and $1.9 billion related to business-type activities. In addition, $58.3 billion of general obligation bonds had been authorized but not issued. This amount includes $20.0 billion authorized by the applicable finance committees for issuance in the form of commercial paper notes. Of this amount, $1.7 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, 2008, the State had $3.0 billion of variable-rate general obligation bonds outstanding, consisting of $987 million in daily rate, $1.9 billion in weekly rate, and $100 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 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 $15.0 billion in Economic Recovery Bonds; during the 2003-04 fiscal year, the State sold a total of $10.9 billion of these bonds. In February 2008, the State sold an additional $3.2 billion Economic Recovery 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, 2008, the State had $10.0 billion of Economic Recovery Bonds outstanding. Of the $10.0 billion outstanding, bonds totaling $1.1 billion are variable rate bonds, consisting of $500 million in daily rates and $627 million 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 $2.4 billion of the outstanding $10.0 billion in Economic Recovery Bonds have interest-reset dates of July 2008 for the bonds issued in 2004 and beginning March 2010 for the bonds issued in 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 3.22% per year for the bonds issued in 2004 and 3.32% per year for the bonds issued in 2008. 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. 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. Stem Cell Research and Cures Bonds

In October 2007, the State issued $250 million in Stem Cell Research and Cures Bonds with an interest reset date of April 1, 2010. At that time, the bonds are subject to mandatory tender for purchase at a price equal to 100% of the principal amount thereof, plus accrued interest, without premium, unless the bonds have been called for redemption on or prior to that date. If the bonds are not redeemed, the interest rate mode for the bonds will be adjusted to a new mode, and the bonds will be remarketed by a remarketing agent appointed by the State. The State has not obtained any credit enhancement with respect to the mandatory tender of the bonds on the first mandatory tender date and does not expect to do so. 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 assumes the full redemption of the bonds on October 1, 2037. In the event of a failed remarketing, funds for the payment will be provided by the General Fund.

D. Debt Service Requirements

Table 28 shows the debt service requirements for all general obligation bonds as of June 30, 2008. The estimated debt service requirements for the $3.0 billion variable-rate general obligation bonds and the $1.1 billion variable-rate Economic Recovery Bonds are calculated using the actual interest rates in effect on June 30, 2008.

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
2009	$ 2,674,480	$ 2,558,766	$ 5,233,246	$ 135,340	$ 94,475	$ 229,815
2010	2,791,790	2,444,152	5,235,942	118,190	85,202	203,392
2011	2,875,421	2,300,115	5,175,536	86,480	77,872	164,352
2012	2,492,710	2,149,274	4,641,984	100,895	73,239	174,134
2013	2,617,645	2,019,699	4,637,344	79,885	69,205	149,090
2014-2018	11,430,770	8,313,037	19,743,807	520,215	273,898	794,113
2019-2023	8,562,140	6,195,025	14,757,165	247,010	175,719	422,729
2024-2028	8,777,275	4,318,449	13,095,724	153,305	132,318	285,623
2029-2033	8,685,050	2,231,621	10,916,671	308,395	76,795	385,190
2034-2038	4,602,000	517,934	5,119,934	107,185	23,834	131,019
2039-2043	1,000	26	1,026	52,090	3,773	55,863
Total	**$ 55,510,281**	**$ 33,048,098**	**$ 88,558,379**	**$ 1,908,990**	**$ 1,086,330**	**$ 2,995,320**

E. General Obligation Bond Defeasances

1. Current Year

On October 18, 2007, the primary government issued $999 million in various-purpose general obligation refunding bonds to current-refund and advance-refund $1.0 billion in general obligation bonds maturing in years 2010 through 2024, 2026, and 2027. 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 $71 million and resulted in an economic gain of $49 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 4.5% per year over the life of the new bonds.

On April 10, 2008, the primary government issued $400 million in general obligation refunding bonds to current-refund $400 million in outstanding refunding commercial paper notes. These refunding commercial paper notes were issued in February and March 2008 to current-refund $400 million outstanding auction–rate general obligation bonds. The commercial paper notes were redeemed within 90 days after issuance of the refunding bonds.

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, 2008, the outstanding balance of general obligation bonds defeased in prior years was approximately $7.3 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. Total principal and interest remaining on the bonds is $510 million, payable through 2015. The annual principal and interest payments on these bonds are expected to require approximately 2% of the federal appropriation pledged. Principal and interest paid in the current year and total federal revenue related to transportation projects were $71 million and $3.0 billion, respectively. These bonds fund activity in the Transportation Fund and are 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, issued revenue bonds to provide funding for public capital improvements serving the California State University, Channel Islands. These bonds were 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 were included in the governmental activities column of the government-wide Statement of Net Assets, but were fully defeased during the 2007-08 fiscal year. For more information, refer to the Revenue Bond Defeasances section.

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 and interest earned on that revenue. The primary government has no legal liability for the payment of principal and interest on these bonds. Total principal and interest remaining on the bonds is $21.4 billion, payable through 2047. The annual principal and interest payments on these bonds are expected to require 100% of the Tobacco Settlement Revenue and interest. Principal and interest paid in the current year and total Tobacco Settlement Revenue and interest were $456 million and $445 million, respectively. 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 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 fund loans to qualified borrowers for single-family houses and multifamily developments. 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, 2008
(amounts in thousands)

Primary government		
Governmental activities		
Transportation Fund	$	462,428
Nonmajor governmental funds		
Golden State Tobacco Securitization Corporation Fund		6,864,356
Building authorities		485,048
Total governmental activities		**7,811,832**
Business-type activities		
Electric Power Fund		9,509,000
Water Resources Fund		2,636,769
Public Building Construction Fund		7,061,248
Nonmajor enterprise funds		3,796,080
Total business-type activities		**23,003,097**
Total primary government		**30,814,929**
Discretely presented component units		
University of California		6,918,284
California Housing Finance Agency		8,617,578
Nonmajor component units		495,443
Total discretely presented component units		**16,031,305**
Total	**$**	**46,846,234**

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*
2009	$ 151,580	$ 365,433	$ 1,036,791	$ 947,786	$ 303,619	$ 644,116
2010	159,120	358,604	1,079,741	902,835	368,232	640,429
2011	162,210	358,488	1,123,835	852,801	424,746	625,053
2012	154,715	350,032	1,165,560	803,565	442,866	608,127
2013	139,900	356,747	1,217,805	750,109	512,639	586,886
2014-2018	513,530	1,759,968	6,622,185	2,932,976	2,480,735	2,628,380
2019-2023	466,391	1,654,362	6,286,148	1,682,344	2,643,149	2,068,461
2024-2028	887,666	1,765,465	2,535,835	806,306	2,755,883	1,500,909
2029-2033	779,975	1,384,488	1,358,570	273,860	2,821,375	932,721
2034-2038	1,345,975	1,220,209	449,775	73,931	2,184,630	425,063
2039-2043	—	847,580	92,020	9,128	815,150	108,968
2044-2048	3,565,367	3,840,812	8,595	391	153,490	18,121
Total	**$ 8,326,429**	**$ 14,262,188**	**$ 22,976,860**	**$ 10,036,032**	**$ 15,906,514**	**$ 10,787,234**

* Includes interest on variable-rate bonds based on rates in effect on June 30, 2008.

Table 31 shows debt service requirements as of June 30, 2008, for variable-rate debt included in Table 30, as well as net swap payments, assuming that current interest rates remain the same for their terms. 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
2009	$ 127,000	$ 61,000	$ 54,000	$ 242,000	$ 35,230	$ 120,474	$ 80,707	$ 236,411
2010	80,000	59,000	52,000	191,000	60,609	125,849	83,173	269,631
2011	241,000	57,000	50,000	348,000	81,070	123,984	81,055	286,109
2012	258,000	53,000	46,000	357,000	100,195	121,465	78,448	300,108
2013	54,000	50,000	45,000	149,000	103,967	118,546	74,626	297,139
2014-2018	2,420,000	180,000	175,000	2,775,000	650,007	545,232	318,942	1,514,181
2019-2023	759,000	31,000	34,000	824,000	812,580	450,085	233,338	1,496,003
2024-2028	—	—	—	—	964,827	333,678	162,731	1,461,236
2029-2033	—	—	—	—	1,221,073	182,815	91,784	1,495,672
2034-2038	—	—	—	—	685,985	58,391	33,200	777,576
2039-2043	—	—	—	—	142,452	16,965	11,092	170,509
2044-2048	—	—	—	—	57,870	3,819	3,199	64,888
Total	**$ 3,939,000**	**$ 491,000**	**$ 456,000**	**$ 4,886,000**	**$ 4,915,865**	**$ 2,201,303**	**$ 1,252,295**	**$ 8,369,463**

* Based on rates in effect on June 30, 2008.

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. Approximately 23% 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 21% 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 A1, 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, 2008	Fair Values at June 30, 2008	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	$ (1,000)	2.914 %	67% of LIBOR	Aaa, AAA, AAA
5/1/2012	234,000	(3,000)	3.024	67% of LIBOR	Aaa, AAA, AAA
5/1/2013	190,000	(3,000)	3.405	SMIFMA	Aa2, AA-, AA-
5/1/2013	95,000	(2,000)	3.405	SMIFMA	Aa3, AA-, A+
5/1/2013	28,000	(1,000)	3.405	SMIFMA	A1, A+, A
5/1/2014	194,000	(4,000)	3.204	67% of LIBOR	Aa2, AA, AA
5/1/2015	287,000	(5,000)	3.184	66.5% of LIBOR	Aa3, AA-, A+
5/1/2015	174,000	(4,000)	3.280	67% of LIBOR	Aaa, AAA, AAA
5/1/2016	202,000	(5,000)	3.342	67% of LIBOR	Aa1, AA, AA+
5/1/2016	485,000	(8,000)	3.228	66.5% of LIBOR	Aa1, AA, AA+
5/1/2017	202,000	(5,000)	3.389	67% of LIBOR	Aa3, AA-, A+
5/1/2017	480,000	(7,000)	3.282	66.5% of LIBOR	Aa3, AA-, AA-
5/1/2018	515,000	(7,000)	3.331	66.5% of LIBOR	Aa1, AA-, AA
5/1/2020	306,000	(3,000)	3.256	64% of LIBOR	Aa1, AA-, AA
5/1/2022	453,000	(3,000)	3.325	64% of LIBOR	Aaa, AA, AA-
Total	**$ 3,939,000**	**$ (61,000)**			

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 the 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 the DWR's bonds trade at levels higher in rate in relation to the tax-exempt market, the DWR's cost would increase.

The DWR has 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). At June 30, 2008, the fair values were provided by the counterparties, using the par value or mark-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, 2008	Fair Values at June 30, 2008	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	$ 4,000	67% of LIBOR	62.83% of CMS	Aa1, AA, AA+
5/1/2014	194,000	3,000	67% of LIBOR	62.70% of CMS	Aa1, AA-, AA
5/1/2015	174,000	3,000	67% of LIBOR	62.60% of CMS	Aa2, AA-, AA-
5/1/2016	202,000	4,000	67% of LIBOR	62.80% of CMS	Aa1, AA, AA+
5/1/2017	202,000	4,000	67% of LIBOR	62.66% of CMS	Aa2, AA-, AA-
Total	**$ 1,006,000**	**$ 18,000**			

As of June 30, 2008, 67% of LIBOR paid on the basis swaps was equal to 1.66%, while the variable rates received based on the five-year CMS Index varied from 3.44 to 5.52%.

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, the 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, the 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 the DWR's underlying floating-rate bonds would no longer be hedged, and the 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, 2008, of the University of California, a discretely presented component unit. Total principal, variable interest, and interest rate net swap payments are $284 million, $165 million, and $148 million, respectively.

Objective: The university 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. The university entered into interest rate swap agreements in connection with certain variable-rate Medical Center Pooled Revenue Bonds.

Terms: The notional amount of the swaps matches the principal amounts of the associated bond issuance. The university's swap agreements contain scheduled reductions to outstanding notional amounts that match scheduled reductions in the associated bond issuance. The university pays the swap counterparties a fixed interest rate payment and receives a variable interest rate payment. The university 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 negative fair value of $24 million as of June 30, 2008. The fair value of the interest rate swaps is the estimated amount the university would have either received or (paid) if the swap agreements had been terminated on June 30, 2008. 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, 2008	Fair Values at June 30, 2008	Fixed Rate Paid by University of California	Variable Rate Received by University of California
05/15/2032	$ 93,730	$ (3,315)	3.5897 %	58% of 1-Month LIBOR + 0.48%
05/15/2047	189,775	(20,848)	4.6868	67% of 3-Month LIBOR + 0.73%*
Total	**$ 283,505**	**$ (24,163)**		

* Weighted average spread

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

Termination and Credit Risk: The university 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. The university 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, the university 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, 2008, 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, $2.0 billion, and $1.1 billion, respectively.

Objective: CalHFA has entered into interest rate swap agreements with various counterparties to protect itself against rising rates by providing synthetic fixed rates 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 $603 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 uses 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. As of June 30, 2008, CalHFA's swap portfolio has an aggregate negative fair value of $184 million due to a decline in interest rates. 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 154 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 A1 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, 2008, the SIFMA rate was 1.55%, 65% of the one-month LIBOR was 1.60%, and 60% of the one-month LIBOR plus 26 basis points was 1.7375%.

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 July 2007, the primary government issued revenue bond anticipation notes (BANs) to immediately refund the remaining $45 million of the Channel Island Financing Authority revenue bonds. As a result, all of these bonds have been repaid and the liability for these bonds has been removed from the financing authority's financial statements.

2. Current Year—Business-type Activities

In August 2007, the primary government issued California State University systemwide revenue refunding bonds to defease the outstanding student union revenue 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 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 $4 million over the life of the bonds and will result in an economic gain of $3 million. The California State University systemwide revenue bonds are reported in the State Dormitory Building Maintenance and Equipment Fund, a nonmajor enterprise fund.

In March through May 2008, the primary government issued an aggregate $1.8 billion in refunding power supply revenue bonds to refund $1.8 billion in outstanding variable-rate power supply revenue bonds. The proceeds were deposited into an escrow account to provide for all future debt service payments on the refunded bonds. The refunded bonds were all redeemed in May 2008. The refunding did not result in an economic gain or loss because the refunded bonds were variable-rate bonds. These power supply revenue bonds are reported in the Electric Power Fund.

In May 2008, the primary government issued $633 million in water system revenue bonds. A portion of the proceeds were used to current-refund and advance-refund $500 million of outstanding water system revenue 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. This refunding will increase debt service payments by $613 million over the life of the bonds and will result in an economic gain of $5 million for the refunded fixed-rate bonds. These water system revenue bonds are reported in the Water Resources Fund.

3. Current Year—Discretely Presented Component Units

In July 2007, the University of California issued $197 million in revenue bonds to refund $188 million in outstanding revenue bonds. This refunding will increase debt service payments by $153 million through 2047 and will result in an economic gain of $2 million. In April 2008, the university issued $323 million in revenue bonds. The proceeds were used to refund $324 million in outstanding revenue bonds and for a swap termination payment of $7 million. This refunding will increase debt service payments by $47 million through 2027 and will result in an economic gain of $23 million.

During the 2007-08 fiscal year, the California Housing Finance Agency issued nine fixed- and variable-rate refunding bond series totaling $369 million to current-refund $368 million in outstanding revenue bonds. This refunding will decrease debt service payments by approximately $45 million and may also provide an economic gain of approximately $45 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, 2008, the outstanding balance of revenue bonds defeased in prior years was $4.9 billion for governmental activities and $2.7 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, 2008, the outstanding balance of University of California revenue bonds defeased in prior years was $1.4 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, 2008
(amounts in thousands)

	Due To					
Due From	**General Fund**	**Federal Fund**	**Transportation Fund**	**Nonmajor Governmental Fund**	**Electric Power Fund**	**Water Resources Fund**
Governmental funds						
General Fund	$ —	$ —	$ 643,986	$ 76,349	$ —	$ —
Federal Fund	582,411	—	1,224,669	482,123	—	—
Transportation Fund	—	—	—	157,789	—	—
Nonmajor governmental funds	320,097	—	27,471	405,321	—	—
Total governmental funds	**902,508**	**—**	**1,896,126**	**1,121,582**	**—**	**—**
Enterprise funds						
Water Resources Fund	—	—	—	—	—	—
Public Building Construction Fund	3,491	—	—	—	—	—
State Lottery Fund	407	—	—	237,609	—	—
Unemployment Programs Fund	44,808	6,268	—	—	—	—
Nonmajor enterprise funds	4,775	—	—	11,334	—	—
Total enterprise funds	**53,481**	**6,268**	**—**	**248,943**	**—**	**—**
Internal service funds	**37,068**	**79**	**51,467**	**156,112**	**27,000**	**5,016**
Fiduciary funds	**371,626**	**—**	**—**	**120**	**—**	**—**
Total primary government	**$ 1,364,683**	**$ 6,347**	**$ 1,947,593**	**$ 1,526,757**	**$ 27,000**	**$ 5,016**

Due To						
Public Building Construction Fund	State Lottery Fund	Unemployment Programs Fund	Nonmajor Enterprise Funds	Internal Service Funds	Fiduciary Funds	Total
$ —	$ —	$ —	$ —	$ 100,703	$ 4,162,337	$ 4,983,375
—	—	—	1,897	81,024	3,830,557	6,202,681
261	—	—	—	9,398	141,046	308,494
—	—	825	33	39,844	971,070	1,764,661
261	**—**	**825**	**1,930**	**230,969**	**9,105,010**	**13,259,211**
—	—	—	—	14,060	—	14,060
—	—	—	—	88,218	25,187	116,896
—	—	—	—	—	—	238,016
—	—	—	—	—	—	51,076
—	—	—	64	285	5	16,463
—	**—**	**—**	**64**	**102,563**	**25,192**	**436,511**
22,372	**3,131**	**13,825**	**14,502**	**26,732**	**5,921**	**363,225**
—	**—**	**—**	**—**	**—**	**432**	**372,178**
$ 22,633	**$ 3,131**	**$ 14,650**	**$ 16,496**	**$ 360,264**	**$ 9,136,555**	**$ 14,431,125**

Interfund receivables and payables are the result of interfund loans that are not expected to be repaid within one year. The $1.6 billion in Transportation 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, 2008
(amounts in thousands)

	Interfund Payables					
Interfund Receivables	**General Fund**	**Transportation Fund**	**Nonmajor Governmental Funds**	**Water Resources Fund**	**Nonmajor Enterprise Funds**	**Total**
Governmental funds						
General Fund	$ —	$ 1,630,331	$ 601,464	$ —	$ —	$ 2,231,795
Nonmajor governmental funds	13,404	15,472	—	—	—	28,876
Total governmental funds	**13,404**	**1,645,803**	**601,464**	**—**	**—**	**2,260,671**
Nonmajor enterprise funds	**—**	**—**	**—**	**—**	**2,126**	**2,126**
Internal service funds	**3,000**	**—**	**1,220**	**91,517**	**—**	**95,737**
Fiduciary funds	**60,025**	**—**	**—**	**—**	**—**	**60,025**
Total primary government	**$ 76,429**	**$ 1,645,803**	**$ 602,684**	**$ 91,517**	**$ 2,126**	**$ 2,418,559**

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 To and Due From Component Units
June 30, 2008
(amounts in thousands)

	Due To				
	Primary Government	Component Units			
Due From	General Fund	University of California	Public Employees' Benefits	Nonmajor Component Units	Total
Governmental funds					
General Fund	$ —	$ 163,561	$ —	$ —	$ 163,561
Transportation Fund	—	2,565	—	—	2,565
Nonmajor governmental funds	—	64,584	—	105	64,689
Total governmental funds	**—**	**230,710**	**—**	**105**	**230,815**
Enterprise funds	**—**	**5,563**	**—**	**—**	**5,563**
Internal service funds	**—**	**—**	**4,622**	**952**	**5,574**
Total primary government	**$ —**	**$ 236,273**	**$ 4,622**	**$ 1,057**	**$ 241,952**
Component units					
Public Employees' Benefits Fund	62,831				
Total component units	**$ 62,831**				

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 $1.4 billion to the Transportation Fund for traffic congestion relief, $1.8 billion to nonmajor governmental funds for support of trial courts, and $1.0 billion to a nonmajor governmental fund for the redemption of outstanding Economic Recovery Bonds. The $3.9 billion transfer from the nonmajor governmental funds to the General Fund includes a $3.3 billion transfer of bond proceeds from the Economic Recovery Fund. Table 38 presents interfund transfers of the primary government.

Table 38

Schedule of Interfund Transfers
June 30, 2008
(amounts in thousands)

	Transferred To					
Transferred From	**General Fund**	**Transportation Fund**	**Nonmajor Governmental Funds**	**Nonmajor Enterprise Funds**	**Internal Service Funds**	**Total**
Governmental funds						
General Fund	$ —	$ 1,416,478	$ 4,010,713	$ —	$ —	$ 5,427,191
Federal Fund	—	—	1,070,105	—	—	1,070,105
Transportation Fund	96,852	—	597,680	—	—	694,532
Nonmajor governmental funds	3,890,585	107	253,847	—	397	4,144,936
Total governmental funds	**3,987,437**	**1,416,585**	**5,932,345**	**—**	**397**	**11,336,764**
Enterprise funds						
Public Building Construction Fund	6,277	—	—	1,237		7,514
Nonmajor enterprise funds	1,982	—	46,735	204		48,921
Total enterprise funds	**8,259**	**—**	**46,735**	**1,441**	**—**	**56,435**
Internal service funds	**—**	**—**	**22,771**	**—**	**—**	**22,771**
Total primary government	**$ 3,995,696**	**$ 1,416,585**	**$ 6,001,851**	**$ 1,441**	**$ 397**	**$ 11,415,970**

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, 2008
(amounts in thousands)

	Governmental Funds	Internal Service Funds
General Fund	$ 4,168,869	$ —
Higher Education Construction Fund	924,901	—
Architecture Revolving Fund	—	24,248
Total	**$ 5,093,770**	**$ 24,248**

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, 2008, the total value of restricted and unrestricted endowments and gifts was $10.3 billion and $1.3 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 $1.7 billion at June 30, 2008. 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 $2.5 billion as of June 30, 2008. 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 $2.5 billion using a 3.5% interest rate. Of the total, $310 million is a current liability, of which $198 million is included in the General Fund, $111 million in the special revenue funds, and $1 million in the internal service funds. The remaining $2.2 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 5.0% 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	
	2008	**2007**	**2008**	**2007**
Unpaid claims, beginning	$ 2,321,887	$ 2,576,741	$ 559,581	$ 524,220
Incurred claims	568,617	97,287	191,819	224,926
Claim payments	(338,638)	(352,141)	(154,659)	(189,565)
Unpaid claims, ending	**$ 2,551,866** [1]	**$ 2,321,887**	**$ 596,741**	**$ 559,581**

[1] Includes $1,364 for business-type activities.

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.

Table 41

Nonmajor Enterprise Segments

(amounts in thousands)

Condensed Statement of Net Assets

June 30, 2008

	High Technology Education	State University Dormitory Building Maintenance and Equipment
Assets		
Due from other funds	$ 403	$ 4,552
Due from other governments	—	1,000
Other current assets	54,231	1,001,250
Capital assets	—	2,178,147
Other noncurrent assets	111,247	280,502
Total assets	**$ 165,881**	**$ 3,465,451**
Liabilities		
Due to other funds	$ 3,490	$ 9,886
Due to other governments	—	—
Other current liabilities	40,592	182,450
Noncurrent liabilities	86,039	2,756,729
Total liabilities	**130,121**	**2,949,065**
Net assets		
Investment in capital assets, net of related debt	—	(605,030)
Restricted	35,760	328,321
Unrestricted	—	793,095
Total net assets	**35,760**	**516,386**
Total liabilities and net assets	**$ 165,881**	**$ 3,465,451**

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

Year Ended June 30, 2008

Operating revenues	$ 20,600	$ 577,694
Depreciation expense	—	(68,829)
Other operating expenses	(16,916)	(630,190)
Operating income (loss)	3,684	(121,325)
Nonoperating revenues	—	62,515
Capital contributions	—	—
Transfers in	1,237	—
Transfers out	—	(24,974)
Change in net assets	4,921	(83,784)
Total net assets, July 1, 2007	**30,839**	**600,170** *
Total net assets, June 30, 2008	**$ 35,760**	**$ 516,386**

Condensed Statement of Cash Flows

Year Ended June 30, 2008

Net cash provided (used) by:		
Operating activities	$ 22,025	$ 84,067
Noncapital financing activities	1,237	(24,974)
Capital and related financing activities	(22,265)	(25,163)
Investing activities	—	(159,792)
Net increase (decrease)	**997**	**(125,862)**
Cash and pooled investments at July 1, 2007	**46,813**	**643,705**
Cash and pooled investments at June 30, 2008	**$ 47,810**	**$ 517,843**

* Restated

State Water Pollution Control	Housing Loan	Total
$ 4,566	$ 4,301	$ 13,822
131,548	—	132,548
398,575	561,384	2,015,440
—	570	2,178,717
2,475,807	1,750,447	4,618,003
$ 3,010,496	**$ 2,316,702**	**$ 8,958,530**
$ 1,351	$ 461	$ 15,188
—	77	77
26,416	112,190	361,648
191,657	1,970,918	5,005,343
219,424	**2,083,646**	**5,382,256**
—	570	(604,460)
537,710	232,486	1,134,277
2,253,362	—	3,046,457
2,791,072	**233,056**	**3,576,274**
$ 3,010,496	**$ 2,316,702**	**$ 8,958,530**
$ 54,474	$ 128,456	$ 781,224
—	(546)	(69,375)
(4,521)	(130,593)	(782,220)
49,953	(2,683)	(70,371)
8,395	721	71,631
189,064	—	189,064
—	—	1,237
—	—	(24,974)
247,412	(1,962)	166,587
2,543,660	**235,018**	**3,409,687**
$ 2,791,072	**$ 233,056**	**$ 3,576,274**
$ (254,868)	$ (150,413)	$ (299,189)
(33,379)	41,235	(15,881)
189,951	—	142,523
20,752	4,148	(134,892)
(77,544)	**(105,030)**	**(307,439)**
418,538	**657,402**	**1,766,458**
$ 340,994	**$ 552,372**	**$ 1,459,019**

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, 2008, these component units had $20.2 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, 2008, one of the special-purpose trusts had approximately $1.7 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, 2008; legal proceedings that were in progress as of June 30, 2008, and were settled or decided against the primary government as of February 25, 2009; and legal proceedings having a high probability of resulting in a decision against the primary government as of February 25, 2009, 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.

The primary government is the defendant in two cases that raise essentially the same issues regarding Assembly Bill 5 (AB 5), which was effective July 1, 2008, and reduced reimbursement to various Medi-Cal service providers by 10%. *Independent Living Center of Southern California, Inc. et al. v. Sandra Shewry et al.* was filed on behalf of various Medi-Cal providers and associations to prevent the reimbursement cuts that they allege violate state and federal Medi-Cal/Medicaid laws. A U. S. district court granted the preliminary injunction for various providers. Multiple appeals have been filed in response to the injunction. *California Medical Association et al. v. Sandra Shewry et al.* raises essentially the same issues; however it was filed by different providers. This case was kept in the state superior court and the preliminary injunction was denied. The plaintiffs have appealed that ruling and will probably amend their original complaint to add a Supremacy Clause so the case can be heard in federal court. It is estimated that AB 5 would save the State approximately

$1.0 billion to $1.5 billion annually. However, following the enactment of AB 5, the Legislature enacted Assembly Bill 1183 (AB 1183), which terminates AB 5 as of March 2009 and replaces the 10% Medi-Cal provider cut with a smaller reimbursement cut. The potential cost to the State if the plaintiffs in these two cases prevail in preventing the 10% cuts under AB 5 prior to its termination in March 2009 would be approximately $750 million to $1.25 billion. The plaintiffs have also filed two lawsuits seeking to prevent the reimbursement cuts under AB 1183, but as AB 1183 is not effective until March 2009, a U.S. district court temporarily suspended the case until the law becomes effective.

The primary government is a defendant in three cases regarding the constitutionality of a fee imposed on limited liability companies (LLC). In *Northwest Energetic Services, LLC v. Franchise Tax Board*, the Court of Appeal found the fee unconstitutional only as applied to the plaintiff. The primary government has already begun to pay refunds to LLCs with the same facts as *Northwest* who have no income earned inside California. In *Ventas Finance I, LLC v. Franchise Tax Board*, the Court of Appeal also ruled that the fee is unconstitutional as applied to the plaintiff, but it awarded only a partial refund because Ventas received income from both inside and outside of California. The plaintiff has filed a petition requesting a review of the case by the U. S. Supreme Court. The third case, *Bakersfield Mall, LLC v. Franchise Tax Board*, is still pending. It raised the same constitutional issues as *Northwest* and *Ventas* but for LLCs that conduct business solely within California, and it intends to bring a class action suit for refund on behalf of all similarly situated LLCs and to declare the LLC fee unconstitutional. However, given the Court of Appeal's decisions in *Northwest* and *Ventas,* the Franchise Tax Board believes that an adverse decision on such a case would be remote. Actual claims for refunds to LLCs like Northwest and potential claims for refunds to LLCs similar to Ventas and Bakersfield are estimated to be approximately $580 million plus interest.

The primary government is a defendant in *River Garden Retirement Home v. Franchise Tax Board*, a case that challenges the constitutionality of the penalty assessed under the State's tax amnesty program. Under the amnesty program, for taxable years beginning before January 1, 2003, taxpayers that had not paid or had underpaid an eligible tax could agree to pay the tax and waive their rights to claim refunds. In exchange, certain penalties and fees associated with the unpaid taxes would be waived and no criminal actions would be brought for the taxable years for which amnesty was allowed. The program also imposed a new penalty equal to 50 percent of accrued interest as of March 31, 2005, on any unpaid tax liabilities ultimately determined to be due for taxable years 2002 and earlier for which amnesty could have been requested. The trial court granted judgment for the State, but the plaintiff appealed. An adverse action in the appellate court could result in the State having to refund in excess of $1.5 billion. This estimate includes the potential return of $1.0 billion to $1.5 billion of protective claim deposits received by the Franchise Tax Board.

The University of California, 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 the university, 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, the university, 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, the university, 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, 2008. The investments of these fiduciary component units are presented in Table 6 in Note 3, Deposits and Investments.

CalPERS administers four defined benefit retirement plans: the Public Employees' Retirement Fund, the Judges' Retirement Fund, the Judges' Retirement Fund II, and the Legislators' Retirement Fund. CalPERS also administers three defined contribution plans: the State Peace Officers' and Firefighters' Defined Contribution Plan Fund, the public employee Replacement Benefit Fund, and the public employee Supplemental Contributions Program Fund. 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 Pension2 Program, formerly known as the Voluntary Investment Program, through a third-party administrator; the Pension2 Program 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 Public Employees' Retirement Fund (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 1,511 public agencies as of June 30, 2008. 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 $31.7 billion at June 30, 2007. This is a result of the difference between the actuarial value of assets of $216.5 billion and the actuarial accrued liability of $248.2 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, 2008, was approximately $16.1 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 by 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, 2008

	Normal Cost	Unfunded Liability	Group Term Life Benefit	Total Rate
Miscellaneous members				
First tier	9.914 %	6.719 %	0.000 %	16.633 %
Second tier	9.846	6.719	0.000	16.565
Industrial (first and second tier)	13.671	3.648	0.026	17.345
California Highway Patrol	16.608	15.507	0.097	32.212
Peace officers and firefighters	17.691	7.861	0.000	25.552
Other safety members	15.510	3.325	0.000	18.835

For the year ended June 30, 2008, the annual pension cost (APC) and the amount of contributions made by the primary government were each $3.0 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, 2007, is also shown in Table 43 for the primary government.

The Schedule of Funding Progress, presented as required supplementary information (RSI) following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets are increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Actuarial Methods and Assumptions: In the June 30, 2007, actuarial valuation, the individual entry age normal cost method was used. The actuarial assumptions included a 7.75% investment rate of return, projected salary increases of 3.25% to 19.95%, depending on duration of service, and post-retirement benefit increases of 2.00% - 3.00%, compounded annually. The projected salary increases include a 3.00% inflation assumption. The UAAL is being amortized as a level percentage of projected payroll on a closed basis over 21 years to 28 years.

B. Judges' Retirement Fund

Plan Description: CalPERS administers the Judges' Retirement Fund (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, 2008. The payroll for employees covered by the JRF for the year ended June 30, 2008, was approximately $125 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, 2008, 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, 2008, 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, 2008, were $315 million and $163 million, respectively. The net pension obligation (NPO) of the JRF at June 30, 2008, was $2.0 billion, an increase of $152 million over last year's balance of $1.9 billion. The APC is comprised of $624 million for the annual required contribution (ARC), $130 million for interest on the NPO, and a negative $439 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, 2007, is shown in Table 43. The aggregate cost method that was used for the June 30, 2007, valuation does not identify or separately amortize the unfunded actuarial accrued liability; therefore, the information about funded status in Table 43 is prepared using the entry age actuarial cost method and is intended to serve as a surrogate for the funded status and funding progress of the plan.

Actuarial Methods and Assumptions: In the June 30, 2007, actuarial valuation, the aggregate cost method was used. The actuarial assumptions included a 7.00% investment rate of return, projected salary increases of 3.25%, and post-retirement benefit increases of 3.25%. The projected salary increases include a 3.00% inflation assumption.

C. Judges' Retirement Fund II

Plan Description: CalPERS administers the Judges' Retirement Fund II (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, 2008, was approximately $174 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, 2008, 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, 2008, the annual pension cost (APC) and the amount of contributions made for the JRF II were approximately $36.8 million, which is more than the actuarially determined required contribution of approximately $31.7 million. The APC and the percentage of APC contributed for the year ended June 30, 2008, are shown in Table 43. Information on the last valuation, which was performed as of June 30, 2007, is also shown in Table 43.

The Schedule of Funding Progress, presented as required supplementary information (RSI) following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets are increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Actuarial Methods and Assumptions: In the June 30, 2007 actuarial valuation, the aggregate entry age normal cost method was used. The actuarial assumptions included a 7.25% investment rate of return, projected salary increases of 3.25%, and post-retirement benefit increases of 3.00%. The projected salary increases include a 3.00% inflation assumption. The UAAL is being amortized as a level percentage of increasing payroll on a closed basis over an average of 30 years.

D. Legislators' Retirement Fund

Plan Description: CalPERS administers the Legislators' Retirement Fund (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 7, 1990, constitutional officers, and legislative statutory officers. For the fiscal year ending June 30, 2008, no statutory contribution was required, based on the June 30, 2006 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 14 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, 2008, 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 toward military service and prior service.

The net pension obligation (NPO) of the LRF on June 30, 2008, 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, 2007, is also shown in Table 43. The aggregate cost method that was used for the June 30, 2007 valuation does not identify or separately amortize the unfunded actuarial accrued liability; therefore, the

information about funded status in Table 43 is prepared using the entry age actuarial cost method and is intended to serve as a surrogate for the funded status and funding progress of the plan.

Actuarial Methods and Assumptions: In the June 30, 2007 actuarial valuation, the aggregate cost method was used. The actuarial assumptions included a 7.00% investment rate of return, projected salary increases of 3.25%, and post-retirement benefit increases of 3.00%. The projected salary increases include a 3.00% inflation assumption.

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

Plan Description: CalPERS administers the State Peace Officers' and Firefighters' Defined Contribution Plan Fund (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. 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, 2008, contributions by the primary government to the SPOFF were approximately $51 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, 2008, there were 40,470 participants in the SPOFF.

F. 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. Three programs comprise the STRP: 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, 2008, the DB Program had approximately 1,700 contributing employers and as of June 30, 2007, had 597,143 active and inactive program members and 215,641 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, 2008, was approximately $28.2 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, 2008, the CB Benefit Program had 33 contributing school districts and 28,857 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 2007-08, 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, 2007, 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, 2008.

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, 2008, the annual pension cost (APC) for the DB Program was approximately $4.4 billion; the employer and primary government contributions were approximately $2.4 billion and $501 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.

G. CalSTRS Pension2 Program

Plan Description: CalSTRS administers the Pension2 Program, formerly known as the Voluntary Investment Program (VIP), an IRC 403(b) program, through a third-party administrator. The Pension2 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, 2008, the Pension2 had approximately 597 participating employers (school districts) and approximately 4,196 plan members.

H. 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, 2008, there were 6,290 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[1]	Judges' Retirement II Fund
Last actuarial valuation	June 30, 2007	June 30, 2007	June 30, 2007
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	21 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	2.00 - 3.00	3.25	3.00
Annual pension costs (in millions)			
Year ended 6/30/06	$ 2,419	$ 315	$ 24
Year ended 6/30/07	2,782	324	27
Year ended 6/30/08	3,016	315	32
Percent contribution			
Year ended 6/30/06	100 %	62 %	95 %
Year ended 6/30/07[3]	100	23	95
Year ended 6/30/08	100	26	116
Net pension obligation (NPO) (in millions)			
Year ended 6/30/06	—	$ 1,672	—
Year ended 6/30/07	—	1,864	2
Year ended 6/30/08	—	2,016	(3)
Funding as of last valuation (in millions)			
Actuarial value – assets	$ 96,988	$ 12	$ 268
Actuarial accrued liabilities (AAL) – entry age	100,352	2,714	295
Excess of actuarial value of assets over AAL (EAV) (unfunded actuarial accrued liability (UAAL))	(3,364)	(2,702)	(27)
Covered payroll	16,136	119	156
Funded ratio	96.6 %	0.4 %	90.7 %
EAV (UAAL) as percent of covered payroll	(20.8) %	(2,265.3) %	(17.5) %

[1] The aggregate cost method is used to determine the annual required contribution of the employer for the Judges' Retirement Fund and the Legislators' Retirement Fund. Because this method does not identify or separately amortize unfunded actuarial liabilities, information about funded status is prepared using the entry age cost method and is intended to serve as a surrogate for the funded status of the plan.

[2] 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 $501 million and $2.4 billion, respectively, for the year ending June 30, 2008. Based on the most recent actuarial valuation, dated June 30, 2007, 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.

[3] 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[1]	State Teachers' Retirement Defined Benefit Program Fund[2]
June 30, 2007	June 30, 2007
Aggregate Cost	Entry Age Normal
None	Level % of Payroll, Open
None	30 years
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
—	$ 3,821
—	3,980
—	4,362
—	64 %
—	67
—	66
$ 10	—
10	—
10	—
142	$ 148,427
102	167,129
40	(18,702)
2	25,906
139.4 %	88.8 %
1,900.9 %	(72.2) %

NOTE 24: POSTEMPLOYMENT HEALTH CARE BENEFITS

A. State of California Other Postemployment Benefits Plan

Plan Description: The primary government and certain discretely presented component units provide health benefits (medical and prescription drug benefits) and dental benefits to annuitants of retirement systems through a substantive single-employer defined benefit plan to which the primary government contributes as an employer. The primary government also offers life insurance, long-term care, and vision benefits to retirees; however, because these benefits are completely paid for by the retirees, the primary government has no liability. The discretely presented component units represent 3.6% of plan participation. The design of health and dental benefit plans can be amended by the California Public Employees' Retirement System (CalPERS) Board of Administration and the Department of Personnel Administration, respectively. Employer and retiree contributions are governed by the primary government and can be amended by the primary government through the Legislature. The plan is not accounted for as a trust fund because an irrevocable trust has not been established for the plan. The plan does not issue a separate report.

Fifty-eight county superior courts (trial courts) are included in the primary government. However, each trial court is a separate employer for GASB Statement 45 reporting purposes. Fifty-one trial courts have a single-employer defined benefit plan, six trial courts (Amador, Fresno, Modoc, San Benito, San Bernardino, and Stanislaus) have no plan, and one trial court (San Diego) has a cost-sharing multiple-employer defined benefit plan. These plans have separate actuarial valuations, are not accounted for in a trust fund, and do not issue separate reports.

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, 2008, approximately 138,300 annuitants were enrolled to receive health benefits and approximately 112,600 annuitants were enrolled to receive dental benefits. The trial courts have approximately 2,700 enrolled retirees and spouses.

Funding Policy: The contribution requirements of plan members and the State are established and may be amended by the Legislature. In accordance with the California Government Code, the State 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 State's contribution toward dental insurance costs, the State 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 State and trial courts fund the cost of providing health and dental insurance to annuitants on a pay-as-you-go basis. Each of the trial courts determines its respective retirees' benefits and benefit levels as well as the funding policy for its respective plan. The maximum 2008 monthly State contribution was $471 for one-party coverage, $886 for two-party coverage, and $1,129 for family coverage. The 2008 monthly contribution rate for the trial courts with single-employer defined benefit plans ranged from zero to $1,567. San Diego, a cost-sharing multiple-employer defined benefit plan, had a contribution rate of 2.31% of annual covered pension payroll. For the year ended June 30, 2008, the State contributed $1.3 billion for current premiums. Of this amount, the trial courts represent $19 million and certain discretely presented component units represent $44 million.

Annual OPEB Cost and Net OPEB Obligation: The State's annual other postemployment benefit (OPEB) cost (expense) is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level

of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years.

The State's OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for the year ended June 30, 2008, including trial courts, is shown in Table 44.

Table 44

Schedule of Annual OPEB Cost, Percentage of Annual OPEB Cost Contributed, and Net OPEB Obligation
June 30, 2008
(amounts in thousands)

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
June 30, 2008	$ 3,731,701	34.06 %	$ 2,460,718

Table 45 shows the components of the State's net OPEB obligation to the OPEB plan, including trial courts.

Table 45

Schedule of Net OPEB Obligation
June 30, 2008
(amounts in thousands)

	Amount
Annual required contribution	$ 3,731,701
Interest on net OPEB obligation	—
Adjustment to annual required contribution	—
Annual OPEB cost (expense)	**3,731,701**
Contributions made	(1,270,983)
Increase in net OPEB obligation	2,460,718
Net OPEB obligation — beginning of year	—
Net OPEB obligation — end of year	**$ 2,460,718**

Funded Status and Funding Progress: As of June 30, 2008, the most recent actuarial valuation date, the actuarial accrued liability (AAL), for benefits was $48.2 billion, with no actuarial value of assets, resulting in an unfunded actuarial accrued liability (UAAL) of negative $48.2 billion. The covered payroll (annual payroll of active employees covered by the plan) was $17.9 billion, and the ratio of the UAAL to the covered payroll was negative 270%.

For the trial courts, as of July 1, 2007, the most recent actuarial valuation date, the AAL for benefits was $1.3 billion, with no actuarial value of assets, resulting in an UAAL of negative $1.3 billion. The covered payroll was $989 million, and the ratio of the UAAL to the covered payroll was negative 131%.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about mortality and the healthcare cost trend. Amounts determined regarding the plan's funded status and the employer's annual required contributions are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Actuarial Methods and Assumptions: Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used are consistent with a long-term perspective.

In the June 30, 2008 actuarial valuation, the individual entry age normal cost method was used. The actuarial assumptions included a 4.50% investment rate of return and an annual health care cost trend rate of actual increases for 2009 and 8.50% in 2010, initially, reduced to an ultimate rate of 4.50% after seven years. Both rates included a 3.00% annual inflation assumption. Annual wage inflation is assumed to be 3.25%. The UAAL is being amortized as a level percentage of projected payroll on an open basis over thirty years.

For the trial courts, in the July 1, 2007 actuarial valuations, the entry age normal cost method was used. The actuarial assumptions included a 4.15% investment rate of return and an annual health care cost trend rate of 9.50%, initially, reduced by 0.50% increments to an ultimate rate of 5.00% after nine years. Annual inflation and payroll growth are assumed to be 3.00% and 3.25%, respectively. The UAAL is amortized on a closed basis over 30 years as a level percentage of payroll for 49 trial courts and as a level dollar amount for two trial courts (Alpine and Mendocino).

B. University of California Retiree Health Plan

Plan Description: The University of California, a discretely presented component unit, administers single-employer health and welfare plans to provide health and welfare benefits, primarily medical, dental and vision, to eligible retirees and their families and survivors (retirees) of the university and its affiliates. The Regents have the authority to establish or amend the plans. Additional information can be obtained from the 2007–08 annual report of the University of California Health and Welfare Plans.

Membership in the University of California Retirement Plan is required to become eligible for retiree health benefits. As of July 1, 2007, the date of the latest actuarial valuation, 32,932 retirees are receiving such benefits.

Funding Policy: The contribution requirements of the university and eligible retirees are established and may be amended by the university. The contribution requirements are based upon projected pay-as-you-go financing. Contributions toward medical and dental benefits are shared between the university and the retiree. The university does not contribute toward the cost of other benefits available to retirees. Employees who meet specific requirements including completed years of credited service may continue their medical and dental benefits into retirement and continue to receive university contributions for those benefits. Active employees do not make any contributions toward the retiree health benefit plans. Retirees pay the excess, if any, of the premium over the applicable portion of the university's maximum contribution.

The university's OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for the year ended June 30, 2008, is shown in Table 46.

Table 46

Schedule of Annual OPEB Cost, Percentage of Annual OPEB Cost Contributed, and Net OPEB Obligation - University of California
June 30, 2008
(amounts in thousands)

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
June 30, 2008	$ 1,399,788	20.08 %	$ 1,118,754

Table 47 shows the components of the university's net OPEB obligation to the University of California Health and Welfare Plans.

Table 47

Schedule of Net OPEB Obligation - University of California
June 30, 2008
(amounts in thousands)

	Amount
Annual required contribution	$ 1,399,788
Interest on net OPEB obligation	—
Adjustment to annual required contribution	—
Annual OPEB cost (expense)	**1,399,788**
Contributions made	(281,034)
Increase in net OPEB obligation	1,118,754
Net OPEB obligation — beginning of year	—
Net OPEB obligation — end of year	**$ 1,118,754**

Funded Status and Funding Progress: For the University of California, as of July 1, 2007, the most recent actuarial valuation date, the actuarial accrued liability (AAL) for benefits was $12.5 billion, with no actuarial value of assets, resulting in an unfunded actuarial accrued liability (UAAL) of negative $12.5 billion. The covered payroll (annual payroll of active employees covered by the plan) was $6.9 billion, and the ratio of the UAAL to the covered payroll was negative 181%.

Actuarial Methods and Assumptions: For the University of California, in the July 1, 2007, actuarial valuation, the individual entry age normal cost method was used. The actuarial assumptions included a 5.5% investment rate of return, an annual health care cost trend rate of 10.0% to 12.0% initially, depending on the type of plan, reduced by increments to an ultimate rate of 5.0% over nine years, with a projected 3.0% inflation rate. The UAAL is being amortized as a flat dollar amount over 30 years on a closed basis.

NOTE 25: SUBSEQUENT EVENTS

The following information describes significant events that occurred subsequent to June 30, 2008, but prior to the date of the auditor's report.

A. Debt Issuances

In July 2008, the primary government issued $1.5 billion in general obligation bonds to retire commercial paper previously issued to finance capital projects for public purposes, including: seismic safety, water supply, river and coastal protection, flood protection, library construction and renovation, public school and university facilities, housing and emergency shelter, children's hospitals, highway and transportation facilities, park and recreation facilities, and disaster preparedness projects. In October 2008, the primary government issued revenue anticipation notes of $5.0 billion, of which $1.2 billion will mature on May 20, 2009, and $3.8 billion will mature on June 22, 2009.

In October 2008, the primary government issued $98 million in Federal Highway Grant Anticipation Revenue Vehicles (GARVEE bonds). GARVEE bonds are used to accelerate the funding and construction of transportation infrastructure projects and are secured and payable from future federal appropriations. Also in October, the primary government issued $5.0 billion in Revenue Anticipation Notes to fund cash flow needs for the 2008-09 fiscal year. These notes are scheduled to be redeemed in May and June 2009.

In November 2008, the Department of Water Resources reoffered $173 million in Power Supply Revenue Bonds to convert certain outstanding Power Supply Revenue Bonds bearing interest at variable rates to fixed-rate instruments. In January 2009, the department reoffered an additional $348 million in Power Supply Revenue Bonds for the same purposes.

Since June 30, 2008, the California State University (CSU) authorized $503 million in commercial paper to finance or refinance construction projects at various campuses. As of December 18, 2008, CSU had issued only $96 million of the authorized commercial paper.

In July 2008, The Regents of the University of California, a discretely presented component unit, authorized an increase in the university's commercial paper program, from $550 million to $2.0 billion, in order to reduce the number of bank line commitments, provide greater access to tax-exempt financing, and preserve flexibility for future interim financing needs.

B. Fair Value of Investments

Subsequent to June 30, 2008, the financial markets and banking systems have experienced substantial volatility due to the credit market crisis, concerns about global recession, and other market factors. These events have had a negative impact on the investment portfolios of the State. The fiduciary funds and similar component units, like CalPERS and CalSTRS, are at a higher risk of exposure due to the long-term focus of their investment portfolios. The long-term effects of this market volatility on any particular investment cannot be determined. However, the short-term effect of the volatility has had a material effect on the reported values of investments subsequent to year-end.

CalPERS reported in its annual financial report that as of October 31, 2008, the Public Employees' Retirement Fund's investment portfolio, excluding securities lending collateral, had declined an estimated $50.4 billion in value since June 30, 2008, to $186.7 billion. The most significant decline was in the domestic and international public-equity portfolios, which declined by $40.5 billion, or 33%. After June 30, 2008, CalPERS's holdings for

American International Group, Fannie Mae, Freddie Mac, Lehman Brothers, and Washington Mutual decreased in value by approximately $1.7 billion. In addition, CalPERS's real estate program continued to experience declines due to overall market conditions and negative returns in the housing program.

Also, CalSTRS reported in its annual financial report that as of September 30, 2008, the State Teachers' Retirement Fund's investment portfolio, excluding securities lending collateral, declined $15 billion in value from June 30, 2008, to $147 billion. The most significant decline was in the international equity portfolio, which declined by $8.4 billion, or 26%, and domestic equity portfolio, which declined $6.4 billion, or 10%. After June 30, 2008, CalSTRS's holdings for American International Group, Lehman Brothers, and Washington Mutual decreased in value by approximately $776 million.

C. Other

In the general election held on November 4, 2008, voters approved the sale of $11.8 billion in general obligation bonds with the passage of three propositions.

- $9.95 billion for Proposition 1A, the Safe, Reliable High-Speed Passenger Train Bond Act for the 21st Century.
- $980 million for Proposition 3, the Children's Hospital Bond Act of 2008.
- $900 million for Proposition 12, the Veterans' Bond Act of 2008.

Due to the State's 2008-09 budget shortfall and the depletion of its cash resources, the primary government was forced to take several measures in the current fiscal year to alleviate its fiscal crisis.

- All state-funded capital projects, including general obligation and lease revenue bond projects, were suspended and disbursements on these projects were frozen beginning December 17, 2008, when the Pooled Money Investment Board voted to significantly curtail loans from the State's Pooled Money Investment Account.
- Unpaid furloughs of state employees for two days each month were ordered and commenced on February 1, 2009.
- A payment-deferral plan was implemented in February 2009 to preserve cash for education, debt service, and other payments required by the State Constitution, federal law, and court rulings.
- The Governor called a special session of the Legislature in November 2008, and two fiscal emergency special sessions in December 2008, which resulted in the enactment of the 2009 Budget Act on February 20, 2009. This budget act covers a 17-month period including the remainder of the 2008-09 fiscal year and the 2009-10 fiscal year. The budget is intended to address the State's current financial crisis and includes spending reductions, temporary revenue increases, new borrowing, and an economic stimulus component. The budget also proposes long-lasting reforms that will require voter approval in May 2009. Since the enactment of this budget, the expenditure reduction and payment delay measures previously discussed were either reversed or revised.

California experienced a significant increase in the State's unemployment rate due to the nation's economic slowdown. The unemployment rate increased from 6.1% in January 2008 to 10.1% in January 2009, which created high demand for Unemployment Insurance and depleted the reserves of the Unemployment Programs

Fund. In response to the State's request, the U.S. Department of Labor approved a $1.8 billion loan to cover a projected shortfall in the Unemployment Programs Fund during the first quarter of 2009. As of February 25, 2009, the State used $414 million of the authorized loan.

In February 2009, Standard & Poor's reduced the State's general obligation bond credit rating from "A+" to "A" due to the State's inability to reach an agreement on the mid-year budget revision and its rapidly eroding cash position. The current ratings from the other two rating services are "A1" from Moody's Investors Service and "A+" from Fitch. These ratings have remained unchanged for almost three years.

Required Supplementary Information

Schedule of Funding Progress

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, 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)
June 30, 2007	96,988	100,352	(3,364)	96.6	16,136	(20.8)

Judges' Retirement Fund[1]

(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, 2007	$ 11,672	$ 2,713,640	$ (2,701,968)	0.4 %	$ 119,274	(2,265.3) %

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, 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)
June 30, 2007	267,604	294,983	(27,378)	90.7	156,300	(17.5)

[1] The Legislators' Retirement Fund (LRF) and the Judges' Retirement Fund (JRF) are funded using the aggregate actuarial cost valuation method. This method does not identify actuarial liabilities and funded ratios. For this reason, no funding progress information is available for either the LRF or the JRF prior to June 30, 2007. Information about funded status is prepared using the entry age actuarial cost method and is intended to serve as a surrogate for the funding progress of the plan.

[2] The trial courts reporting is based on 51 individual actuarial valuations as of July 1, 2007.

Legislators' Retirement Fund[1]

(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, 2007	$ 141,603	$ 101,571	$ 40,032	139.4 %	$ 2,106	1,900.9 %

State Teachers' Retirement Defined Benefit Program

(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, 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)
June 30, 2007	148,427	167,129	(18,702)	88.8	25,906	(72.2)

Other Postemployment Benefit Plan

(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)
Primary government and certain component units						
June 30, 2007	$ —	$ 47,878	$ (47,878)	— %	$ 17,940	(266.9) %
June 30, 2008	—	48,220	(48,220)	—	17,890	(269.5)
Trial Courts [2]						
July 1, 2007	—	1,291	(1,291)	—	989	(130.6)

Schedule of Funding Progress (continued)

University of California Retiree Health Plan

(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)
July 1, 2007	$ —	$ 12,534	$ (12,534)	— %	$ 6,913	(181.3) %

Infrastructure Assets Using the Modified Approach

Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 34, the State uses the modified approach to report the cost of its infrastructure assets (state roadways and bridges). Under the modified approach, the State does not report depreciation expense for roads and bridges but capitalizes all costs that add to the capacity and efficiency of State-owned roads and bridges. All maintenance and preservation costs are 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, 2008, are in the following categories and amounts: state highway infrastructure (completed highway projects), totaling $58.5 billion; land purchased for highway projects, totaling $11.7 billion; and infrastructure construction-in-progress (uncompleted highway projects), totaling $5.3 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, 2008. Relinquishments for the fiscal year ending June 30, 2008, are $117 million of state highway infrastructure and $24 million of infrastructure land.

B. Condition Baselines and Assessments

1. Bridges

The State uses the Bridge Health Index — a numerical rating scale from 0% to 100% that uses 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 Elements for Bridge Inspection."

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 has 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 2005-06 through 2007-08 are shown in the following table.

Fiscal Year Ending June 30	Established BHI Baseline*	Actual BHI
2006	80.0 %	94.5 %
2007	80.0	94.3
2008	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 as of June 30, 2008.

BHI Description	Bridge Count	Percent	Network BHI
Excellent	6,270	51.46 %	99.9 %
Good	4,657	38.23	96.2
Acceptable	884	7.26	85.7
Fair	204	1.67	74.8
Poor	168	1.38	60.4
Total	**12,183**	**100.00 %**	

2. Roadways

The State uses AASHTO "Pavement Performance Data Collection Protocols" in its periodic 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 or 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 from the last three pavement condition surveys are shown in the following table.

Condition Assessment Date	Established Condition Baseline Distressed Lane Miles (maximum)*	Actual Distressed Lane Miles	Actual Distressed Lane Miles as Percent of Total Lane Miles
February 2005	18,000	13,845	27.9 %
April 2006	18,000	12,905	26.1
November 2007	18,000	12,998	26.3

* 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 on the State's actual distressed lane miles as of the last pavement condition survey.

Pavement Condition	Lane Miles	Distressed Lane Miles
Excellent/Good	36,479	—
Fair	981	981
Poor	12,017	12,017
Total	**49,477**	**12,998**

C. Budgeted and Actual Preservation Costs

The estimated budgeted preservation costs represent the preservation projects approved by the California Transportation Commission and the State's scheduled preservation work for each fiscal year. The actual preservation costs represent the cumulative cost to date for the projects approved and work scheduled in each fiscal year. Up to fiscal year 2006-07, the State included encumbrances with actual preservation costs. Beginning in fiscal year 2007-08, the State excluded encumbrances from actual preservation costs and restated the costs reported for previous years.

The State's budgeted and actual preservation cost information for the most recent and four previous fiscal years is shown in the following table.

Fiscal Year Ending June 30	Estimated Budgeted Preservation Costs (in millions)	Actual Preservation Costs (in millions)
2004	$ 975	$ 856
2005	1,049	884
2006	2,025	1,580
2007	2,313	1,218
2008	2,575	392

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Budgetary Comparison Schedule

General Fund and Major Special Revenue Funds

Year Ended June 30, 2008
(amounts in thousands)

	General			
	Budgeted Amounts		Actual	Variance With
	Original	Final	Amounts	Final Budget
REVENUES				
Corporation tax	$ 10,675,000	$ 11,926,000	$ 11,849,096	$ 76,904
Intergovernmental	—	—	—	—
Cigarette and tobacco taxes	116,300	114,000	109,871	4,129
Inheritance, estate, and gift taxes	—	—	6,303	(6,303)
Insurance gross premiums tax	2,075,000	2,171,000	2,172,935	(1,935)
Vehicle license fees	27,713	—	27,367	(27,367)
Motor vehicle fuel tax	—	—	—	—
Personal income tax	52,681,000	54,380,000	54,763,105	(383,105)
Retail sales and use taxes	27,689,000	26,813,000	26,613,264	199,736
Other major taxes and licenses	334,200	334,000	329,758	4,242
Other revenues	6,427,288	6,092,519	2,658,966	3,433,553
Total revenues	**100,025,501**	**101,830,519**	**98,530,665**	**3,299,854**
EXPENDITURES				
State and consumer services	596,768	604,477	588,983	15,494
Business and transportation	1,432,866	1,432,746	1,432,656	90
Resources	1,191,678	1,649,970	1,472,130	177,840
Health and human services	29,884,890	29,939,782	29,492,395	447,387
Correctional programs	9,829,041	10,224,959	9,959,143	265,816
Education	50,854,052	50,454,687	50,444,696	9,991
General government:				
Tax relief	983,887	983,280	961,088	22,192
Debt service	3,523,706	3,542,736	3,536,470	6,266
Other general government	5,307,296	5,119,962	4,870,933	249,029
Total expenditures	**103,604,184**	**103,952,599**	**102,758,494**	**1,194,105**
OTHER FINANCING SOURCES (USES)				
Transfers from other funds	—	—	6,900,994	—
Transfers to other funds	—	—	(3,649,462)	—
Other additions and deductions	—	—	99,840	—
Total other financing sources (uses)	**—**	**—**	**3,351,372**	**—**
Excess (deficency) of revenues and other sources over (under) expenditures and other uses	—	—	(876,457)	—
Fund balances, July 1, 2007 (restated)	**—**	**—**	**6,565,208**	—
Fund balances, June 30, 2008	**$ —**	**$ —**	**$ 5,688,751**	**$ —**

Federal				Transportation			
Budgeted Amounts		Actual	Variance With	Budgeted Amounts		Actual	Variance With
Original	Final	Amounts	Final Budget	Original	Final	Amounts	Final Budget
$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —
44,743,852	44,743,852	44,743,852	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	3,545,851	3,503,863	3,351,268	152,595
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	3,095,929	2,966,413	2,925,781	40,632
453	453	453	—	604,995	623,325	617,588	5,737
44,744,305	**44,744,305**	**44,744,305**	**—**	**7,246,775**	**7,093,601**	**6,894,637**	**198,964**
52,941	52,941	52,941	—	113,663	115,864	109,970	5,894
3,193,996	3,193,996	3,193,996	—	7,632,620	9,893,092	9,252,264	640,828
264,353	264,353	264,353	—	567,447	573,590	569,570	4,020
31,156,589	31,156,589	31,156,589	—	132,213	138,388	137,863	525
21,942	21,942	21,942	—	—	—	—	—
6,389,926	6,389,926	6,389,926	—	101,575	101,605	101,418	187
—	—	—	—	—	—	—	—
—	—	—	—	900	949	949	—
1,336,458	1,336,458	1,336,458	—	55,397	494,094	335,242	158,852
42,416,205	**42,416,205**	**42,416,205**	**—**	**8,603,815**	**11,317,582**	**10,507,276**	**810,306**
—	—	5,933,917	—	—	—	8,599,560	—
—	—	(8,234,823)	—	—	—	(8,181,160)	—
—	—	(2,843)	—	—	—	851,979	—
—	**—**	**(2,303,749)**	**—**	**—**	**—**	**1,270,379**	**—**
—	—	24,351	—	—	—	(2,342,260)	—
—	**—**	**(14,108)**	**—**	**—**	**—**	**25,468,222**	**—**
$ —	**$ —**	**$ 10,243**	**$ —**	**$ —**	**$ —**	**$ 23,125,962**	**$ —**

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

June 30, 2008
(amounts in thousands)

		Special Revenue Funds	
	General	**Federal**	**Transportation**
Budgetary fund balance reclassified into GAAP statement fund structure	**$ 5,688,751**	**$ 10,243**	**$ 23,125,962**
Basis difference:			
Interfund receivables	76,429	—	1,645,803
Loans receivable	103,082	46,011	—
Interfund payables	(2,231,795)	—	—
Escheat property	(969,109)	—	—
Bonds authorized but unissued	—	—	(18,820,405)
Other	9,567	—	75,377
Timing difference:			
Liabilities budgeted in subsequent years	(6,845,794)	(13,502)	(581,305)
GAAP fund balance (deficit), June 30, 2008	**$ (4,168,869)**	**$ 42,752**	**$ 5,445,432**

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 *Comprehensive Annual Financial 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. This report includes the comparison of the annual appropriated budget with expenditures at the legal level of control. A copy of the *Comprehensive Annual Financial Report Supplement* is available upon request from the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250-5872.

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 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 $76 million increase to the fund balance in the General Fund and a $1.6 billion increase to the fund balance in the Transportation Fund. The adjustments related to loans receivable caused increases of $103 million in the General Fund and $46 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 $2.2 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 $969 million decrease to the General Fund balance.

Bond Authorized but Unissued: In the year that general obligation bonds are authorized by the voters, the full amount authorized is recognized as revenue on a budgetary basis. In accordance with GAAP, only the amount of bonds issued each year is reported as an other financing source. The adjustments related to bonds authorized but unissued caused an $18.8 billion decrease to the fund balance in the Transportation Fund.

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 $10 million in the General Fund and $75 million in the Transportation 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 $6.8 billion in the General Fund, $14 million in the Federal Fund, and $581 million in the Transportation Fund. The large decrease in the General Fund primarily consists of $2.2 billion for deferred apportionment payments to K-12 schools and community colleges, $445 million in tax amnesty program overpayments, and $2.3 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, CPA
State Auditor

Date: March 24, 2009

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Government Organization and Economy
Department of Finance
Attorney General
State Controller
State Treasurer
Legislative Analyst
Senate Office of Research
California Research Bureau
Capitol Press

State of California:

Internal Control and State and Federal Compliance Audit Report for the Fiscal Year Ended June 30, 2008

May 2009 Report 2008-002

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Elaine M. Howle
State Auditor

Doug Cordiner
Chief Deputy

CALIFORNIA STATE AUDITOR

Bureau of State Audits

555 Capitol Mall, Suite 300 Sacramento, CA 95814 916.445.0255 916.327.0019 fax www.bsa.ca.gov

May 27, 2009 2008-002

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

Dear Governor and Legislative Leaders:

As required by California Government Code, Section 8546 et seq., the Bureau of State Audits presents its audit report concerning our review of the State of California's internal controls and compliance with state and federal laws and regulations for the year ended June 30, 2008.

This report concludes that the State did not materially comply with certain requirements for 20 of the 39 federal programs or clusters of programs we audited. Additionally, we were unable to obtain sufficient documentation to determine whether the State complied with relevant federal requirements for nine programs or clusters of programs. Further, the State continues to experience certain deficiencies in its accounting and administrative practices that affect its internal controls over financial reporting and over compliance with federal requirements. Although none of the deficiencies we identified are material to the State's financial statements, deficiencies in the State's internal control system could adversely affect its ability to provide accurate financial information and to administer federal programs in compliance with applicable requirements.

Respectfully submitted,

Elaine M. Howle

ELAINE M. HOWLE, CPA
State Auditor

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AUDITOR'S SECTION

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

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Bureau of State Audits

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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 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, 2008, which collectively comprise the State of California's basic financial statements, and have issued our report thereon dated February 25, 2009. 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. 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 86 percent, 53 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 90 percent, 81 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 91 percent, 93 percent, and 12 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 or 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 2008-15-1, 2008-15-2, 2008-15-3, 2008-15-4, 2008-15-5, 2008-15-6, and 2008-15-7 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 are 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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 J. JELICICH, CPA
Deputy State Auditor

February 25, 2009

Elaine M. Howle
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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, 2008. 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 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, 2008. The University of California and the California State University systems, and the California Housing Finance Agency, which reported expenditures of federal awards totaling $3.3 billion, $1.5 billion, and $75.6 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 on the next page, 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 described in Table 1, nor were we able to satisfy ourselves as to the State of California's compliance with those requirements by other auditing procedures.

Table 1

FEDERAL PROGRAM	CATALOG OF FEDERAL DOMESTIC ASSISTANCE NUMBER	COMPLIANCE REQUIREMENT(S)
Community Development Block Grants/State's Program	14.228	Earmarking (Public Services)
Special Education—Grants for Infants and Families with Disabilities	84.181	Activities allowed/allowable costs and level of effort—maintenance of effort
Help America Vote Act Requirements Payments	90.401	Level of effort—maintenance of effort
Aging Cluster: Special Programs for the Aging—Title III, Part B—Grants for Supportive Services and Senior Centers, Special Programs for the Aging—Title III, Part C—Nutrition Services, and Nutrition Services Incentive Program	93.044 93.045 93.053	Eligibility and matching, level of effort—and earmarking
Temporary Assistance for Needy Families	93.558	Activities allowed/allowable costs
Child Support Enforcement	93.563	Eligibility
Foster Care—Title IV-E	93.658	Activities allowed, allowable costs/cost principles, and period of availability
Adoption Assistance	93.659	Activities allowed, allowable costs/cost principles, and period of availability
Block Grants for Prevention and Treatment of Substance Abuse	93.959	Activities allowed/allowable costs

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:

Table 2

FINDING NUMBER	FEDERAL DEPARTMENT	PROGRAM	CATALOG OF FEDERAL DOMESTIC ASSISTANCE NUMBER	COMPLIANCE REQUIREMENT(S)
2008-1-4	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
2008-1-9	Defense	National Guard Military Operations and Maintenance (O&M) Projects	12.401	Activities allowed/ allowable costs
2008-1-10	Education	Safe and Drug-Free Schools and Communities—State Grants	84.186	Activities allowed/ allowable costs and subrecipient monitoring
2008-1-14	Housing and Urban Development	Community Development Block Grants/ State's Program	14.228	Activities allowed/ allowable costs and subrecipient monitoring
2008-2-3	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
2008-2-5	Health and Human Services	Medical Assistance Program	93.778	Allowable costs and cost principles
2008-3-2	Agriculture	Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)	10.557	Cash management
2008-3-3	Education	Adult Education—Basic Grants for States, Title I Grants to Local Educational Agencies, Safe and Drug-Free Schools and Communities—State Grants, Twenty-First Century Community Learning Centers, English Language Acquisition Grants, Improving Teacher Quality State Grants	84.002 84.010 84.186 84.287 84.365 84.367	Cash management

FINDING NUMBER	FEDERAL DEPARTMENT	PROGRAM	CATALOG OF FEDERAL DOMESTIC ASSISTANCE NUMBER	COMPLIANCE REQUIREMENT(S)
2008-3-9	Homeland Security	Disaster Grants—Public Assistance (Presidentially Declared Disasters), Homeland Security Grant Program	97.036 97.067	Cash management
2008-3-10	Health and Human Services	Child Support Enforcement	93.563	Cash management
2008-5-3	Health and Human Services	HIV Care Formula Grants	93.917	Eligibility
2008-5-4	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
2008-7-4	Education	Adult Education—Basic Grants to States	84.002	Matching and level of effort—maintenance of effort
2008-7-10	The Corporation for National and Community Service	AmeriCorps	94.006	Matching
2008-7-15	Housing and Urban Development	Community Development Block Grants/ State's Program	14.228	Earmarking
2008-8-4	Health and Human Services	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 93.596	Period of availability
2008-8-8	Education	Safe and Drug-Free Schools and Communities—State Grants	84.186	Period of availability
2008-8-9	Health and Human Services	Block Grants for Prevention and Treatment of Substance Abuse	93.959	Period of availability
2008-8-11	Health and Human Services	Block Grants for Community Mental Health Services	93.958	Period of availability
2008-9-2	Health and Human Services	Block Grants for Community Mental Health Services	93.958	Procurement, suspension and debarment
2008-9-3	Health and Human Services	Promoting Safe and Stable Families, Refugee and Entrant Assistance—State Administered Programs	93.556 93.566	Procurement, suspension and debarment
2008-9-4	Health and Human Services	Promoting Safe and Stable Families, Temporary Assistance for Needy Families, Refugee and Entrant Assistance—State Administered Programs, Child Welfare Services—State Grants, Foster Care—Title IV-E, Adoption Assistance	93.556 93.558 93.566 93.645 93.658 93.659	Procurement, suspension and debarment
2008-9-5	Housing and Urban Development	Community Development Block Grants/ State's Program	14.228	Suspension and debarment
2008-12-1	Election Assistance Commission	Help America Vote Act Requirement Payments	90.401	Reporting
2008-12-3	Education	Title I Grants to Local Educational Agencies, English Language Acquisition Grants	84.010 84.365	Reporting
2008-13-12 and 2008-13-13	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	Subrecipient monitoring
2008-13-20	Health and Human Services	Child Support Enforcement	93.563	Subrecipient monitoring
2008-13-21	Education	Safe and Drug-Free Schools and Communities—State Grants	84.186	Subrecipient monitoring
2008-13-22	Health and Human Services	Block Grants for Prevention and Treatment of Substance Abuse	93.959	Subrecipient monitoring
2008-13-23	Health and Human Services	Block Grants for Community Mental Health Services	93.958	Subrecipient monitoring

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FINDING NUMBER	FEDERAL DEPARTMENT	PROGRAM	CATALOG OF FEDERAL DOMESTIC ASSISTANCE NUMBER	COMPLIANCE REQUIREMENT(S)
2008-13-25	Health and Human Services	Promoting Safe and Stable Families	93.556	Subrecipient monitoring
2008-13-28	Health and Human Services	Temporary Assistance for Needy Families, Foster Care—Title IV-E, Adoption Assistance	93.558 93.658 93.659	Subrecipient monitoring
2008-13-29	Health and Human Services	Adoption Assistance	93.659	Subrecipient monitoring
2008-13-31	Housing and Urban Development	Community Development Block Grants/State's Program, HOME Investment Partnerships Program	14.228 14.239	Subrecipient monitoring
2008-14-5	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	Special tests and provisions—provider eligibility
2008-14-8	Education	Special Education—Grants for Infants and Families with Disabilities	84.181	Special tests and provisions
2008-14-9	Health and Human Services	Child Support Enforcement	93.563	Special tests and provisions
2008-14-10	Health and Human Services	Block Grants for Community Mental Health Services	93.958	Special tests and provisions
2008-14-11	Health and Human Services	Adoption Assistance	93.659	Special tests and provisions

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, 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, 2008. 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:

2008-1-3, 2008-1-5, 2008-1-8, 2008-2-1, 2008-2-2, 2008-2-6, 2008-2-7, 2008-2-8, 2008-2-9, 2008-2-11, 2008-3-4, 2008-3-6, 2008-3-8, 2008-3-11, 2008-3-12, 2008-5-5, 2008-5-6, 2008-5-7, 2008-7-9, 2008-8-2, 2008-8-5, 2008-8-7, 2008-8-10, 2008-9-1, 2008-12-2, 2008-12-5, 2008-12-7, 2008-12-8, 2008-12-9, 2008-12-10, 2008-12-11, 2008-12-12, 2008-12-13, 2008-12-14, 2008-12-16, 2008-12-18, 2008-13-1, 2008-13-2, 2008-13-3, 2008-13-4, 2008-13-5, 2008-13-6, 2008-13-7, 2008-13-8, 2008-13-10, 2008-13-11, 2008-13-14, 2008-13-15, 2008-13-16, 2008-13-18, 2008-13-19, 2008-13-26, 2008-13-27, 2008-13-32, 2008-14-1, 2008-14-2, and 2008-14-4.

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 2008-1-1, 2008-1-2, 2008-1-3, 2008-1-4, 2008-1-5, 2008-1-6, 2008-1-7, 2008-1-8, 2008-1-9, 2008-1-10, 2008-1-11, 2008-1-12, 2008-1-13, 2008-1-14, 2008-2-1, 2008-2-2, 2008-2-3, 2008-2-4, 2008-2-6, 2008-2-7, 2008-2-8, 2008-2-9, 2008-2-10, 2008-3-1, 2008-3-2, 2008-3-3, 2008-3-4, 2008-3-5, 2008-3-6, 2008-3-7, 2008-3-8, 2008-3-9, 2008-3-10, 2008-3-12, 2008-3-13, 2008-5-2, 2008-5-3, 2008-5-4, 2008-5-5, 2008-5-6, 2008-5-7, 2008-7-1, 2008-7-2, 2008-7-3, 2008-7-4, 2008-7-5, 2008-7-6, 2008-7-7, 2008-7-8, 2008-7-9, 2008-7-10, 2008-7-11, 2008-7-12, 2008-7-13, 2008-7-14, 2008-7-16, 2008-7-17, 2008-8-1, 2008-8-2, 2008-8-3, 2008-8-4, 2008-8-5, 2008-8-8, 2008-8-10, 2008-8-11, 2008-8-12, 2008-9-1, 2008-9-2, 2008-9-3, 2008-9-4, 2008-9-5, 2008-12-1, 2008-12-2, 2008-12-3, 2008-12-4, 2008-12-5, 2008-12-6, 2008-12-7, 2008-12-8, 2008-12-9, 2008-12-10, 2008-12-11, 2008-12-12, 2008-12-13, 2008-12-15, 2008-12-18, 2008-12-19, 2008-12-20, 2008-13-2, 2008-13-3, 2008-13-4, 2008-13-5, 2008-13-6, 2008-13-7, 2008-13-8, 2008-13-9, 2008-13-10, 2008-13-11, 2008-13-12, 2008-13-13, 2008-13-14, 2008-13-15, 2008-13-16, 2008-13-17, 2008-13-19, 2008-13-20, 2008-13-22, 2008-13-23, 2008-13-25, 2008-13-26, 2008-13-27, 2008-13-28, 2008-13-29, 2008-13-30, 2008-13-31, 2008-14-1, 2008-14-2, 2008-14-3, 2008-14-4, 2008-14-5, 2008-14-6, 2008-14-7, 2008-14-8, 2008-14-9, 2008-14-10, and 2008-14-11 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 2008-1-4, 2008-1-5, 2008-1-6, 2008-1-7, 2008-1-9, 2008-1-10, 2008-1-11, 2008-1-12, 2008-1-13, 2008-1-14, 2008-2-3, 2008-2-4, 2008-2-9, 2008-2-10, 2008-3-2, 2008-3-3, 2008-3-9, 2008-3-10, 2008-3-13, 2008-5-3, 2008-5-4, 2008-5-6, 2008-7-1, 2008-7-2, 2008-7-3, 2008-7-4, 2008-7-10, 2008-7-11, 2008-7-13, 2008-7-14, 2008-7-16, 2008-8-1, 2008-8-3, 2008-8-4, 2008-8-8, 2008-8-11, 2008-8-12, 2008-9-1, 2008-9-2, 2008-9-3, 2008-9-4, 2008-12-1, 2008-12-2, 2008-12-3, 2008-12-15, 2008-13-12, 2008-13-13, 2008-13-16, 2008-13-17, 2008-13-20, 2008-13-22, 2008-13-23, 2008-13-25, 2008-13-27, 2008-13-28, 2008-13-29, 2008-14-1, 2008-14-5, 2008-14-7, 2008-14-8, 2008-14-9, 2008-14-10, and 2008-14-11 to be material weaknesses.

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.

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, 2008, and have issued our report thereon dated February 25, 2009. 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 86 percent, 53 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 90 percent, 81 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 91 percent, 93 percent, and 12 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.

Our audit was performed for the purpose of forming our 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

February 25, 2009

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, 2008

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
National Guard Military Operations and Maintenance (O&M) Projects (12.401)	Qualified
Community Development Block Grants/State's Program (14.228)	Qualified
HOME Investments Partnerships Program (14.239)	Qualified
Adult Education—Basic Grants to States (84.002)	Qualified
Title I Grants to Local Educational Agencies (84.010)	Qualified
Safe and Drug-Free Schools and Communities—State Grants (84.186)	Qualified
Twenty-First Century Community Learning Centers (84.287)	Qualified
English Language Acquisition Grants (84.365)	Qualified
Improving Teacher Quality State Grants (84.367)	Qualified
Temporary Assistance for Needy Families (93.558)	Qualified

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Child Support Enforcement (93.563)	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
Foster Care—Title IV-E (93.658)	Qualified
Adoption Assistance (93.659)	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
HIV Care Formula Grants (93.917)	Qualified
Disaster Grants—Public Assistance (Presidentially Declared Disasters) (97.036)	Qualified
Homeland Security Grant Program (97.067)	Qualified
Block Grants for Prevention and Treatment of Substance Abuse (93.959)	Qualified
All other major programs	Unqualified
Any audit findings disclosed that are required to be reported in accordance with Section .510(a) of OMB Circular A-133?	Yes
Dollar threshold used to distinguish between Type A and Type B programs	$79.6 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
	Child Nutrition Cluster
	Employment Services Cluster
	Homeland Security Cluster
	Medicaid Cluster
	Special Education Cluster
	WIA Cluster
10.557	Special Supplemental Nutrition Program for Women, Infants, and Children
10.558	Child and Adult Care Food Program
12.401	National Guard Military Operations and Maintenance (O&M) Projects
14.228	Community Development Block Grants/State's Program
14.239	HOME Investments Partnerships Program
16.606	State Criminal Alien Assistance Program
64.114	Veterans Housing—Guaranteed and Insured Loans
66.458	Capitalization Grants for Clean Water State Revolving Funds
84.002	Adult Education—Basic Grants to States
84.010	Title I Grants to Local Educational Agencies
84.011	Migrant Education—State Grant Program
84.032	Federal Family Education Loans—Guaranty Agencies
84.048	Career and Technical Education—Basic Grants to States
84.181	Special Education—Grants for Infants and Families with Disabilities
84.186	Safe and Drug-Free Schools and Communities—State Grants
84.287	Twenty-First Century Community Learning Centers
84.357	Reading First State Grants
84.365	English Language Acquisition Grants
84.367	Improving Teacher Quality State Grants
93.283	Centers for Disease Control and Prevention—Investigations and Technical Assistance
93.558	Temporary Assistance for Needy Families
93.563	Child Support Enforcement
93.568	Low-Income Home Energy Assistance
93.658	Foster Care—Title IV-E
93.659	Adoption Assistance
93.767	State Children's Insurance Program
93.889	National Bioterrorism Hospital Preparedness Program
93.917	HIV Care Formula Grants
93.959	Block Grants for Prevention and Treatment of Substance Abuse
97.036	Disaster Grants—Public Assistance (Presidentially Declared Disasters)
97.046	Fire Management Assistance Grant

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

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CALIFORNIA EMERGENCY MANAGEMENT AGENCY

Reference Number: 2008-15-1

Condition

In preparing its adjustments for fiscal year 2007–08, the California Emergency Management Agency (Emergency Management), formerly the Office of Emergency Services, overstated its liabilities and expenditures by $352 million for the Federal Trust 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 them are either reimbursed or funded from other sources, or the State will not own the resulting asset. The overstatement errors were caused by Emergency Management's recording commitments as liabilities.

When departments make errors in their generally accepted accounting principles (GAAP) adjustments, the State Controller's Office (SCO) 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 SCO is required to issue a report prepared strictly in accordance with GAAP. To assist it in this responsibility, the SCO annually requests departments to provide adjustments to conform their financial statements to GAAP. Further, the SCO provides instructions to help departments prepare their GAAP adjustments.

Recommendation

Emergency Management should make improvements to its financial reporting process to ensure that it prepares and submits accurate GAAP adjustments to the SCO. In particular, Emergency Management should properly distinguish between commitments and encumbrances in preparing its GAAP adjustments.

Department's View and Corrective Action Plan

Emergency Management concurs with our finding and submitted the GAAP adjustments for the Federal Trust Fund upon learning of the error. In addition, Emergency Management indicated it would submit required adjustments related to commitments in the future.

DEPARTMENT OF PARKS AND RECREATION

Reference Number: 2008-15-2

Condition

For the fiscal year ended 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 Service's 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 in 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 that it had 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 that of General Services. In November 2008 Parks and Recreation informed us that it had not fully implemented our prior year's 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 was $33.2 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 departments 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 (SCO) in a Statement of Changes in General Fixed Assets all additions and deductions to real property funded by governmental funds. The SCO includes this information in the State's financial statements.

Recommendation

Parks and Recreation should 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 but indicates that additional time is necessary for full implementation of the recommendation.

DEPARTMENT OF MENTAL HEALTH

Reference Number: 2008-15-3

Condition

In preparing its adjustments for fiscal year 2007–08, the Department of Mental Health (Mental Health) overstated its encumbrance reserve amount by $581 million for the Mental Health Services Fund. On a budgetary/legal basis, local assistance contracts or grants are recorded as encumbrances when the contract or grant 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 them are either reimbursed or funded from other sources, or the State will not own the resulting asset. The overstatement error was caused by Mental Health not submitting a generally accepted accounting principles (GAAP) adjustment to reduce the encumbrance reserve and reclassify its local assistance obligation as a commitment. When departments make errors in their GAAP adjustments, the State Controller's Office (SCO) 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 SCO is required to issue a report prepared strictly in accordance with GAAP. To assist it in this responsibility, the SCO annually requests departments to provide adjustments to conform their financial statements to GAAP. Further, the SCO provides instructions to help departments prepare their GAAP adjustments.

Recommendation

Mental Health should make improvements to its financial reporting process to ensure that it prepares and submits accurate GAAP adjustments to the SCO. In particular, Mental Health should properly distinguish between commitments and encumbrances in preparing its GAAP adjustments.

Department's View and Corrective Action Plan

Mental Health concurs with our finding and indicates that it will incorporate this GAAP adjustment to reclassify encumbrance balances related to commitments as a part of its annual financial reporting process.

DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

Reference Number: 2008-15-4

Condition

In preparing its adjustments for fiscal year 2007–08, the Department of Housing and Community Development (Housing) overstated its encumbrance reserve amount by $50 million for the Building Equity and Growth in Neighborhoods Fund and $400 million for the Regional Planning, Housing, and Infill Incentive Account, Housing and Emergency Shelter Trust Fund of 2006. On a budgetary/legal basis, local assistance contracts or grants are recorded as encumbrances when the contract or grant 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 them are either reimbursed or funded from other sources, or the State will not own the resulting asset. The overstatement errors were caused by Housing not submitting its generally accepted accounting principles (GAAP) adjustments to reduce the encumbrance reserves and reclassify its local assistance obligations as commitments.

When departments make errors in their GAAP adjustments, the State Controller's Office (SCO) 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 SCO is required to issue a report prepared strictly in accordance with GAAP. To assist it in this responsibility, the SCO annually requests departments to provide adjustments to conform their financial statements to GAAP. Further, the SCO provides instructions to help departments prepare their GAAP adjustments.

Recommendation

Housing should make improvements to its financial reporting process to ensure that it prepares and submits accurate GAAP adjustments to the SCO. In particular, Housing should properly distinguish between commitments and encumbrances in preparing its GAAP adjustments.

Department's View and Corrective Action Plan

Housing plans to further research our recommendation to ensure it abides by the California Government Code and if appropriate, apply adjusting entries consistently in subsequent fiscal years. If appropriate, Housing will incorporate its analysis and the recommendations of the Bureau of State Audits into its annual financial reporting process.

CALIFORNIA DEPARTMENT OF TRANSPORTATION

Reference Number: 2008-15-5

Condition

In preparing its financial reports for fiscal year 2007–08, the Department of Transportation (Caltrans) overstated its reserve for encumbrances and commitments by a total of $192 million by understating various liability accounts and related expenditures. Funds affected by this misstatement are the State Highway Account, Bicycle Transportation Account, Public Transportation Account, Traffic Congestion Relief Fund, Transportation Investment Fund, and the Transportation Deferred Investment Fund. In accordance with the accounting principles generally accepted in the United States of America, a reserve for encumbrance derives from an executed agreement with unperformed services or undelivered goods. A commitment arises out of an agreement to provide funding to a local government for expenditure. For any goods or services received by year-end that remain unpaid, or funding for a local government that is due, Caltrans must prepare an accrual to report these costs as a liability and reflect the related expenditure. This error occurred because Caltrans excluded liabilities totaling $192 million when preparing its accruals, and instead recorded these liabilities as encumbrances and commitments.

Criteria

Under California Government Code, sections 12460 and 12461, the State Controller's Office (SCO) is required to issue a report prepared strictly in accordance with generally accepted accounting principles (GAAP). To assist it in this responsibility, the SCO annually requests departments to provide adjustments to conform their financial statements to GAAP. Further, the SCO provides instructions to help departments prepare their GAAP adjustments.

Recommendation

Caltrans should make improvements to its financial reporting process to ensure it accurately reports reserve for encumbrances, commitments, and various liability accounts and related expenditures.

Department's View and Corrective Action Plan

Caltrans concurred that it overstated reserve for encumbrances and commitments by a total of $192 million by understating various liability accounts and related expenditures. Caltrans stated its accruals reflected the cost of goods or services received by year-end for which an invoice had been given prior to a cut-off date necessary to meet the State's financial reporting deadlines. The $192 million in liabilities and related expenditures reflected the cost of goods or services received for which Caltrans had not been given an invoice before the cut-off date. In the future, Caltrans agreed to accrue an estimate for such obligations based on historical data. However, Caltrans stated that due to significant fluctuations in funding levels, it could not provide assurance that the estimate prepared at the time of reporting deadlines would reasonably approximate the actual data available several months later.

CALIFORNIA DEPARTMENT OF TRANSPORTATION

Reference Number: 2008-15-6

Condition

In preparing its adjustments for fiscal year 2007–08, the Department of Transportation (Caltrans) overstated its reserve for encumbrances by $617 million for the Public Transportation Account. On a budgetary/legal basis, local assistance contracts or grants are recorded as encumbrances when the underlying agreement 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 are either reimbursed or funded from other sources, or the State will not own the resulting asset. The error occurred because Caltrans did not submit a generally accepted accounting principles (GAAP) adjustment to the State Controller's Office (SCO) reclassifying $617 million in encumbrance reserves to commitments.

When departments do not prepare necessary GAAP adjustments, the SCO does not have the data it needs to accurately prepare the State's GAAP-basis financial statements included in the Comprehensive Annual Financial Report.

Criteria

Under California Government Code, sections 12460 and 12461, the SCO is required to issue a report prepared strictly in accordance with GAAP. To assist it in this responsibility, the SCO annually requests departments to provide adjustments to conform their financial statements to GAAP. Further, the SCO provides instructions to help departments prepare their GAAP adjustments.

Recommendation

Caltrans should make improvements to its financial reporting process to ensure that it prepares and submits accurate GAAP adjustments to the SCO. In particular, Caltrans should properly distinguish between commitments and encumbrances in preparing its GAAP adjustments.

Department's View and Corrective Action Plan

Caltrans concurred with our finding and submitted a GAAP entry to the SCO to reclassify $617 million from reserve for encumbrances to commitments.

FRANCHISE TAX BOARD

Reference Number: 2008-15-7

Condition

The Franchise Tax Board (FTB) overstated its fiscal year 2007–08 revenue accruals for corporation taxes by a combined $808 million. Chapter 751, Statutes of 2008, required a change in the calculation of tax revenue accruals, and Chapter 1 of the First Extraordinary Session, Statutes of 2008, directed the Department of Finance (Finance) to provide guidance to the FTB on the implementation of this change. Finance subsequently provided the FTB with instructions for executing this change on a budgetary/legal basis, but directed it to only partially implement the changes in fiscal year 2007–08 and to fully implement these changes in fiscal year 2008–09. The FTB subsequently estimated this change would amount to a $305 million increase to its corporation tax revenue accruals for fiscal year 2007–08. Under accounting principles generally accepted in the United States of America an estimate can be a valid basis for calculating an accrual, but there must be a reasonable basis for the estimate. However, neither Finance nor the FTB was able to provide adequate support for the methodology the FTB used to estimate these additional revenues, nor could they provide a valid reason for only partially implementing this change in fiscal year 2007–08. Although the $305 million increase to the FTB's corporation tax revenue accruals was appropriate on a budgetary/legal basis, the FTB should have submitted a generally accepted accounting principles (GAAP) adjustment to the State Controller's Office (SCO) to reverse this accrual.

In addition, Chapter 1 of the First Extraordinary Session, Statutes of 2008, established a new penalty to be assessed against any corporation that has an understatement of tax of $1 million or more in any open tax year from January 1, 2003. However, this same law allows corporations to file amended tax returns by May 31, 2009, to pay any additional self-assessed taxes and avoid the penalty. The FTB estimated that corporations will self-assess and remit an additional $1.4 billion by this deadline and increased its corporation tax revenue accruals by the same amount for fiscal year 2007–08. However, the FTB also estimated that corporations would submit refund claims against the $1.4 billion they submitted. Thus, because the FTB expects to net only $900 million from the $1.4 billion it estimates it will receive from this new tax penalty in fiscal year 2007–08, it should have submitted a GAAP adjustment to the SCO to reduce its revenue accruals by $503 million to account for future refunds.

When departments do not prepare necessary GAAP adjustments, the SCO does not have accurate data when preparing the State's GAAP-based financial statements included in the Comprehensive Annual Financial Report. Subsequent to our review, the FTB submitted GAAP adjustments to the SCO to reduce its corporation tax revenue accruals by a net of $808 million, which were then properly reflected in the State's Comprehensive Annual Financial Report.

Criteria

Under California Government Code, sections 12460 and 12461, the SCO is required to issue a report prepared strictly in accordance with GAAP. To assist it in this responsibility, the SCO annually requests departments to provide adjustments to conform their financial statements to GAAP. Further, the SCO provides instructions to help departments prepare their GAAP adjustments.

Recommendations

The FTB needs to ensure that its revenue accruals are adequately supported and develop a reasonable basis for estimating the taxes it will generate in fiscal year 2008–09 and subsequent fiscal years under the changes in law made by Chapter 751, Statutes of 2008. In addition, the FTB should make improvements to its financial reporting process to ensure that it prepares and submits appropriate GAAP adjustments to the SCO.

Department's View and Corrective Action Plan

The FTB concurred with our finding and submitted GAAP adjustments to the SCO to reduce its corporation tax revenue accruals by a net of $808 million.

Compliance Issues Related to All Federal Grants

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U.S. OFFICE OF MANAGEMENT AND BUDGET

Reference Number:	2008-12-17
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 $300,000 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 339) 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 noted 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$Cal). In light of the current economic climate in California, and FI$Cal's heavy reliance on bond funding, the project has slowed its forward progress on the Request for Proposal. Once full funding is obtained, forward progress will quickly continue. It is anticipated that the new system will have the capability to provide total expenditures for each federal program as required by OMB Circular A-133.

U.S. DEPARTMENT OF THE TREASURY

Reference Number:	2008-3-14
Federal Program Title:	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, 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 205.29—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. Establish the annual CMIA threshold amount. Identify the State agencies and federal assistance programs that will be impacted by CMIA.

b. Notify CMIA participating departments of their roles and responsibilities.

c. Negotiate with the U.S. Department of the Treasury, Financial Management Service (FMS) on new agreements and amendments to the existing Agreement.

d. With the assistance of the SCO, develop patterns by programs for the average number of days from warrant issuance to redemption.

e. Calculate the state and federal interest liabilities by programs and direct costs for DOF's interest calculation costs.

f. Prepare annual interest reports and interest calculation cost claims for submittal to FMS.

g. Budget funds from the General Fund and special funds for the payment of the state interest liability to the federal government.

Condition

Finance entered into the Treasury-State Agreement (TSA) with the U.S. Department of the Treasury for fiscal year 2007–08 on August 17, 2007. Our review of Finance's implementation of the TSA found that it does not have adequate written policies and procedures to ensure that its staff are accurately calculating the state and federal interest liabilities by program. Annually, Finance conducts a training session with the departments responsible for administering programs subject to the TSA to instruct them on how to prepare the quarterly work sheets it uses to calculate the state and federal interest liability. The departments prepare work sheets quarterly that include information on federal drawdowns and the related payments for the programs they administer that are subject to the TSA. Currently, one staff person is responsible for reviewing and compiling the work sheets.

Our review of the interest calculations for the fiscal year 2007–08 annual report found that Finance incorrectly calculated the federal interest liability, interest liability related to disbursement without warrants and Medi-Cal refund interest liability. Specifically, the TSA prescribes that when calculating the 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.

Furthermore, according to the TSA, to calculate the federal interest liability for disbursement 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. Instead, Finance again calculated the federal interest liability using the methodology outlined in the TSA for calculating the state interest liability. Finally, the TSA requires Finance to calculate the interest liability on Medi-Cal refunds by using the predisbursement period and the clearance pattern period. The predisbursement period is identified as 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 incorrectly calculated the midpoint date to be between the deposit date and the remittance date, which is the date the departments request the funds prior to the issuance of the warrants. As a result of Finance's miscalculation of the midpoint date, its calculation of the Medi-Cal refund interest liability is incorrect. Without adequate written policies and procedures, those responsible for reviewing the compilation of the work sheets 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 (SCO) to develop clearance patterns to ensure that it is consistent with the TSA. In fact, despite certifying in the fiscal year 2007–08 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 its review of the clearance patterns. However, Finance's review of the methodology used by the SCO is particularly important because we noted an inconsistency between the SCO's written process that it gave to Finance and the TSA requirements related to the calculation of the dollar-weighted average day of clearance. Finance was unable to explain the inconsistency. Because Finance is responsible for the development of the clearance patterns, it has the responsibility to ensure that the SCO's methodology is consistent with that of 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, liability for disbursements without warrants, and Medi-Cal refund interest liability and revise its fiscal year 2007–08 annual report. Finally, Finance should review the methodology used by the SCO to develop the clearance patterns by program and retain evidence of its review for audit purposes.

Department's View and Corrective Action Plan

1. Inadequate Written Policies and Procedures

   Finance concurs with this finding. Finance stated that it does have an extensive procedures manual. However, it agrees that the procedures manual would be enhanced by including more narrative describing how to calculate the state and federal interest liabilities. The additional narrative will be prepared and incorporated into the procedures manual. Finance anticipates this will be accomplished by June 2009.

2. Federal Interest Liability

   Finance agrees that the calculation of the federal interest liability does not appear to be correct based on the language currently contained in the TSA. Finance stated that it is reevaluating its procedures for calculating the federal interest liability. Finance also stated that it plans to discuss this issue with the federal Financial Management Service (FMS) to reach an agreement on the correct method for calculating federal interest liabilities and to implement any necessary changes to either the procedures or the language in the TSA. Finance anticipates this will be accomplished by June 2009.

3. Disbursements Without Warrants

   Finance agrees that the calculation of the interest liability for disbursements without warrants does not appear to be correct based on the language currently contained in the TSA. Finance plans to discuss this issue with the federal FMS to reach an agreement on the correct method for calculating the interest liability for disbursements without warrants and to implement any necessary changes to either the procedures or the language in the TSA. Finance anticipates this will be accomplished by June 2009.

4. Medi-Cal Refund Interest Liability

Finance agrees that the calculation of the interest liability on Medi-Cal refunds does not appear to be correct based on the language currently contained in the TSA. Finance believes the language in the TSA needs to be clarified. Therefore, Finance will draft revised language and will work with the federal FMS to incorporate the revision in the next TSA. Finance anticipates this will be accomplished by June 2009.

5. Clearance Patterns

Finance agrees that the methodology used by the SCO to develop clearance patterns has not been adequately reviewed and verified. Finance stated that, in January 2008, it verified the SCO's methodology. However, it did not adequately verify that the computer programming is consistent with the proper methodology. Therefore, Finance will take the following actions: (1) develop a certification form that incorporates a description of the methodology contained in the written documentation, which will be provided to the SCO with a request to certify that this methodology was used for developing the clearance patterns; (2) establish an agreement with the SCO that when requested by Finance, the SCO will provide the certification, the clearance pattern reports, and a copy of the computer programming that produces the reports; and (3) establish a process for Finance's Information Services staff to review the computer programming and verify that the programming is consistent with the methodology contained in the TSA. Finance anticipates these actions will be accomplished by May 2009.

U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Reference Number:	2008-2-12
Federal Program Title:	All Programs
Category of Finding:	Allowable Costs
State Administering Department:	Department of Finance (Finance)

Criteria

TITLE 2—GRANTS AND AGREEMENTS, PART 225—*COST PRINCIPLES FOR STATE, LOCAL, AND INDIAN TRIBAL GOVERNMENTS* (OMB CIRCULAR A-87)

Appendix C to Part 225—State/Local-Wide Central Service Cost Allocation Plans

E. Documentation requirements for submitted plans

1. General. All proposed plans must be accompanied by the following: an organization chart sufficiently detailed to show operations including the central service activities of the State/local government whether or not they are shown as benefiting from central service functions; a copy of the Comprehensive Annual Financial Report (or a copy of the Executive Budget if budgeted costs are being proposed) to support the allowable costs of each central service activity included in the plan; and a certification that the plan was prepared in accordance with this and other appendices to this part, contains only allowable costs, and was prepared in a manner that treated similar costs consistently among the various Federal awards and between Federal and non-Federal awards/activities.

3. Billed services

(b) Internal service funds.

(1) For each internal service fund or similar activity with an operating budget of $5 million or more, the plan shall include: a brief description of each service; a balance sheet for each fund based on individual accounts contained in the

governmental unit's accounting system; a revenue/expenses statement, with revenues broken out by source, e.g., regular billings, interest earned, etc.; a listing of all non-operating transfers (as defined by Generally Accepted Accounting Principles (GAAP)) into and out of the fund; a description of the procedures (methodology) used to charge the costs of each service to users, including how billing rates are determined; a schedule of current rates; and, a schedule comparing total revenues (including imputed revenues) generated by the service to the allowable costs of the service, as determined under this Circular, with an explanation of how variances will be handled.

G. Other Policies

5. Records retention. All central service cost allocation plans and related documentation used as a basis for claiming costs under Federal awards must be retained for audit in accordance with the records retention requirements contained in the Common Rule.

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 92.42—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).

(c) Starting date of retention period:

(4) Indirect cost rate proposals, cost allocation plans. This paragraph applies to the following types of documents, and their support records: indirect cost rate computations or proposals, cost allocation plans, and any similar accounting computations of the rate at which a particular group of costs is chargeable (such as computer usage chargeback rates or composite fringe benefit rates).

(i) If submitted for negotiation. If the proposal, plan, or other computation is required to be submitted to the Federal Government (or to the grantee) to form the basis for negotiation purposes, then the 3-year retention period for its supporting records starts from the date of such submission.

(ii) If not submitted for negotiation. If the proposal, plan, or other computation is not required to be submitted to the Federal Government (or to the grantee) for negotiation purposes, then the 3-year retention period for the proposal plan, or computation and its supporting records starts from the end of the fiscal (or other accounting period) covered by the proposal, plan, or other computation.

Condition

Each year, Finance prepares and submits California's statewide cost allocation plan to the U.S. Department of Health and Human Services for approval. A statewide cost allocation plan is used to recover a portion of the State's costs for administering federal programs. Finance requires central service agencies, those state agencies providing general administrative services to all state departments, to report expenditure and workload information that it then uses to develop the statewide cost allocation plan. Specifically, Finance requires the central service agencies to report actual expenditures from a prior year, estimated expenditures for the current plan year, and workload data.

Finance uses an Access database to perform complex calculations and generate reports to prepare the statewide cost allocation plan. We found that it was sometimes difficult to obtain explanations from a Finance staff member regarding differences in the amounts for the various Access-generated reports, which also required extra work on the part of Finance staff. The assistant chief of Finance's fiscal systems and consulting unit agreed that the Access database programming is not adequately

documented. He also stated that although Finance is able to generate reports using Access, the programming is difficult to understand. Further, he stated that because Access does not have the capability to track changes and identify those queries or macros that were run or not run, it is difficult to identify and explain errors. In addition, he stated that Finance is working with an analyst with expertise in Excel and Access to analyze the Access database and create an Excel spreadsheet that will replace the database. The analyst will also document the steps taken to create the Excel spreadsheet, which will be more easily supportable and will enable Finance to more easily identify and correct errors. Until Finance replaces its Access database with the Excel spreadsheet, it will continue to experience difficulty in identifying and correcting differences that may exist in the Access-generated reports.

Finally, we found that Finance did not submit the required information with its proposed cost allocation plan. Specifically, federal regulations require Finance to submit an organization chart sufficiently detailed to show operations of the central service activities. However, Finance did not submit this organization chart. Also, one department responsible for an internal service fund function did not include a balance sheet in its annual report as required. Instead, the department included a Statement of Change in Fund Balance. Federal regulations require that the annual report include a balance sheet based on individual accounts contained in the governmental unit's accounting system. Both Finance and the department responsible for the internal service fund were unaware of the error until we informed them that the incorrect document was submitted. Thus, Finance is not ensuring that it and the departments responsible for internal service funds are complying with the federal regulations and providing the U.S. Health and Human Services with complete information to render its approval of the statewide cost allocation plan.

Questioned Costs

Unknown

Recommendations

Finance should continue its efforts to work with an analyst to analyze the Access database and create an Excel spreadsheet that will replace the database so that it can more easily identify, explain, and correct errors. Finance should also ensure that it submits all documentation required for the statewide cost allocation plan, including the annual reports for internal service funds.

Department's View and Corrective Action Plan

1. Difficulty Identifying, Explaining, and Correcting Errors

   Finance concurs with this finding. In November 2008, Finance staff began the development of an Excel spreadsheet to replace the Access database that performs the SWCAP allocations. Current plans are to begin testing and running the new spreadsheet parallel to the existing database for the 2010–11 cost allocation. Finance will create adequate documentation as an integral part of developing the new spreadsheet.

2. Submission of Required Information with Proposed Cost Allocation Plan

   Finance concurs with this finding. Finance stated that its staff will ensure that all required documentation for the statewide cost allocation plan is submitted. Finance also stated that one additional staff person will be redirected to assist with the coordination of the large volume of information required to be submitted to the federal government.

U.S. OFFICE OF MANAGEMENT AND BUDGET

Reference Number:	2008-13-24
Federal Program:	All programs subject to OMB Circular A-133
Category of Finding:	Subrecipient Monitoring
State Administering Department:	State Controller's Office (SCO)

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.

STATE ADMINISTRATIVE MANUAL, Section 20070—Federal Pass-Through Funds

The OMB Circular A-133, Subpart D describes the responsibilities of federal agencies and pass-through entities. Specifically, Section .400(d) prescribes the responsibilities of a pass-through entity for the federal awards it makes.

To ensure that the State of California carries out its responsibilities in accordance with this federal act, the following procedures shall apply:

2. The SCO will coordinate single audit compliance with local governments.

a. Each state entity will monitor the federal funds it disburses to local governments to ensure compliance with federal laws and regulations. State entities will receive local government audit reports performed in accordance with the Single Audit Act of 1984, P.L. 98-502, and the Single Audit Act Amendments of 1996, P.L. 104-156 from the SCO when the audit report includes a schedule of findings and questioned costs with respect to federal funds that were passed through state entities. In addition, the SCO will distribute the single audit reports to state entities when the prior fiscal year's single audit report included audit findings related to federal funds. The state entity will review these reports and evaluate the corrective action plans submitted in response to findings of noncompliance.

b. All contracts or agreements issued by state entities concerning disbursement of federal funds to local government will include the requirement for an audit in accordance with P.L. 104-156 and amendments.

c. The SCO will inform units of local government to submit copies of audit reports and corrective action plans, when warranted, prepared in accordance with P.L. 104-156 and amendments directly to the SCO.

d. The SCO will distribute copies of each audit report and corrective action plan to state entities affected by audit findings.

e. State entities will follow up on audit findings pertaining to federal programs, which they administer, and the SCO will follow up on general findings such as those relating to internal control.

f. The SCO will review and monitor the audit reports issued by external independent auditors. The SCO will determine whether or not the audit reports conform to *Government Auditing Standards*.

Condition

During our audit we found that some state departments are not issuing management decisions on audit findings within six months after the State receives the local governments' audit reports. Consequently, the State cannot ensure that local governments are taking timely and appropriate corrective action to address the audit findings.

The State has established a process that requires local governments such as counties to submit their audit reports to the SCO. If the local governments' audit report includes a schedule of findings and questioned costs with respect to federal funds, the SCO must forward copies of the report and corrective action plan to state entities affected by the audit findings. Specifically, upon receipt of the local governments' audit reports, the SCO screens the reports to determine if more than $500,000 in federal funds was spent and if the report contains all of the required elements. The next step in the SCO's process is to review the reports and perform procedures to determine if it should return the report due to missing information, reject the report due to noncompliance with the applicable reporting standards and requirements, or accept (certify) the report. Once the SCO certifies the report, it sends a copy of the acceptance letter and audit report(s) to the appropriate state agencies. Although this is the process established by the SCO, the State does not require it to certify the reports before forwarding them to the appropriate agencies.

During fiscal year 2007–08, we reviewed the status of local government audit reports issued for fiscal year ended June 30, 2007. OMB Circular A-133 requires each auditee to submit an audit report and a data collection form to the OMB's clearing house within the earlier of 30 days after their receipt of the auditor's report or nine months after the end of the audit period, unless they have received an extension from their federal cognizant or oversight agency. We found that, for 26 of the 58 counties, the SCO took between 1.2 months and 9.2 months to certify the reports before sending them to the appropriate state agencies. Additionally, as of December 2008, the SCO had not certified the audit reports for 29 counties because the reports were either rejected or pending rejection. These reports have been held by the SCO and not forwarded to the appropriate state agencies for roughly 7.6 months. The SCO stated that, in response to the President's Council on Integrity and Efficiency's report titled *Report on National Single Audit Sampling Project* issued in June 2007, it revised its review process, which resulted in it rejecting a higher number of OMB Circular A-133 audit reports.

The SCO also stated that its process has been in place since 1984. Further, the SCO stated that it believes the local governments' OMB Circular A-133 audit reports are not valid until it completes its certification process. Finally, the SCO stated that forwarding the OMB Circular A-133 audit reports to the appropriate state agencies before certifying them would create a duplication of its efforts. Nevertheless, the SCO's decision to certify the audit reports before forwarding them to the state agencies prevents the State from meeting the six-month requirement for issuing management decisions.

Questioned Costs

Not applicable.

Recommendations

The SCO should improve its process for forwarding the local governments' audit reports to the appropriate state agencies so that the State can meet the six-month requirement for issuing management decisions.

The SCO should also work closely with the state agencies by informing them of how much time they have to issue the management decisions once they receive the audit. For example, if the SCO takes two months to forward the report, the state agencies have only four months to issue their decisions.

Finally, the SCO should work closely with the Department of Finance to evaluate the process outlined in the *State Administrative Manual* for complying with OMB Circular A-133 Section .400. If the State believes that the SCO must certify the local governments' OMB Circular A-133 audit reports before forwarding them to the appropriate state agencies, the SCO should obtain a waiver from the six-month requirement for issuing the management decisions from the State of California's federal cognizant agency, the U.S. Department of Health and Human Services.

Department's View and Corrective Action Plan

The SCO provided the following response:

Since the inception of the Single Audit Program in 1984, the federal government has designated the SCO as the "cognizant agency" for single audits of California local governments receiving federal funds that "pass-through" various state departments. Under OMB Circular A-133, the cognizant agency's responsibilities include but are not limited to:

Providing technical audit advice and liaison to auditees and auditors.

Advising the auditor and, where appropriate, the auditee of any deficiencies found in the audits when the deficiencies require corrective action by the auditor. When advised of deficiencies, the auditee should work with the auditor to take corrective action. If corrective action is not taken, the cognizant agency for the audit should notify the auditor, the auditee, and the applicable federal awarding agency(ies) and pass-through entities of the facts and make recommendations for follow-up action. Significant deficiencies or on-going performance issues by auditors will be referred to appropriate state licensing agencies and professional bodies for disciplinary action.

Coordinating a management decision for audit findings that affect the federal programs of more than one federal agency.

The cognizant agency role is a federal function delegated to the SCO by the federal Department of Health and Human Services. The SCO's decision to assume this role was in part motivated by the desire to simplify and streamline the duties and responsibilities of numerous state pass-through agencies with respect to meeting federal audit requirements. After extensive discussions between the SCO, the California Department of Finance, and the former Auditor General's Office during meetings of the AB 861 Committee, which is no longer active, a decision was made to establish a single audit oversight function within the SCO to review and certify all audit reports before forwarding such reports to the state pass-through agencies for appropriate action.

The SCO has always operated under the premise that the federal six-month requirement for pass-through agencies to issue a management decision on audit finding starts when the state pass-through agency receives the certified audit report from the SCO. The Audit Finding Resolution letter that the SCO sent to the pass-through agencies includes a statement that the agencies have six months to resolve audit findings. Thus, the state pass-through agencies know that the audits performed are acceptable to the federal government before having to take corrective measures. Over the past 25 years, the SCO single audit oversight function and processes have been repeatedly reviewed by various federal departments as well as the Bureau of State Audits (BSA) and there never have been

any questions or concerns raised with respect to this issue. Therefore, the SCO continues to believe that the six-month requirement starts when the pass-through agencies receive the certified audit report from the SCO.

In light of the questions raised by this BSA audit, the SCO is seeking a clarification from officials of the OMB. The SCO will share the OMB's response with the BSA.

Thank you for the opportunity to respond to this finding.

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Compliance and Internal Control Issues Related to Specific Grants Administered by Federal Departments

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Bureau of State Audits

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U.S. DEPARTMENT OF DEFENSE

Reference Number:	2008-1-9
Federal Catalog Number:	12.401
Federal Program Title:	National Guard Military Operations and Maintenance (O & M) Projects
Federal Award Numbers and Years:	W912LA-08-02; 2008 W912LA-07-02; 2007
Category of Finding:	Activities Allowed/Allowable Costs
State Administering Department:	Military Department (Military)

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

(h) Support of salaries and wages. These standards regarding time distribution are in addition to the standards for payroll documentation.

(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.

(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 (5) 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 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.

(6) Substitute systems for allocating salaries and wages to Federal awards may be used in place of activity reports. These systems are subject to approval if required by the cognizant agency. Such systems may include, but are not limited to, random moment sampling, case counts, or other quantifiable measures of employee effort.

(7) Salaries and wages of employees used in meeting cost sharing or matching requirements of Federal awards must be supported in the same manner as those claimed as allowable costs under Federal awards.

Condition

Military lacks internal controls that would allow it to prevent and/or detect instances when personnel costs are being inappropriately charged to this federal program. At the time when it creates a new position, or when a new employee fills an existing position, Military reviews the associated job duties and decides whether charging this federal program is allowable. However, Military lacks a process to identify instances when personnel, who are funded by this federal program, may no longer be working on allowable activities.

Further, we noted that Military did not comply with the requirements of OMB Circular A-87. Specifically, Military does not have adequate documentation to support personnel costs it charged to the federal fiscal year 2007 and 2008 awards. We reviewed a sample of monthly personnel expenditures for 30 individuals amounting to more than $260,000. In each case we noted the lack of documentation—such as certifications or personnel activity reports—that are required under OMB Circular A-87. Although the personnel costs were associated with time sheets, these time sheets did not describe what activities the employee worked on for the stated time period.

According to the United States Property and Fiscal Officer (USPFO)—the federal representative in California who has oversight over this program—employees charging time to the federal program but spending incidental amounts of time on state projects is acceptable. The USPFO defines "incidental time" as less than 25 percent. However, without the personnel activity reports required under OMB Circular A-87, it is unclear how Military can comply with the USPFO's guidance. Further, Section 304 of the Master Cooperative Agreement between Military and the Department of Defense states that the allowability of costs shall be determined according to the terms and conditions of OMB Circular A-87.

Questioned Costs

Our sample of monthly personnel expenses for 30 employees amounted to more than $260,000. Overall, personnel expenses accounted for more than $31 million—or approximately 55 percent—of $56.8 million in program expenditures between July 1, 2007, and June 30, 2008.

Recommendations

Military should establish procedures that would allow it to prevent or detect instances when employees, who are funded under the federal program, are no longer working on allowable activities. Further, Military should implement procedures to ensure that it documents its personnel costs in accordance with OMB Circular A-87.

Department's View and Corrective Action Plan

Military stated that it is implementing a process to certify federally funded employees on their duties associated with their positions. These certifications will be prepared at least semiannually and will be signed by the employee or supervisory official having firsthand knowledge of the work performed by the employee. When an employee works on multiple activities or cost objectives, a distribution of their salaries or wages will be supported by personnel activity reports. The certifications will be conducted and completed during the months of June and December each year and attached to the employees' monthly time sheets.

Reference Number:	2008-8-7
Federal Catalog Number:	12.401
Federal Program Title:	National Guard Military Operations and Maintenance (O & M) Projects
Federal Award Numbers and Years:	W912LA-07-02; 2007 W912LA-06-02; 2006
Category of Finding:	Period of Availability
State Administering Department:	Military Department (Military)

Criteria

NATIONAL GUARD BUREAU MASTER COOPERATIVE AGREEMENT (MCA), Section 306—Fiscal Year Close-out and Settlement

a. Within 90 days after the end of the [federal] fiscal year or upon termination of the [cooperative agreement], whichever is earlier, the State shall promptly deliver to the [United States Property and Fiscal Officer] USPFO, as a representative of [National Guard Bureau] NGB, a final accounting of all funding and disbursements under the agreement for the fiscal year. After completion of the State's final accounting, the USPFO shall make a final settlement of the total NGB contribution for that fiscal year.

b. If unliquidated claims and undisbursed obligations arising from the State's performance of the agreement will remain 90 days or longer after the close of the fiscal year, the State shall provide a detailed listing of uncleared obligations and a projected timetable for their liquidation and disbursement no later than 31 December. The USPFO shall then set an appropriate new timetable for the State to submit its final accounting.

Condition

Military did not include estimated liquidation dates for uncleared obligations on its report of outstanding obligations to the USPFO for the federal fiscal year 2006 and 2007 grants. Specifically, in its January 2008 report to the USPFO, Military did not provide estimated liquidation dates for over $37,000 in uncleared obligations from the 2006 award and more than $1.2 million from the 2007 award. According to the accounting section supervisor who is responsible for preparing the reports, Military staff lacks adequate time to gather the missing information before the submission deadline and explained that the USPFO has not had concerns with the lack of this information and has continued to accept these reports. The USPFO informed us that he did not believe that knowing the estimated liquidation dates is critical and the report is acceptable without the required estimated liquidation dates. However, Section 703 of the MCA states any modifications to the MCA must be in writing and executed by both parties. Our review found no modification to this requirement.

Questioned Costs

Not applicable.

Recommendations

Military should include estimated liquidation dates on its report of outstanding obligations for federal awards as required under the MCA. Otherwise, Military and the USPFO should execute a modification to the MCA to omit this requirement.

Department's View and Corrective Action Plan

Military has completed its report of outstanding obligations for federal awards as required under the MCA and has included the estimated liquidation dates.

U.S. DEPARTMENT OF EDUCATION

Reference Number:	2008-1-6
Federal Catalog Number:	84.181
Federal Program Title:	Special Education—Grants to Infants and Families with Disabilities
Federal Award Numbers and Years:	H181A070037; 2007 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 the expenses incurred by regional centers are only for allowable activities and costs. Specifically, the regional centers' reimbursement claims lack the necessary detail to allow Developmental Services staff who approve them 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 $31.9 million they were paid during fiscal year 2007–08. Consequently, we are unable to determine if Developmental Services is in compliance with this requirement.

This is a repeat finding. According to the chief of its Early Start Section, Developmental Services is implementing a new regional center invoicing process that will become effective in fiscal year 2008–09. Specifically, this new process will require staff to check the regional centers' reimbursement claim amounts against a monthly file generated from their Uniform Fiscal System (UFS). Additionally, according to the manager of its Audits Branch, Developmental Services' auditors review UFS data during their audits of the regional centers. However, until the new process is implemented, Developmental Services cannot be certain the federal funds are being used to reimburse only allowable activities and costs.

Questioned Costs

Unknown

Recommendations

Developmental Services should implement procedures to ensure that regional centers are using federal funds for only allowable activities and costs.

Developmental Services should also continue to require its auditors to review UFS data during their audits of the regional centers.

Department's View and Corrective Action Plan

Developmental Services stated that, as discussed with the auditors, it is in the final stages of completing the design and implementation of a process for both regional center staff to bill for allowable services and for its program staff to have the capability to monitor and assure that only allowable service claims are reimbursed.

Developmental Services also stated it will require that regional center claims for services that are submitted to it include more detail to ensure that only allowable services are billed and that claims to it be based on monthly totals. Program staff currently have the capability to monitor total monthly service expenditures by service category and by regional center. The new process will give program staff the ability to "drill down" to individual consumer service data through its UFS if claim activity indicates possible billing for unallowable costs. Regional center claim amounts will be reduced for any services determined unallowable. This process is expected to be completed and implemented before the end of fiscal year 2008–09.

Reference Number:	2008-1-7
Federal Catalog Number:	84.181
Federal Program Title:	Special Education—Grants for Infants and Families with Disabilities
Federal Award Numbers and Years:	H181A070037; 2007 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 totals for its expenses related to personnel, consultants, travel, operations, and administration management. Developmental Services paid WestEd $2.7 million during fiscal year 2007–08. However, WestEd did not submit supporting documentation with its invoices that would allow Developmental Services staff who approve the invoices to make an informed assessment about whether the costs claimed are for allowable activities. Consequently, we are unable to determine if Developmental Services is in compliance with this requirement.

This is a repeat finding. According to the chief of its Early Start Section, Developmental Services is in the process of implementing a new invoicing process for West Ed that will require it to provide supporting documentation for amounts shown on the invoices. This new process will become effective in fiscal year 2008–09. However, until the new process is implemented, Developmental Services cannot assure that federal funds are spent only for allowable activities and costs.

Questioned Costs

Unknown

Recommendation

Developmental Services should implement its plans to require WestEd to submit detailed supporting documentation with its invoices so that the department can assure that only allowable activities and costs will be funded by the federal grant.

Department's View and Corrective Action Plan

Developmental Services stated that, as indicated in its response to the previous year's findings, its program and audit staff worked with WestEd to amend the contract so that program and audit staff can assure that only activities and costs allowed are reimbursed. Specifically, the contract between it and WestEd was amended to include the following language:

"Beginning in August 2008, Contractor shall submit monthly invoices with year-to-date expenditures to the State Project Representative. The expenditure reports shall indicate staff and consultant activities, expenditures under this contract by line item for the reporting period, scholarship fund status, and the total contract budget status. Labor reports will be submitted monthly and will include employee name and hours expended on the project tasks. An annual budget reconciliation report will be submitted by August 30, 2009, and August 30, 2010, in a format approved by the State."

Reference Number:	2008-1-10
Federal Catalog Number:	84.186
Federal Program Title:	Safe and Drug-Free Schools and Communities—State Grants (SDFSC)
Federal Award Numbers and Years:	Q186B070005; 2007 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 intolerance;

(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 subgrantees to submit a claim form and a progress report with copies of invoices for its subrecipients or vendors. ADP also requires its noncounty subgrantees to submit invoices and progress reports.

ADP lacks proper segregation of duties for reviewing and approving claims for payment because its program manager does not review claims submitted by its subgrantees and reviewed by its analysts before they are submitted to ADP's accounting office for payment. Additionally, in its grant administrative manual, ADP states that its analysts may choose to review subgrantee 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. Consequently, our review of 45 claims and invoices found only 18 that had adequate documentation to support a portion of the subgrantees' expenditures.

Moreover, although ADP's policy is to conduct site visits for its subgrantees once within the grant period, the primary outcome of the site visit is not to ensure that financial records support expenditures claimed. Thus, ADP does not use its site visits to ensure that the claims and invoices submitted by the subgrantees include only allowable activities and costs. Further, ADP did not conduct any site visits during fiscal year 2007–08.

We reported a similar finding last year. 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

$1,299,697 of the $1,610,358 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 stated that, as the Bureau of State Audits notes, a similar finding was reported last year. ADP is in the process of resolving this issue with the United States Department of Education.

Reference Number:	2008-2-6
Federal Catalog Number:	84.186
Federal Program Title:	Safe and Drug-Free Schools and Communities—State Grants (SDFSC)
Federal Award Numbers and Years:	Q186B070005; 2007 Q186B060005; 2006
Category of Finding:	Activities Allowed/Allowable Costs; Earmarking
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(a)—State Reservation for the Chief Executive Officer of a State

(6) Administrative Costs. The chief executive officer of a State may use not more than 3 percent of the amount described in paragraph (1) for the administrative costs incurred in carrying out the duties of such officer under this section.

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 personnel 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 monitors employee time sheets to ensure that it remains below the 3 percent cap for administrative expenses. ADP uses two program cost account (PCA) codes 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. 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 two instances in which ADP's accounting records did not agree with the time reported on employees' time sheets. Specifically, in one instance ADP's accounting records showed that the employee had charged 139 hours to PCA 52020, but the time sheet indicated that the employee had charged 128 hours to PCA 52020 and 11 hours to PCA 52021. This error occurred because, although the employee indicated that she worked 11 hours on administrative activities during the month, she incorrectly identified the PCA for these activities as 52020. Consequently, ADP overcharged the costs associated with its program activities and undercharged the costs associated with administration of the program. In the other case, the employee did not accurately total the hours she worked on various activities, which caused ADP's accounting staff to charge 3.23 additional hours to the SDFSC grant PCA instead of the federal Block Grants for Prevention and Treatment of Substance Abuse (SAPT). Both of these time sheets had been certified by the employee and approved by the supervisor. Inaccurate reporting by employees and the lack of effective controls regarding the allocation of employee hours increase ADP's risk of noncompliance with the limit on administration costs for the SDFSC grant and inappropriate charges to the SAPT grant.

We reported a similar finding in the prior year's audit report.

Questioned Costs

Of the $35,639.09 sampled, $653 was overcharged.

Recommendations

ADP should establish a quality control process to ensure it accurately charges payroll costs to the federal programs it administers. Additionally, ADP should promptly make adjustments for any discrepancies that come to its attention.

Department's View and Corrective Action Plan

ADP stated that it concurs with the auditors' findings. ADP will establish and document procedures for processing monthly time sheets to ensure their accuracy and timely submission. ADP will also conduct training sessions for its managers and timekeepers to emphasize and review their responsibilities and the procedures. Its accounting office will review late time sheets and enter adjusted time sheets, when necessary. Finally, ADP plans to have in place by December 2009 an automated time sheet, which will resolve the allocation issues.

Reference Number:	2008-7-11
Federal Catalog Number:	84.181
Federal Program Title:	Special Education—Grants for Infants and Families with Disabilities
Federal Award Numbers and Years:	H181A070037; 2007 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, Statement of Assurances, 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. During fiscal year 2007–08, Developmental Services did not have controls in place to prevent or detect the supplanting of state and local funds with federal funds for the Early Start program. Further, Developmental Services did not provide sufficient information to demonstrate its compliance with the Early Start program's maintenance of effort (MOE) requirement. Specifically, Developmental Services does not separately budget the state funds it plans to spend at the 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. Developmental Services also 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" because the General Fund expenditures are coded to a program cost account code that does not specifically identify charges paid with state funds for the Early Start program. Consequently, we are unable to determine if Developmental Services is in compliance with this requirement.

This is a repeat finding. According to Developmental Services, it is in the process of revising its procedures related to the MOE requirement, and these procedures will become effective in fiscal year 2008–09. For example, to determine the total amount of state funds actually expended, regional centers will only receive federal Early Start funds for reimbursement of their purchase of services. Developmental Services believes that it will be able to use the regional centers' Uniform Fiscal System (UFS) to calculate the actual amount of purchase of service (POS) expenditures for Early Start because the system associates services with individual consumers. Developmental Services procedures also use the actual amount of expenditures from UFS to determine if it has a sufficient amount of state funds budgeted for the MOE requirement.

Until Developmental Services uses a consistent and accurate methodology for calculating the MOE requirement and can document the amount of state and local funds budgeted for the Early Start program, it cannot demonstrate that it is in compliance with this requirement.

Questioned Costs

Unknown

Recommendations

Developmental Services should implement procedures to annually establish a budget that includes the total amount of state and local funds to be spent on the program. Developmental Services should also implement procedures related to documenting the amount of state and local funds spent on regional centers' purchase of services expenditures for the program's eligible children and their families.

Department's View and Corrective Action Plan

Developmental Services stated that to ensure continuity of its budgetary process, the budget for the Early Start program will be established as separate components of 10 programmatic service budget categories and associated operational funding. The Early Start program POS budget will be calculated as a percentage of each budget category attributable to infants and toddlers in the Early Start program, as set by the prior-year expenditures for these consumers in that budget category. This percentage will be applied to the enacted total POS budget, adjusted for caseload and utilization growth. The Early Start program operations budget will be calculated through the application of a "core staffing" formula specific to the Early Start program caseload and the allocation of related support and managerial staffing and other related costs.

Developmental Services also stated that for purposes of demonstrating that California has met the MOE requirements, it will compare the Early Start budget, as established above, to the prior-year expenditures in the program, taking into consideration the federal grant amount.

Reference Number:	2008-8-8
Federal Catalog Number:	84.186
Federal Program Title:	Safe and Drug-Free Schools and Communities—State Grants (SDFSC)
Federal Award Numbers and Years:	Q186B060007; 2007 Q186B050006; 2006 Q186B050005; 2005
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 subgrantees and are to include on the counties' quarterly claim forms the appropriate federal grant award and amount to charge prior to sending the forms to the accounting unit. However, one of the 45 claims we tested indicated that the total amount payable should be split between the 2005 and 2006 federal grants, but it did not indicate how much to charge to each federal grant. Without this information the risk of charging the incorrect federal grant increases.

Further, we found that ADP liquidated two obligations outside of the allotted liquidation time period. Specifically, the liquidation period for the 2005 grant ended on December 31, 2007. However, ADP made two payments totaling $6,060 on January 9, 2008.

Questioned Costs

$6,059.83

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 subgrantees' quarterly claim forms identify the correct federal award and amounts to charge. Finally, ADP should ensure it liquidates funds within the allotted time period.

Department's View and Corrective Action Plan

ADP stated that the "questioned costs" of $6,059.83 were expenses incurred within the period of availability for the 2005 award and that they were processed for payment prior to the December 31, 2007, liquidation date. The claims were submitted to the State Controller's Office (SCO) for payment on December 21, 2007, and the funds were drawn from the federal Department of Education on December 24, 2007. The January 9, 2008, date was the date that SCO issued the warrants.

Auditor's Comments on Department's View

Although ADP correctly states that it drew down federal funds and processed the claims for payment before the end of the period of availability for liquidation, the payment occurred outside the period of availability for liquidation. The federal Department of Education's June 5, 2007, policy memorandum on the extension of liquidation periods states that a grantee must liquidate (or make final payment on) all obligations incurred under an award not later than 90 days after the end of the obligation period. Because ADP made the two payments more than 90 days after the end of the period of availability for obligation, it did not comply with the period of availability requirement for liquidation.

Reference Number:	2008-13-17
Federal Catalog Number:	84.181
Federal Program Title:	Special Education—Grants for Infants and Families with Disabilities

Federal Award Numbers and Years:	H181A070037; 2007 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 does not have an adequate internal control in place to assure that federal award identification information such as the Catalog of Federal Domestic Assistance (CFDA) title, CFDA number, award name, and federal agency name are communicated to subrecipients. Without the required information, Developmental Services cannot ensure that subrecipients understand and are aware of all relevant federal requirements governing the program.

According to assistant section chief of its Customer Support Section, Developmental Services implemented a new process in fiscal year 2008–09 that requires its program staff to complete a contract request form that contains the federal award information before sending the request to its contract unit staff.

Questioned Costs

Not applicable.

Recommendation

Developmental Services should implement its procedure that requires program staff to complete the new contract request form that includes the federal award identification information before sending it to its contract unit staff.

Department's View and Corrective Action Plan

Developmental Services stated that it revised its internal contracting forms and procedures to identify all contracts with subrecipients and to require all federal award information in all subrecipient contracts. The procedure was fully implemented in August 2008.

Reference Number:	2008-13-18
Federal Catalog Number:	84.181
Federal Program Title:	Special Education—Grants to Infants and Families with Disabilities
Federal Award Numbers and Years:	H181A070037; 2007 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 B—Audits, Section .200—Audit Requirements

(a) Audit required. Non-Federal entities that expend $300,000 (*$500,000 for fiscal years ending after December 31, 2003*) or more in a year in Federal awards shall have a single or program-specific audit conducted for that year in accordance with the provisions of this part. Guidance on determining Federal awards expended is provided in Section .205.

Condition

Our review of Developmental Services' contracts with three of its 27 family resource centers unaffiliated with a regional center found that it incorrectly stated the threshold for them to have an audit in accordance with OMB Circular A-133 as $300,000 instead of $500,000. Until Developmental Service corrects this error, it may lead to these family resource centers unnecessarily obtaining OMB Circular A-133 audits.

Questioned Costs

Not applicable.

Recommendation

Developmental Services should revise its contracts with family resource centers to accurately reflect the threshold related to the OMB Circular A-133 audit requirement.

Department's View and Corrective Action Plan

Developmental Services stated that it will revise the contracts as soon as possible, but no later than June 30, 2009.

Reference Number:	2008-13-21
Federal Catalog Number:	84.186
Federal Program Title:	Safe and Drug-Free Schools and Communities—State Grants (SDFSC)

Federal Award Numbers and Years:	Q186B070005; 2007 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.

STATE ADMINISTRATIVE MANUAL, Section 20070—Federal Pass-Through Funds

The Federal Single Audit Act of 1984 as amended by the Single Audit Act Amendment of 1996 and amendments in conjunction with the OMB Circular A-l33, defines a pass-through entity as a non-federal entity that provides a federal award to a subrecipient to carry out a federal program. The OMB Circular A-133, Subpart D describes the responsibilities of federal agencies and pass-through entities. Specifically, Section 400(d) prescribes the responsibilities of a pass-through entity for the federal awards it makes.

To ensure that the State of California carries out its responsibilities in accordance with this federal act, the following procedures shall apply:

2. The SCO will coordinate single audit compliance with local governments.

a. Each state entity will monitor the federal funds it disburses to local governments to ensure compliance with federal laws and regulations. State entities will receive local government audit reports performed in accordance with the Single Audit Act of 1984, P.L. 98-502, and the Single Audit Act Amendments of 1996, P.L. 104-156 from the SCO when the audit report includes a schedule of findings and questioned costs with respect to federal funds that were passed through state entities. In addition, the SCO will distribute the single audit reports to state entities when the prior fiscal year's single audit report includes audit findings related to federal funds. The state entity will review these reports and evaluate the corrective action plans submitted in response to findings of noncompliance.

b. All contracts or agreements issued by state entities concerning disbursement of federal funds to local governments will include the requirement for an audit in accordance with P.L. 104-156 and amendments.

c. The SCO will inform units of local government to submit copies of audit reports and corrective action plans, when warranted, prepared in accordance with P.L. 104-156 and amendments directly to the SCO.

d. The SCO will distribute copies of each audit report and corrective action plan to state entities affected by audit findings.

e. State entities will follow up on audit findings pertaining to federal programs, which they administer, and the SCO will follow up on general findings such as those relating to internal control.

f. The SCO will review and monitor the audit reports issued by external independent auditors. The SCO will determine whether or not the audit reports conform to *Government Auditing Standards*.

Condition

Our review of ADP's award documents and contracts for five of its subgrantees 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."

Further, 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 (SCO) notifies state agencies of those local governments that are required to submit an OMB Circular A-133 audit but have not done so. 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. Although the position was filled in October 2007, ADP did not initiate written or verbal contact with the six counties that had delinquent OMB Circular A-133 audits. ADP's general auditor responsible for initiating contact with counties with delinquent OMB Circular A-133 audits stated that ADP is waiting for the SCO to put out a final report listing all entities with delinquent OMB Circular A-133 audits before it initiates contact with any counties.

Questioned Costs

Not applicable.

Recommendations

ADP should institute procedures to ensure that it properly informs each subgrantee of the correct award information such as the CFDA title. ADP should also ensure that its staff follow up with subgrantees that have not submitted their OMB Circular A-133 audits as required.

Department's View and Corrective Action Plan

ADP stated that the SCO is the single audit oversight agency for most California local governments. Because the SCO is the first point of contact for ADP in the audit resolution process, it works closely with the SCO with regard to OMB Circular A-133 submissions. For the audits completed for fiscal year 2006–07, and as explained to the Bureau of State Audits (BSA) auditors, the SCO rejected some audits and granted a number of audit extensions to counties. These actions extended the date for the counties' audit report submission into the beginning of calendar year 2009. All the OMB Circular A-133 audits identified as delinquent in the BSA's audit report were included in those either rejected or extended by the SCO. However, the SCO has provided a final list, and ADP has conducted necessary follow-up.

The SCO is planning to make some procedural changes for the audits completed for fiscal year 2007–08, which will allow ADP to follow up with the counties in a more timely manner. ADP remains committed to working with the SCO in an effort to achieve a more efficient and timely process in meeting its OMB Circular A-133 audit requirements.

Auditor's Comments on Department's View

The SCO provided the BSA a list of counties whose OMB Circular A-133 audit reports were either missing, rejected, or pending rejection as of December 2008. During our review, ADP staff acknowledged that nothing had been done to follow up with the six subgrantees that received SDFSC funds and that were included on the SCO's list until the BSA inquired about it in February 2009. Further, an ADP staff member indicated that based on her follow-up with the SCO after our inquiry, only one of the six subgrantees had an extension until January 31, 2009.

Reference Number:	2008-14-7
Federal Catalog Number:	84.032
Federal Program Title:	Federal Family Education Loans—Guaranty Agencies
Federal Award Number and Year:	None; State Fiscal Year 2007–08
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 Programs 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 participation by the commission 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 (Public Law 89-329) and amendments to that act.

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. Although EDFUND has addressed a number of the weaknesses in its controls over security management that we had identified in the past, it still needs to address others. Further, we found that EDFUND has not located its tape library in a separate, secure area and that the audit trail designed to capture changes made to sensitive data does not track certain types of transactions.

EDFUND has made significant progress in addressing the weaknesses we noted related to security management by fully implementing its entity-wide security program plan. However, weaknesses still exist with regard to security management. In June 2005, EDFUND hired a contractor that completed a security risk assessment. The security risk assessment identified and categorized a number of weaknesses. EDFUND has not addressed all of the high-risk and moderately high-risk findings. EDFUND is currently working on addressing the remaining high-risk and moderately high-risk findings. The lack of security management has the potential to result in insufficient protection of sensitive or critical computer records.

Further, EDFUND has not located its tape library in a separate, secure area with limited access. Specifically, we noted that various devices supporting mainframe and network systems, as well as EDFUND's tape library, are centrally located in the data center. Although a limited number of employees have physical access to all devices housed within the data center and most devices are protected by logical access controls, EDFUND's tape library is not. We observed tapes stored on open shelves and racks that do not lock. Failure to adequately secure EDFUND's tape library at the data center may allow unauthorized destruction of or access to sensitive data.

We previously reported that EDFUND allows a limited number of employees to make changes to sensitive data, even though these changes are not subject to the normal edits of its information system. In addition, we reported that EDFUND did not maintain a complete history or audit trail of the changes made to the data. In October 2007, EDFUND implemented a project designed to create an audit trail of such changes. However, the resulting audit trail still does not track certain types of transactions related to collections and accounting.

Questioned Costs

Not applicable.

Recommendations

Student Aid should ensure that EDFUND takes the following steps to maintain current, complete, and accurate records for each loan it holds:

- Address all of the high-risk and moderately high-risk findings in its security risk assessment.
- Physically secure its tape library or move it to a separate, secure area of its data center with limited access.
- Maintain a complete history or audit trail of all changes made to its data.

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.

Security Risk Assessment Findings

EDFUND has an Enterprise Security Program in place, and as part of EDFUND's continuous improvement to the program, the six remaining high-risk and moderately high-risk findings from the 2005 risk assessment are on track to be completed by June 30, 2009.

Tape Library

A keyed locking devise on the tape storage unit will be installed by March 31, 2009.

Data Maintenance

EDFUND will modify the Financial Aid Processing System by May 31, 2009, to provide the same capability of a systematic audit trail for the remaining files in which such transactions are completed in data maintenance. With the completion of this project, EDFUND will address the stated weakness in our electronic access controls for data maintenance.

Reference Number:	2008-14-8
Federal Catalog Number:	84.181
Federal Program Title:	Special Education—Grants for Infants and Families with Disabilities
Federal Award Numbers and Years:	H181A070037; 2007 H181A060037; 2006
Category of Finding:	Special Tests and Provisions
State Administering Department:	Department of Developmental Services (Developmental Services)

Criteria

GRANT AWARD NOTIFICATION, AWARD YEAR 2007, Terms and Conditions

(2) When issuing statements, press releases, requests for proposals, bid solicitations, and other documents describing this project or programs funded in whole or in part with federal money, all grantees receiving federal funds, including but not limited to state and local governments, shall state clearly:

1) The dollar amount of federal funds for the project,

2) The percentage of the total cost of the project that will be financed with federal funds, and

3) The percentage and dollar amount of the total cost of the project that will be financed by non-governmental sources.

Condition

Developmental Services refers to the Special Education—Grants for Infants and Families With Disabilities as the Early Start program. Developmental Services lacks an internal control process to ensure that the documents describing this program include information on the percentage of the total cost of the project that will be financed with federal funds and the percentage and dollar amount of the total cost of the project that will be financed by non-governmental sources. The chief of its Early Start section acknowledges that Developmental Services does not have procedures in place for complying with this requirement contained in the grant's terms and conditions.

Further, we noted that the documents describing the Early Start program that we reviewed did not contain the required information. For example, the contracts Developmental Services has with the independent family resource centers that are funded exclusively with federal funds from the Early Start program do not explicitly state this funding source. Developmental Services did not provide us with

its plans for complying with this requirement. Until Developmental Services establishes a process to ensure that it includes this information in all documents describing the program, it will continue to be unable to demonstrate its compliance with this requirement.

Questioned Costs

Not applicable.

Recommendation

Developmental Services should establish processes and procedures to ensure that all the documents that it uses to describe the program explicitly state the information required in the terms and conditions of the grant.

Department's View and Corrective Action Plan

Developmental Services stated that it will begin to insert the information required in the terms and conditions of the grant in the appropriate documents as soon as possible, but no later than June 30, 2009.

U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Reference Number:	2008-1-11
Federal Catalog Number:	93.959
Federal Program Title:	Block Grants for Prevention and Treatment of Substance Abuse (SAPT)
Federal Award Number and Year:	06B1CASAPT-05; 2006
Category of Finding:	Activities Allowed/Allowable Costs
State Administering Department:	Department of Alcohol and Drug Programs (ADP)

Criteria

TITLE 42—THE PUBLIC HEALTH AND WELFARE,CHAPTER 6A—PUBLIC HEALTH SERVICES, SUBCHAPTER XVII—BLOCK GRANTS, PART B—BLOCK GRANTS REGARDING MENTAL HEALTH AND SUBSTANCE ABUSE, Subpart ii—Block Grants for Prevention and Treatment of Substance Abuse, Section 300x-31—Restrictions on Expenditure of Grant

(a) In general

(1) Certain Restrictions

A funding agreement for a grant under section 300x-21 of this title is that the State involved will not expend the grant—

(A) to provide inpatient hospital services, except as provided in subsection (b) of this section;

(B) to make cash payments to intended recipients of health services;

(C) to purchase or improve land, purchase, construct, or permanently improve (other than minor remodeling) any building or other facility, or purchase major medical equipment;

(D) to satisfy any requirement for the expenditure of non-Federal funds as a condition for the receipt of Federal funds;

(E) to provide financial assistance to any entity other than a public or nonprofit private entity; or

(F) to carry out any program prohibited by section 300ee-5 of this title.

TITLE 42—THE PUBLIC HEALTH AND WELFARE, CHAPTER 6A—PUBLIC HEALTH SERVICES, SUBCHAPTER XXIII—PREVENTION OF ACQUIRED IMMUNE DEFICIENCY SYNDROME, Section 300ee-5—Use of Funds to Supply Hypodermic Needles or Syringes for Illegal Drug Use; Prohibition

None of the funds provided under this Act or an amendment made by this Act shall be used to provide individuals with hypodermic needles or syringes so that such individuals may use illegal drugs, unless the Surgeon General of the Public Health Service determines that a demonstration needle exchange program would be effective in reducing drug abuse and the risk that the public will become infected with the etiologic agent for acquired immune deficiency syndrome.

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

ADP does not ensure that subgrantees expend SAPT funds only for allowable activities. Specifically, ADP provides SAPT funds to subgrantees in 12 monthly installments during the fiscal year. Although ADP requires subgrantees to submit quarterly federal financial management reports that track their cumulative expenditures for specific line items, these quarterly reports do not provide sufficient data to ensure funds are only being spent on allowable activities and costs.

Moreover, ADP's policy requires its analysts to conduct an on-site visit for each subgrantee at least once every two years and perform a desk audit of those subgrantees that do not receive an on-site audit during the year. However, ADP management indicated that ADP staff do not review the subgrantees' financial records during its on-site audits and desk audits to determine whether they spent SAPT funds on only allowable activities and costs. We reviewed 45 transactions totaling $2.4 million. However, due to ADP's lack of supporting documentation, we are unable to conclude that these transactions were for allowable activities and costs.

Questioned Costs

Unknown

Recommendation

ADP should establish policies and procedures that include reviewing the subgrantees' supporting documentation to ensure that SAPT funds are spent only for allowable activities and costs.

Department's View and Corrective Action Plan

ADP provided the following response:

Per Title 45 CFR, Part 96.31 (b) states:

> Title 45 CFR 96.31 (b) Subgrantees
> State or local governments, as those terms are defined for purposes of the Single Audit Act Amendments of 1996, that provide awards to a subgrantee, expending $300,000 (or other amount as specified by OMB) in Federal awards in a fiscal year, shall:
>
> (1) Determine whether subgrantees have met the audit requirements….
>
> (2) <u>Determine whether the subgrantee spent Federal assistance funds provided in accordance with applicable laws and regulations. This may be accomplished by reviewing an audit of the subgrantee made in accordance with the Act</u> or through other means (e.g. program reviews) if the subgrantee has not had such an audit.

ADP meets this requirement. All counties receiving SAPT Block Grant funds are also audited in accordance with the requirements set forth in the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-profit Organizations* (OMB Circular A-133). ADP reviews Audit findings related to SAPT Block Grant funds, assures that corrective actions are taken, and recovers funds as necessary.

In e-mails sent by ADP to the Bureau of State Audits on February 9, 2009, and February 10, 2009, ADP confirmed that reviewing OMB Circular A-133 audit reports is one of the processes and procedures ADP uses to determine whether the counties spent SAPT Block Grant funds for allowable activities.

Auditor's Comments on Department's View

ADP's citation of 45 CFR, Part 96.31, is correct. However, it fails to mention that in its 2007 SAPT application, it reported to the federal government that, in addition to the OMB Circular A-133 audits, ADP would also conduct financial and compliance audits on some number of its subgrantees each year. ADP also reported that these audits are designed to rely upon OMB Circular A-133 audits that have been conducted. Further, ADP reported that a primary focus of its financial and compliance audits is to ensure that SAPT grant and various other federal and state funding sources are charged for their fair share of costs. Thus, it is inappropriate for ADP to now state that its reviews of the subgrantees' OMB Circular A-133 audit reports alone meet the requirement for ensuring that SAPT funds are spent only for allowable activities and costs. Furthermore, as we discuss in our finding number 2008-13-22, ADP has not appropriately followed up on audit findings reported in its subgrantees' OMB Circular A-133 audit reports, and it has failed to appropriately follow up with subgrantees that have not submitted their OMB Circular A-133 audit reports to the State in a timely manner.

Reference Number:	2008-1-12
Federal Catalog Number:	93.958
Federal Program Title:	Block Grants for Community Mental Health Services
Federal Award Numbers and Years:	2B09SM010005-07; 2007 06B1CACMHS-01; 2006 05B1CACMHS-01; 2005
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 SERVICES, 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 SERVICES, 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

In our prior-year audit, we reported that Mental Health did not ensure that subgrantees' expenditures were only for allowable activities and costs. Mental Health relied on the counties' budget and program description components of their applications to determine if funds were used for allowable costs and activities. Specifically, the Substance Abuse and Mental Health Services Administration's Block Grants for Community Mental Health Services (SAMHSA CMHS) grant renewal application instructions directs counties to include in their program narrative a description that specifies what is actually being paid for by the block grant funds. However, our review of program narratives found that counties provided a general outline of program activities and did not explain each budget item. We also found that one program narrative was missing and one program narrative did not clearly specify its target population as children with serious emotional disturbance or adults with serious mental illness. Additionally, Mental Health did not require the counties to submit invoices, receipts or payroll information to verify amounts they reported as expenditures. Finally, Mental Health did not perform regular site visits to the counties to verify the allowability of their programs' costs and activities.

During our follow-up procedures for fiscal year 2007–08, we found that Mental Health did not implement a process to ensure that counties were only expending SAMHSA CMHS funds for allowable activities and costs. Mental Health stated that it will strengthen its current review process and will add clarifying language to the state fiscal year 2009–10 Planning Estimate and Renewal Application to ensure counties are charging allowable costs and activities to the SAMHSA CMHS block grant. Mental Health plans to complete its revised application by March 2009 and send it to the counties by May 2009. According to Mental Health, it will require counties to add greater detail to their program narratives to explain each budget line item. Without sufficient processes and procedures, Mental Health has no way of knowing whether the 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

Mental Health stated that it recognizes the importance of monitoring counties for appropriate expenditures of SAMHSA CMHS grant funds and understands the approach identified in this report. Mental Health disagrees with the general statement that, ". . . Mental Health has no way of knowing whether the counties are charging unallowable costs and activities to the program."

Mental Health stated that it currently has policies and procedures in place which require each participating county mental health department to submit an annual application and expenditure plan for the SAMHSA CMHS grant funds. The application must address all programs funded with the grant funds and requires signed federal agreements, certifications, program data sheets, budgets, and narrative (statement of purpose, program description, target population, staffing chart, designated peer review representative, implementation and evaluation plan). Furthermore, the county application and expenditure plan are reviewed and approved by Mental Health's program and fiscal liaisons prior to the county receiving its block grant allocation.

Mental Health stated that, based on the audit finding, it will strengthen its current application review process by requiring counties to add greater detail to their program narratives to explain each budget line item. Mental Health will complete its revised application and send it to the counties by May 2009. Mental Health believes this strategy will ensure expenditures are solely for allowable costs and activities.

Auditor's Comments on Department's View

The Bureau of State Audits (BSA) stands by its statement that Mental Health has no way of knowing whether the counties are charging unallowable costs and activities to the program. As indicated in the condition, Mental Health did not implement a process to ensure that counties were only expending SAMHSA CMHS funds for allowable activities and costs to correct the BSA's prior-year finding. In its prior-year audit, the BSA found that counties provided a general outline of program activities and did not explain each budget item; that Mental Health did not require the counties to submit invoices, receipts, or payroll information to verify amounts they reported as expenditures; and that Mental Health did not perform regular site visits to the counties to verify the allowability of their programs' costs and activities. Thus, Mental Health's process and procedures did not ensure that the SAMHSA CMHS funds were used only for allowable activities and costs.

Reference Number:	2008-1-13
Category of Finding:	Activities Allowed/Allowable Costs
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:	G-0802CATANF; 2008

Federal Catalog Number:	93.658
Federal Program Title:	Foster Care—Title IV-E
Federal Award Numbers and Years:	0801CA1401; 2008 0701CA1401; 2007

Federal Catalog Number:	93.659
Federal Program Title:	Adoption Assistance
Federal Award Numbers and Years:	0801CA1407; 2008 0701CA1407; 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—

(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' processes for reviewing and authorizing the counties' expense and assistance claims do not provide reasonable assurance that federal funds were expended only for allowable activities and costs. The counties' expense claims include their administrative costs, and their assistance claims include a summary total of county assistance payments to beneficiaries by program. In fiscal year 2007–08, Social Services reimbursed counties approximately $4.9 billion for the three programs listed above.

Counties submit their expense claims electronically to Social Services quarterly. Social Services performs a desk audit of these claims. During the desk audits, Social Services' staff ensure that the counties' welfare directors' and auditor-controllers' signatures on the certification pages of the claims match the counties' authorizing signature letters on file and that the amounts on the signed certification pages match the amounts in the claims. The counties are also required to submit tracking system status reports with their claims, which include program codes that correspond with the counties' countywide cost allocation plans and their letters that outline their plans for charging direct expenses. Social Services reviews the program codes to determine if the counties are charging allowable activities and costs.

The counties also submit their assistance claims electronically to Social Services monthly. Social Services performs a desk review of these claims prior to payment. The steps in the desk review include making sure the counties' welfare directors and auditor-controllers have signed the certification page attesting to the accuracy of the claims, among other things. Another step includes staff identifying variances that are greater than 20 percent between months and following up with the counties for explanations.

However, Social Services does not require the counties to submit detailed supporting documentation for their expense and assistance claims. For example, prior to July 1, 2005, Social Services required counties to submit detailed supporting documentation for specific line items with their county assistance claims. 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 county assistance claim template. Moreover, Social Services did not conduct any on-site visits to the counties to review their supporting documentation for their expense and assistance claims in fiscal year 2007–08. Without procedures such as reviewing the supporting documentation for the counties' expense and assistance claims prior to payment or conducting on-site visits to review the claims during

the award period, Social Services has no way of assuring that counties are spending federal funds only on allowable activities and costs. Thus, we are unable to conclude that Social Services is in compliance with this requirement for the programs listed above.

Questioned Costs

Unknown

Recommendation

Social Services should strengthen its desk audits and reviews of the counties' expense and assistance claims. For example, Social Services can review the underlying supporting documentation for a sample of the claims submitted by the counties during the award period to ensure the counties are only charging allowable activities and costs to the federal programs.

Department's View and Corrective Action Plan

Social Services stated that it does not concur with this finding and provided the following response:

The findings of the Bureau of State Audits (BSA) are based on several premises:

- States are required to monitor the performance of subrecipients. The county welfare departments are considered subrecipients for Social Services programs.
- Prior to July 1, 2005, Social Services required counties to submit detailed supporting documentation for the assistance claim. No supporting documentation was required for the County Expense Claim.
- After July 1, 2005, Social Services no longer required counties to submit the supporting documentation with the claim. In lieu of this requirement, counties were to maintain the documentation for future review and audit at the county.
- Social Services does not request samples of the documentation, nor does it conduct field visits to review the documentation.

The BSA concludes that Social Services is unable to verify the validity of the costs claimed by the counties.

The BSA's recommendation cannot be implemented for the following reasons:

- Social Services advances the funds for the assistance payments to the counties. It is not feasible to interrupt this process to perform audits of the supporting documentation.
- Social Services and the counties use federally approved automated systems to make and report all assistance claims. The automated systems effectively eliminate errors that generally occur in preparing the assistance claim.
- Prior evaluations of the assistance claim did not demonstrate a benefit to Social Services and the counties for the supporting documentation that was previously submitted with the assistance claim.

The BSA's findings and recommendations are based on an incomplete review of the process used by Social Services. The BSA's discussion of the finding does not correctly represent the rationale used by Social Services to stop the requirement for counties to submit supporting documentation with the assistance claim.

The decision to stop having the counties submit supporting documentation was part of a much larger project to fully automate the claim process. The automated assistance claim was implemented in January 2004. The automated claim incorporates several edit checks and the submission of five additional supporting documents in electronic form. The desk audit function, performed manually for several decades, was automated.

For 18 months, from January 2004 to July 2005, Social Services required the counties to submit the supporting documentation with the automated claim. A review of the relationship between the automated claim and the supporting documentation was conducted during this period. The review concluded that the supporting documentation did not add value to the auditing or processing of the automated claim. Effective July 1, 2005, Social Services instructed the counties to stop submitting the documentation with the claim. Counties are required to prepare and maintain the documentation at the county for future review and audits.

It should be noted that the BSA did not review any of the documentation submitted with the assistance claim prior to July 1, 2005.

During the course of this audit, Social Services staff reviewed a sampling of the OMB A-133 audits for the counties. All findings for Social Services programs were reviewed. Samples of the supporting documentation previously submitted with the claims were also reviewed. No link could be established between the OMB A-133 audit findings and the supporting documentation. None of the A-133 audit findings would have been discovered, prevented or corrected through a review of the supporting documentation.

The BSA's recommendation for a review of randomly selected supporting documentation is without merit.

Finally, the assistance payments are advanced to the counties immediately prior to the actual payments made by the counties. It would be impossible to perform case level audits of these payments without significantly disrupting the payment process.

Auditor's Comments on Department's View

Social Services' statement that the findings and recommendations of the BSA are based on an incomplete review of the process it uses is incorrect. In its finding, the BSA has accurately stated the processes Social Services uses for reviewing the counties' administrative and assistance claims. During its desk audits and desk reviews, Social Services does not require its staff to review the counties' underlying data that supports their administrative and assistance claims. Further, although Social Services requires the counties to retain their documentation related to their assistance claims for future review, it did not conduct on-site visits to the counties to review this information. Instead, Social Services relied on an automated claim process that does nothing more than offer edit checks to ensure that the counties did not charge expenditures to improper aid or program codes and line items, that they did not exceed certain dollar amounts, and that they had the required staff sign the claim.

The automated claim process does not allow Social Services to determine if the counties have charged only allowable activities and costs. For example, according to its September 2008 report titled *Review of Improper Temporary Assistance for Needy Families Basic Assistance Payments in California for April 1, 2006 Through March 31, 2007*, the U.S. Department of Health and Human Services' Office of Inspector General (OIG) estimated that Social Services made improper payments of $91,613,100 (federal share only). The improper payments consisted of $72.9 million related to eligibility and payment calculation errors and $18.7 million related to documentation errors. Thus, the OIG's report illustrates that Social Services' reliance on its automated claim process alone cannot ensure the counties' assistance claims include only allowable activities or costs. The report also shows that the BSA's recommendation for Social Services to review the underlying documentation for a sample of claims submitted by the counties during the award period has merit and can also be beneficial to the State. For example, according to the OIG, the State made assistance payments to or on behalf of TANF

recipient families totaling roughly $2.6 billion, of which $1.6 billion represented the federal share. Using this information, the BSA estimates that the State's share of the improper payments is roughly $57 million.

Social Services states that the BSA did not review any of the documentation submitted with the assistance claim prior to July 1, 2005. Social Services raised this issue in our exit conference that was held on February 18, 2009. However, Social Services did not bring to the BSA's attention the review it conducted of the relationship between the automated claim and the supporting documentation where it found that the particular policy in place between January 2004 and July 2005 did not add value to the auditing or processing of the automated claim until it submitted its response to the BSA on March 2, 2009. Upon receiving Social Services' response, the BSA requested a copy of its review. However, Social Services did not provide the BSA with a copy of the review and the related supporting documentation.

Social Services states that it reviewed a sample of the supporting documentation previously submitted with the claims and could not find a link between the documentation and the audit findings presented in the counties' OMB Circular A-133 audits. As previously stated, Social Services did not provide the BSA with a copy of the review it conducted of the relationship between the automated claim and the supporting documentation where it found that the particular policy in place between January 2004 and July 2005 did not add value to the auditing or processing of the automated claim and the related supporting documentation. However, the BSA would like to point out that Social Services would need to review varying underlying documentation for the counties' administrative and assistance claims. For example, Social Services could review the counties' time studies to verify the information in their administrative claims. For the assistance claims, Social Services could review documentation to support the TANF recipients' payment amount.

Finally, the BSA did not recommend to Social Services that it should interrupt its process for making advance payments to the counties to perform audits. The BSA has found that it is not uncommon for state departments to make advance payments to their subgrantees. However, state departments typically have also established processes and procedures to ensure that during the award period they either require the local agencies to submit documentation to support their costs or they conduct on-site visits to verify the costs. Currently, Social Services lacks such processes and procedures.

Reference Number:	2008-2-4
Federal Catalog Number:	93.563
Federal Program Title:	Child Support Enforcement (CSE)
Federal Award Numbers and Years:	0804CA4004; 2008 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, Section74.27—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 OMB Circular A-87, and the federal requirements for the CSE program. This matter was the subject of a finding we reported for fiscal year 2006–07, and Child Support Services asserted that it concurred with the recommendation and was in the process of providing all staff with the OMB Circular A-87 list of allowable/unallowable expenditures. Comparing expenditures to this list is particularly important because OMB Circular A-87 contains specific instructions on costs that are allowable and unallowable.

During our fieldwork this year, Child Support Services told us that it interpreted the finding to mean that staff scheduling invoices for payment, in this case the accounting office, should review the invoices for allowability. As such, Child Support Services stated that it distributed copies of OMB Circular A-87 to all accounting staff and that the accounting staff routinely audit invoices for compliance and return any that fall outside of the guidelines. However, we were unable to verify the existence of this review as the accounting office has no written procedure directing it to perform this comparison. Without a written procedure, Child Support Services cannot demonstrate that its process ensures expenditures are in compliance with the requirements of the program and OMB Circular A-87 and raises the risk that the allowability check is being overlooked.

In addition, Child Support Services' approval process for proposed contracts, as well as its invoice and purchase order approval processes, includes reviews and approvals by other analysts and managers. However, according to Child Support Services, these reviews do not include a comparison of the supporting documentation to the list of allowable and unallowable expenditures described in OMB Circular A-87. Although it is important that actual expenditures are reviewed for allowability by the accounting office, Child Support Services' current process increases the difficulty of resolving unallowable costs by delaying their identification until invoices or purchase orders reach accounting (late in the approval process) rather than determining their allowability in the contracts or purchasing units (early in the approval process).

Questioned Costs

Not applicable.

Recommendations

Child Support Services should provide all staff that review and approve contracts, invoices, and purchase orders with a list of allowable and unallowable expenditures so that they can ensure expenditures are made in conformance with OMB Circular A-87. Child Support Services should also establish written policies and procedures requiring these staff to use the list to ensure that expenditures are allowable.

Department's View and Corrective Action Plan

Child Support Services stated that, as a result of the prior finding, it distributed copies of OMB Circular A-87 to all accounting staff and that it directed accounting staff to routinely audit invoices for compliance with the OMB Circular A-87 guidelines.

Child Support Services also stated that it concurs with the recommendation and will provide all staff who review and approve contracts, invoices, and purchase orders with a list of allowable and unallowable expenditures so that they can ensure expenditures are made in conformance with OMB Circular A-87. Child Support Services will also establish written policies and procedures requiring these staff to use the list to ensure that expenditures are allowable. In addition, Child Support Services will provide training to all staff who review and approve contracts, invoices, and purchase orders on the allowability of costs under OMB Circular A-87.

Reference Number:	2008-2-5
Federal Catalog Number:	93.778
Federal Program Title:	Medical Assistance Program (Medi-Cal)
Federal Award Numbers and Years:	05-0805CA5028; 2008 05-0705CA5028; 2007 05-0605CA5028; 2006 05-0505CA5028; 2005
Category of Finding:	Allowable Costs/Cost Principles
State Administering Department:	Department of Health Care Services (Health Care Services)

Criteria

TITLE 42—PUBLIC HEALTH, 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 the 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 facilities. Subsequently, EDS further revised the special processing guidelines to correct this oversight. In response to our 2006 finding, Health Care Services stated that it would increase its quality control over the claims override function.

On April 30, 2008, Health Care Services instructed EDS to conduct a review of the override function for error codes 802 and 803 that identify claims suspended because they are potentially duplicate payments. This review, which was conducted from April 2008 through September 2008, indicates that the percentage of suspended claims that were erroneously overridden was within EDS's established acceptable error rate of 5 percent. The results are based on 25 errors found in the 601 claims sampled by EDS, which equates to a 4.2 percent error rate. However, we noted the error rate for code 802 in both April 2008 and May 2008 was 10 percent and in July 2008 was 6 percent. Further, the error rate for code 803 in May 2008 was 11.8 percent. Health Care Services is requiring EDS to continue reviewing the claims override function for error codes 802 and 803 for an additional six-month period from October 2008 through March 2009. Health Care Services also stated that, at the end of this period, it would determine whether additional quality controls are warranted.

Because the scope of our report for the fiscal year ended June 30, 2006, focused only on long-term care payments made to facilities subject to the new reimbursement rates, we subsequently 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. Health Care Services stated it has identified $6.4 million in duplicate payments to either a single facility or multiple long-term care providers for services to the same individual on the same day. Health Care Services stated that in September 2007 it began to recoup duplicate payments made to long-term care providers during the period from October 5, 2005, through November 18, 2006, 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 had recouped $5,082,842 by October 10, 2008. Health Care Services also stated that in May 2008 it began recouping the amount of duplicate payments that were made to multiple long-term care providers during the period from October 5, 2005, through November 18, 2006, for the same individual on the same day. Health Care Services estimates that $1,315,834 was paid to providers as a result of this type of duplicate payment, of which $62,159 had been recouped as of October 24, 2008.

Finally, Health Care Services stated that it did not identify any duplicate vision claims paid for fiscal year 2005–06. However, Health Care Services also stated that in April 2008 it began recouping overpayments for duplicate medical and outpatient claims that were made during this period. Health Care Services estimates that $207,500 was paid to providers as a result of this type of duplicate payment, including $119,871 in outpatient claims and $87,629 in medical claims. Of this $207,500, $193,589 had been recouped as of October 14, 2008. However, we could not validate this information because Health Care Services did not retain the supporting documentation used to arrive at these amounts. Until Health Care Services fully 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

Not determined.

Recommendations

To ensure that EDS authorizes disbursements of Medi-Cal funds only to facilities and providers entitled to them, Health Care Services should take the following steps:

- Continue to increase its quality control over the claims override function until it can provide assurance that the manual processing of suspended claims does not result in duplicate payments.
- Follow its existing claims processing quality control guidelines for all error codes, which include coordinating with EDS to initiate problem analysis, identifying root causes, recommending possible solutions, implementing process improvements, and evaluating corrective action when the monthly error rate for an individual error code related to duplicate payments exceeds 5 percent.
- Ensure that EDS documents and tracks the reasons for overriding claims that have been suspended in the system.
- Continue to recoup all duplicate payments related to long-term care providers as well as those related to medical and outpatient claims.
- Direct EDS to retain documentation to support all of its recoupment efforts.

Department's View and Corrective Action Plan

Health Care Services agrees with the finding and will take the following corrective action:

- Continue to increase its quality control over the claims override function until it can provide assurance that the manual processing of suspended claims does not result in duplicate payments.

  Health Care Services instructed EDS to perform an additional review, including an increase to the customary sample size, from each of the claim categories identified as Suspense Claims Processing Error Code 802 and Error Code 803 for a full year. At the conclusion of this period, Health Care Services will evaluate the results and determine if there is a need for further review or action.

- Follow its existing claims processing quality control guidelines for all error codes, which include coordinating with EDS to initiate problem analysis, identifying root causes, recommending possible solutions, implementing process improvements, and evaluating corrective action when the monthly error rate for an individual error code related to duplicate payments exceeds 5 percent.

  Health Care Services follows existing claims processing quality control guidelines and holds EDS accountable to error rate thresholds as established in the EDS *Quality Assurance Procedures and Standards Manual*. Health Care Services' quality management (QM) analyst reviews the QM Monthly Performance Report from EDS and directs EDS to perform further review or produce additional data for areas under scrutiny. Health Care Services' analyst actively meets with EDS QM staff to identify and resolve problems and issues, conduct special studies, and implement process improvements for areas associated with the claim adjudication processes.

- Ensure that EDS documents and tracks the reasons for overriding claims that have been suspended in the system.

  Health Care Services continues to maintain that there is no need to document the reasons a suspended claim's error code has been overridden. An EDS claim examiner can only override a claim that had been suspended for review when the claim meets specific criteria as documented in the claims processing guidelines for the error code condition that resulted in the claim being suspended. Developing a systematic process for documenting the reasons for overriding claims that have been suspended would have the following impacts:

  > Incur approximately 1,600 hours / $200,000 costs to the California Medicaid Management System (CA-MMIS) to implement this recommendation under the current fiscal intermediary (FI) contract. The current state budget crisis has resulted in Health Care Services limiting system changes to projects that are required by state or federal legal mandates.
>
> Require claim examiners to determine and input the new field in the system that would negatively impact their ability to meet the contractually required claim processing timelines with the staffing levels supported by the existing contract terms. Health Care Services would most likely incur a claim to be reimbursed for additional FI staffing to meet claim processing time requirements should the FI not be able to maintain compliance with processing time requirements.

  The existing controls limit FI claim examiners to only override a claim's error code for specific Health Care Services-approved reasons. Health Care Services believes this provides an adequate level of documentation and tracking of error code overrides. Health Care Services believes it would be more cost effective to implement the recommendation of the Bureau of State Audits (BSA) with the project to replace the existing CA-MMIS that is part of the currently active FI reprocurement.

- Continue to recoup all duplicate payments related to long-term care providers as well as those related to medical and outpatient claims.

  Health Care Services continues to seek full reimbursement of all duplicate payments through the recovery process while the Audits and Investigation Division continues to include the duplicate claim overpayment data as part of its ongoing audit and recovery activities.

- Direct EDS to retain documentation to support all of its recoupment efforts.

  Health Care Services maintains that the existing recoupment process already documents the collection of amounts owed at the individual provider level in weekly financial reports. This information is available for review via on-line query, a demonstration of which was provided to the auditors. Health Care Services believes the cost and effort required to implement the BSA's recommendation for a new report, to consolidate and track the progress of erroneous payment correction actions in a more easily accessible format, exceeds the benefit of developing the report in

light of the current State and departmental budget environment. Creating this report would require a change to the Medi-Cal claims processing system that is estimated at approximately $937,500 (7,500 programming hours @ $125/hr). Currently, an ad hoc reporting capability can produce point-in-time account balances at the individual provider level and at a cost of approximately $1,250 to $2,500 per request. The BSA's recommendation will be considered further with implementation of the CA-MMIS replacement system.

Auditor's Comments on Department's View

Health Care Services has not fully addressed our recommendation related to its claims processing quality control guidelines for error codes. Currently, Health Care Services calculates its error rates by grouping the various error codes together. However, our recommendation is directed toward it evaluating the monthly error rate for individual error codes related to duplicate payments separately. If the error rate for the individual error codes associated with duplicate payments exceeds 5 percent, then Health Care Services should direct EDS to perform additional analysis as detailed in its claims processing quality control guidelines.

Health Care Services stated that it believes it would be more cost effective to implement our recommendations related to documenting and tracking the reasons for overriding claims that have been suspended in the system as well as retaining documentation to support all of its recoupment efforts with the implementation of its project to replace the existing CA-MMIS. Although this project has been approved by the Department of Finance and is in the Request for Proposal phase of the system development life cycle, the estimated completion date for this project is September 2015. The BSA believes that more immediate attention should be directed toward resolving the issues in our finding given the fact that according to Health Care Services, it has already recouped more than $5.3 million.

Reference Number:	2008-2-7
Federal Catalog Number:	93.959
Federal Program Title:	Block Grants for Prevention and Treatment of Substance Abuse (SAPT)
Federal Award Numbers and Years:	08B1CASAPT; 2008 07B1CASAPT; 2007
Category of Finding:	Activities Allowed/Allowable Costs
State Administering Department:	Department of Alcohol and Drug Programs (ADP)

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. 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.

STATE ADMINISTRATIVE MANUAL, Section 8539—Attendance Records

Agencies will maintain complete records of attendance and absences for each employee during each pay period. These records will be properly certified.

Condition

ADP staff track the hours they spend on various activities and grants and charge their time to different program cost account (PCA) codes. ADP has set up several PCA codes for SAPT. ADP's accounting staff enter their time sheet information into the State's Labor Distribution System, which results in funds being drawn down from their ultimate funding sources.

Our review of 45 employee time sheets found 14 instances in which ADP's accounting records did not substantially agree with the hours reported by the employee. For example, 176 hours were charged to a SAPT PCA for an employee, even though the employee reported that she did not work on activities related to SAPT during the month. This error resulted in an overcharge to the SAPT grant of $6,830.46. Conversely, another employee's time sheet indicated that 120 hours plus 56 hours for holidays and leave time should have been charged to a SAPT PCA. However, ADP's accounting records showed that only 17.6 hours were charged to the SAPT PCA for the employee. The remaining hours were charged to a PCA not related to SAPT. Consequently, ADP undercharged the SAPT grant by $6,645.78.

Generally, the differences arose because accounting staff did not key in the hours reported on the time sheet, and the labor distribution system defaulted to base PCAs on the employee's profile. One of ADP's accounting administrators explained that in some cases, employees did not always submit their time sheets in time for accounting to process them and meet the State Controller's Office deadline. She also stated that during fiscal year 2007–08 ADP did not regularly make adjustments to its accounting records once a time sheet had been received. Without an adequate control process, ADP cannot assure that it is accurately charging payroll costs to the SAPT grant.

Questioned Costs

Of $176,727.80 sampled, $14,065.65 was undercharged and $11,206.66 was overcharged.

Recommendations

ADP should establish a quality control process to ensure that it correctly charges payroll costs to the proper PCA codes for SAPT. Additionally, ADP should promptly make adjustments for any discrepancies that come to its attention.

Department's View and Corrective Action Plan

ADP stated that it concurs with the auditors' findings. ADP will establish and document procedures for processing monthly time sheets to ensure their accuracy and timely submission. ADP will also conduct training sessions for managers and timekeepers to emphasize and review their responsibilities and discuss the procedures. Its accounting office will review late time sheets and enter adjusted time sheets, when necessary. Finally, ADP plans to have in place by December 2009 an automated time sheet, which will resolve the allocation issues.

Reference Number:	2008-2-9
Federal Catalog Number:	93.566
Federal Program Title:	Refugee and Entrant Assistance—State Administered Programs (Refugee Program)

Federal Award Numbers and Year:	G-07AACA9100; 2007 G-07AACA9110; 2007
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 8.h.(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 allocations 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

In our prior-year audit, we reported that Social Services could not substantiate the payroll expenditures it charged to the Refugee Program. Social Services used funds from four federal programs to administer California's Refugee Program. However, Social Services did 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 used percentages that were developed a long time ago based on a time study or time studies to charge its payroll expenditures.

During our follow-up procedures for fiscal year 2007–08, we found that Social Services did not require the requisite staff to submit personnel activity reports or equivalent documentation to support the actual amount of time they spent working on activities related to the Refugee Program. Instead, it continued to rely on an outdated time study or time studies to charge payroll expenditures to this program.

According to an analyst in the Refugee Policy Unit in its Refugee Programs Bureau (RPB), the RPB is in the process of updating its time study process. Specifically, it will be conducting monthly time studies for all employees for one year beginning in March 2008. After the one-year period, the RPB will analyze and consider the results to determine how to allocate payroll costs to the various federal grants it uses to administer the Refugee Program. The RPB plans to review and update, if needed, the time study data quarterly. However, until it does so, Social Services cannot ensure that only allowable costs are charged to the program.

Questioned Costs

$1,035,003

This amount represents the total salaries and benefits for the RPB in fiscal year 2007–08. In accordance with 45 CFR, Part 400.13(c), which states certain administrative costs for the overall management of the State's refugee program may be charged to the cash assistance, medical assistance, and related administrative costs (CMA) grant, the salaries and benefits related to the RPB's chief and one support staff have been charged 100 percent to the CMA grant. However, these individuals also work on activities related to a state-funded program. Social Services did not provide us with the portion of their salaries and benefits associated with the time they spent on the state-funded program. Therefore, we were unable to adjust the questioned costs for this amount.

Recommendation

Social Services should ensure that its process for charging compensation for personal services to the Refugee Program conforms to the requirements of OMB Circular A-87.

Department's View and Corrective Action Plan

Social Services stated that it concurs with the finding and provided the following response:

- The RPB required staff to complete time studies monthly beginning March 3, 2008. The RPB is in the process of conducting an annual time study, covering March 2008 through February 2009. The RPB will use the data from this 12-month period for comparison to the percentages reported on the 2006–07 and 2007–08 Time Reporting Summaries.

- The RPB will use adjusted time study percentages beginning with the April-May-June 2009 quarter, as appropriate.

- Beginning March 2009 the RPB will begin time studying in the middle month of each quarter, as approved by the federal Office of Refugee Resettlement (ORR).
- The RPB will check with Social Services' Accounting and Budgets to inquire whether the RPB chief and support staff need to perform a time study, or if their time can be based on the RPB's time study percentages per Social Services' cost allocation plan.
- On March 3, 2008, RPB staff began recording monthly time studies for all staff during each work day.
- On March 20, 2008, RPB requested from ORR approval to move from monthly to quarterly time studies. On March 21, 2008, ORR approved that request.

Reference Number:	2008-2-10
Category of Finding:	Allowable Cost/Cost Principles
State Administering Department:	Department of Social Services (Social Services)
Federal Catalog Number:	93.658
Federal Program Title:	Foster Care—Title IV-E
Federal Award Numbers and Years:	0801CA1401; 2008 0701CA1401; 2007

Federal Catalog Number:	93.659
Federal Program Title:	Adoption Assistance
Federal Award Numbers and Years:	0801CA1407; 2008 0701CA1407; 2007

Criteria

TITLE 45—PUBLIC WELFARE, PART 95—GENERAL ADMINISTRATION—GRANT PROGRAMS (PUBLIC ASSISTANCE, MEDICAL ASSISTANCE AND STATE CHILDREN'S HEALTH INSURANCE PROGRAMS), Subpart E—Cost Allocation Plans, Section 95.507—Plan Requirements

(b) The cost allocation plan shall contain the following information:

(7) If the public assistance programs are administered by local government agencies under a State supervised system, the overall State agency cost allocation plan shall also include a cost allocation plan for the local agencies. It shall be developed in accordance with the requirements set forth above. More than one local agency plan shall be submitted if the accounting systems or other conditions at the local agencies preclude an equitable allocation of costs by the submission of a single plan for all local agencies. Prior to submitting multiple plans for local agencies, the State should consult with the Director, DCA. Where more than one local agency plan is submitted, the State shall identify the specific local agencies covered by each plan.

TITLE 45—PUBLIC WELFARE, PART 95—GENERAL ADMINISTRATION—GRANT PROGRAMS (PUBLIC ASSISTANCE, MEDICAL ASSISTANCE AND STATE CHILDREN'S HEALTH INSURANCE PROGRAMS), Subpart E—Cost Allocation Plans, Section 95.517—Claims for Federal Financial Participation

(a) A State must claim FFP for costs associated with a program only in accordance with its approved cost allocation plan. However, if a State has submitted a plan or plan amendment for a State agency it may, at its option, claim FFP based on the proposed plan or plan amendment unless otherwise advised by the DCA. However, where a State has claimed costs based on a proposed plan or plan amendment the State, if necessary, shall retroactively adjust its claims in accordance with the plan or amendment as subsequently approved by the Director, DCA. The State may also continue to claim FFP under its existing approved cost allocation plan for all costs not affected by the proposed amendment.

Condition

Social Services does not have adequate internal controls in place to ensure that county welfare departments are claiming costs according to the cost allocation plan for local agencies. Social Services submits to the U.S. Department of Health and Human Services a cost allocation plan for the county welfare departments (local agency CAP) that describes the allocation basis and direct charge rationale for charging programs and projects supported by federal funds. The counties charge these program costs on the county expense claims (CECs) that they submit quarterly to Social Services. However, Social Services does not have a process in place to ensure that the costs that are reflected on the CECs are calculated in accordance with the local agency CAP. Specifically, Social Services does not require counties to submit supporting documentation with their quarterly CECs, nor does Social Services conduct site visits during the award year to review the counties' processes related to capturing and allocating the costs reported in the CECs they submit.

Social Services does provide guidance to the counties on how to complete their CECs in quarterly time study and claiming instructional fiscal letters, which reflect any changes in program code descriptions and the local agency CAP. Social Services also provides the counties the template for completing the CEC. However, these procedures do not provide reasonable assurance that the counties are adhering to the local agency CAP. Until Social Services can ensure counties are following the cost reporting methodologies described in the local agency CAP, it lacks assurance that the counties are claiming only allowable costs.

Questioned Costs

Unknown

Recommendation

Social Services should develop a process and procedures to ensure counties are adhering to the local agency CAP and claiming only allowable costs.

Department's View and Corrective Action Plan

Social Services stated that it does not concur with this finding for the following reasons:

The CEC is an automated process that is based entirely on the federally approved Cost Allocation Plan for local assistance. This automated database application allows counties areas to input data; however it does not allow counties to modify the programming that executes the CEC. Social Services would like the reader to refer to its response to the Bureau of State Audits' finding number 2008-1-13.

The CEC incorporates the following controls into the system:

- All approved cost allocation codes are embedded in the claim template and cannot be modified by the counties.
- The cost allocation codes allocate the identified costs to the appropriate program funding sources based on federally approved methodologies. These methodologies and formulas are embedded in the claim template. The counties cannot modify the formulas.
- The county costs are determined through a federally approved time study methodology.
- The CEC claiming instructions and county template are updated each quarter.

The CEC, in its various stages of automation from 20/20, Unify, Lotus and to the current FoxPro version, has proven to be an effective tool for capturing, reporting and allocating county administrative costs in accordance with approved cost allocation principles. The Cost Allocation Plan and methodology for capturing, allocating and reporting the county administrative expenditures has been approved by the federal government.

Auditor's Comments on Department's View

Social Services' response does not address the basis of the Bureau of State Audits (BSA) finding. Specifically, Social Services is focusing on the CEC process while the BSA is concerned with the data that is input into the CEC. Social Services' current process for paying counties does not provide a reasonable assurance that the data entered into the CEC was obtained through a process that is compliant with the local agency CAP.

Although Social Services stated that "county costs are determined through a federally approved time study methodology", it did not address how it ensures the counties are following this methodology. The primary basis for distributing costs through the local agency CAP is individual caseworker time studies. Additionally, according to the local agency CAP, the 40 largest counties must identify their clerical and support salaries using a separate time study/time certification process and submit a Support Staff Time Reporting Plan annually to Social Services for review. However, Social Services did not provide us any evidence that it conducts these reviews.

The cost allocation process is complex and errors can occur in the time study process. For example, as we point out in our finding number 2008-2-11, Social Services' Sacramento district office accidentally included an employee's time-reporting document twice, which affected the allocation of federal funds for that program. It is possible that similar errors can be occurring in the counties' time study processes. Thus, the BSA stands by its conclusion that until Social Services can ensure counties are following the cost-reporting methodologies described in the local agency CAP, it lacks assurance that the counties are claiming only allowable costs.

Reference Number:	2008-2-11
Federal Catalog Number:	93.659
Federal Program Title:	Adoption Assistance
Federal Award Numbers and Years:	0801CA1407, 2008 0701CA1407, 2007
Category of Finding:	Allowable Costs/Cost Principles
State Administering Department:	Department of Social Services (Social Services)

Criteria

TITLE 45—PUBLIC WELFARE, PART 95—GENERAL ADMINISTRATION—GRANT PROGRAMS (PUBLIC ASSISTANCE, MEDICAL ASSISTANCE AND STATE CHILDREN'S HEALTH INSURANCE PROGRAMS), Subpart E—Cost Allocation Plans, Section 95.517—Claims for Federal Financial Participation

(a) A State must claim FFP for costs associated with a program only in accordance with its approved cost allocation plan. However, if a State has submitted a plan or plan amendment for a State agency it may, at its option, claim FFP based on the proposed plan or plan amendment unless otherwise advised by the DCA. However, where a State has claimed costs based on a proposed plan or plan amendment the State, if necessary, shall retroactively adjust its claims in accordance with the plan or amendment as subsequently approved by the Director, DCA. The State may also continue to claim FFP under its existing approved cost allocation plan for all costs not affected by the proposed amendment.

CALIFORNIA DEPARTMENT OF SOCIAL SERVICES STATE COST ALLOCATION PLAN FOR DIRECT AND INDIRECT COSTS—FY 2007–08, Chapter III, Step IV—Basis for Time Reporting

R-3 Group Percentages: Single programs and multi-program units in which the structure and workload permit the assignment of a specific number of personnel to a particular program. This enables the unit to readily identify the time spent on a specific program. The unit completes a Group Activity Percentage Time Reporting Summary showing the percentage of time spent on each program.

Condition

Social Services' Adoptions Services Bureau (Adoptions Services) did not comply with its public assistance cost allocation plan. Specifically, the percentages for Adoptions Services' Sacramento district office that were submitted for the first quarter of fiscal year 2007–08 contained an error in the Group Activity Percentage Time Reporting Summary. The error occurred because one employee inadvertently submitted two individual time summaries, which understated the amount charged to the federal government by roughly $7,200. According to the manager of the district office, this error was an oversight because she reviews the time summaries before they are sent to the fiscal services bureau. Nevertheless, errors such as this one hinder Social Services' ability to accurately charge costs to the program in accordance with its public assistance cost allocation plan.

Questioned Costs

Social Services undercharged the federal government $7,239.

Recommendation

Social Services should ensure that it accurately charges time spent on the program in accordance with its approved state public assistance cost allocation plan.

Department's View and Corrective Action Plan

Social Services stated that it concurs with the finding. An adoptions specialist submitted her time study report inaccurately. She resubmitted the time study report with the appropriate federal allocations. Clerical staff failed to pull the first report and both studies were calculated into the statistical report. The figures were recalculated and submitted with the corrected information.

The adoptions district office manager has been counseled by Adoptions Services' central office about this error. Adoptions Services' central office will be instructing all district office managers to review all time study reports. The managers will supervise clerical staff and review time studies as they are submitted on a bimonthly basis.

Reference Number:	2008-3-10
Federal Catalog Number:	93.563
Federal Program Title:	Child Support Enforcement (CSE)
Federal Award Numbers and Years:	0804CA4004; 2008 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, 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 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) Recipients' financial management systems shall provide for the following: 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, 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.

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 205.6—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.

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 205.9—What Is a Treasury-State Agreement?

(c) Funding techniques to be applied to Federal assistance programs subject to this subpart A.

CASH MANAGEMENT IMPROVEMENT ACT AGREEMENT BETWEEN THE STATE OF CALIFORNIA AND THE SECRETARY OF THE TREASURY, UNITED STATES DEPARTMENT OF THE TREASURY, PART 6—FUNDING TECHNIQUES, Section 6.2—Description of Funding Techniques

Pre-Issuance

The State shall request funds such that they are deposited in a State account not more than three business days prior to the day the State makes a disbursement. The request shall be made in accordance with the appropriate Federal agency cut-off time specified in Exhibit I. The amount of the request shall be the amount the State expects to disburse. This funding technique is interest neutral.

Monthly Estimate/Monthly Draw—Administrative Costs

Monthly operating and equipment expenditures shall be estimated monthly and estimated on the median day of the month. The State shall request payroll funds such that they are deposited to coincide with the State's monthly payroll cycle. The amount of the requests shall be an estimate of expenditures based on historical data. The request shall be made in accordance with the appropriate Federal agency cut-off time specified in Exhibit I. The estimate will be reconciled to actual costs within 45 days after the end of the month, and future draws will be adjusted accordingly. This funding technique is interest neutral.

CASH MANAGEMENT IMPROVEMENT ACT AGREEMENT BETWEEN THE STATE OF CALIFORNIA AND THE SECRETARY OF THE TREASURY, UNITED STATES DEPARTMENT OF THE TREASURY, PART 6—FUNDING TECHNIQUES, Section 6.3 Application of Funding Techniques to Programs, Section 6.3.2 Programs

93.563 Child Support Enforcement
Component: Payroll/Operating expenses
Technique: Monthly Estimate/Monthly Draw—Administrative Costs
Component: Payments to local agencies
Technique: Pre-Issuance

Condition

Child Support Services lacks adequate policies and procedures to provide reasonable assurance that cash management requirements are met for drawing federal funds for the CSE program administrative costs. Specifically, Child Support Services failed to consistently follow the funding technique specified in the Treasury-State Agreement (TSA) during state fiscal year 2007–08. The funding technique described in the agreement states that Child Support Services will estimate monthly operating and

equipment expenditures on the median day of the month and base that estimate on historical data. However, Child Support Services currently draws down only the amount of *actual expenditures* incurred up until the median day of the month instead of using historical data to estimate the amount expended as well as the amount it expects to expend during the remainder of the month. Child Support Services subsequently draws the actual amount of expenditures for the second half of the month during the next month's estimate. Child Support Services' current methodology relies on the State to pay for the expenditures until the federal government reimburses it. As a result, the State foregoes earning interest on these funds. Child Support Services has chosen not to estimate and draw down funds in advance for the second half of the month because of possible large changes in expenditures from month to month that it believes could skew the estimate. Nevertheless, Child Support Services' current process is not in compliance with the TSA.

Child Support Services also experienced difficulty conducting aspects of this process in a timely manner. Specifically, Child Support Services did not estimate operating and equipment expenditure costs on the required median day of the month for four of the eight months during fiscal year 2007–08 that it drew down federal funds for these purposes. The estimates were generally prepared two to five days after the required date. Child Support Services only drew down federal funds for eight of the 12 months for several reasons. For the first two months, it did not make an operating and equipment expenditure draw because the State's budget had not been approved. Later in the fiscal year, Child Support Services did not make operating and equipment expenditure draws in two months because of insufficient fund and award balances. Additionally, Child Support Services did not reconcile operating and equipment expenditure estimates within the required 45 days of the end of the month on four occasions. Reconciliations for these four months occurred 48 to 81 days after the required dates.

In addition, Child Support Services did not always use accurate information to calculate the median day estimate for two of the eight months we reviewed. Instead of including the total mid-month expenditures in the median day estimate, Child Support Services omitted more than $300,000 of expenditures in November 2007 and more than $80,000 of expenditures in January 2008, which resulted in inaccurate draws. A Child Support Services accounting administrator indicated that a keying error and a line item omission resulted in the November 2007 error, and that a line item omission resulted in the January 2008 error.

Finally, Child Support Services used the pre-issuance funding technique for certain operating and equipment expenditures, contrary to instruction set forth in the TSA. As a result, more than $2.9 million was drawn using this process, and not the required monthly estimate/monthly draw process. The Department of Finance (Finance) stated that it has no objection to Child Support Services' use of this technique as long as these draws are not happening on a regular basis and only occur when Child Support Services does not have sufficient funds available in its clearing account to pay all obligations. Finance is planning to revise the TSA for either state fiscal year 2008–09 or for the following year to add language explicitly allowing Child Support Services to deviate from the monthly estimate/monthly draw technique when its funds run low. However, according to a Child Support Services accounting administrator, Child Support Services generally uses this technique whenever expenditures are charged that are reimbursed entirely from federal funds in contrast to the principles outlined by Finance.

Questioned Costs

Not applicable.

Recommendations

Child Support Services should follow the requirements specified in the TSA, including conducting the estimate and reconciliation processes in a timely manner and accurately estimating the amount of the entire month's expenditures. Child Support Services should also work with Finance to include a disclosure in the TSA that describes its use of the pre-issuance funding technique for certain categories

of operating and equipment expenditures. If the techniques described in the current TSA do not meet Child Support Services' needs, it should work with Finance to establish funding techniques that better fit its needs.

Department's View and Corrective Action Plan

Child Support Services concurs with the finding and is in the process of revising the monthly plan of financial adjustments (PFA) procedures to utilize historical data as the basis to ensure that the transfers are processed in a timely manner. However, Child Support Services does have outside constraints; for example, the lack of a state budget and/or budget restrictions that may be imposed by control agencies that affect our timeliness and/or ability to strictly utilize a historical process as a basis.

Procedures are also being revised to incorporate a review or cross-checking process to ensure that the PFAs are accurate.

In 2007–08, Child Support Services had received affirmation from Finance that the pre-issuance technique Child Support Services occasionally used was appropriate, and no changes to the TSA were necessary. Due to the current audit, Child Support Services once again contacted Finance, which resulted in Finance's agreement to incorporate the pre-issuance technique into the 2009–10 TSA.

Reference Number:	2008-3-11
Federal Catalog Number:	93.959
Federal Program Title:	Block Grants for Prevention and Treatment of Substance Abuse (SAPT)
Federal Award Numbers and Years:	08B1CASAPT; 2008 07B1CASAPT; 2007
Category of Finding:	Cash Management
State Administering Department:	Department of Alcohol and Drug Programs (ADP)

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 205.6—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 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.

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

ADP advances one-twelfth of the counties' annual allocation to them on a monthly basis. On August 17, 2007, the Department of Finance and the U.S. Department of the Treasury executed a Cash Management Improvement Act Treasury-State Agreement (TSA) for fiscal year 2007–08. According to the TSA, ADP must use the pre-issuance funding technique to make payments to the counties. This funding technique requires the State to request federal funds such that they are deposited in a state account not more than three business days prior to the day the State makes a disbursement.

We tested 45 advance payments ADP made to the counties and found three in which the State disbursed the funds to the counties four business days after the funds were deposited in the State's account. The State's delays in making the disbursements occurred because either the State Controller's Office (SCO) identified an insufficient balance remaining on the contract for one of the payments submitted on the claim schedule or the SCO noted that there were insufficient funds available to process the claim schedules.

Additionally, we noted an instance in which the State disbursed the funds to a noncounty subgrantee 33 business days subsequent to the transfer of federal funds to the state account. Specifically, ADP received the federal funds on October 30, 2007, but the payment was not made to the subgrantee until December 18, 2007, primarily because the SCO rejected the claim schedule on November 7, 2007, due to insufficient funds. As a result of these errors, ADP was not in compliance with the TSA.

Recommendation

ADP should ensure that it submits accurate claims and has sufficient federal funds available before sending them to the SCO for payment.

Questioned Costs

Not applicable.

Department's View and Corrective Action Plan

ADP concurs that disbursement of funds was delayed in the examples cited. ADP would like to point out, however, that the vast majority of its transactions have been timely; an analysis of all pre-issuance funding for fiscal year 2007–08 showed that the weighted average was 1.93 days—well within the required three days.

The SAPT block grant is not part of the fiscal year 2008–09 TSA; therefore, ADP is unable to implement a corrective action plan specific to the Cash Management Improvement Act. However, the ADP will continue to use its existing procedures to ensure disbursement of federal funds occurs in a timely manner.

It is important to correct the Bureau of State Audits' (BSA) characterization of payments to the counties as "advances." ADP disburses funds monthly in arrears, per California Health and Safety Code, Section 11758.12: "These net amounts . . . shall be disbursed to participating counties monthly in arrears…."

Auditor's Comments on Department's View

The BSA believes its characterization of the payments to counties as advances is appropriate. The federal regulations related to SAPT allow ADP and its subgrantees to expend SAPT funds over a 24-month period. In its contracts with subgrantees, ADP states that "the State will reimburse the contractor monthly in arrears an amount equal to one-twelfth of the amount encumbered for the

negotiated net amount (NNA) portion of the approved contract or the most recent allocation based on the Budget Act allocation, whichever is less. However, based on expenditure information submitted by the counties in the Quarterly Federal Financial Management Report (QFFMR), the State may adjust monthly payments of encumbered federal funds to extend the length of time (not to exceed 21 months) over which payments of federal funds will be made."

Because ADP is issuing monthly payments to its subgrantees based on either their NNA or their budget allocation and the subgrantees are receiving the funds before they are required to demonstrate they have incurred the expenditures, the BSA believes it is appropriate to characterize ADP's payments to its subgrantees as advances. The BSA would also like to point out that ADP's statement in its contract "the State will reimburse the contractor" is incorrect because a reimbursement can only occur after the subgrantees have presented ADP with a reimbursement claim that includes documentation to support their actual expenditures incurred.

Reference Number:	2008-3-13
Federal Catalog Number:	93.958
Federal Program Title:	Block Grants for Community Mental Health Services
Federal Award Number and Year:	2B09SM010005-07; 2007
Category of Finding:	Cash Management
State Administering Department:	Department of Mental Health (Mental Health)

Criteria

TITLE 45—PUBLIC WELFARE AND HUMAN SERVICES, 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 2007–08 FINAL BUDGET SUMMARY, CHAPTER 171/172, Page 406, 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 2007–08 fiscal year.

Condition

In our prior-year audit, we reported that Mental Health's procedures for monitoring the Substance Abuse and Mental Health Services Administration's Block Grants for Community Mental Health Services (SAMHSA CMHS) did not adequately ensure that the advances made to counties were appropriate. Specifically, the formula in an Excel spreadsheet that Mental Health used to verify that the counties did not have cash balances that were more than 15 percent of their monthly expenditures was flawed, and the 15 percent calculation was based on old information that often did not reflect the counties' current balances. Further, 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. Finally, Mental Health's procedures did not require a supervisory review and approval of monthly advance amounts.

During our follow-up procedures for fiscal year 2007–08, we found that Mental Health did not implement procedures to address this finding. We observed that Mental Health continued to use the same procedures for fiscal year 2007–08 to determine the amount to pay counties, including using the same flawed spreadsheet. According to its program staff, Mental Health has revised the spreadsheet, and it will be implemented in fiscal year 2009–10. During our review of payment authorizations for fiscal year 2007–08, we found only one instance where, according to Mental Health's calculations, a county had excessive cash on hand and still received an unadjusted payment. However, we reported last year that this spreadsheet should not be relied upon to make an accurate determination of counties' cash on hand. Finally, Mental Health has yet to require a supervisory review and approval of the monthly advance amounts.

These deficiencies continue to 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 these issues, 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 require supervisory review of payment authorizations prior to submitting the authorizations to the accounting unit.

Department's View and Corrective Action Plan

Mental Health stated it will establish and implement procedures to accurately monitor county SAMHSA CMHS cash balances. Mental Health also stated that its practice of providing advances to counties has been discontinued. Finally, Mental Health stated it will also document any exceptions and require supervisory review of payment authorizations prior to submitting the authorizations to the accounting unit.

Reference Number:	2008-5-1
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:	08AACAT3SP; 2008 07AACAT3SP; 2007
Category of Finding:	Eligibility
State Administering Department:	Department of Aging (Aging)

Federal Catalog Number:	93.045
Federal Program Title:	Special Programs for the Aging—Title III, Part C—Nutrition Services
Federal Award Numbers and Years:	08AACAT3SP; 2008 07AACAT3SP; 2007

Federal Catalog Number:	93.053
Federal Program Title:	Nutrition Services Incentive Program
Federal Award Numbers and Years:	08AACANSIP; 2008 07AACANSIP; 2007

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 3027—State Plans

(a)(1) The plan shall—

(A) require each area agency on aging designated under section 3025(a)(2)(A) of this title to develop and submit to the State agency for approval, in accordance with a uniform format developed by the State agency, an area plan meeting the requirements of section 3026 of this title.

TITLE 42—THE PUBLIC HEALTH AND WELFARE, CHAPTER 35—PROGRAMS FOR OLDER AMERICANS, SUBCHAPTER III—Grants for State and Community Programs on Aging, Section 3025—Designation of State Agencies

(a)(2) the State agency shall—

(C) in consultation with area agencies, in accordance with guidelines issued by the Assistant Secretary, and using the best available data, develop and publish for review and comment a formula for distribution within the State of funds received under this subchapter that takes into account—

(i) the geographical distribution of older individuals in the State; and

(ii) the distribution among planning and service areas of older individuals with greatest economic need and older individuals with greatest social need, with particular attention to low-income minority older individuals.

(D) submit its formula developed under subparagraph (C) to the Assistant Secretary for approval.

Condition

The U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* (A-133 Compliance Supplement) issued in March 2008 suggests auditors perform procedures to verify amounts awarded to subrecipients were within funding limits. Our review found that Aging did not always maintain supporting documentation for certain amounts used in its calculation of awards to its subgrantees. Specifically, federal law allows Aging to use a portion of its grant to conduct an effective ombudsman program. In calculating its fiscal year 2007–08 allocation, Aging deducted $889,000 from its federal fiscal year 2007 grant for the ombudsman program but could not provide supporting documentation for this amount. Additionally, federal law requires that Aging place special emphasis on older individuals with the greatest economic or social need, with particular attention to low-income minority older individuals. According to the intrastate funding formula found in its state plan, Aging takes this into account by defining older as age 60 and above and by assigning weights to factors such as income levels, minority status, and geographical areas. However, Aging could not provide the census and low income data it used to calculate the weighted factor for each of its subgrantees. Thus, we were unable to determine whether Aging's awards to its subgrantees were within the funding limits outlined in its state plan. According to a program analyst, the employee who prepared the 2007–08 allocation no longer works for Aging, and the program analyst was unable to locate any of the supporting documentation. The program analyst also stated that he has taken steps to ensure that supporting documentation exists for the 2008–09 allocation.

Questioned Costs

Not applicable.

Recommendations

To the extent possible, Aging should recreate its fiscal year 2007–08 allocation to subgrantees and retain all documentation pertaining to the calculation as evidence of its compliance with the eligibility requirements. If differences exist between the original calculation and the revised calculation, Aging should adjust these amounts on its next annual allocation. Aging should also ensure that for future allocations it documents the methodology used and retains all supporting documentation.

Department's View and Corrective Action Plan

Ombudsman's $889,000 State Operations:

The Older Americans Act provides that the State Unit on Aging may determine the amount of the federal grant it uses to support the Office of the State Long Term Care Ombudsman (OSLTCO). The amount budgeted and deducted in fiscal year 2007–08 represents a historical baseline of support. Aging is in the process of documenting the methodology used to determine the federal portion. Staff will also prepare procedures that identify what supporting documentation must be retained in the file in order to ensure that federal requirements have been met.

Demographics Supporting The 2007–08 Allocations:

Aging appreciates the issues raised by the Bureau of State Audits (BSA). As recommended, staff will prepare procedures that cover the processes of both the data and budget teams in order to ensure that the methodology is consistent with federal requirements, processes are clearly documented, and new staff coming in is aware they must retain the appropriate supporting documentation in clearly marked files.

Subsequent to the BSA's exit, Aging's budget staff identified supporting demographic data for the fiscal year 2007–08 allocations, which will be provided upon request.

Aging's data team is in the process of validating the demographic data they prepared and provided to the budget staff when the fiscal year 2007–08 allocations were originally made. Aging does not anticipate a need to recreate or revise the allocation as suggested in the BSA's recommendations. If the data cannot be validated for any reason, Aging will re-evaluate the appropriate course of action.

Reference Number:	2008-5-6
Federal Catalog Number:	93.568
Federal Program Title:	Low-Income Home Energy Assistance (LIHEAP)
Federal Award Numbers and Years:	G-08B1CALIEA; 2008 G-07B1CALIEA; 2007
Category of Finding:	Eligibility
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—

(2) make payments under this subchapter only with respect to—

(B) households with incomes which do not exceed the greater of—

(i) an amount equal to 150 percent of the poverty level for such State; or

(ii) an amount equal to 60 percent of the State median income.

TITLE 8—ALIENS AND NATIONALITY, CHAPTER 14—RESTRICTING WELFARE AND PUBLIC BENEFITS FOR ALIENS, SUBCHAPTER I—ELIGIBILITY FOR FEDERAL BENEFITS, Section 1611—Aliens Who Are Not Qualified; Aliens Ineligible for Federal Public Benefits

(a) In general

Notwithstanding any other provision of law and except as provided in subsection (b) of this section, an alien who is not a qualified alien (as defined in section 1641 of this title) is not eligible for any Federal public benefit (as defined in subsection (c) of this section).

TITLE 8—ALIENS AND NATIONALITY, CHAPTER 14—RESTRICTING WELFARE AND PUBLIC BENEFITS FOR ALIENS, SUBCHAPTER IV—GENERAL PROVISIONS, Section 1642—Verification of Eligibility for Federal Public Benefits

(d) No verification requirement for nonprofit charitable organizations

> Subject to subsection (a) of this section, a nonprofit charitable organization, in providing any Federal public benefit (as defined in section 1611(c) of this title) or any State or local public benefit (as defined in section 1621(c) of this title), is not required under this chapter to determine, verify, or otherwise require proof of eligibility of any applicant for such benefits.

Condition

CSD contracts with local agencies to make eligibility determinations and to provide assistance under LIHEAP to eligible participants residing in their service areas. However, local agencies did not always maintain sufficient documentation such as applicants' monthly income or citizenship status to substantiate their eligibility determinations. Specifically, our review of 24 (26.7 percent) of the 90 applicant files tested found that local agencies did not provide us with sufficient documents supporting applicants' monthly income amounts. For example, CSD's *LIHEAP Eligibility and Verification Guide* (guide) states that proof of income documents submitted by the applicant must be within six weeks of the applicant's intake date, which is the date the applicant applies for the services. Yet, in 15 instances local agencies accepted documents from applicants that were up to 19 months from the applicants' intake dates. In other instances, local agencies did not provide sufficient documentation supporting the amount of the applicants' incomes. For example, one local agency allowed the applicant to provide a signed statement regarding the receipt of spousal support when CSD's guide requires applicants to provide a current signed and dated statement from the person providing the support.

We also found that public local agencies did not obtain sufficient citizenship documentation for six (26.1 percent) of 23 applicants. For five of these applicants, the public local agencies relied on the birth certificates of the applicants' children to establish citizenship rather than the applicants' own birth certificates. CSD's guide lists acceptable citizenship documents such as the applicant's U.S. birth certificate and passport. Also, according to a CSD manager, the use of a child's birth certificate is an unacceptable practice. For the sixth applicant, the public local agency did not provide us with any documentation to substantiate the applicant's citizenship. When local agencies do not follow appropriate CSD guidance for eligibility determinations, they may inappropriately allow ineligible applicants to receive LIHEAP benefits.

Additionally, we found that CSD's computer system used to track intake and eligibility determinations contained an error that could have affected local agencies' eligibility determinations for certain applicants. We also found similar errors in CSD's published guide. Specifically, in its computer system, CSD incorrectly coded the monthly income limit for a household size of 18 at $5,828, which is $112 lower than the actual monthly income limit of $5,940. CSD also incorrectly coded the annual income limit for a household size 18 as $69,932, which is $1,345 lower than it should have been. Further, in its 2008 guide CSD published an incorrect maximum monthly income for a household size of 18 as $6,046, which is $106 higher than the $5,940 it should have been. CSD also published incorrect maximum annual income amounts for household sizes ranging from 10 through 17, resulting in errors included in annual amounts that were either $95 too low or $1,273 too high. Although our eligibility testing revealed no instances when incorrect eligibility determinations were made based on these incorrect amounts, local agencies that relied on them may have inappropriately approved or disapproved applicants for LIHEAP services. A CSD manager attributed the mistaken income amounts to typographical errors.

Finally, we noted that the flexibility CSD allows when calculating monthly income amounts could lead local agencies to inappropriately approve some applicants whose monthly income amounts would otherwise make them ineligible. CSD calculates limits on monthly income for determining the eligibility of applicants from various household sizes using factors that include the median annual income for a California family of four, as determined by the U.S. Census Bureau. However, when applicants present local agencies with income documents that are weekly or biweekly, CSD's guide allows local agencies to calculate an applicant's monthly income amount by using multipliers of 4 or 4.333 for weekly income amounts and either 2 or 2.167 for biweekly income amounts. When local agencies use 4 as a multiplier for weekly income amounts or 2 for biweekly income amounts, they could inappropriately approve some applicants whose monthly income would otherwise exceed federal annual income standards.

For example, if a local agency applied a multiplier of 4 to an applicant's weekly income of $880, the calculated monthly income would be $3,520, or $42,240, which equates to a 48-week year. With a household size of four, the applicant would be within the maximum income limit of $3,535.58 per month, or $42,427 annually, for LIHEAP eligibility. However, if a local agency applies a multiplier of 4.333, the calculated monthly income would be $3,813.04, or $45,756.48 annually, which equates to a 52-week year. With a household size of four, this applicant would be above the maximum income limit and deemed ineligible to receive assistance. A CSD manager stated that it provided local agencies this flexibility because CSD is guided by the need to grant "local determination" and that it allows local agencies to determine which method to use to calculate income as long as they use it consistently.

Questioned Costs

Payments of $7,022.78 to nine applicants out of a total of $58,257.10 in payments to our sample of 90 applicants.

Recommendations

CSD should ensure that local agencies use only acceptable documentation to verify applicants' income and citizenship. CSD should also ensure that local agencies maintain adequate documentation to support their eligibility determinations for LIHEAP applicants. Further, before using its computer system to verify eligibility and before publishing its annual *LIHEAP Eligibility and Verification Guide*, CSD should ensure that the income levels they contain are accurate. Finally, CSD should require local agencies to calculate an applicant's monthly income amount by multiplying weekly income amounts by 4.333 or biweekly income amounts by 2.167.

Department's View and Corrective Action Plan

CSD provided the following response:

1. To ensure that local agencies clearly understand the acceptable forms for determining eligibility, including citizenship, and calculating monthly income, CSD will revise the LIHEAP Eligibility and Verification Guide to clearly and concisely define the requirements. Currently, during CSD's on-site field monitoring, its field analysts select a random sample of client files to verify compliance with client income eligibly and citizenship document requirements. Field analysts will provide training and technical assistance on-site if income eligibility discrepancies exist to build the local agencies' knowledge of eligibility requirements. CSD will continue this practice, and will conduct training on eligibility in the near future.
2. CSD will evaluate the documentation the Bureau of State Audits (BSA) collected to determine the validity of the documentation in question and make a determination if the questioned costs are allowable. If the questioned costs are not allowable, CSD will notify the agency that the costs are disallowed and seek reimbursement from the agency.
3. After careful review of the 2008 eligibility guidelines published on our computer system for a household size of 18, CSD did not incorrectly post the monthly income for a household size of 18. To ensure that the eligibility guidelines are correctly posted in our system, CSD has internal systems in place to verify the accuracy of guidelines and benefit levels in the computer system before actual payments are made. Prior to the beginning of a program year, a sampling of applications are entered in a test database and monitored for accuracy. In addition, CSD is required to submit and obtain approval from the State Controller's Office on a test file of the forthcoming program year criteria before generating actual payments.
4. When a client is unable to supply a full month of income verification, CSD agrees with the recommendation to adopt a consistent method for calculating an applicant's monthly income by multiplying weekly income amounts by 4.333 or biweekly income amounts by 2.167. CSD will review its requirements on determining the calculation of income and establish one standard.

Auditor's Comments on Department's View

Regarding the statements made by CSD in item 3 of its view and corrective action plan, the Bureau of State Audits (BSA) stands by the statements included in its finding and the related recommendation. On February 17, 2009, the BSA requested CSD to provide information BSA could use to verify that the formulas used in CSD's computer system for eligibility purposes were accurate. At that time, CSD was unable to test its computer system and respond to the BSA's request. Instead, on February 18, 2009, CSD provided the BSA with a spreadsheet that purportedly showed the median income guidelines and monthly income amounts. CSD provided the spreadsheet to its information technology staff for use in eligibility determinations. The BSA examined the spreadsheet and identified the errors discussed in its finding.

Reference Number:	2008-5-7
Federal Catalog Number:	93.659
Federal Program Title:	Adoption Assistance
Federal Award Numbers and Years:	0801CA1407, 2008 0701CA1407, 2007
Category of Finding:	Eligibility
State Administering Department:	Department of Social Services (Social Services)

Criteria

TITLE 45—PUBLIC WELFARE, PART 1356—REQUIREMENTS APPLICABLE TO TITLE IV-E, Section 1356.41—Nonrecurring Expenses of Adoption

(b) The agreement for nonrecurring expenses may be a separate document or a part of an agreement for either State or Federal adoption assistance payments or services. The agreement for nonrecurring expenses must be signed prior to the final decree of adoption, with two exceptions:

(1) Cases in which the final decree of adoption was entered into on or after January 1, 1987, and within six months after the effective date of the final rule; or

(2) Cases in which a final decree was entered into before January 1, 1987, but nonrecurring adoption expenses were paid after January 1, 1987.

AGENCY ADOPTION PROGRAM MANUAL, Section IV—Adoption Assistance Program, Part 2—Forms

(2) To satisfy the disclosure requirements and for AAP management, the following forms and written materials have been established:

8. AAP Benefit Determination and Approval form

Condition

Social Services can improve the operating effectiveness of its internal controls over eligibility. Specifically, one of the 32 adoption case files we reviewed did not contain the appropriate approvals. Social Services' Adoptions Services Bureau (Adoptions Services) requires supervisors in its seven district offices to review case file documentation and verify the eligibility determinations made by the adoption specialists assigned to the cases. The supervisors sign the AAP Benefit Determination and Approval form to indicate their review and approval. However, one of the case files we reviewed did not

contain the form. The manager of the district office could not explain why this form was absent from the adoption case file. Consequently, there was no evidence that the district office adoption specialist and supervisor reviewed and approved the family's benefit amount.

Furthermore, we also noted two other instances related to missing forms. Specifically, federal regulations require the adoptive parent(s) to sign the Agreement for Reimbursement of Nonrecurring Expenses of Adoption (agreement) prior to the final decree of adoption. However, this agreement was absent from two of the 33 case files we tested at two of Social Services' district offices. A supervisor at one district office stated the agreement was absent from the case file because the private adoption agency failed to provide the district office with a copy of the signed agreement. The manager from the other district office did not provide an explanation for the missing agreement. By not ensuring that adoption case files contain documentation required by federal regulations, Social Services runs the risk of the federal government disallowing reimbursement for the nonrecurring costs of adoptions.

Questioned Costs

Not applicable.

Recommendation

Social Services should establish a quality control process to ensure that staff in its Adoption Services are retaining the appropriate documentation to demonstrate that it is following established internal control procedures and complying with federal laws and regulations.

Department's View and Corrective Action Plan

Social Services stated that it concurs with the finding. A closing work sheet is used to ensure all documentation is approved before adoption case records are closed and filed. Supervisors will monitor this work sheet to determine if all documentation is present in each case file and sign off on their review.

The Adoption Services central office will be standardizing the district office's closing case summary checklist and requiring a supervisor's signature on all case closing review/summary sheets. Adoptions Services will provide training to supervisors so they are aware of the new form and protocol.

Reference Number:	2008-7-3
Category of Finding:	Matching, Level of Effort, 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:	08AACAT3SP; 2008 07AACAT3SP; 2007 06AACAT3SP; 2006

Federal Catalog Number:	93.045
Federal Program Title:	Special Programs for the Aging—Title III, Part C—Nutrition Services
Federal Award Numbers and Years:	08AACAT3SP; 2008 07AACAT3SP; 2007 06AACAT3SP; 2006

Federal Catalog Number:	93.053
Federal Program Title:	Nutrition Services Incentive Program
Federal Award Numbers and Years:	08AACANSIP; 2008 07AACANSIP; 2007 06AACANSIP; 2006

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.

TITLE 45—PUBLIC WELFARE, PART 1321—GRANTS TO STATE AND COMMUNITY PROGRAMS ON AGING, Subpart B—State Agency Responsibilities, Section 1321.49—State Agency Maintenance of Effort

In order to avoid a penalty, each fiscal year the State agency, to meet the required non-federal share applicable to its allotments under this part, shall spend under the State plan for both services and administration at least the average amount of State funds it spent under the plan for the three previous fiscal years. If the State agency spends less than this amount, the Commissioner reduces the State's allotments for supportive and nutrition services under this part by a percentage equal to the percentage by which the State reduced its expenditures.

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. Further, Aging's accounting section does not have written policies and procedures that include the review and approval of its calculations and the amounts it reports to the federal government. According to its fiscal branch manager, in response to our prior-year finding, Aging is still in the process of compiling official written policies and procedure manuals that document the underlying policies and steps taken by its budget, accounting, and program staff to ensure compliance with the requirements. He also stated that Aging is working toward providing training to its accounting

staff and establishing a monthly review process. However, until Aging completes the tasks outlined by its fiscal branch manager, the absence of controls will continue to hinder Aging's ability to prevent errors or detect early any errors that may exist.

In fact, we determined that the Certification of the Maintenance of Effort filed for federal fiscal year 2007 relies on a spreadsheet that includes various calculations to arrive at the state expenditures. However, we found that the formulas in the spreadsheet contain numerous errors and that some of the amounts are not supported by the accounting records. Therefore, we are unable to determine if Aging is in compliance with the level-of-effort requirements. Additionally, the certification was filed about one week after the due date established by the U.S. Department of Health and Human Services.

Questioned Costs

Not applicable.

Recommendations

Aging should establish policies and procedures to ensure that it complies with the matching, level of effort, and earmarking requirements of the programs it administers. Aging should also follow through on its plans to provide training to its accounting staff and to establish a monthly review process. Finally, Aging should revise the calculation spreadsheet it used for the federal fiscal year 2007 certification of the maintenance of effort to ensure that it contains accurate formulas and amounts, and resubmit the certification if necessary to the U.S. Department of Health and Human Services.

Department's View and Corrective Action Plan

Aging will complete the accounting procedures already started and provide its accounting staff with training on its fiscal team's budgeting, payment, and monitoring processes so that the accounting staff understand how their procedures and the program's procedures overlap to ensure that matching requirements are met and costs are allowable. Furthermore, to ensure the accuracy of future submissions, Aging will include in these procedures additional levels of review to detect and prevent errors.

Aging will correct the errors in the formulas and regenerate the maintenance of effort (MOE) calculations. The MOE is a process where Aging reports that its expenditures supporting a grant equal or exceed the average amount of state funds it spent in the three previous fiscal years. Once corrected, Aging will conduct an analysis to determine the impact to the three-year average requirement and if a corrected MOE certification needs to be submitted. Aging has already notified the U.S. Department of Health and Human Services' Administration on Aging that it is in the process of reviewing and possibly resubmitting the MOE.

Reference Number:	2008-7-12
Federal Catalog Number:	93.568
Federal Program Title:	Low-Income Home Energy Assistance (LIHEAP)
Federal Award Number and Year:	G-07B1CALIEA; 2007
Category of Finding:	Earmarking
State Administering Department:	Department of Community Services and Development (CSD)

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. 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 evidence of a review and approval process to ensure that its subgrantees do not exceed earmarks. Specifically, CSD uses an allocation spreadsheet to distribute the LIHEAP award to its subgrantees. This allocation spreadsheet is used to help CSD ensure that it does not award money to its subgrantees that exceeds the earmarks for weatherization, administration, Assurance 16, and developing leveraging assistance programs. Although CSD staff stated that management reviewed the spreadsheet, CSD provided no evidence of this review process. Without a formal review and approval process, CSD is unable to demonstrate that it has adequate controls for the earmarking requirement.

Questioned Costs

Unknown

Recommendation

CSD should revise its allocation spreadsheet to include evidence of its review and approval of this document.

Department's View and Corrective Action Plan

CSD provided the following response:

Because CSD is a small department with staff that work very closely with one another, the allocation spreadsheets have been personally hand carried to executive staff for review and given verbal approval before finalization and distribution. However, CSD agrees with the recommendation to demonstrate evidence of the review and approval process.

CSD's corrective action plan to address the Bureau of State Audits' recommendation is to attach a Review/Approval Route Tag (Greenie)—Form CSD 601 to the allocation spreadsheet packet to be signed and dated by the Energy Division manager, Financial Services manager, deputy director of Administration, chief deputy director, and director. Once approved and finalized for distribution, the original allocation packet with the attached signed route tag will be kept on file.

Reference Number:	2008-7-13
Federal Catalog Number:	93.958
Federal Program Title:	Block Grants for Community Mental Health Services

Federal Award Numbers and Years:	2B09SM010005-07; 2007 06B1CACMHS-01; 2006 05B1CACMHS-01; 2005
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 SERVICES, 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

In our prior-year audit we reported that Mental Health did not have an official written policy or procedures in place to ensure that administrative costs were charged appropriately to the Substance Abuse and Mental Health Services Administration's Block Grants for Community Mental Health Services (SAMHSA CMHS). Mental Health charged all or only a portion of salaries for certain key SAMHSA CMHS staff to the grant based on approved time sheets, but other expenditures such as travel were allocated to the SAMHSA CMHS grant by staff's choice.

During our follow-up procedures for fiscal year 2007–08, we found that Mental Health had not developed written policies and procedures to ensure that it consistently and properly applied administrative costs to the SAMHSA CMHSA grant. According to its chief of financial services, Mental Health plans to update its procedures by March 1, 2009. Without an official policy that outlines the allowable costs that may be claimed and procedures such as 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

Mental Health stated that it has updated its procedures and that they are under review and pending the approval of its management. Mental Health also stated that it plans to conduct a review of the current process and will develop a written policy and procedures to ensure that only allowable costs are used to meet the earmarking requirement.

Reference Number:	2008-7-14
Federal Catalog Number:	93.958

Federal Program Title:	Block Grants for Community Mental Health Services
Federal Award Numbers and Years:	2B09SM010005-07; 2007 06B1CACMHS-01; 2006 05B1CACMHS-01; 2005
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 SERVICES, 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 SERVICES, 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 2-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.

U.S. 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

In our prior-year audit we reported that Mental Health lacked processes and procedures to ensure that it complies with the maintenance of effort (MOE) requirement for this program. Specifically, for the MOE requirement related to the allocation for systems of integrated services for children with SED, we found that two of the seven components that Mental Health included in its MOE calculation—the Early Mental Health Initiative (EMHI) program and the California AIDS mental health project—did not specifically target children with SED. Mental Health also 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. Finally, Mental Health was unable to provide documentation that showed the components and expenditures that were used to generate the fiscal year 1994–95 threshold of $160 million. For the MOE requirement related to the State's expenditures for community mental health services, we found that Mental Health did not report all state expenditures for adults with SMI and children with SED. Specifically, it did not include any expenditures made with funds from the Mental Health Services Act (MHSA), and it could not positively state whether other state agencies fund community mental health programs for adults with SMI or children with SED. Finally, one of the six components—the EMHI program—Mental Health included in its calculations of total expenditures for community mental health services did not specifically target adults with SMI or children with SED.

During our follow-up procedures for fiscal year 2007–08, we found that Mental Health had not corrected this finding. Specifically, for its fiscal year 2007–08 calculation of the MOE for integrated services for children with SED, Mental Health continued to include amounts for the EMHI program and the California AIDS mental health project. Additionally, Mental Health had yet to determine how the percentages it applied against the total managed care and realignment dollars used for the calculation of the MOE were derived. Finally, Mental Health continued to be unable to provide documentation to show the components and expenditures that it used to calculate the fiscal year 1994–95 threshold amount. For the calculation of the MOE for community mental health services

for fiscal year 2007–08, Mental Health continued to include an amount for the EMHI program. Additionally, Mental Health did not report all state expenditures for adults with SMI and children with SED. For example, it did not include any funding from the MHSA in its calculation.

However, we noted for its fiscal year 2008–09 MOE, Mental Health removed the EMHI program and the California AIDS mental health project from its calculation for the integrated services for children with SED and the EMHI program from its calculation for community mental health services. Also, according to staff in its budgets office, Mental Health is examining the possibility of including components of MHSA in its calculation of the MOE for community mental health services. Until it includes only appropriate expenditures in its calculation of MOE and can adequately support that calculation, Mental Health cannot ensure that it is complying with the MOE requirement for both integrated services for children with SED and for community mental health services.

Finally, Mental Health did not provide us with its plans for providing 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 or documentation to support the components and expenditures that were used to generate the fiscal year 1994–95 threshold of $160 million.

Questioned Costs

Not applicable.

Recommendations

Mental Health should ensure its calculation of the MOE for integrated mental health services for children with SED contains 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 all state expenditures for adults with SMI and children with SED only.

Department's View and Corrective Action Plan

Mental Health stated it will conduct a reengineering evaluation of the current processes and procedures to ensure that the methodology used to calculate MOE is consistent with federal requirements and the Center for Mental Health Services' guidelines. In addition, Mental Health stated it will review its methodology for the calculation of the MOE related to services for children with SED (the set-aside) in consultation with the Center for Mental Health Services. Finally, Mental Health stated it will retain supporting documentation in the future.

Reference Number:	2008-8-9
Federal Catalog Number:	93.959
Federal Program Title:	Block Grants for Prevention and Treatment of Substance Abuse (SAPT)
Federal Award Number and Year:	07B1CASAPT; 2007
Category of Finding:	Period of Availability

State Administering Department: Department of Alcohol and Drug Programs (ADP)

Criteria

TITLE 42—THE PUBLIC HEALTH AND WELFARE, CHAPTER 6A—PUBLIC HEALTH SERVICES, SUBCHAPTER XVII—BLOCK GRANTS, PART B—BLOCK GRANTS REGARDING MENTAL HEALTH AND SUBSTANCE ABUSE, Subpart iii—General Provisions, 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

ADP does not follow its procedures for ensuring that its county subgrantees expend all funds awarded to them before the period of availability for the grant expires. Specifically, ADP requires the counties to submit their SAPT expenditure data to it quarterly. ADP's policies require its staff to review the counties' quarterly expenditure data to ensure that they are not at risk of losing the SAPT funds. If counties' expenditure data indicate they will not spend SAPT funds before the end of the period of availability, ADP staff will work with them to either ensure timely expenditure of funds or to reallocate their awards to other counties. The period of availability for the federal fiscal year 2007 grant was October 1, 2006, through September 30, 2008.

However, our review of six of the 58 counties found that one county did not expend the SAPT funds allocated to it by September 30, 2008. Specifically, one county expended 91 percent of its allocation. Further, although ADP provided some documentation to demonstrate that it followed up with this county, its follow-up occurred too late to ensure reallocation of the $31,536 in excess funds to other counties. Moreover, when we asked ADP whether it had made efforts to obtain the unspent funds back from this county, one of its senior accounting officers stated that ADP has not yet invoiced the county, but it plans to do so by February 27, 2009.

Questioned Costs

$31,536 (allocation to one county not spent as of September 30, 2008).

Recommendation

ADP should ensure that it monitors the counties' expenditures and follows up on any discrepancies between their allocations and expenditures promptly.

Department's View and Corrective Action Plan

ADP stated that it is in the process of reviewing and updating its procedures.

ADP also stated that the expenditure period for the federal fiscal year 2007 Substance Abuse Prevention and Treatment Block Grant was October 1, 2006, through September 30, 2008. The ending date of the period of availability is in the state fiscal year 2008–09, which is outside the scope of this audit.

ADP is currently in the process of settling the county cost reports; it is following its established procedures for recovering the unexpended federal fiscal year 2007 SAPT block grant funds. The recovery letter was sent to Alpine County on January 30, 2009.

Auditor's Comments on Department's View

The review of the Bureau of State Audits (BSA) focused on activities undertaken by ADP staff for all SAPT grants open during state fiscal year 2007–08. The BSA found that as of June 30, 2008, two of ADP's subgrantees had expended less SAPT funds than ADP had disbursed to them. The BSA followed up to determine whether ADP took subsequent actions in accordance with its policies and procedures to ensure that subgrantees expend the funds before the grant closed and found that for one subgrantee it had not.

Reference Number:	2008-8-11
Federal Catalog Number:	93.958
Federal Program Title:	Block Grants for Community Mental Health Services
Federal Award Numbers and Years:	2B09SM010005-07; 2007 06B1CACMHS-01; 2006 05B1CACMHS-01; 2005
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 SERVICES, SUBCHAPTER XVII—BLOCK GRANTS, PART B—Block Grants Regarding Mental Health and Substance Abuse, Subpart iii—General Provisions, 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

In our prior-year audit, we reported that Mental Health did not have an adequate process to establish obligations of federal awards to counties for a predetermined time period. The total amount Mental Health obligated to counties for fiscal year 2006–07 was unclear, and Mental Health did not ensure the federal award was expended within the period of availability. Specifically, Mental Health used $3.1 million of its $52.3 million drawdown from the 2006 Block Grants for Community Mental Health Services (CMHS) to pay expenditures from fiscal years other than fiscal year 2006–07.

During our follow-up work for fiscal year 2007–08, we found that Mental Health partially corrected this finding. On August 20, 2008, Mental Health issued a letter to notify the counties of the total proposed allocation to them from the 2007 CMHS grant, which agreed with the amount shown on its balance sheet. However, Mental Health did not revise its accounting procedures to instruct staff on how to charge expenditures to each CMHS grant so that it could ensure the two-year period of availability requirement is met. Mental Health instructs its staff to draw down federal funds for the actual state fiscal year the expenditures are incurred. For example, the 2008 CMHS grant has a two-year period of availability that starts October 1, 2007, and ends September 30, 2009. Mental Health would allocate these funds for state fiscal year 2008–09, which extends from July 1, 2008, through June 30, 2009.

According to its accounting staff, Mental Health verbally instructed them to follow this procedure in approximately September 2008. However, until Mental Health fully implements its revised accounting procedures for expending federal award funds, it cannot ensure that federal funds are expended within the period of availability.

Questioned Costs

Unknown

Recommendation

Mental Health should implement its recently revised accounting procedures to ensure that CMHS grant funds are used within the two-year period of availability.

Department's View and Corrective Action Plan

Mental Health stated that it has implemented its recently revised accounting procedures to ensure that CMHS grant funds are used within the two-year period of availability.

Reference Number:	2008-8-12
Category of Finding:	Period of Availability
State Administering Department:	Department of Social Services (Social Services)
Federal Catalog Number:	93.658
Federal Program Title:	Foster Care—Title IV-E
Federal Award Numbers and Years:	0801CA1401; 2008 0701CA1401; 2007

Federal Catalog Number:	93.659
Federal Program Title:	Adoption Assistance
Federal Award Numbers and Years:	0801CA1407; 2008 0701CA1407; 2007

Criteria

TITLE 45—PUBLIC WELFARE, PART 95—GENERAL ADMINISTRATION—GRANT PROGRAMS (PUBLIC ASSISTANCE, MEDICAL ASSISTANCE AND STATE CHILDREN'S HEALTH INSURANCE PROGRAMS), Subpart A—Time Limits for States to File Claims

Section 95.7—Time Limit for Claiming Payment for Expenditures Made After September 30, 1979

Under the programs listed in Section 95.1, we will pay a State for a State agency expenditure made after September 30, 1979, only if the State files a claim with us for that expenditure within 2 years after the calendar quarter in which the State agency made the expenditure. Section 95.19 lists the exceptions to this rule.

Section 95.19—Exceptions to Time Limits

The time limits in Sections 95.7 and 95.10 do not apply to any of the following—

(a) Any claim for an adjustment to prior year costs, which means an adjustment in the amount of a particular cost item that was previously claimed under an interim rate concept and for which it is later determined that the cost is greater or less than that originally claimed.

(b) Any claim resulting from an audit exception.

(c) Any claim resulting from a court-ordered retroactive payment.

(d) Any claim for which the Secretary decides there was good cause for the State's not filing it within the time limit.

Condition

Social Services' processes for reviewing and authorizing the counties' administrative and assistance claims do not provide reasonable assurance that adjustments included on the claims are for expenditures made within two years after the calendar quarter in which the expenditures were initially paid. Specifically, Social Services does not require the counties to provide documentation to support the adjustments on their claims.

On March 13, 1997, Social Services notified the counties that its newly established policy for claiming adjustments for administrative and assistance expenditures was nine months and 18 months, respectively. For adjustments related to the assistance claims, prior to July 1, 2005, Social Services required the counties to submit a prior-month positive adjustment report, which included the initial date of the expenditures. However, effective July 1, 2005, Social Services informed the counties that their submission of this report was no longer required. Instead Social Services relies on the counties' welfare directors and auditor-controllers to certify that the period of availability has not been exceeded.

In its April 1, 2008, fiscal letter to the counties, Social Services notified them of its established due dates for submitting their adjusted claims. For example, if the original claim was for the quarter ending September 2008, the counties have until July 1, 2009, to submit a revised September 2008 claim that includes any adjustments. Social Services believes this process ensures that it is meeting the two-year limit for claiming payments.

However, because Social Services does not require the counties to submit detailed supporting documentation for their administrative and assistance claims, we are unable to conclude that the counties' adjustments are for expenditures made within the two-year limit for claiming payment.

Questioned Costs

Unknown

Recommendation

Social Services should require counties to submit documentation to demonstrate that the adjustments included on their claims are within the two-year period of availability.

Department's View and Corrective Action Plan

Social Services stated that it does not concur with this finding and plans to take additional steps for clarity, because various county fiscal letters (CFLs) address the cash claiming and adjustment claim process. Specifically, Social Services stated it will take additional steps to ensure counties are informed of the cash claim requirements by incorporating standard language in the quarterly claiming instruction CFLs to instruct and inform counties about the policy and regulations concerning adjustment claims. This would include information regarding the period of availability for federal funds and the requirement to maintain supporting documentation for all adjustments to the claim. Social Services also wanted the reader to refer to its response for the Bureau of State Audits (BSA) finding number 2008-1-13 related to activities allowed and allowable costs.

Auditor's Comments on Department's View

Social Services' corrective action plan does not address the BSA's finding and related recommendation. Informing counties of federal requirements cannot substitute for Social Services' responsibility to periodically evaluate whether the underlying transactions for adjustments are within the period of availability applicable to each federal program included in the counties' administrative and assistance claims. By relying on the counties to certify that their adjustments to prior claims are for activities that took place within the two-year period of availability, Social Services is abrogating its responsibility to ensure that federal requirements for period of availability are satisfied.

Please refer to the BSA's comments on the department's view for finding number 2008-1-13 related to activities allowed and allowable costs.

Reference Number:	2008-9-2
Federal Catalog Number:	93.958
Federal Program Title:	Block Grants for Community Mental Health Services
Federal Award Number and Year:	2B09SM010005-07; 2007
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

In our prior-year audit, we reported that Mental Health did not require counties, as part of their suspension and debarment certifications to the State, to ensure that lower-tier entities with which they entered into covered transactions were not suspended or debarred. Mental Health also did not require counties to pass the requirements down to each person with whom they entered into a covered transaction.

In our follow-up procedures for fiscal year 2007–08, we found that Mental Health had not yet addressed this finding. According to Mental Health staff, a revised suspension and debarment certification relative to county staff and their subcontractors will be included in the fiscal year 2009–10 Planning Estimate and Renewal Application sent to counties in May 2009. Staff also stated Mental Health is working toward developing the revised language and expects to complete it by March 2009. Until it completes these tasks, counties could inadvertently pass federal 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

Mental Health stated it would review its contract terms and conditions, and amend as appropriate.

Reference Number:	2008-9-3
Category of Finding:	Procurement, Suspension and Debarment
State Administering Department:	Department of Social Services (Social Services)
Federal Catalog Number:	93.566
Federal Program Title:	Refugee and Entrant Assistance—State Administered Programs (Refugee Program)
Federal Award Numbers and Years:	08AACA9100; 2008 07AACA9100; 2007

Federal Catalog Number:	93.556
Federal Program Title:	Promoting Safe and Stable Families (PSSF)
Federal Award Numbers and Years:	G-0801CAFPSS; 2008 G-0701CA00FP; 2007 G-0601CA00FP; 2006

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 180.200

A covered transaction is a nonprocurement or procurement transaction that is subject to the prohibitions of this part. It may be a transaction at—

(a) The primary tier, between a Federal agency and a person; or

(b) A lower tier, between a participant in a covered transaction and another person.

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 180.330

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 participation in the transaction. You may do so 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.

U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES—ADMINISTRATION FOR CHILDREN AND FAMILIES—ADMINISTRATION ON CHILDREN, YOUTH AND FAMILIES TERMS AND CONDITIONS—SUBRECIPIENTS 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

In our prior-year audit, we reported that 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 when entering into contracts with noncounty subrecipients. During our follow-up procedures for fiscal year 2007–08, we found that Social Services has not corrected this issue.

Our review of contracts with two noncounty subrecipients found that the standard contract Social Services uses to award federal funds from an ACF grant to noncounty subrecipients did not include the correct suspension and debarment terms and/or conditions. For example, the standard contract Social Services used for a noncounty subrecipient to provide services for the Refugee Program stated that "for federally funded agreements in the amount of $25,000 or more, by signing this agreement, the contractor certifies that to the best of his/her knowledge and belief that he/she and their principals or affiliates are not debarred or suspended from federal financial assistance programs and activities nor proposed for debarment, declared ineligible, or voluntarily excluded from participation in covered transactions by any federal department or agency." However, these terms are incorrect because there is no dollar threshold for the suspension and debarment requirement for programs receiving federal funds from an ACF grant. Further, the terms do not include language specific to lower-tier subrecipients. According to its program staff, Social Services was not clear regarding its subrecipients' responsibility to include suspension and debarment language in their subcontracts and is working on a process to address this matter.

Social Services staff did not consult the federal Excluded Parties List System (EPLS) Web site prior to issuing subawards or contracts to noncounty subrecipients as required by the ACF terms and conditions. According to the chief of the Contracts and Financial Analysis Bureau, although Social Services has developed a contract checklist that requires staff to check the EPLS Web site prior to entering into a federally funded contract with a noncounty subrecipient, this document was not implemented during fiscal year 2007–08.

Until Social Services corrects these issues, it will be unable to ensure its noncounty subrecipients have not been suspended or debarred.

Questioned Costs

Not applicable.

Recommendations

For contracts with noncounty subrecipients that are funded by ACF grants, Social Services should do the following:

(1) Ensure that the suspension and debarment terms and/or conditions it includes in the contracts comply with ACF terms and conditions.

(2) Establish a process to ensure that its subrecipients include the appropriate suspension and debarment language in their contracts.

(3) Continue the use of its contract checklist that prompts staff to consult the EPLS Web site prior to entering into these contracts.

Department's View and Corrective Action Plan

Social Services stated that it concurs with the finding. Social Services also stated that in fiscal year 2008–09 it added the need to consult the EPLS Web site prior to entering into a contract to its contract checklist for all contracts. Additionally, Social Services stated it has now modified its suspension and debarment certification language to eliminate the monetary threshold and incorporate the appropriate language to address the suspension and debarment clearance requirement for any subcontractor. The revised language is as follows:

Debarment and Suspension

For federally funded agreements, Contractor certifies that to the best of his/her knowledge and belief that he/she and their principals, affiliates or any sub-contractor utilized under this agreement, are not debarred or suspended from federal financial assistance programs and activities nor proposed for debarment, declared ineligible, or voluntarily excluded from participation in covered transactions by any federal department or agency. The Contractor also certifies that it or any of its sub-contractors are not listed on the Excluded Parties Listing System (http://www.epls.gov) (Executive Order 12549, 7 CFR, Part 3017, 45 CFR, Part 76, and 44 CFR, Part 17).

Reference Number:	2008-9-4
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 Numbers and Years:	G-0802CATANF; 2008 G-0702CATANF; 2007

Federal Catalog Number:	93.658
Federal Program Title:	Foster Care—Title IV-E
Federal Award Numbers and Years:	0801CA1401; 2008 0701CA1401; 2007

Federal Catalog Number:	93.659
Federal Program Title:	Adoption Assistance
Federal Award Numbers and Years:	0801CA1407; 2008 0701CA1407; 2007

Federal Catalog Number:	93.566
Federal Program Title:	Refugee and Entrant Assistance—State Administered Programs (Refugee Program)
Federal Award Numbers and Years:	08AACA9100; 2008 07AACA9100; 2007

Federal Catalog Number:	93.556
Federal Program Title:	Promoting Safe and Stable Families (PSSF)

Federal Award Numbers and Years:	G-0801CAFPSS; 2008 G-0701CA00FP; 2007 G-0601CA00FP; 2006

Federal Catalog Number:	93.645
Federal Program Title:	Child Welfare Services—State Grants (CWS)
Federal Award Numbers and Years:	G-0801CA1400; 2008 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."

U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES—ADMINISTRATION FOR CHILDREN AND FAMILIES TERMS AND CONDITIONS—FISCAL YEARS 2007 and 2008, SUBRECIPIENTS 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. Specifically, Social Services did not adequately notify the counties of the suspension and debarment terms articulated in the terms and conditions. The counties received notification of these requirements from Social Services for the Refugee Program only during fiscal year 2007–08. Although Social Services has periodic, ongoing correspondence with counties through the use of fiscal letters that it uses to notify them of any issues related to administrative costs and other services, these letters were not used to notify counties receiving funds for the remaining five programs of the suspension and debarment requirements.

Additionally, Social Services does not send any notification to the counties regarding their subawards for the administrative expenses and the assistance payments they make to program beneficiaries. Instead, Social Services makes monthly cash advances to the counties and then requires the counties to submit administrative claims quarterly and assistance claims monthly. Although Social Services does not enter into a contract or similar agreement with the counties, it is clear that the State is granting subawards to the counties and is required to notify them of the suspension and debarment requirements.

Furthermore, Social Services had not consulted the federal Excluded Parties List System (EPLS) for any of the six programs identified prior to disbursing funds to the counties. According to the chief of its Contract and Financial Analysis Bureau, Social Services did not consult the EPLS Web site prior to disbursing federal funds to counties because the counties self-certify on their county administrative claims that they are not on the ELPS. However, the counties' certification occurs after the funds have been disbursed and cannot be a substitute for the ACF terms and conditions.

Until Social Services addresses these weaknesses in its internal controls, it risks losing federal funds for noncompliance with this requirement.

Questioned Costs

Not applicable.

Recommendations

Social Services should amend its process for making subawards to the counties to include using either its annual fiscal letters or providing additional information with its single funding page crosswalk to notify counties of the suspension and debarment terms and conditions as required by the ACF. Finally, prior to issuing subawards to counties, Social Services should establish procedures to ensure that it consults the EPLS, as required by the ACF terms and conditions.

Department's View and Corrective Action Plan

Social Services stated that it concurs with this finding. Social Services will issue an annual county fiscal letter (CFL) that provides counties with the policies and regulations as required by the ACF for the suspension and debarment requirements. This CFL will include information regarding the EPLS. Social Services will also develop a methodology to routinely check all California counties against the EPLS.

Reference Number:	2008-12-2
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:	08AACAT3SP; 2008 07AACAT3SP; 2007 06AACAT3SP; 2006

Federal Catalog Number:	93.045
Federal Program Title:	Special Programs for the Aging—Title III, Part C—Nutrition Services
Federal Award Numbers and Years:	08AACAT3SP; 2008 07AACAT3SP; 2007 06AACAT3SP; 2006

Federal Catalog Number:	93.053
Federal Program Title:	Nutrition Services Incentive Program
Federal Award Numbers and Years:	08AACANSIP; 2008 07AACANSIP; 2007 06AACANSIP; 2006

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

(b) 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 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 or 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 lacked adequate policies and procedures to provide reasonable assurance that the Financial Status Report and Administration on Aging Supplemental Form (SF-269) and the Federal Cash Transaction Report (PSC-272) it submitted to the federal government include all activities, are supported by accounting records, and are fairly presented. Specifically, during fiscal year 2007–08, Aging did not have an official written policy that established responsibility for reporting, provided the procedures for periodic monitoring of due dates, and verified the report content. For example, the instructions Aging provided for the SF-269 report focused primarily on how staff should query the data. Thus, Aging was unable to prevent errors in its reports. Specifically, Aging submitted several reports that were not adequately supported by the accounting records used by its accounting specialist to prepare the reports.

Our review of the SF-269 reports as of March 31, 2008, for each of the three programs listed found that the amounts reported by Aging are inaccurate and do not trace to accounting records. Specifically, Aging failed to identify several errors in the underlying documentation used by the accounting specialist to prepare the reports. For example, Aging reported the federal share of net outlays for federal fiscal year 2008 Title III, Part C-1, as $16 million. However, according to its accounting records, this amount should have been roughly $4.1 million—representing a reporting error of almost $12 million. Further, Aging's SF-269 report for the 2007 grant is incorrect because the accounting specialist unintentionally submitted the amounts that had already been reported for the previous reporting period. Finally, Aging submitted each of the three SF-269 reports several months beyond the required due date.

Additionally, in reviewing two of the four PSC-272 reports that Aging submitted to the U.S. Department of Health and Human Services during fiscal year 2007–08, we noted several errors in the disbursement amounts for the Title III, Part B and Part C programs. For example, in the PSC-272 report for the federal fiscal quarter ending March 2008, Aging reported disbursements for the Title III, Part B program of roughly $14.5 million; however, the underlying documentation reflected a total disbursement amount of about $15 million—representing a reporting error of more than $500,000. Similarly, in the SF-269 report for the federal fiscal quarter ending June 2008, Aging reported an amount of about $20.9 million in disbursements for the Title III, Part B program; however, the underlying documentation reflected roughly $21.9 million—a difference of nearly $1 million. Moreover, Aging reported about $13 million and $12.5 million in disbursements for the Title III, Part C-1 and Part C-2 programs, respectively; however, these amounts also did not trace to the underlying documentation and were understated by roughly $100,000 and $20,000, respectively. Finally, although the underlying documentation for the SF-269 report for the federal fiscal quarter ending March 2008 included cash on hand of roughly $68,000, Aging did not report this amount.

In November 2008 Aging developed procedures for the reports that establish supervisory review and specify the respective due dates. If followed, these procedures should allow for the prevention and/or early detection of any errors in future reports it submits to the federal government. Additionally, Aging stated that it has experienced significant staff turnover and is in the process of training new staff on its recently developed procedures. Until Aging fully implements its new procedures and trains its staff, it will continue to run the risk of noncompliance with the federal reporting requirements.

Questioned Costs

Not applicable.

Recommendations

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. These policies and procedures should provide for management review and approval, as well as a system to track due dates of the reports.

Aging should review, revise, and resubmit the SF-269 and PSC-272 reports it submitted to the U.S. Department of Health and Human Services during fiscal year 2008 to ensure it submits accurate and complete information.

Department's View and Corrective Action Plan

Aging appreciates the Bureau of State Audits' recommendations and is establishing policies and procedures that will include the verification of content and accounting record support, management review and approval, and a system to track due dates for the SF-269 and PSC-272 reports. Aging will be working with the U.S. Health and Human Services' Administration on Aging (AoA) in developing these procedures to ensure that its methodology is consistent with AoA's process and expectations.

Aging has notified AoA that it is in the process of reviewing, correcting and resubmitting any reports from 2008 that are inaccurate. Aging is also documenting best practices and procedures in order to consistently and accurately complete these forms regardless of staff turnover.

Reference Number:	2008-12-13
Federal Catalog Number:	93.568
Federal Program Title:	Low-Income Home Energy Assistance (LIHEAP)
Federal Award Numbers and Years:	G-07B1CALIEA; 2007 G-0601CALIE2; 2006 G-06B1CALIEA; 2006 G-05B1CALIEA; 2005 G-04B1CALIEA; 2004
Category of Finding:	Reporting
State Administering Department:	Department of Community Services and Development (CSD)

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—

(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 is 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.

Financial Status Report (Short Form)—SF-269A, Instructions

10a Total Outlays. Enter total program outlays less any rebates, refunds, or other credits. For reports prepared on a cash basis, outlays are the sum of actual cash disbursements for direct costs for goods and services, the amount of indirect expense charged, the value of in-kind contributions applied, and the amount of cash advances and payments made to subrecipients. For reports prepared on an accrual basis, outlays are the sum of actual cash disbursements for direct charges for goods and services; the amount of indirect expense incurred; the value of in-kind contributions applied; and the net increase or decrease in the amounts owed by the recipient for goods and other property received for services performed by employees, contractors, subgrantees and other payees; and other amounts becoming owed under programs for which no current services or performances are required, such as annuities, insurance claims, and other benefit payments.

Condition

CSD lacks adequate internal controls to ensure that proper federal reporting requirements are met. Although it follows general guidance outlined in the F*ederal Grant Management Handbook* and California's *State Administrative Manual* in preparing reports, CSD did not have formal policies and procedures in place when completing the Financial Status Report (FSR) or the Carryover and Reallotment Report during fiscal year 2007–08. Further, CSD lacks written procedures for its process to reconcile information it uses to prepare the FSRs. CSD uses an internally developed spreadsheet to track federal drawdowns for LIHEAP and reports these drawdowns as the federal share of program outlays on the FSR as opposed to the actual cash disbursements. Although CSD reconciles total drawdowns per the spreadsheet to cash disbursements per its accounting records quarterly, it does not have written procedures that describe how the reconciliation should occur. Without written policies and procedures that establish responsibility and provide guidance to staff on how to prepare, review, and approve the reconciliation and the FSRs, the risk of reporting errors increases.

On January 22, 2009, CSD completed desk procedures for completing FSRs. However, it has yet to complete desk procedures for reconciling the drawdowns to disbursements or for the Carryover and Reallotment Report.

Further, CSD's Carryover and Reallotment Report did not include all required information. Specifically, our review of its Carryover and Reallotment Report dated July 3, 2007, found that CSD did not include the applicable description of the types of assistance to be provided with the funds to be carried over or evidence that the report had been reviewed and approved prior to CSD submitting it to the U.S. Department of Health and Human Services. CSD staff stated that this oversight was corrected for the 2008 report. We reported on a similar finding in our prior year's report.

Questioned Costs

Not applicable.

Recommendations

CSD should develop and implement written policies and procedures to ensure that its reconciliations of drawdowns to disbursements are appropriate. CSD should also develop and implement written procedures to ensure that its annual Carryover and Reallotment reports are accurate and complete. For example, 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 and retain evidence of its supervisory review and approval process.

Department's View and Corrective Action Plan

CSD agrees that written policies and procedures promote adherence and accuracy to federal reporting requirements. However, a recent vacancy in the Accounting Unit has proved to be a hardship to staff, and the main objective is to continue uninterrupted daily work processes. Although CSD is making every effort to fill the vacant position, qualified candidates for accounting classifications are severely limited at this time. 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 remains ongoing and has been put on hold until the position is filled.

Accounting employees at this time must defer to the state regulations for administrative and financial functions that are contained in the State Administrative Manual (SAM). Accounting staff continuously utilize SAM to provide general guidelines for their current processes.

In addition, to ensure proper federal reporting requirements are followed, CSD Accounting staff have access to the various resources available within the office, including the Federal Grants Management Handbook. The Accounting staff also has access to the U. S. Department of Health and Human Services (Administration for Children and Families) and other federal Web sites to obtain guidance on federal drawdown requirements and to learn of any updates, changes or new requirements.

Senior Accounting staff are crosstrained in the above procedure so that should a vacancy occur it can be safely assumed that there still remains trained staff.

Accounting staff duty statements clearly establish functional responsibilities for the Unit. CSD believes that these resources and internal documents comply 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."

Auditor's Comments on Department's View

The Bureau of State Audits stands by its finding and related recommendations. Further, in the last two paragraphs of its response, CSD implies that its practices comply with requirements found in the A-133 Compliance Supplement. However, CSD fails to mention that the first characteristic that the OMB cites under its description of control activities is, "Operating policies and procedures **clearly written** [emphasis added] and communicated."

Reference Number:	2008-12-15
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

In our prior-year audit, we reported that Mental Health did not have processes and procedures in place to ensure that the annual Standard Form (SF269A), Financial Status Report, is accurate and submitted on a timely basis. Specifically, we found that the same accounting specialist who prepared the SF-269A report for the federal fiscal year 2005 block grants for Community Mental Health Services (CMHS) was also responsible for keeping track of when the report was due and completing, signing, and submitting the report. However, Mental Health did not ensure that the report was reviewed and approved by someone other than the preparer. Further, although the report was due December 29, 2006, Mental Health did not submit it until March 15, 2007.

During our follow-up work for fiscal year 2007–08, we found that Mental Health partially corrected this finding. Specifically, it submitted the SF-269A for the federal fiscal year 2006 CMHS grant before the submission deadline and the staff member who approved the report was different than the staff member who prepared the report. We also found that Mental Health's accounting procedures specified when the SF-269A was due and established methods to ensure the report's accuracy. However, Mental Health's accounting procedures did not specifically identify the segregation of duties related to the preparation and approval of the report.

After we brought this to Mental Health's attention, it revised its procedures in February 2009 to require both the preparer and the accounting administrator to sign the report.

Questioned Costs

Not applicable.

Recommendation

Mental Health should implement its procedures to ensure that the individual who approves the SF-269A is not the same individual who prepares it.

Department's View and Corrective Action Plan

Mental Health stated it has implemented procedures to ensure segregation of duties for approval and preparation of the SF-269A.

Reference Number:	2008-12-16
Federal Catalog Number:	93.566
Federal Program Title:	Refugee and Entrant Assistance—State Administered Programs (Refugee Program)
Federal Award Numbers and Year:	G-07AACA9100; 2007 G-07AACA9110; 2007
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, Performance Report Instructions, (OMB No. 0970-0036.) states; "The Office of Refugee Resettlement (ORR) uses data gathered from the ORR-6 Performance Report to determine the number of months of Refugee Cash Assistance (RCA) and Refugee Medical Assistance (RMA) use based on appropriations. State-by-state RCA and RMA utilization rates derived from the ORR-6 are calculated for use in formulating program initiatives, priorities, standards, budget requests, and assistance policies. The revised ORR-6 Performance Report is intended to provide participation and performance data and **no longer requests program expenditures for the reporting period**. Also, medical screening data are used in the annual report to Congress to document the number of newly arrived refugees and other eligible populations accessing medical screening during the year."

Condition

In our prior-year audit, we reported that Social Services submitted its second quarter federal fiscal year 2007 ORR-6 report to the federal ORR despite the report containing several errors. Specifically, in a summary chart that reported 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.

During our follow-up procedures for fiscal year 2007–08, we found that Social Services made similar errors. Specifically, in its federal fiscal year 2007–08 second trimester ORR-6 report, the beginning balances for the number of persons and/or cases for 26 of 58 counties did not agree with the ending balances Social Services reported on its federal fiscal year 2007–08 first trimester ORR-6 report. For example, in its second trimester report, Social Services reported the total number of persons at the end of the previous trimester as 1,486. However, in its first trimester report, Social Services reported 1,879 as the total number of persons at the end of the trimester.

Additionally, Social Services was missing data for five of 58 counties included in its second trimester ORR-6 report. According to staff in its Refugee Programs Bureau (RPB), discrepancies in the second trimester ORR-6 report occurred because counties are incorrectly reporting their data. Further,

staff stated that the county data was missing because the five counties did not submit their data to Social Services in sufficient time to allow it to meet the ORR reporting deadline. Nevertheless, Social Services' submission of incorrect data in its ORR-6 reports affect the ORR's ability to calculate accurately the rates it uses to formulate program initiatives, priorities, standards, budget requests, and assistance policies.

Staff in its RPB stated that Social Services will provide instruction to RPB staff on the ORR's new reporting requirements as well as provide guidance and training to the counties.

Questioned Costs

Not applicable.

Recommendations

Social Services should implement its plans to provide more guidance and training to RPB staff and the counties regarding the ORR's reporting requirements. Social Services should also ensure that the reports it submits to the ORR are accurate and complete.

Department's View and Corrective Action Plan

Social Services concurs with the finding and stated that its RPB has completed the following to improve the accuracy of the data submitted in the federal Quarterly Performance Report (ORR-6):

- Reviewed federal ORR-6 reporting instructions with RPB staff and provided guidance on reviewing the report contents on January 5, 2009.
- Reviewed federal ORR-6 reporting instructions with county refugee coordinators (CRCs) at the Quarterly CRC meeting on January 29, 2009.
- Reviewed federal ORR-6 reporting instructions with staff from Northern California counties as part of the RPB-hosted Refugee Resettlement Program (RRP) training on January 30, 2009. RPB also has planned RRP training for other counties in the State, which will be conducted in March 2009 and April 2009 (specifics of those training sessions are being finalized).
- Issued federal ORR-6 reporting instructions to all counties with the trimester report due date reminder on January 27, 2009.

In addition to the above, the RPB will do the following:

- Reissue federal ORR-6 reporting instructions to all counties, via an all-county letter by April 1, 2009.
- Correct errors identified in the federal ORR-6s for federal fiscal year 2007–08 and submit amended reports to the federal Office of Refugee Resettlement by May 1, 2009.
- Internally check reports before submission to ORR to identify and explain missing county reports or discrepancies with prior reports.

Reference Number:	2008-13-2
Category of Finding:	Subrecipient Monitoring
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:	08AACAT3SP; 2008 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:	08AACAT3SP; 2008 07AACAT3SP; 2007

Federal Catalog Number:	93.053
Federal Program Title:	Nutrition Services Incentive Program
Federal Award Numbers and Years:	08AACANSIP; 2008 07AACANSIP; 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:

(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.

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 92.21—Payment

(c) 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.

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 92.40—Monitoring and Reporting Program Performance

(a) Monitoring by grantees. Grantees are responsible for managing the day-to-day operating conditions 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

Aging lacks internal controls to ensure it identifies the federal agency name to its subgrantees at the time of the award. Specifically, Aging's contract review and approval process does not ensure that its staff include specific references to the name of the federal agency—the U.S. Department of Health and Human Services—on the standard agreements it sends annually to each of its subgrantees.

During-the-Award Monitoring

Although Aging has a process in place for monitoring subgrantees' use of funds, which includes site visits by its fiscal and contracts team (team), it lacks adequate procedures that require staff to document the specific procedures they performed or the documents they reviewed to support their conclusions. While on-site, the team uses Aging's fiscal review tool that is designed to guide their assessment of subgrantees' compliance with various federal requirements outlined in U.S. Office of Management and Budget (OMB) Circular A-102, *Grants and Cooperative Agreements with States and Local Governments*, which is codified at Title 45, Code of Federal Regulations, Part 92, including those pertaining to allowable costs, cash management, and program income. However, in reviewing the files related to three of the eight site visits conducted by the team during fiscal year 2007–08, we were unable to identify the procedures performed or arrive at the same conclusions as Aging's staff due to the lack of sufficient documentation. For example, we could not determine whether the team had verified subgrantees' compliance with established cash management procedures to minimize the time elapsing between drawdown and disbursement of program funds. Additionally, we could not conclude whether Aging verified that subgrantees used program income, rebates, refunds, and other income and receipts before requesting additional federal funds.

Furthermore, the lack of adequate procedures results in inconsistencies. For instance, two of the three files we reviewed contained adequate supporting documentation for the requirement related to allowable costs; however, the third file only contained the fiscal review tool and did not include any supporting documentation related to this requirement. Thus, we could not identify the procedures performed or records reviewed by Aging's team to conclude the subgrantee complied with this requirement. According to the team coach, Aging requires only the completion of the fiscal review tool and does not require staff to retain further supporting documentation to demonstrate their conclusions are drawn from adequate sources. She also stated that she has confidence in the professional judgment of the team and is present during the on-site review. However, we noted that for its program reviews, Aging does require its staff to retain copies of all documents they obtain from the subgrantee as part of its official records. Aging should also extend this requirement to its fiscal reviews because without adequate documentation to support conclusions reached during these reviews, Aging cannot demonstrate that it effectively monitors its subgrantees and ensures that they are using program funds in accordance with applicable federal requirements.

Questioned Costs

Not applicable.

Recommendations

Aging should identify the federal agency in its annual standard agreements that it enters into with each of its subgrantees. Furthermore, it should revise its subgrantee monitoring procedures to require its fiscal and contracts review team to identify the specific procedures they perform and to retain copies of all documents they obtain from the subgrantee as part of its official records.

Department's View and Corrective Action Plan

Award Notification:

Aging stated that it has added the federal agency name to its subgrantee contracts for fiscal 2009–10. In addition, Aging stated that it complies with OMB Circular A-133, Subpart B, requiring identification of federal awards made, Catalog of Federal Domestic Assistance title and number, award name and number, award year, and name of federal agency by providing its subgrantees, area agencies on aging (AAAs) with a copy of its *Single Audit Guide*. The guide provides the required information, including the name of the federal agency, and also informs the AAAs of their own obligation to meet the requirement with their subrecipients.

During-the-Award-Monitoring:

Aging stated that its fiscal and contracts team will develop written procedures documenting the fiscal monitoring process. The procedures will include a requirement to identify specific procedures performed during on-site fiscal monitoring and to retain copies of all documents obtained from the subgrantee as part of the official monitoring file.

Auditor's Comments on Department's View

Aging's statement that it complies with OMB Circular A-133, Subpart B, which requires the identification of federal awards made by informing each subgrantee of the name of the federal agency is questionable. Specifically, although its deputy director stated that Aging informs each of its subgrantees of the name of the federal agency in its *Single Audit Guide*, she was unable to provide us with a written policy requiring its auditors to provide the guide to the subgrantees. Thus, it is unclear if the subgrantees actually received the guide.

Reference Number:	2008-13-19
Federal Catalog Number:	93.568
Federal Program Title:	Low-Income Home Energy Assistance (LIHEAP)
Federal Award Numbers and Years:	G-08B1CALIEA; 2008 G-07B1CALIEA; 2007 G-06B1CALIEA; 2006 G-0601CALIE2; 2006 G-05B1CALIEA; 2005
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.

(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

Award Identification

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. Our review of eight of the 143 LIHEAP subgrantee contracts with active contract terms during fiscal year 2007–08 found that three contracts issued in 2006 and 2007 did not contain the appropriate award identification information. We reported a similar finding in our report last year, and CSD responded by revising its 2008 subgrantee contracts to comply with requirements. By not providing complete award information, CSD cannot be sure that its subgrantees are aware of all the program's requirements.

OMB Circular A-133 Audits

CSD's audit services unit (ASU) lacks sufficient internal controls to ensure that it receives and follows up on all subgrantee audits timely. Specifically, according to CSD's staff management auditor, through late 2008, ASU used an Access database to track the receipt of subgrantees' OMB Circular A-133 audits and its desk reviews and follow-up letters related to those audits. However, he also stated that beginning in approximately January 2008, staff responsible for entering audit information into this database were transferred out of the ASU, and the database was not maintained properly.

Consequently, because of the inaccurate audit report tracking information in the database and lack of procedures to identify missing or late audit reports, some subgrantees did not receive timely desk reviews. During our review of five of the OMB Circular A-133 reports for the roughly 45 subgrantees, we found that ASU auditors did not receive and perform desk reviews of the 2006 and 2007 OMB Circular A-133 audit reports for one of the subgrantees until mid-January 2009. Although the subgrantee's audit report did not contain any audit findings related to LIHEAP, delays such as this one could hinder CSD's ability to issue management decisions on OMB Circular A-133 audit reports that do contain audit findings.

According to CSD's staff management auditor, the new ASU manager requested that CSD's information technology (IT) unit develop a more complete and customized application to track the ASU's audit reviews. However, CSD's IT unit is working on other projects so in the interim ASU is using Outlook reminders and tracking spreadsheets to ensure that staff review and follow up all OMB Circular A-133 audits.

Questioned Costs

Not applicable.

Recommendations

CSD should continue to ensure that its agreements with its subgrantees include all required award identification information. Additionally, CSD's ASU should continue its efforts to ensure that all subgrantee OMB Circular A-133 audits are received and reviewed within the time frames established by OMB Circular A-133.

Department's View and Corrective Action Plan

CSD concurs with this finding. As discussed in the condition, CSD has already implemented a manual tracking process to identify missing or late independent auditor reports. These procedures were provided to the Bureau of State Audits (BSA) during its fieldwork.

Auditor's Comments on Department's View

The final sentence of CSD's view and corrective action plan implies that the BSA did not sufficiently take into consideration the procedures it provided. The BSA would like to clarify that its concern relates to CSD's *implementation* of its procedures, not the procedures themselves.

Reference Number:	2008-13-20
Federal Catalog Number:	93.563
Federal Program Title:	Child Support Enforcement (CSE)
Federal Award Numbers and Years:	0804CA4004; 2008 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

(c)(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 the CSE program. In the prior year, we reported that Child Support Services did not provide the Catalog of Federal Domestic Assistance (CFDA) title and number, the award number, and the name of the federal agency in the agreement that it executes with each local child support agency (LCSA). The U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* states that pass-through entities are responsible for identifying this information to the subrecipient at the time of the award. In its corrective action plan, Child Support Services stated that it had included the required award identification information in the current agreement for subsequent approval by each LCSA. However, when we reviewed the agreement effective June 2008, we determined that it did not include this information. In September 2008, Child Support Services sent each subrecipient an e-mail notifying them of the CFDA title and number, as well as the awarding agency. Child Support Services stated that it believes it has fulfilled the requirement by sending the September notice. However, this was more than three months after the effective date of the agreement, and the notification did not explain that this information was supplemental to the earlier agreement. Further, the e-mail did not include the award number. If subrecipients are not notified of the federal award information at the time of the agreement, they may not be aware of award requirements as they are expending funds.

In the prior year, we also reported that Child Support Services did not effectively monitor the LCSAs' use of federal funds through site visits, limited scope audits, or other means. Specifically, we determined that its use of limited scope audits conducted by the Department of Finance provided insufficient assurance of LCSAs' compliance with federal requirements. Child Support Services contracted with the Department of Finance in August 2004 to conduct audits that evaluate the LCSAs' compliance with U.S. Office of Management and Budget Circulars A-133 and A-87, state codes and regulations applicable to the Administrative Expense Claim Schedule and Certification, and related internal controls.

During state fiscal year 2007–08, the Department of Finance completed audits of only three of the 52 LCSAs. Including these three audits, we found that only 16 of 52 LCSAs have been audited since 2004. Child Support Services stated that funding for these audits has not increased, and as a result only a limited number of audits can be completed. Further, of the 14 findings issued for the audits completed during fiscal year 2007–08, only two findings had been fully corrected by January 2009. Also, Child Support Services did not request follow-up documentation for four of the findings, which included several significant issues. These audits are central to Child Support Services' oversight of the LCSAs' compliance with federal requirements, and according to Child Support Services, are the key control for allowability of costs at the LCSA level. The contract between Child Support Services and the Department of Finance limits audit costs to $400,000 per year. However, audits completed during fiscal year 2007–08 yielded findings that resulted in Child Support Services requesting $676,106 in repayment from LCSAs (as of January 2009, $359,104 has been repaid). Without these audits, Child Support Services' current procedures do not provide reasonable assurance that the LCSAs meet federal requirements, such as spending federal funds only on allowable activities and costs. Also, without sufficient follow-up on audit findings in a timely manner, Child Support Services has no assurance that the findings have been resolved, and LCSAs may continue to be out of compliance with state and federal regulations.

In addition, we found in the prior year that Child Support Services did not issue management decisions related to subrecipients' OMB Circular A-133 audit findings within the required six-month time frame. OMB Circular A-133 requires a management decision to be issued for subrecipient A-133 audit findings within six months of receipt of the report from the subrecipient. The State has established a process whereby local governments submit copies of their OMB Circular A-133 reports to the State Controller's Office (SCO). The SCO is responsible for certifying that the report conforms to

auditing standards. Upon certification, it sends copies of OMB Circular A-133 audit reports to state agencies. In response to this finding in fiscal year 2007–08, Child Support Services stated that it would use the SCO's report date and ensure that management decisions on findings are issued within the required period. However, although Child Support Services no longer calculated the six-month period from the date it received the reports, it changed its process to calculate from the date that the SCO certifies the reports rather than when the SCO received the reports. Despite the fact that the State of California has assigned aspects of the OMB Circular A-133 review process to different agencies, to ensure audit findings are dealt with promptly, this six-month period should be calculated from the date the SCO receives a final OMB Circular A-133 report from the local government.

By December 2008, Child Support Services had received copies of only 16 of the 58 county OMB Circular A-133 audit reports due March 30, 2008. On average, these reports were certified five months after the SCO received them. Five of the 16 audits included findings requiring Child Support Services to issue a management decision. However, Child Support Services received four of these five audits more than six months after the State initially received it, and the fifth was received four days before the six-month deadline. As of December 2008, the five reports had been in Child Support Services' possession for an average of nearly three months, and it had not yet issued any management decisions. Further, as of December 2008, Child Support Services' records indicated that it had not received several audits that had been certified according to the SCO's records. As a result, Child Support Services has not issued management decisions within the required time frame.

Questioned Costs

Not applicable.

Recommendations

Child Support Services should ensure that it provides all required federal award information to subrecipients at the beginning of their agreements.

Further, Child Support Services should increase during-the-award monitoring conducted of LCSAs. If Child Support Services believes that it is cost-beneficial to do so, it should consider increasing the number of audits performed by the Department of Finance each year. If it does not believe these reviews to be cost-beneficial, it should explore other alternatives for reviews of LCSAs.

Finally, Child Support Services should work with the SCO to ensure that it receives county OMB Circular A-133 audits promptly, allowing it sufficient time to issue management decisions regarding audit findings. These decisions should be issued within six months of the date the State receives the report from the subrecipient.

Department's View and Corrective Action Plan

Child Support Services will provide all the required information to the LCSAs at the beginning of their agreements.

Child Support Services has improved its process to resolve findings of the LCSAs and plans to use a new approach to increase its monitoring of the LCSAs, which may be in conjunction with the Department of Finance audits.

Child Support Services will communicate with the SCO to work towards a more timely response in issuing management decisions.

Reference Number:	2008-13-22
Federal Catalog Number:	93.959
Federal Program Title:	Block Grants for Prevention and Treatment of Substance Abuse
Federal Award Numbers and Years:	08B1CASAPT; 2008 07B1CASAPT; 2007
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:

(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.

STATE ADMINISTRATIVE MANUAL, Section 20070—Federal Pass-Through Funds

The Federal Single Audit Act of 1984 as amended by the Single Audit Act Amendment of 1996 and amendments in conjunction with the OMB Circular A-l33, defines a pass-through entity as a non-federal entity that provides a federal award to a subrecipient to carry out a federal program. The OMB Circular A-133, Subpart D, describes the responsibilities of federal agencies and pass-through entities. Specifically, Section .400(d) prescribes the responsibilities of a pass-through entity for the federal awards it makes.

To ensure that the State of California carries out its responsibilities in accordance with this federal act, the following procedures shall apply:

2. The SCO will coordinate single audit compliance with local governments.

g. Each state entity will monitor the federal funds it disburses to local governments to ensure compliance with federal laws and regulations. State entities will receive local government audit reports performed in accordance with the Single Audit Act of 1984, P.L. 98-502, and the Single Audit Act Amendments of 1996, P.L. 104-156 from the SCO when the audit report includes a schedule of findings and questioned costs with respect to federal funds that were passed through state entities. In addition, the SCO will distribute the single audit reports to state entities when the prior fiscal year's single audit report included audit findings related to federal funds. The state entity will review these reports and evaluate the corrective action plans submitted in response to findings of noncompliance.

h. All contracts or agreements issued by state entities concerning disbursement of federal funds to local governments will include the requirement for an audit in accordance with P.L. 104-156 and amendments.

i. The SCO will inform units of local government to submit copies of audit reports and corrective action plans, when warranted, prepared in accordance with P.L. 104-156 and amendments directly to the SCO.

j. The SCO will distribute copies of each audit report and corrective action plan to state entities affected by audit findings.

k. State entities will follow up on audit findings pertaining to federal programs, which they administer, and the SCO will follow up on general findings such as those relating to internal control.

l. The SCO will review and monitor the audit reports issued by external independent auditors. The SCO will determine whether or not the audit reports conform to *Government Auditing Standards*.

Condition

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 (SCO) notifies state agencies of those local governments that are required to submit an OMB Circular A-133 audit but have not done so. 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. Although the position was filled in October 2007, ADP did not initiate written or verbal contact with the two counties that had delinquent OMB Circular A-133 audits.

Additionally, ADP does not have any written policies or procedures in place regarding the OMB Circular A-133 requirement to issue management decisions. Further, ADP did not issue management decisions for the audit findings contained in the OMB Circular A-133 audits for two other counties. The staff in charge of this task stated that since a large number of reports have had to be resubmitted to the SCO, ADP elected to wait for the remaining reports to be submitted before issuing audit resolution letters for those counties with audit findings. However, the delays resulting from either the SCO or ADP prevent the State from complying with the OMB Circular A-133 six-month time period for issuing management decisions.

Questioned Costs

Not applicable.

Recommendations

ADP should ensure that staff follow up with counties that have not submitted their OMB Circular A-133 audits. ADP should also work closely with the SCO to ensure that it promptly receives those county OMB Circular A-133 audit reports that have audit findings. Finally, ADP should ensure that it issues management decisions on audit findings within six months after the SCO receives the counties' OMB Circular A-133 audit reports.

Department's View and Corrective Action Plan

ADP stated that the SCO is the Single Audit oversight agency for most California local governments. Because the SCO is ADP's first point of contact in the audit resolution process, it works closely with SCO with regard to OMB Circular A-133 audit submissions. For the audits completed for fiscal year 2006–07, and as explained to the Bureau of State Audits (BSA) auditors, the SCO rejected some audits and granted a number of audit extensions to counties. These actions extended the date for audit report submission into the beginning of calendar year 2009. All the OMB Circular A-133 audits identified as delinquent in the BSA's audit report were included in those either rejected or extended by the SCO. However, the SCO has provided a final list, and ADP has conducted necessary follow-up.

The SCO is planning to make some procedural changes for the audits completed for fiscal year 2007–08, which will allow ADP to follow-up with the counties timelier. ADP remains committed to working with the SCO in an effort to achieve a more efficient and timely process in meeting its OMB Circular A-133 audit requirements.

Auditor's Comments on Department's View

ADP's statement that the two OMB Circular A-133 audits identified as delinquent were rejected or extended by the SCO is incorrect. According to the information the BSA received from the SCO, as of March 18, 2009, these two subgrantees had not submitted their OMB Circular A-133 audit reports for fiscal year 2006–07.

Reference Number:	2008-13-23
Federal Catalog Number:	93.958
Federal Program Title:	Block Grants for Community Mental Health Services
Federal Award Numbers and Years:	2B09SM010005-07; 2007 06B1CACMHS-01; 2006 05B1CACMHS-01; 2005
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.

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133, *AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS* (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

In our prior-year audit, we reported that Mental Health used the incorrect Catalog of Federal Domestic Assistance (CFDA) title in its correspondence to the counties by referring to the grant as "Federal Substance Abuse and Mental Health Services Administration (SAMHSA) Block Grant." We also reported that Mental Health did not have procedures in place to follow up when counties had not submitted their annual OMB Circular A-133 audits to the State.

During our follow-up procedures for fiscal year 2007–08, we found that Mental Health had not addressed this finding. Specifically, it did not use the correct CFDA title in its correspondence to the counties. We also found that Mental Health continued to lack a procedure for following up with counties that have delinquent OMB Circular A-133 audits. According to staff in its Program Compliance Division, Mental Health has developed a procedure to enforce counties' compliance with the audit requirement that includes a template for the letter it will send to the counties when the State Controller's Office (SCO) indicates that it has not received the county's OMB Circular A-133 audit. Mental Health estimates that the template will be finalized approximately March 15, 2009. Mental Health stated that upon approval of the template, it would commence enforcement by communicating with the SCO on any outstanding issues that may require Mental Health's attention. Until Mental Health establishes procedures, it will be unable to identify and take appropriate corrective action against the counties that fail to comply with the OMB Circular A-133 audit requirements.

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 implement 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 stated it concurs that the CFDA title "Block Grants for Community Mental Health Services" had not been used in its correspondence with the counties. Mental Health will change all forms sent to the county to the correct title as recommended by the audit finding.

Mental Health also stated that it would implement procedures to follow up with counties that have not submitted their OMB Circular A-133 audits and take appropriate actions.

Reference Number:	2008-13-25
Federal Catalog Number:	93.556
Federal Program Title:	Promoting Safe and Stable Families (PSSF)

Federal Award Numbers and Years:	G-0811CAFPCV; 2008 G-0701CA00FP; 2007 G-0601CA00FP; 2006 G-0501CA00FP; 2005
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

In our prior-year audit, we reported that Social Services did not have processes and procedures to ensure that its noncounty subrecipients have met the OMB Circular A-133 audit requirements. Specifically, Social Services did 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.

During our follow-up procedures for fiscal year 2007–08, Social Services stated that staff in its Office of Child Abuse Prevention (OCAP) have identified all noncounty subrecipients and will include the OMB Circular A-133 audit requirement in its awards to them. Additionally, Social Services stated that its OCAP staff are working with its audit staff to draft processes and procedures to ensure that the audit requirements are met. Finally, according to the chief of OCAP, Social Services plans to have these processes and procedures in place in fiscal year 2008–09. However, as of November 2008, Social Services had yet to implement them. 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 implement the processes and procedures that it has proposed to collect and respond to noncounty subrecipients' OMB Circular A-133 audits, including processes and procedures to do the following:

(1) Ensure that all required subrecipients meet the audit requirement.

(2) Issue a management decision on audit findings within six months after receipt of the audit report.

(3) Ensure that the subrecipient takes appropriate and timely corrective action.

Department's View and Corrective Action Plan

Social Services stated that it concurs with this finding. Specific to the OMB Circular A-133 audit requirements addressed in this finding, the OCAP, in consultation with the Children and Family Services Division (CFSD) Foster Care Audits and Rates Branch, developed procedures to ensure that specified subrecipients meet the OMB Circular A-133 audit requirements and that CFSD staff follow up on any audit findings to ensure that appropriate and timely corrective action is taken.

Social Services also stated that although this finding was specific to the Promoting Safe and Stable Families program, in order to ensure compliance with all the federal requirements referenced in the Bureau of State Audits' (BSA) 2008 Federal Compliance Audit, its CFSD has incorporated language to reflect the specific requirements noted in various findings. Specifically, the CFSD has established procedures to ensure that OMB Circular A-133 audit requirements, suspension and debarment requirements, and the CFDA title and number requirements are addressed in all of its grants and contracts. These procedures also include a Grantee Certification Form that must be signed by the grant recipient and submitted as part of the grant award. See Attachment C (Checklist), Attachment D (Grantee Certification) and Attachment E (Revised Procedures). The attachments are available for review at the BSA.

Reference Number:	2008-13-26
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 Numbers and Years:	G-0802CATANF; 2008 G-0702CATANF; 2007

Federal Catalog Number:	93.658
Federal Program Title:	Foster Care—Title IV-E
Federal Award Numbers and Years:	0801CA1401; 2008 0701CA1401; 2007

Federal Catalog Number:	93.659
Federal Program Title:	Adoption Assistance
Federal Award Numbers and Years:	0801CA1407; 2008 0701CA1407; 2007

Federal Catalog Number:	93.566
Federal Program Title:	Refugee and Entrant Assistance—State Administered Programs (Refugee Program)

Federal Award Numbers and Years:	08AACA9100; 2008 07AACA9100; 2007

Federal Catalog Number:	93.556
Federal Program Title:	Promoting Safe and Stable Families (PSSF)
Federal Award Numbers and Years:	G-0801CAFPSS; 2008 G-0701CA00FP; 2007 G-0601CA00FP; 2006

Federal Catalog Number:	93.645
Federal Program Title:	Child Welfare Services—State Grants (CWS)
Federal Award Numbers and Years:	G-0801CA1400; 2008 G-0701CA1400; 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:

(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 the 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

Social Services did not identify federal award information, such as Catalog of Federal Domestic Assistance (CFDA) title and number, when issuing subawards to the counties for the programs listed above, excluding the Refugee Program. Although Social Services has periodic, ongoing correspondence with counties through the use of its fiscal letters that it uses to notify them of any issues related to administrative costs and other services, these letters were not used to notify counties receiving funds for the remaining five programs of the federal award information and relevant federal laws and regulations governing the programs. According to the chief of the Contracts and Financial Analysis Bureau, by the time the prior-year finding was brought to her attention, the county fiscal letters had already been released for these programs.

Additionally, Social Services does not send any notification to the counties regarding their subawards for the administrative expenses and the assistance payments they make to program beneficiaries. Instead, Social Services makes monthly cash advances to the counties and then requires the counties to submit administrative claims quarterly and assistance claims monthly. Although Social Services does not enter into a contract or similar agreement with the counties, it is clear that the State is granting subawards to the counties and is required to notify them of the federal award information and the relevant federal laws and regulations governing the programs.

Finally, during our follow-up procedures for the PSSF and Refugee programs, we found that Social Services did not provide all of the required federal award information in its contracts with its noncounty subrecipients. According to the chief of the Contracts and Financial Analysis Bureau, Social Services is working on a revised process to communicate award information to its noncounty subrecipients.

By not providing complete award information to its county and noncounty subrecipients, Social Services cannot be sure that its subrecipients are aware of and following all program requirements imposed on them.

Questioned Costs

Not applicable.

Recommendations

Social Services should amend its process for making subawards to the counties to include using either its annual fiscal letters or providing additional information with its single funding page crosswalk to notify the counties of the federal award information and relevant federal laws and regulations governing the programs.

Social Services should also continue its implementation of a process to communicate the federal award information and relevant federal laws and regulations governing the programs to its noncounty subrecipients.

Department's View and Corrective Action Plan

Social Services stated that it concurs with the finding. Social Services will correct this problem through the release of an annual county fiscal letter that will identify the general federal award information for the counties.

Social Services also stated it will work with the federal granting agency, the Administration for Children and Families, regarding the requirement to notify subrecipients of the federal award information and relevant federal laws and regulations that govern the grant award.

Reference Number:	2008-13-27
Federal Catalog Number:	93.658
Federal Program Title:	Foster Care—Title IV-E
Federal Award Numbers and Years:	0801CA1401; 2008 0701CA1401; 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:

(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.

Condition

Social Services did not adequately monitor the activities of its contractor. Specifically, in accordance with its state plan, Social Services contracts with the Judicial Council of California (Judicial Council), which evaluates the counties' juvenile court procedures and provides technical assistance to the counties' judges, commissioners, referees, and court staff. Additionally, the Judicial Council will participate in meetings with the counties' welfare and probation department staff to improve compliance with Title IV-E. As part of its evaluation, the Judicial Council reviews court files and makes recommendations to the counties.

However, Social Services did not follow up on the recommendations made by the Judicial Council to the counties. According to Social Services, its follow-up on Judicial Council findings would be determined by the severity of the error found. For example, Social Services considers clerical errors less critical than a missing court order. Further, Social Services stated it would consider whether an error was isolated or systemic. Although Social Services stated that it has a process in place for following up on errors found by the Judicial Council, it failed to provide us any evidence of its follow-up efforts. Further, Social Services was unable to provide any written policy or procedures regarding its follow-up activities. Social Services stated that it would assign a staff person to monitor the Judicial Council's contract and reports.

If Social Services does not follow up on errors identified by its contractor, it risks allowing county practices that are out of compliance with Title IV-E program eligibility requirements to continue.

Questioned Costs

Not applicable.

Recommendation

Social Services should establish a process to ensure that it follows up with the counties on the recommendations made by the Judicial Council. The process should include written policies and procedures that dictate those recommendations that require follow-up.

Department's View and Corrective Action Plan

Social Services stated that it concurs with this finding. The Foster Care Audits and Rates Branch (FCARB) is responsible for the Judicial Review and Technical Assistance Program (JRTA) contract and receives the reports from the Administrative Office of the Courts (AOC) for review. FCARB will assign staff in the Funding and Eligibility Unit to review the recommendations submitted in the AOC reports. The appropriate child welfare agency will be contacted via a template letter that identifies the AOC recommendations and advise the county that the Funding and Eligibility Unit is available for technical assistance in addition to the technical assistance provided by JRTA. The FCARB has developed procedures for this activity and a template letter identifying JRTA recommendations. See Attachment A (County Director Letter) and Attachment B (Proposed CDSS Protocol). The attachments are available for review at the Bureau of State Audits.

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
Federal Award Number and Year:	G-0802CATANF; 2008

Federal Catalog Number:	93.658
Federal Program Title:	Foster Care—Title IV-E
Federal Award Numbers and Years:	0801CA1401; 2008 0701CA1401; 2007

Federal Catalog Number:	93.659
Federal Program Title:	Adoption Assistance
Federal Award Numbers and Years:	0801CA1407; 2008 0701CA1407; 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:

(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 action.

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133, *AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS* (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.

STATE ADMINISTRATIVE MANUAL, Section 20070—Federal Pass-Through Funds

The OMB Circular A-133, Subpart D describes the responsibilities of federal agencies and pass-through entities. Specifically, Section .400(d) prescribes the responsibilities of a pass-through entity for the federal awards it makes.

To ensure that the State of California carries out its responsibilities in accordance with this federal act, the following procedures shall apply:

2. The SCO will coordinate single audit compliance with local governments.

   a. Each state entity will monitor the federal funds it disburses to local governments to ensure compliance with federal laws and regulations. State entities will receive local government audit reports performed in accordance with the Single Audit Act of 1984, P.L. 98-502, and the Single Audit Act Amendments of 1996, P.L. 104-156 from the SCO when the audit report includes a schedule of findings and questioned costs with respect to federal funds that were passed through state entities. In addition, the SCO will distribute the single audit reports to state entities when the prior fiscal year's single audit report included audit findings related to federal funds. The state entity will review these reports and evaluate the corrective action plans submitted in response to findings of noncompliance.

   b. All contracts or agreements issued by state entities concerning disbursement of federal funds to local governments will include the requirement for an audit in accordance with P.L. 104-156 and amendments.

   c. The SCO will inform units of local government to submit copies of audit reports and corrective action plans, when warranted, prepared in accordance with P.L. 104-156 and amendments directly to the SCO.

   d. The SCO will distribute copies of each audit report and corrective action plan to state entities affected by audit findings.

   e. State entities will follow up on audit findings pertaining to federal programs, which they administer, and the SCO will follow up on general findings such as those relating to internal control.

   f. The SCO will review and monitor the audit reports issued by external independent auditors. The SCO will determine whether or not the audit reports conform to *Government Auditing Standards*.

Condition

Social Services lacks adequate policies and procedures to ensure that it issues management decisions on audit findings within six months after the State receives the counties' OMB Circular A-133 audit reports. As of September 18, 2008, the State Controller's Office (SCO) had received fiscal year 2006–07 OMB Circular A-133 audit reports for 55 of the 58 counties. However, as of November 21, 2008, it had only provided Social Services with the OMB Circular A-133 audit reports for 22 counties. Five of the 22 reports contained audit findings for the programs listed that required Social Services to issue management decisions. Also, 13 audit findings related to either the counties' lack of internal controls or noncompliance with requirements such as activities allowed/allowable costs, eligibility, and reporting. Yet Social Services did not issue a management decision for any of these findings. Moreover, Social Services was unaware of six of the 13 findings because it determined incorrectly that two of the five audit reports did not have any findings for programs it administers.

Additionally, we found that it took the SCO between 37 and 311 days to send the 22 reports to Social Services. These delays and the SCO's delay in forwarding the remaining 33 reports to Social Services appear to be due to the process it uses to certify the audits. Finally, we found that Social Services did not take any action, including imposing sanctions, for two of the three counties that continue to either be unwilling or unable to have an audit conducted and submitted to the SCO in a timely manner in accordance with OMB Circular A-133. In June and September 2008, the SCO provided all state agencies a list of local governments with delinquent 2006–07 fiscal year OMB Circular A-133 audit reports. However, in both cases, Social Services did not take any action to encourage or force these counties to submit their delinquent audit reports to the SCO.

By not issuing management decisions and not following up on delinquent reports, Social Services has no assurance that counties are addressing the audit findings in a timely and appropriate manner.

Questioned Costs

Unknown

Recommendations

Social Services should establish policies and procedures to ensure that it issues management decisions for audit findings contained in the counties' OMB Circular A-133 audit reports within the required six-month time period. Social Services should also improve the process it uses to determine whether management decisions are warranted so that no findings are omitted. Further, Social Services should work with the SCO to obtain each county's OMB Circular A-133 audit report as soon as possible after the SCO receives the reports. Finally, Social Services should establish policies and procedures, such as sanctions to be taken, to address instances when counties continue to either be unwilling or unable to have an audit conducted in accordance with OMB Circular A-133 and submitted to the SCO in a timely manner.

Department's View and Corrective Action Plan

Social Services stated that it concurs with this finding. Social Services also stated that by the end of calendar year 2009, it will establish policies and procedures to ensure achievement of the OMB Circular A-133 requirements. Additionally, to achieve OMB Circular A-133 requirements, Social Services will discuss and develop a memorandum of understanding with the SCO documenting changes to policies and procedures.

Reference Number:	2008-13-29
Federal Catalog Number:	93.659
Federal Program Title:	Adoption Assistance
Federal Award Numbers and Years:	0801CA1407; 2008 0701CA1407; 2007
Category of Finding:	Subrecipient Monitoring
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 92.40—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

Social Services lacks formal processes to ensure it fulfills its pass-through responsibility to monitor the counties during the award period. For example, Social Services does not perform monitoring procedures such as on-site visits or desk reviews of the counties' activities to ensure they are administering the program in compliance with federal laws and regulations. Although Social Services provides technical assistance to the counties by answering questions regarding eligibility determinations and attending quarterly meetings with some of them, these efforts are not sufficient to ensure their compliance with all applicable federal laws and regulations.

According to the manager of its Adoptions Services Bureau, Social Services did not have sufficient resources available to perform monitoring procedures during fiscal year 2007–08. However, if Social Services does not monitor the counties, it has no assurance that they are always making correct eligibility determinations and complying with other requirements applicable to the program.

Questioned Costs

Not applicable.

Recommendation

Social Services should establish policies and procedures for monitoring the counties during the award period to ensure that they are complying with applicable laws, regulations, and the provisions of contracts or grant agreements.

Department's View and Corrective Action Plan

Social Services stated that it concurs with this finding. Within the Outcomes and Accountability Bureau (OAB), two outcomes and accountability units partner with counties to implement and monitor the California Outcomes and Accountability System as mandated by the Child Welfare System Improvement and Accountability Act of 2001 (AB 636 [Steinberg], Chapter 678, Statutes of 2001). The units provide oversight and technical assistance to California's 58 counties as county child welfare and probation agencies improve outcomes for children and families. These units measure, track, monitor, and collaborate with counties on an ongoing basis and provide focused attention and technical assistance during each component of the continuous improvement process: Quarterly Data Reports, Peer Quality Case Reviews, County Self-Assessments, and County System Improvement Plans. AB 636 (WIC 10601.2) suspended Social Service's formal Child Welfare Compliance Reviews to enable those resources to implement and oversee the State's Outcomes and Accountability System.

Although Social Services does not have a singularly focused Adoption Assistance Program (AAP) monitoring function in place, it does utilize the State (AB 636) outcomes and accountability process to help focus counties on important safety, permanency, and well-being areas as they develop their triennial System Improvement Plans. Adoption is an important permanency goal for eligible children, and as such, counties often include related strategies as part of their improvement plans.

Social Services also relies on OMB Circular A-133 Single Audit Reports for each county and when AAP issues are discovered by those audits, state AAP analysts coordinate with Social Services' Internal Audits Office and offending counties to develop and monitor corrective actions.

Auditor's Comments on Department's View

Social Services stated it concurs with the Bureau of State Audits' finding; however, its corrective action plan implies that it has been and continues to monitor the counties during the award period to ensure that they are complying with applicable laws, regulations, and the provisions of contracts or grant agreements. Thus, Social Services' characterization of its efforts to monitor the counties requires clarification.

The state law establishing the California Outcomes and Accountability System (COAS) states, "child and family service reviews shall maximize compliance with the federal regulations for the receipt of money from Subtitle E (commencing with Section 470) of Title IV of the federal Social Security Act (42 U.S.C. Section 670 and following) and ensure compliance with the state plan requirements set forth in Subtitle B (commencing with Section 421) of Title IV of the federal Social Security Act (42. U.S.C. Section 621 and following)." However, as Social Services indicated, the COAS focuses primarily on measuring outcomes for safety, permanence, and child and family well-being.

Although the focus of the COAS is critical for California's child welfare system, it does not address other important aspects of Social Services' responsibility for administering the day-to-day operations of the program in accordance with federal requirements, such as ensuring the counties are only spending federal funds on allowable costs and activities or ensuring they make correct eligibility determinations.

Furthermore, as indicated in finding number 2008-13-28, Social Services lacks adequate policies and procedures to ensure it issues management decisions on audit findings in the counties' OMB Circular A-133 audit reports and does not follow up on delinquent reports. Finally, these audits do not relieve Social Services of its responsibility for performing subrecipient monitoring procedures during the award period to ensure the counties are complying with federal laws and regulations.

Reference Number:	2008-14-1
Federal Catalog Number:	93.053
Federal Program Title:	Nutrition Services Incentive Program (NSIP)
Federal Award Number and Year:	08AACANSIP; 2008
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. Specifically, although its policy states that NSIP funding to subrecipients is based on the number of meals they served in the prior year in proportion to the number of meals served statewide, during fiscal year 2007–08 Aging lacked procedures to ensure staff follow the policy. Further the draft procedures Aging gave us in August 2008 do not require supervisory review and approval of the analyst's calculation of the allocation. The lack of adequate procedures hinders Aging's ability to prevent errors or to detect early any errors that may exist in the allocation.

Aging's draft procedures direct analysts to use meal counts in the most recently documented year. According to Aging, in practice, these are the meal counts most recently certified as accurate by the United States Department of Health and Human Services' Administration on Aging and reported for the prior-prior state fiscal year for the next year's allocation. For example, meal counts certified as accurate for fiscal year 2006–07 are used to calculate the fiscal year 2009–10 allocation. By contrast, Aging's policy issued to its subrecipients specifies the use of meal counts from the prior year. This is inconsistent. For example, in reviewing its calculation of the allocation for fiscal year 2007–08, we found that the analyst used meal counts from fiscal year 2004–05 instead of those from the prior year, fiscal year 2006–07, in accordance with its policy. According to the manager of Aging's Fiscal and Contracts Team, the fiscal year 2004–05 meal counts were the most recently finalized meal counts available at the time the fiscal year 2007–08 allocation was prepared. Our analysis found that Aging's departure from the policy issued to its subrecipients results in discrepancies in the amounts they would have received. Specifically, we found that the total NSIP allocation for one of the three subrecipients we tested was 10 percent lower than the allocation would have been if Aging had used total meal counts from fiscal year 2006–07, while the allocation for another subrecipient was almost 14 percent higher.

Questioned Costs

Not applicable.

Recommendations

Aging should establish procedures for handling cash received in lieu of commodities for the NSIP to ensure that it distributes the funds equitably. Specifically, these procedures should incorporate a supervisory review and approval process.

Aging should revise the policy issued to its subrecipients to reflect the actual methodology it uses to determine NSIP funding allocations.

Department's View and Corrective Action Plan

Aging stated that its procedures have been updated to be consistent with its current methodology and to avoid potential confusion and error. Aging assures the Bureau of State Audits that the procedures include the requirement for two levels of supervisory review and approval, including double-checking all calculations and supporting documentation. Aging stated that it will also issue a policy memo update to its subrecipients to remind them of its policy and procedures.

Reference Number:	2008-14-9
Federal Catalog Number:	93.563
Federal Program Title:	Child Support Enforcement (CSE)

Federal Award Numbers and Years:	0804CA4004; 2008 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 did not adequately fulfill its responsibility to respond to interstate case requests and status review requests within the time required. Specifically, our review of 23 interstate cases found that Child Support Services' responses for 17 cases were made between 14 and 86 working days after receipt instead of the 10 working days required. We found no record that Child Support Services responded at all for an additional three cases, and it could not locate another sample item. Further, our review of 23 status requests found that Child Support Services' responses for seven requests took between six and 17 days, instead of the five days required. For six additional requests, we found no record that Child Support Services responded to the requesting state, and for two other requests, we could not determine compliance because Child Support Services could not locate the sample items.

We identified several control weaknesses hindering Child Support Services' compliance with these requirements. Specifically, it failed to update or follow its procedures for maintaining case and status request documentation. In response to a similar finding we issued for fiscal year 2006–07, Child Support Services reported that, as of May 2007, it had instituted procedures to file copies of documentation sent and received as part of each status request. However, Child Support Services rescinded these documentation requirements in September 2007 after determining that electronic data constituted sufficient evidence. According to Child Support Services, it reinstated the documentation requirements in May 2008 after an internal audit. However, we observed that specific documentation requirements were absent from current status request procedures, and Child Support Services was unable to provide complete hard copy documentation for any of the 23 status requests that we reviewed.

According to Child Support Services, status request procedures were not formally updated due to other higher-priority activities. Further, although its procedures require that documentation be kept for all interstate cases, Child Support Services had not maintained supporting documentation for six of the 23 sample cases we reviewed. By not regularly updating its procedures, Child Support Services elevates the risk that staff responsible for performing critical tasks will not perform them correctly. Further, without maintaining hard-copy documentation indicating activities performed, Child Support Services cannot document that it is appropriately responding to all case and status requests. This is particularly critical given that Child Support Services has recently transitioned to a new, statewide case and financial management system (new system). According to the department, this transition has put a strain on its ability to remain in compliance.

In addition, Child Support Services has not ensured that it acts upon all case requests or that it notifies initiating jurisdictions when it rejects electronically submitted cases. Specifically, states sometimes submit case requests to Child Support Services electronically through a federal data system. According to Child Support Services, 548 electronically submitted case requests were mistakenly rejected by the new system during our audit period even though they had been approved by the federal data system. Further, Child Support Services explained that it did not act on any of these 548 requests and that the initiating states that submitted the requests were not informed that their cases had been rejected. As of February 2009 Child Support Services expected to shortly implement a change to its software that would ensure that all electronically submitted cases that are approved by the federal data system be appropriately processed by the new system.

Child Support Services also does not have ready access to critical data regarding its activities and workload. Specifically, it could not readily provide us with an accurate range of case numbers entered into the new system over our audit period, nor could staff readily explain to us why one of our sample cases could not be located within the new system. To effectively monitor compliance, it is critical that Child Support Services develop efficient methods of extracting data concerning its activities from the new system. In addition, we observed that Child Support Services does not effectively monitor its own compliance with status request response requirements. Although Child Support Services maintains spreadsheets that it regularly monitors tracking whether it responds to interstate cases within the required 10 days, it does not effectively track whether it responds to status requests within the required five days. Without regularly monitoring compliance, Child Support Services is unable to accurately measure its progress toward meeting federal response requirements.

Further, Child Support Services has weak procedures for recording status request activities within the new system, and staff are not consistently following these procedures. Specifically, Child Support Services' procedures require staff to record all activities taking place on a status request, such as the receipt of a request or a county's response, within the new system. Staff are to manually record these activities in sentence form, following a format included as part of the procedures. Our review of 23 status requests revealed that department staff frequently did not follow this format. They instead used a variety of different written responses to record performed activities, and in some cases did not include critical information, such as the date when an activity took place. The use of manually typed activity logs invites inconsistency in data entry and does not allow Child Support Services to easily collect and analyze this data. Further, by not ensuring that staff are following the provided format, Child Support Services risks being unable to document that it is in compliance with response requirements.

Finally, controls implemented by Child Support Services did not sufficiently ensure that counties fulfilled their responsibilities to process case requests. Specifically, if a county had not yet transitioned to the new system in fiscal year 2007–08, Child Support Services delegated responsibility to the county to open the case, which would trigger the notification to the initiating jurisdiction. According to its procedures, Child Support Services was responsible for calling the assigned county for each case that remained unopened within seven days of it being forwarded. However, due to the large number of unopened cases, and to competing demands on staff time, Child Support Services did not find this process to be feasible. As a result, it instituted additional changes to encourage counties to open these cases. Nonetheless, initiating jurisdictions did not receive notifications for three of the 23 cases we reviewed. For all three cases, counties were responsible for opening the cases and triggering the

notifications. Delegating responsibility for response activities to counties does not absolve the State from its need to ensure that notifications are completed. Without instituting procedures ensuring that all counties open cases promptly, Child Support Services risks that initiating jurisdictions will not receive responses within the 10 days required. However, because all counties had transitioned to the new system by November 2008 and Child Support Services is now responsible for responding to initiating jurisdictions, this control weakness exists only for fiscal year 2007–08 and the first part of fiscal year 2008–09. Thus, no corrective action is necessary for this obsolete process.

Questioned Costs

Not applicable.

Recommendations

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 and status requests within the required time periods. Specifically, it should regularly review internal procedures for processing case and status requests to ensure that they are up to date and include key controls, including specific documentation requirements. It should also monitor staff to make sure that they consistently follow these procedures. Child Support Services should also make sure that all electronically submitted case requests are appropriately processed within the new system. In addition, it should work to ensure that information critical to monitoring compliance is readily available and ensure that management regularly reviews data on compliance with status request response requirements. Further, Child Support Services should ensure that staff consistently follow the prescribed format for recording status request activities. In addition, it should determine if it is cost-effective to change how it records this information in the new system to standardize and simplify its process.

Department's View and Corrective Action Plan

The automated performance reports through the CSE system are being developed to monitor the status request and case opening process. California Central Registry (CCR) management developed new manual management reports that include more statistical information to assist in a comprehensive first and second level monitoring of functions. This, along with quality assurance procedures, will identify risks regarding compliance time frames and enable the program to take timely, appropriate, and effective actions that will mitigate the risks identified.

Program procedures for both the status request and case opening processes have been updated to provide required language for activity log comments, document retention, and required date stamps. Our procedure updates are completed by staff, reviewed by management, and saved to a common drive available to all CCR staff. These procedures are saved with the revised date as part of the naming convention to enable staff to identify and access the most current procedures while maintaining a history of the procedure documents. As procedures are updated, copies are distributed to staff via structured meetings to communicate the changes and assure staff's comprehension and adoption of new procedures. If a staff member is not available for a meeting, the supervisor will meet with him or her separately to discuss the updated procedures and ensure understanding.

With the implementation of first and second level management review, management will regularly review work and ascertain consistency and completion in accordance with the program's procedures. Our management review process will evaluate hard-copy documents in files and on electronic spreadsheets, validating the information against information contained in our CSE system to ensure compliance with procedures and accuracy of data.

Reference Number:	2008-14-10
Federal Catalog Number:	93.958
Federal Program Title:	Block Grants for Community Mental Health Services
Federal Award Number and Year:	2B09SM010005-07; 2007
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 SERVICES, 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

In our prior-year audit, we reported that Mental Health did not facilitate peer reviews. Mental Health had facilitated peer reviews in the past in conjunction with its site reviews but phased them out in 2004 after a departmental reorganization.

During our follow-up procedures for fiscal year 2007–08, we found that Mental Health continued to not facilitate peer reviews. According to its program staff, although Mental Health planned to resume peer reviews, it experienced another departmental reorganization, and no further action has been taken. Mental Health has yet to establish a date for resuming peer reviews. The lack of peer reviews further diminishes Mental Health's oversight of the programs offered by counties using the block grants for Community Health Services 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

Mental Health stated it would seek guidance from the federal Center for Mental Health Services prior to developing options for meeting all applicable grant requirements.

Reference Number:	2008-14-11
Federal Catalog Number:	93.659
Federal Program Title:	Adoption Assistance
Federal Award Numbers and Years:	0801CA1407; 2008 0701CA1407; 2007
Category of Finding:	Special Tests and Provisions
State Administering Department:	Department of Social Services (Social Services)

Criteria

TITLE 45—PUBLIC WELFARE, PART 1355—GENERAL, Section 1355.21—State Plan Requirements for Titles IV-E and IV-B

(b) The State plans for titles IV-E and IV-B must provide for compliance with the Department's regulations listed in 45 CFR 1355.30.

Condition

While obtaining an understanding of internal controls, we noted that Social Services does not have controls in place to ensure that state laws, regulations, and policies and procedures are regularly updated to align with federal rules and regulations. Specifically, in May 2008, the U.S. Department of Health and Human Services (Health and Human Services) notified Social Services that its review of the state plan raised concerns that the State is not in compliance with a number of federal program requirements.

Health and Human Services pointed out that the State plan makes several references to state laws, regulations, and policies and procedures that either conflict with, omit, or are more restrictive than federal requirements. For example, California's regulations conflict with federal requirements regarding children who meet the Supplemental Security Income (SSI) pathway to adoption assistance eligibility. Because state regulations do not clearly indicate that an SSI-eligible child does not need to be subject to an agency adoption, it is possible that several children were subject to an agency adoption when an independent adoption would have sufficed. Additionally, Social Services' manual of policies and procedures outlines adoption assistance eligibility criteria for children of minor parents that are more restrictive than the federal requirements contained in the Social Security Act. Because the state's policies are more restrictive, it is possible that families meeting these criteria may have inappropriately been denied adoption assistance payments.

Due to these instances of noncompliance with federal requirements, Health and Human Services required Social Services to develop a program improvement plan that outlines the steps and the associated time frames for bringing the State into compliance with federal requirements. Social Services submitted its proposed program improvement plan to the department in December 2008, which indicates that Social Services plans to bring the State into full compliance by September 2010.

Questioned Costs

Not applicable.

Recommendations

Social Services should develop internal controls to ensure that state laws, regulations, and its policies and procedures are regularly updated to align with federal laws and regulations. Additionally, Social Services should continue to implement its program improvement plan in accordance with the specified time frames approved by Health and Human Services.

Department's View and Corrective Action Plan

Social Services stated that it concurs with this finding. In response to several concerns raised by Health and Human Services' Administration for Children and Families, regarding areas of noncompliance with federal Adoption Assistance Program (AAP) requirements, the Adoptions Services Bureau (Adoptions Services) submitted a Program Improvement Plan on December 23, 2008, for Health and Human Services' approval. The plan addresses implementing necessary legislative and regulatory changes and training to bring the State into compliance with the Title IV-E AAP. This involves not only revising the State's Welfare and Institutions Code and Family Code statutes, but also the State's regulations, forms, and procedures to align with federal AAP regulations. Adoptions Services is awaiting federal approval of this plan.

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Reference Number:	2008-1-14
Federal Catalog Number:	14.228
Federal Program Title:	Community Development Block Grants/State's Program (CDBG)
Federal Award Number and Year:	B-07-DC-06-0001; 2007
Category of Finding:	Activities Allowed/Allowable Costs; Subrecipient Monitoring
State Administering Department:	Department of Housing and Community Development (Housing)

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:

(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 24—HOUSING AND URBAN DEVELOPMENT, PART 570—COMMUNITY DEVELOPMENT BLOCK GRANTS, Subpart I—State Community Development Block Grant Program, Section 570.492—State's Reviews and Audits

(a) The state shall make reviews and audits including on-site reviews, of units of general local government as may be necessary or appropriate to meet the requirements of section 104(e)(2) of the Act.

Condition

Housing's process for reviewing subrecipient fund requests does not provide reasonable assurance that its subrecipients' expenditures are only for allowable activities and costs.

According to the CDBG program manager, Housing does not require subrecipients to submit supporting documentation that would allow CDBG program staff to verify the eligibility of expenditures contained in the fund requests. Consequently, program staff must rely on site visits to verify the eligibility of subrecipient expenditures. The CDBG program manager told us that the program is now working to improve its control process to address this issue. According to the program manager, Housing is in the process of implementing a requirement that grantees submit signature cards, so program staff can verify that an authorized individual signed the funds requests. Housing is also in the process of implementing a summary of expenditures form, which will require subrecipients to submit supporting documentation with their fund requests.

The CDBG program manager also stated that on-site monitoring review was the only way to ensure that program funds were spent in a timely manner and for the appropriate purposes. However, our review of CDBG grant information for 35 of its subrecipients found that CDBG did not consistently follow its process regarding subrecipient on-site monitoring reviews. Specifically, based on our review, 22 of the 35 grants we tested were not adequately monitored via a risk assessment or a site visit.

For 12 of the grants, CDBG did not perform a site visit, and the grant either had a risk assessment score that was above the program's threshold for requiring a site visit or the program did not perform a risk assessment. For another of the grants, although CDBG staff performed an initial site visit, the subrecipient's records were incomplete; the program informed the subrecipient that it would visit a second time, which it did not do. Finally, the CDBG program has a goal of performing a site visit of all CDBG economic development grants before they are completed. However, the CDBG program did not perform site visits for nine of the 10 grants we reviewed that were due to be completed on or before June 30, 2008. According to the CDBG program manager, the CDBG program is developing a comprehensive monitoring plan that will include, among other things, monitoring objectives, strategies, risk assessment steps, and steps for on-site visits.

Until Housing establishes stronger processes and procedures for its CDBG program, it has no way of knowing whether its subrecipients are charging unallowable costs and activities to the program.

Questioned Costs

Unknown

Recommendations

Housing should improve its control processes over subrecipient fund requests in its CDBG program, including putting into place a system to obtain documentation such as invoices to support subrecipient fund requests, and requiring subrecipient signature cards to help in reviewing fund requests to increase assurance that subrecipient funds are spent for the appropriate purposes.

With respect to subrecipient monitoring, Housing should adhere to its written policies and procedures to identify subrecipients at high risk of noncompliance with program requirements and follow through with site visits of those subrecipients to ensure they comply with program requirements.

Department's View and Corrective Action Plan

Housing has taken the steps cited by the Bureau of State Audits to improve its control processes over subrecipient fund requests. Specifically, Housing has implemented a requirement that subrecipients provide source documentation (for example, a summary of expenditures, invoices, or cost allocation plans) when requesting grant funds. In addition, Housing requires subrecipients to submit signature cards that authorize which officials may sign funds requests before submitting them to the State of California.

Furthermore, Housing will adhere to its monitoring policies and procedures to identify subrecipients at high risk of noncompliance with program requirements by performing the following steps:

1. Annually adopting the monitoring plan (by May 2009 for fiscal year 2009–10).
2. Training its staff to conduct risk assessments and on-site visits of the high-risk grantees (by September 2009 for fiscal year 2009–10).
3. Developing a three-month schedule of on-site visits based on the availability of resources (by November 2009 for fiscal year 2009–10).
4. Supplementing the on-site visits with additional monitoring techniques, such as desk monitoring (by November 2009 for fiscal year 2009–10).

Reference Number:	2008-7-15
Federal Catalog Number:	14.228

Federal Program Title:	Community Development Block Grants/State's Program (CDBG)
Federal Award Number and Year:	B-07-DC-06-0001; 2007
Category of Finding:	Earmarking
State Administering Department:	Department of Housing and Community Development (Housing)

Criteria

TITLE 24—HOUSING AND URBAN DEVELOPMENT, PART 570—COMMUNITY DEVELOPMENT BLOCK GRANTS, Subpart I—State Community Development Block Grant Program, Section 570.484—Overall Benefit to Low and Moderate Income Persons

(a) General. The State must certify that, in the aggregate, not less than 70 percent of the CDBG funds received by the state during a period specified by the state, not to exceed three years, will be used for activities that benefit persons of low and moderate income. The period selected and certified to by the state shall be designated by fiscal year of annual grants, and shall be for one, two or three consecutive annual grants. The period shall be in effect until all included funds are expended. No CDBG funds may be included in more than one period selected, and all CDBG funds received must be included in a selected period.

(b) Computation of 70 percent benefit. Determination that a state has carried out its certification under paragraph (a) of this section requires evidence that not less than 70 percent of the aggregate of the designated annual grant(s), any funds reallocated by the U.S. Department of Housing and Urban Development (HUD) to the state, any distributed program income and any guaranteed loan funds under the provisions of subpart M of this part covered in the method of distribution in the final statement or statements for the designated annual grant year or years have been expended for activities meeting criteria as provided in section 570.483(b) for activities benefiting low and moderate income persons (national objective).

Condition

In October 2007, during the fiscal year that we audited, HUD issued a program monitoring review of Housing's CDBG program. In its review, HUD identified a finding regarding the documentation of the national objective. HUD noted that, in accordance with the CDBG program's record-keeping requirements, Housing's records must document the specific national objective criteria met by each activity. HUD found that although Housing documents its application reviews, the review sheets used in that process do not specifically identify the statutory requirement met by each activity. Further, HUD's review found that although Housing does require recipients to include how they will meet the national objective criteria in their applications, it does not require a further breakdown of the national objective criteria into low and moderate limited clientele, low and moderate housing, low and moderate area, or low and moderate jobs. Additionally, HUD found that Housing was inconsistent in including census data for individual activities and included no supporting documentation was present in project files to outline the service area of activities assisting low-income persons on an area-wide basis. Due to the lack of documentation, HUD could not determine if all of the activities were serving low- and moderate-income persons as intended.

Our evaluation of Housing's internal controls over compliance with the national objective requirement resulted in a similar finding to HUD's. For 13 of the 16 approved CDBG program applications we reviewed, Housing did not have adequate documentation to demonstrate that it had reviewed the projects to ensure that they met the national objective. In each of the 13 applications, we found that the applicant submitted documentation pertaining to the national objective requirement. For one of the 13, Housing could not provide evidence that it had reviewed the applicant's documentation before it awarded the CDBG funding. For the remaining 12 applications, although Housing completed a review sheet, the review sheets used did not sufficiently demonstrate how Housing determined that the

applicants met the national objective before it awarded CDBG funding. Because of the lack of evidence of its review, Housing could not sufficiently demonstrate that the activities included in the applications were serving low- and moderate-income persons as intended.

According to a CDBG program manager at Housing, as of the 2008 funding cycle, Housing has implemented a more comprehensive application review sheet that requires the reviewer to thoroughly verify that the national objective has been met.

Questioned Costs

Unknown

Recommendation

Housing should implement the corrective action plan for documenting the national objective as directed by HUD.

Department's View and Corrective Action Plan

As noted in the finding, Housing implemented a comprehensive application review sheet during the 2008 funding cycle. As part of this implementation, Housing revised the activity review sheet, which the program staff use to document that the activity is eligible and meets the CDBG national objective. Housing conducts this review for eligibility and documentation of the CDBG national objective as part of the threshold review it performs when it receives the application for funding.

Reference Number:	2008-7-16
Federal Catalog Number:	14.228
Federal Program Title:	Community Development Block Grants/State's Program (CDBG)
Federal Award Number and Year:	B-07-DC-06-0001; 2007
Category of Finding:	Earmarking (Public Services)
State Administering Department:	Department of Housing and Community Development (Housing)

Criteria

TITLE 42—THE PUBLIC HEALTH AND WELFARE, CHAPTER 69—COMMUNITY DEVELOPMENT, Section 5305—Activities Eligible for Assistance

(a) Enumeration of eligible activities

(8) provision of public services, including but not limited to those concerned with employment, crime prevention, child care, health, drug abuse, education, energy conservation, welfare or recreation needs, if such services have not been provided by the unit of general local government (through funds raised by such unit, or received by such unit from the State in which it is located) during any part of the twelve-month

period immediately preceding the date of submission of the statement with respect to which funds are to be made available under this chapter, and which are to be used for such services, unless the Secretary finds that the discontinuation of such services was the result of events not within the control of the unit of general local government, except that not more than 15 per centum of the amount of any assistance to a unit of general local government . . . under this chapter including program income may be used for activities under this paragraph unless such unit of general local government used more than 15 percent of the assistance received under this chapter for fiscal year 1982 or fiscal year 1983 for such activities (excluding any assistance received pursuant to Public Law 98-8), in which case such unit of general local government may use not more than the percentage or amount of such assistance used for such activities for such fiscal year, whichever method of calculation yields the higher amount.

TITLE 24—HOUSING AND URBAN DEVELOPMENT, PART 570—COMMUNITY DEVELOPMENT BLOCK GRANTS, Subpart I—State Community Development Block Grant Program, Section 570.490—Recordkeeping Requirements

(a) State records. (1) The state shall establish and maintain such records as may be necessary to facilitate review and audit by the U.S. Department of Housing and Urban Development (HUD) of the state's administration of CDBG funds under section 570.493. The content of records maintained by the state shall be as jointly agreed upon by HUD and the states and sufficient to enable HUD to make the determinations described at section 570.493. For fair housing and equal opportunity purposes, and as applicable, such records shall include data on the racial, ethnic, and gender characteristics of persons who are applicants for, participants in, or beneficiaries of the program. The records shall also permit audit of the states in accordance with the Code of Federal Regulations, Title 24, Part 85.

Condition

Housing could not provide sufficient supporting documentation to demonstrate that it did not allocate more than 15 percent of its 2007 CDBG award for the provision of public services. A CDBG program manager at Housing (program manager) asserted that Housing calculated the maximum public services allocation after it developed a preliminary funding list. She stated that Housing ensures it does not exceed the 15 percent cap (public services cap) by applying a 15 percent cap to the awards made by Housing to local governments under the general allocation component.

However, Housing did not separately track the dollar value of public services associated with local government contracts that it approved for funding from its 2007 CDBG award. One of the spreadsheets that Housing provided as evidence that it complied with the public services cap appeared to be its preliminary funding list, but it included applications that were not approved for funds from the 2007 CDBG award. Additionally, this spreadsheet did not identify the contract numbers and dollar value of public services for contracts that Housing had approved; therefore we could not use the spreadsheet to verify the public services dollar amounts that Housing awarded. Another spreadsheet Housing provided to support that it complied with the public services cap did not identify the dollar amount it awarded for any public services activity components and it did not identify a contract number. Without documentation of the specific contracts and amounts funded from the 2007 CDBG award that Housing used to support its adherence to the public services cap, we were unable to verify whether Housing met this requirement.

Questioned Costs

Unknown

Recommendations

Housing's CDBG staff should continue to document public services funds requested as they review applications for funding. After the applications are approved and contracts are awarded, however, Housing should document the amount of public services allocations to ensure that the amount does not exceed the cap.

Department's View and Corrective Action Plan

Housing's CDBG staff will continue to document public services funds requested when reviewing applications. In addition, beginning with fiscal year 2009–10, CDBG staff will develop a more comprehensive tracking system to ensure that the allocations do not exceed the 15 percent cap. Specifically, CDBG staff will perform the following:

- Continue to use the preliminary funding list to determine the proposed amount to be expended on public services.
- Establish the maximum allowable to be expended on public services and insert formulas in the tracking sheets to signal if the maximum amount has been exceeded.
- After contract execution, complete the tracking sheets with contract numbers.
- Regularly monitor that the cap is not exceeded by additional awards and maintain a record of all monitoring activity.

Reference Number:	2008-7-17
Federal Catalog Number:	14.239
Federal Program Title:	HOME Investment Partnerships Program (HOME Program)
Federal Award Number and Year:	M06-SG-06-0100; 2006
Category of Finding:	Matching
State Administering Department:	Department of Housing and Community Development (Housing)

Criteria

TITLE 24—HOUSING AND URBAN DEVELOPMENT, PART 92—HOME INVESTMENT PARTNERSHIPS PROGRAM, Subpart E—Program Requirements, Section 92.218—Amount of Matching Contribution

a) General. Each participating jurisdiction must make contributions to housing that qualifies as affordable housing under the HOME Program, throughout a fiscal year. The contributions must total not less than 25 percent of the funds drawn from the jurisdiction's HOME Investment Trust Fund Treasury account in that fiscal year, excluding funds drawn for purposes identified in paragraph (c) of this section.

TITLE 24—HOUSING AND URBAN DEVELOPMENT, PART 92—HOME INVESTMENT PARTNERSHIPS PROGRAM, Subpart K—Program Administration, Section 92.508—Recordkeeping

(a) General. Each participating jurisdiction must establish and maintain sufficient records to enable the U.S Department of Housing and Urban Development (HUD) to determine whether the participating jurisdiction has met the requirements of this part. At a minimum, the following records are needed:

(ix) Records demonstrating compliance with the matching requirements of section 92.218 through section 92.222 including a running log and project records documenting the type and amount of match contributions by project.

Condition

Housing lacks adequate internal controls to ensure that it reports accurate matching information to HUD. Housing must submit a match report to HUD for each year that it draws down funds from the U.S. Treasury for HOME Program projects. Our review of the HOME Program Match Report Housing submitted to HUD for fiscal year 2006–07 revealed that the match liability and contribution data Housing reported were inaccurate. Housing could not provide supporting documentation for some of the amounts it used in its determinations, and we identified inconsistencies in the data generated by the database Housing uses to track subrecipient matching activity.

The fiscal manager in Housing's HOME Program confirmed the errors in the match liability and matching contribution information Housing reported. She stated that she reviewed the supporting calculations for the report, but she did not review all of the various source documentation used in determining Housing's match liability and match contributions. The fiscal manager also confirmed that the database Housing uses to track subrecipient matching activity incorrectly double-counted some of the match contribution amounts used in determining the match contribution information reported in the HOME Program Match Report. The manager stated that she would submit a corrected HOME Match Report to HUD.

Although we found that Housing met its matching requirement, its lack of internal controls hindered its ability to provide accurate matching information to HUD in its fiscal year 2006–07 match report.

Questioned Costs

Not applicable.

Recommendations

Housing should ensure that the matching information generated from its database accurately represents the data submitted by subrecipients, and it should conduct a more thorough review of the accuracy of its match report before it submits the report to HUD.

Department's View and Corrective Action Plan

Housing stated that by July 31, 2009, it will: a) select a random sample of subrecipients to ensure that the data provided in the Project Completion Report is accurately portrayed in the match report; b) test the computer program that generates the match report before the report is generated to make sure that the computer program produces an accurate report with the data in the system at the time; and c) train enough staff to prepare the report so that in the event of staff absences, the report will be generated by staff, with the fiscal manager responsible to ensure its accuracy.

Reference Number:	2008-9-5
Federal Catalog Number:	14.228

Federal Program Title:	Community Development Block Grants/State's Program (CDBG)
Federal Award Number and Year:	B-07-DC-06-0001; 2007
Category of Finding:	Suspension and Debarment
State Administering Department:	Department of Housing and Community Development (Housing)

Criteria

TITLE 24—HOUSING AND URBAN DEVELOPMENT, Part 570—COMMUNITY DEVELOPMENT BLOCK GRANTS, Subpart I—State Community Development Block Grant Program, Section 570.489—Program Administrative Requirements

(l) Debarment and suspension. As required by the Code of Federal Regulations, Title 24, part 24, each CDBG participant shall require participants in lower tier covered transactions to include a certification that neither it nor its principals are currently debarred, suspended, proposed for debarment, declared ineligible, or voluntarily excluded from participation in the covered transaction in any proposal submitted in connection with the lower tier covered transactions. A participant may rely on the certification, unless it knows the certification is erroneous.

Condition

Housing does not require its subrecipients to certify that neither they nor their principals are currently debarred, suspended, proposed for debarment, declared ineligible, or voluntarily excluded from participation in federal assistance programs.

Housing's Notice of Funding Availability and Application Package (application) for the CDBG program requires subrecipients to certify that they will not award contacts to or otherwise engage the services of any contractor if that contractor or its principals are suspended or debarred. However, because Housing's application does not require the subrecipient to certify that neither it nor its principals are suspended or debarred, it does not meet the requirements of the Code of Federal Regulations, Title 24, Section 570.489(l). Additionally, like the application, the language in Housing's contracts with its subrecipients also does not require subrecipients to certify that they are not suspended or debarred.

As described in the Code of Federal Regulations, Title 2, Section 180.300, another method by which Housing could meet the federal suspension and debarment requirements would be to check the federal Excluded Parties List System (EPLS) to verify that subrecipients are not suspended or debarred before entering into contracts. However, Housing staff do not refer to the EPLS to verify whether a city or county is on the list.

Questioned Costs

Not applicable.

Recommendation

Housing should require its subrecipients to certify that they are not suspended or debarred from participating in federal assistance programs.

Department's View and Corrective Action Plan

Housing stated that, beginning with the 2009–10 funding round, it will:

1. Include language in the Notice of Funding Availability explicitly instructing applicants to verify and document their status on the Excluded Party List System; and

2. Revise its Application Statement of Assurances to include a certification that neither the applicant nor its principals are debarred, suspended, proposed for debarment, declared ineligible, or voluntarily excluded from participating in federal assistance programs.

Reference Number:	2008-12-18
Federal Catalog Number:	14.228
Federal Program Title:	Community Development Block Grants/State's Program (CDBG)
Federal Award Number and Year:	B-06-DC-06-0001; 2006
Category of Finding:	Reporting
State Administering Department:	Department of Housing and Community Development (Housing)

Criteria

TITLE 24—HOUSING AND URBAN DEVELOPMENT, PART 135—ECONOMIC OPPORTUNITIES FOR LOW- AND VERY LOW-INCOME PERSONS, Subpart E—Reporting and Recordkeeping, Section 135.90—Reporting

Each recipient which receives directly from the U.S. Department of Housing and Urban Development (HUD) financial assistance that is subject to the requirements of this part shall submit to the Assistant Secretary an annual report in such form and with such information as the Assistant Secretary may request, for the purpose of determining the effectiveness of section 3.

TITLE 24—HOUSING AND URBAN DEVELOPMENT, PART 91—CONSOLIDATED SUBMISSIONS FOR COMMUNITY PLANNING AND DEVELOPMENT PROGRAMS, Subpart F—Other General Requirements, Section 91.520—Performance Reports

General. Each jurisdiction that has an approved consolidated plan shall annually review and report, in a form prescribed by HUD, on the progress it has made in carrying out its strategic plan and its action plan. The performance report must include a description of the resources made available, the investment of available resources, the geographic distribution and location of investments, the families and persons assisted (including the racial and ethnic status of persons assisted), actions taken to affirmatively further fair housing, and other actions indicated in the strategic plan and the action plan.

TITLE 24—HOUSING AND URBAN DEVELOPMENT, PART 570—COMMUNITY DEVELOPMENT BLOCK GRANTS, Subpart I—State Community Development Block Grant Program, Section 570.490—Recordkeeping Requirements

State records. (1) The state shall establish and maintain such records as may be necessary to facilitate review and audit by HUD of the state's administration of CDBG funds under Section 570.493. The content of records maintained by the state shall be as jointly agreed upon by HUD and the states and sufficient to enable HUD to make the determinations described at Section 570.493. For fair housing and equal opportunity purposes, and as applicable, such records shall include data on the racial, ethnic, and gender characteristics of persons who are applicants for, participants in, or beneficiaries of the program. The records shall also permit audit of the states in accordance with the Code of Federal Regulations, Title 24, Part 85.

Condition

Section 3 Summary Report

Housing lacks adequate internal controls to ensure the completeness of the Section 3 report that it submits to HUD. The Section 3 Summary Report includes information on the number of new employees hired that are low or very low-income residents (Section 3 employees) and the amount of contracts awarded to businesses that are owned by low or very low-income persons or that employ a certain percentage of Section 3 employees (Section 3 businesses) on projects funded with CDBG grants during the fiscal year. Housing does not maintain a central list or tracking system to ensure that it receives Section 3 reports from all applicable subrecipients. Instead, a program manager in the Community and Economic Development section acknowledged that subrecipients determine whether they meet the expenditure threshold that requires them to submit the report on Section 3 activity to Housing. Because it does not have a process in place to independently identify which of its subrecipients meet the requirement to report and ensure that it receives all of the required Section 3 reports, Housing cannot demonstrate that the Section 3 report that it submits to HUD is complete.

Consolidated Annual Performance and Evaluation Report (performance report)

Housing could not demonstrate how it arrived at the amount of total resources available that it reported to HUD in the performance report for fiscal year 2006–07. According to the performance report, Housing had $11.7 million available for award from contracts that had reserved funds from previous years. However, Housing could not provide supporting documentation to show the specific contracts or years these funds came from. A program manager for CDBG acknowledged that she and her staff could not substantiate the amount of total resources available that Housing reported in the performance report. Specifically, the program manager stated that supporting documentation was not immediately available to demonstrate what funds from previous years were used to support the total reported amount awarded to subrecipients, and also stated that this information was prepared by people other than her and her staff. Other program managers within the CDBG program at Housing were also unable to provide documentation to substantiate the information. Without adequate procedures in place to document and support the information it provides to HUD in its performance report, Housing cannot ensure that it accurately identifies the State's allocation of CDBG program funds.

Questioned Costs

Not applicable.

Recommendations

Housing should establish controls to ensure that it obtains and reports the Section 3 activity from all its subrecipients that meet the requirements to report this activity. In addition, Housing should establish processes and procedures to ensure that the information in its performance report is accurate and can be traced to supporting documentation.

Department's View and Corrective Action Plan

Housing stated that, beginning with fiscal year 2009–10, it will establish controls to ensure that it obtains and reports the Section 3 activity. For instance, by September 2009 Housing will establish and maintain a central list or tracking system to independently identify which of its subrecipients meet the requirement to report. In addition, by November 2009 Housing will establish a process to ensure that the information reported in its performance report is accurate and can be traced to supporting documentation. This process will include a clear delineation of steps and specific, written procedures.

Reference Number:	2008-12-19
Federal Catalog Number:	14.239
Federal Program Title:	HOME Investment Partnerships Program (HOME Program)
Federal Award Number and Year:	M06-SG-06-0100; 2006
Category of Finding:	Reporting
State Administering Department:	Department of Housing and Community Development (Housing)

Criteria

TITLE 24—HOUSING AND URBAN DEVELOPMENT, PART 135—ECONOMIC OPPORTUNITIES FOR LOW- AND VERY LOW-INCOME PERSONS, Subpart E—Reporting and Recordkeeping, Section 135.90—Reporting

Each recipient which receives directly from the U.S. Department of Housing and Urban Development (HUD) financial assistance that is subject to the requirements of this part shall submit to the Assistant Secretary an annual report in such form and with such information as the Assistant Secretary may request, for the purpose of determining the effectiveness of section 3.

Condition

Housing lacks adequate internal controls to ensure the accuracy of the data in and the completeness of the annual Section 3 Summary Report it is required to submit to HUD. The Section 3 Summary Report includes, information on the number of new employees hired that are low or very low-income residents (Section 3 employees) and the amount of contracts awarded to businesses that are owned by low or very low-income persons or that employ a certain percentage of Section 3 employees (Section 3 businesses) on projects funded with HOME Program grants during the fiscal year. Our review of the Section 3 Summary Report that Housing submitted to HUD for the fiscal year ending June 30, 2007, found that some of the information Housing reported was inconsistent with the data on the summary spreadsheet it prepared from the annual Section 3 reports its subrecipients submitted to it. Specifically, for the number of new Section 3 employees hired, Housing underreported by one in one category and overreported by one in another. In addition, Housing reported the number of Section 3 businesses receiving contracts as zero when its summary spreadsheet reflected nine. A manager in the HOME Program confirmed the inconsistencies and stated that they were the result of transposition errors from Housing's spreadsheets to the report. After we brought these errors to Housing's attention, the manager submitted a revised report to HUD.

Housing's HOME Program fiscal manager also told us that Housing does not have a central list or tracking system specific to the Section 3 reporting requirement and for this reason could not supply a list of subrecipients that are required to file. Instead, Housing relies on its subrecipients to determine whether they meet the expenditure threshold that requires them to report their Section 3 activities. Because it does not have a process in place to independently identify which of its subrecipients meet the requirement to report and ensure that it receives all of the required reports, Housing cannot demonstrate that the Section 3 report that it submits to HUD is complete.

Questioned Costs

Not applicable.

Recommendations

Housing should strengthen its reviews over the preparation of the Section 3 Summary Report it submits to HUD to ensure it accurately reflects the State's Section 3 activities. In addition, Housing should establish controls to ensure that it obtains and reports the Section 3 activity from all its subrecipients that meet the requirements to report this activity.

Department's View and Corrective Action Plan

Housing stated that, by May 31, 2009, it will develop procedures to obtain and report to the maximum extent practicable the Section 3 activity from its subrecipients that meet the requirement to report Section 3 activity. In addition, to ensure that the report accurately reflects the State's Section 3 activities reported by subrecipients, Housing will do the following: a) select a random sample of subrecipients to ensure that the data provided in their Section 3 report is accurately portrayed in the Section 3 Summary Report; b) test the computer program that generates the Section 3 report before the report is generated to make sure that the computer program produces an accurate report with the data in the system at the time; and c) train enough staff to prepare the report so that in the event of staff absences, the report will be generated by staff, with a HOME Program manager or specialist responsible to ensure its accuracy.

Reference Number:	2008-12-20
Federal Catalog Number:	14.239
Federal Program Title:	HOME Investment Partnerships Program (HOME Program)
Federal Award Number and Year:	M07-SG-06-0100; 2007
Category of Finding:	Reporting
State Administering Department:	Department of Housing and Community Development (Housing)

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 Catalog of Federal Domestic Assistance (CFDA) number or other identifying number when the CFDA information is not available.

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133, *AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS* (OMB CIRCULAR A-133), Subpart B—Audits, Section .205—Basis for Determining Federal Awards Expended

(b) Loan and loan guarantees (loans). Since the Federal Government is at risk for loans until the debt is repaid, the following guidelines shall be used to calculate the value of Federal awards expended under loan programs, except as noted in paragraphs (c) and (d) of this section:

(1) Value of new loans made or received during the fiscal year; plus

(2) Balance of loans from previous years for which the Federal Government imposes continuing compliance requirements; plus

(3) Any interest subsidy, cash, or administrative cost allowance received.

Condition

Housing did not report to the Department of Finance for inclusion in the Schedule of Federal Assistance the correct amount of its outstanding loans of HOME Program funds for which affordability requirements continue for five to 20 years. Specifically, Housing included $1 million in grants to cities and counties that the HOME Program fiscal manager acknowledged had been miscoded in Housing's accounting records as outstanding loans. In addition, Housing understated the loan balance of one loan recipient by $188,000. The HOME Program fiscal manager confirmed the error and said Housing is working to identify the cause.

Questioned Costs

Not applicable.

Recommendation

Housing should establish controls to ensure that it accurately identifies, codes, and tracks the outstanding loans of HOME Program funds that it makes as the state lender.

Department's View and Corrective Action Plan

Housing stated that, by December 31, 2009, it will do the following: a) reconcile the CALSTARS S01 report to the CAPES and City Software list of state loans to ensure that all information in CALSTARS is correct; b) submit appropriate forms/documentation to the Accounting Branch to make any required changes; and c) develop procedures to ensure that new awards to community housing development organizations continue to be correctly coded in CALSTARS.

Reference Number:	2008-13-30
Federal Catalog Number:	14.228
Federal Program Title:	Community Development Block Grants/State's Program (CDBG)
Federal Award Number and Year:	B-07-DC-06-0001; 2007
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Housing and Community Development (Housing)

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 research and development, 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

Housing did not completely fulfill its subrecipient monitoring responsibilities for the CDBG program. Our review of CDBG program award documents and contracts issued to 10 subrecipients found that CDBG informed subrecipients of most of the federal award information and compliance requirements. However, the award information did not properly include the Catalog of Federal Domestic Assistance (CFDA) number for the CDBG program.

The CDBG program manager confirmed that the program did not specifically include the CFDA number in the contracts or any other award information provided to subrecipients; however, it plans to include this number in future contracts or award letters. Without the required federal award information, Housing cannot ensure its subrecipients are aware of all the program's requirements.

Questioned Costs

Not applicable.

Recommendation

Housing should ensure that it includes the CFDA number of the CDBG program in the contracts it enters into with subrecipients.

Department's View and Corrective Action Plan

In January 2009, Housing implemented procedures to include the CFDA number of the CDBG program in the contracts entered into with subrecipients.

Reference Number:	2008-13-31
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Housing and Community Development (Housing)
Federal Catalog Number:	14.239
Federal Program Title:	HOME Investment Partnerships Program (HOME Program)
Federal Award Number and Year:	M07-SG-06-0100; 2007

Federal Catalog Number:	14.228
Federal Program Title:	Community Development Block Grants/State's Program (CDBG)
Federal Award Number and Year:	B-07-DC-06-0001; 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:

(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.

Condition

Housing did not issue management decisions related to subrecipients' OMB Circular A-133 audit findings within the required six-month time frame. The State has established a process whereby local governments submit copies of their OMB Circular A-133 reports to the State Controller's Office (SCO). The SCO is responsible for certifying that the report conforms to auditing standards. Upon certification, it sends copies of OMB Circular A-133 reports to state agencies, which are responsible for following up on the audit findings related to the federal programs they administer. Despite the fact that the State of California has assigned aspects of the OMB Circular A-133 review process to different agencies to ensure audit findings are dealt with promptly, the six-month period should be calculated from the date the SCO receives a final OMB Circular A-133 report from the local government.

By early February 2009, Housing had received copies of nine OMB Circular A-133 audit reports, which were due March 31, 2008, from cities or counties that included findings requiring Housing to issue a management decision. On average, these reports were certified seven months after the SCO received them. Specifically, Housing received seven of these nine audits more than six months after the State initially received the audit, and it received the other two 47 days and 114 days, respectively, before the six-month deadline. As of February 19, 2009, the nine reports had been in Housing's possession for an average of nearly two months, and it had not yet issued any management decisions. The additional delay occurred at Housing because the audit division staff member responsible for processing the OMB Circular A-133 audit reports was on extended leave when Housing received the reports from the SCO. According to the manager of Housing's Internal Audits Division, his unit did not have written procedures to address the situation when the staff member who was responsible for OMB Circular A-133 audit follow-up was not available. Further, he confirmed that no one else in the Internal Audits Division had access to the audit report tracking system and, thus, Housing was unable to input information into the system to then pass on to the HOME and CDBG programs.

Once the Internal Audits Division staff process the information, they prepare a memo regarding the audit findings applicable to the HOME or CDBG program and send the memos to the HOME and CDBG section chiefs. According to the project managers of the HOME and CDBG programs, as of January 2009 their units had received most of the OMB Circular A-133 audit information from Housing's audit division and were working with subrecipients to resolve the audit findings. The program manager for the CDBG program also noted that, for our testing period, Housing did not have written procedures detailing what program staff should do to resolve the audit findings and program staff were acting based on verbal instructions from the previous program manager.

Following our discussion with Housing regarding the delays in processing the SCO audit information, Housing's audit division developed written procedures regarding the audit division's responsibilities and procedures for processing the OMB Circular A-133 audit report information from the SCO, including assigning someone as backup if the primary staff person responsible is not available.

In addition, the manager of the Internal Audits Division told us that Housing calculates the six-month period for the management decision from the date Housing receives copies of the certified audit report from the SCO rather than from the date the State first received the report. As a result, Housing did not issue a management decision related to findings identified for fiscal year 2006–07 within the required six-month time frame. By not performing these functions in a timely manner, Housing is unable to ensure that subrecipients have taken timely and appropriate corrective action on all audit findings.

Questioned Costs

Unknown

Recommendations

Housing should work with the SCO to ensure that it receives local government OMB Circular A-133 audits promptly, allowing it sufficient time to issue management decisions regarding audit findings. In addition, Housing should improve its policies and procedures to minimize the delay between when Housing receives the audit reports and when it provides the reports to program staff for resolution. The management decisions should be issued within six months of the date the State receives the report from the subrecipient.

Department's View and Corrective Action Plan

The OMB Circular A-133 audits are received by Housing, from the SCO via Housing's Audit Division, which distributes the audits to program staff for action. The Audit Division has a Single Audit Information System database and a Findings Tracking Excel spreadsheet that has been used for the last 15 years. The Audit Division has a process to track the date the OMB Circular A-133 audits are sent to program staff, track the date that findings are sent to recipients, and track the date findings are resolved. The condition that resulted in the Audit Division's untimely direction of the OMB Circular A-133 audits to program staff was that the key Audit Division staff person was not available to complete the task, and at that time, backup staff was neither identified nor trained to accomplish that responsibility. Since this issue was identified, backup staff have both been identified and trained. Further, the Audit Division's written procedures, entitled "Single Audit Desktop Procedures for Audit Division," were issued on February 25, 2009, and the backup staff was trained on these procedures on March 13, 2009. The Audit Division also will annually review the "Single Audit Desktop Procedures" and update it for applicable changes.

The HOME and CDBG program staff will work with Housing's Audit Division to ensure that delays in issuing management decisions regarding audit findings are minimized. To assist in this effort, the program staff has developed written procedures for routing and tracking the audit findings and has designated an OMB Circular A-133 audit-finding coordinator to expeditiously address the resolution of any findings. Housing will also work with the SCO. However, to the degree OMB Circular A-133 audits continue to be received from the SCO without sufficient time for Housing to process them within the required time limitation, Housing's process improvements alone cannot fully address the timeliness problems identified by the Bureau of State Audits.

Reference Number:	2008-13-32
Federal Catalog Number:	14.239

Federal Program Title:	HOME Investment Partnerships Program (HOME Program)
Federal Award Number and Year:	M07-SG-06-0100; 2007
Category of Finding:	Subrecipient Monitoring; Special Tests and Provisions
State Administering Department:	Department of Housing and Community Development (Housing)

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:

(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 24—HOUSING AND URBAN DEVELOPMENT, PART 92—HOME INVESTMENT PARTNERSHIPS PROGRAM, Subpart K—Program Administration, Section 92.504—Participating Jurisdiction Responsibilities; Written Agreements; On-Site Inspection.

(d) On site inspections—

(1) HOME assisted rental housing. During the period of affordability, the participating jurisdiction must perform on-site inspections of HOME-assisted rental housing to determine compliance with the property standards of section 92.251 and to verify the information submitted by the owners in accordance with the requirements of section 92.252 no less than: every three years for projects containing 1 to 4 units; every two years for projects containing 5 to 25 units; and every year for projects containing 26 or more units. Inspections must be based on a sufficient sample of units.

Condition

Housing did not consistently meet its subrecipient monitoring responsibilities related to conducting inspections of rental projects for compliance with housing quality standards. In August 2008 the U.S. Department of Housing and Urban Development (HUD) conducted an on-site programmatic review of Housing's HOME Program and found that Housing was falling behind in meeting its long-term monitoring requirements and was accumulating a backlog of monitoring reviews.

A HOME Program manager (program manager) told us that, with respect to the Community Housing Development Organization (CHDO) projects, Housing is the lender and the participating jurisdiction, which requires it to conduct the inspections of rental projects for compliance with housing quality standards. Further, because the CHDO is the owner of the project, there would be a conflict of interest if CHDOs inspected their own projects. According to the program manager, Housing conducts these inspections of the housing quality of CHDO rentals as part of its long-term monitoring site visits.

Similar to HUD's concern, we found that Housing did not consistently conduct site visit reviews and rental housing inspections of CHDO projects in accordance with its monitoring policies. Specifically, for three of the four CHDO projects we reviewed, Housing did not conduct the site visits that were due during fiscal year 2007–08. According to the program manager, these site visits were not conducted because of staffing and resource issues. She told us that to address this, Housing recently hired new staff and is currently working to become compliant with the long-term monitoring site visit requirements.

Without consistently following its own procedures regarding subrecipient monitoring, Housing cannot demonstrate that it met its federal monitoring responsibilities, including inspections of rental projects for compliance with housing quality standards.

Questioned Costs

Unknown

Recommendation

Housing should ensure that it complies with its long-term monitoring policies and federal monitoring responsibilities.

Department's View and Corrective Action Plan

Housing stated that, in December 2008, it doubled its HOME long-term monitoring staffing from three to six full-time employees. As a result, site monitoring visits for 18 CHDO projects have already been conducted.

Housing also stated that it will conduct all of the required on-site monitoring visits for CHDO projects by the end of fiscal year 2009–10 (June 30, 2010); for the first cycle, all projects must be monitored. Thereafter, Housing is required to monitor only large projects annually and small projects either every two or three years. Thereafter, Housing will conduct all required site visits every year.

U.S. DEPARTMENT OF JUSTICE

Reference Number:	2008-1-8
Federal Catalog Number:	16.606
Federal Program Title:	State Criminal Alien Assistance Program (SCAAP)
Federal Award Numbers and Year:	2007-AP-BX-0762; 2007 2008-AP-BX-0186; 2007
Category of Finding:	Activities Allowed/Allowable Costs
State Administering Department:	Department of Corrections and Rehabilitation (Corrections)

Criteria

TITLE 8—ALIENS AND NATIONALITY, CHAPTER 12—IMMIGRATION AND NATIONALITY, SUBCHAPTER II—IMMIGRATION, Part IV—Inspection, Apprehension, Examination, Exclusion, and Removal

(i)(3) For purposes of this subsection, the term "undocumented criminal alien" means an alien who—

(B)(i) entered the United States without inspection or at any time or place other than as designated by the Attorney General;

(ii) was the subject of exclusion or deportation proceedings at the time he or she was taken into custody by the State or a political subdivision of the State; or

(iii) was admitted as a nonimmigrant and at the time he or she was taken into custody by the State or a political subdivision of the State has failed to maintain the nonimmigrant status in which the alien was admitted or to which it was changed under section 1258 of this title, or to comply with the conditions of any such status.

Condition

Corrections submitted ineligible inmates in its fiscal year 2007 SCAAP application. Specifically, in a sample of 35 records from the SCAAP inmate data file, we found five records for inmates who were U.S. citizens, naturalized U.S. citizens, or not deportable due to immigration status. Corrections stated that the federal government is responsible through due diligence to determine and ensure inmate immigration status. While fiscal year 2007 SCAAP Guidelines state that "[t]he U.S. Department of Homeland Security will make the final determination on the status of submitted inmate records for undocumented alien purposes," the guidelines also state that applicants may submit records for inmates who "[w]ere born outside the United States or one of its territories and had no reported or documented claim to U.S. citizenship." In addition, the guidelines state ". . . the inmate file reflects the jurisdiction's good faith and due diligence efforts to identify and list undocumented criminal aliens housed in its correctional facilities." Corrections certified on the SCAAP application that it used due diligence and that it did not include ineligible inmates in its SCAAP application.

The process Corrections uses to compile the inmate data file may inappropriately include ineligible inmates. Specifically, the program Corrections utilizes to extract data from its databases may inappropriately change the birthplace from a U.S. state or territory to a foreign country for certain inmates. In addition, the program Corrections uses may inappropriately change the birthplace to "unknown" when an inmate is identified as both born in the U.S. or one of its territories and as being held by Corrections for U.S. Immigration and Customs Enforcement. Corrections stated that it does not have access to citizenship information and that it assumes all foreign-born inmates are not U.S. citizens. By making this assumption, and by making changes to birthplaces without verifying the changes are correct, Corrections risks reporting ineligible inmates in the SCAAP application.

Finally, during data accuracy testing we identified several records in the inmate data file containing information that differed from the inmates' records. Of the 43,698 cases Corrections submitted in the fiscal year 2007 SCAAP application, we randomly sampled 35 inmate records and found one or more exceptions in nine cases. We found five cases in which the alien number in the inmate data file did not correspond to the inmate records. According to Corrections, a programming problem caused four of the errors, which it stated it remedied for the next year's application. For another case, Corrections stated that the alien number in the inmate data file was related to the inmate's prior Corrections identification number but could not provide documentation for this statement. We also found three cases in which the foreign country of birth field in the inmate data file did not correspond to the inmate records. Two were data entry errors, and one may have been caused by one of the programming issues we previously discussed. Finally, in two cases we were unable to verify whether Corrections accurately submitted the foreign country of birth in the data file due to conflicting documentation in the inmate records.

Questioned Costs

Not applicable.

Recommendation

Corrections should seek guidance from the federal government to ensure it practices due diligence in its SCAAP application and, as necessary, develops procedures to ensure it does so.

Department's View and Corrective Action Plan

Corrections is pleased to submit this letter in response to the Bureau of State Audits' (BSA) federal compliance audit of the State Criminal Alien Assistance Program (SCAAP) for the 2007–08 state fiscal year. We appreciate your recommendation to seek guidance from the federal government to ensure we practice due diligence in our SCAAP application. In fact, we have already contacted the federal government to solicit such feedback.

(1) Indeed, we are confident that Corrections is already acting with due diligence. The purpose of the SCAAP application is to seek funding from the federal government for state costs incurred as a result of incarcerating undocumented criminal aliens. To receive such funding, Corrections submits records of foreign-born persons in our custody to the United States Immigration and Customs Enforcement agency. During the audit period, Corrections submitted 43,698 records as part of its SCAAP application. Each of those 43,698 records is compiled from a lengthy Corrections central file that contains, in some cases, information dating back over 20 years. Obviously, when dealing with such voluminous files, there are bound to be instances of conflicting information regarding the (2) subject's country of birth. This is especially true when one considers that these files mostly pertain to foreign-born criminals—persons who typically frustrate accurate record-keeping if not falsify it altogether. Since the federal government, not the state, is the ultimate keeper of records pertaining to national origin, Corrections includes in its SCAAP application records for which there may be conflicting information so long as we have a good-faith belief to support our submission.

In fact, some of the examples cited by the BSA demonstrate the reasonableness of our approach. (3) For example, the BSA faults Corrections for including in our request for federal funding five records for ineligible persons, but in three of those records the federal government itself provided the State with information identifying those subjects for possible deportation. In the other two cases, Corrections had information in our files indicating a foreign place of birth. While subsequent investigation by the federal government may have ultimately revealed these persons to be United States citizens or otherwise ineligible for SCAAP funding, that does not change the propriety of Corrections' including such persons in our SCAAP application for the federal government's ultimate review and determination.

The same is true for the two examples cited by the BSA as "data-entry errors." In one case Corrections received conflicting information from the California Department of Justice regarding the subject's birthplace and in the other case Corrections received information from the federal government indicating that the subject was an alien. Even when such information conflicts with other information in our records, Corrections includes such records so that they can be presented to the federal government for their ultimate determination regarding eligibility. That the BSA was itself unable to resolve conflicting information in two other cases only underscores the difficulty of Corrections' task as it tries in good faith to determine eligibility from evidence that is at times contradictory. And, again, in both of these latter two cases the federal government had provided information to Corrections indicating that each of the two persons was an alien. Surely Corrections would be faulted were it not to seek alien assistance funding from the federal government for persons whom the federal government itself had previously declared to be aliens. (4)

Of course, the audit did reveal some errors, including errors that were the result of a computer program employed by Corrections. That computer program was fixed in March 2008. But more importantly, Corrections does not believe that such errors negate our due diligence in the submission of our SCAAP application. We have used our best efforts in good faith to determine SCAAP eligibility, and we will continue to work with the federal government to find ways to improve our process for doing so.

Corrections would like to thank the BSA for this report. We welcome your input and look forward to your future efforts to ensure our compliance with federal guidelines.

Auditor's Comments on Department's View

(1) The BSA disagrees with Corrections' assessment of its due diligence. SCAAP guidelines state that applicants may submit records for inmates who "[w]ere born outside the United States or one of its territories and had no reported or documented claim to U.S. citizenship." As we point out, although Corrections certified on the SCAAP application that it exercised due diligence to ensure it did not include ineligible inmates, we found that Corrections included ineligible inmates in its application.

(2) Corrections provided the BSA with an explanation of the federal data-vetting process, and we acknowledge that the process is thorough. However, until Corrections engages in a dialogue with the federal government to determine if the federal government concurs with its practice to include all foreign-born inmates, even when Corrections has documentation stating that the inmate is not deportable due to citizenship or other reasons, the BSA stands by its conclusion that Corrections is not in compliance with the SCAAP guidelines.

(3) In four of the five cases, the BSA was able to locate documentation in the inmates' records showing that the federal government had conducted immigration investigations on the inmates. According to the investigation notices, the federal government assigned alien numbers to three of these inmates. However, in all four cases, the investigation results clearly state that the inmates are not deportable and were dated well before the date of the SCAAP application. In the fifth case, early documentation states that the inmate was born in Mexico. More recent information from the federal government, however, shows that the inmate was born in California.

(4) The two data entry errors the BSA found were not due to conflicting documentation in the inmate records. For the two cases, Corrections informed us that the discrepancies between the inmates' records and the SCAAP data file were a result of differences in "place of birth" codes. Specifically, Corrections entered the inmate place of birth pursuant to the California Department of Justice code, but the code represented a different country within Corrections' data system.

U.S. DEPARTMENT OF LABOR

Reference Number:	2008-1-5
Federal Catalog Number:	17.245
Federal Program Title:	Trade Adjustment Assistance (TAA)
Federal Award Numbers and Year:	TA-16788-08-55-A-6; 2008 UI-16735-08-88-A-6; 2008
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 the 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

In our prior year's audit, we reported that EDD lacked adequate controls to ensure that its field offices made appropriate eligibility determinations for the TAA program. We reported that the State Trade Act Coordinator (coordinator) conducted quarterly desk reviews of files sent to him by field offices despite a 2006 report by the U.S. Department of Labor (Federal Labor) recommending that the coordinator conduct on-site monitoring and randomly select files to review. Additionally, we reported that EDD field offices lacked the information necessary to determine how to document the six conditions of training approval on the Trade Adjustment Assistance Training Plan (DE8751).

Our follow-up procedures began with inquiring whether or not the coordinator was conducting on-site monitoring and randomly selecting files to review and whether EDD developed policies and procedures specifying what documents should support each of the six training conditions in the Training Plan. EDD asserted to us that it has not made the necessary changes to its monitoring plans or its policies and procedures for documenting training conditions in fiscal year 2007–08.

According to the Audit and Evaluation Division chief, EDD made policy and procedure changes, but the changes were not implemented in fiscal year 2007–08. The chief anticipates that the changes will be implemented during calendar year 2009. EDD revised its TAA Training Plan, DE8751, which will serve

as a control document and when completed correctly will provide justification for TAA eligibility. In addition, EDD will implement a revised monitoring system that will combine both onsite monitoring and document reviews.

Questioned Costs

Unknown

Recommendations

EDD should improve its internal controls related to the TAA program. Specifically, EDD should conduct quarterly on-site reviews of randomly selected participant files, as recommended by Federal 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

EDD stated that it revised and published the TAA Training Plan, DE8751, in October 2008. The Training Plan serves as a control document. When completed correctly, the Training Plan provides justification for TAA eligibility. The procedures for the revised DE 8751 and a TAA Procedural Checklist were published on the TAA Team Site in SharePoint (the EDD's Intranet) in October 2008. The TAA Team Site can be updated on a daily basis and allows TAA field specialists day-to-day access to current program policies and procedures. This helps ensure compliance with current program regulations until the Trade Act Manual is updated.

EDD also stated that it has procedures in place to randomly monitor TAA document files on a quarterly basis by TAA program staff in EDD's Central Office. The EDD's Workforce Services Branch is coordinating with the Compliance and Review Division to develop onsite document monitoring one quarter of every year.

Reference Number:	2008-2-8
Federal Catalog Number:	17.503
Federal Program Title:	Occupational Safety and Health—State Program
Federal Award Numbers and Years:	60F8-0900; 2008 60F7-0900; 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

In our prior-year audit, we reported that Industrial Relations lacked adequate controls to ensure that the personal services costs it charged to the California Occupational Safety and Health program (program) are allowable. Specifically, Industrial Relations did not require employees who were expected to work solely on the program to complete required certifications and did not ensure that a responsible official approved the employees' Absence and Additional Time Worked Report.

During our follow-up procedures for fiscal year 2007–08, we found that Industrial Relations implemented the recommendation related to ensuring a responsible party approved the employees' Absence and Additional Time Worked Reports. However, we also found that Industrial Relations had not yet implemented the recommendation related to ensuring it prepares semiannual certifications for its employees who work solely on that program. Industrial Relations stated that it plans to implement procedures to conduct periodic certifications for employees who worked solely on federal grants and who do not submit daily time sheets during fiscal year 2008–09. Specifically, Industrial Relations stated that the first certification will occur at the end of March 2009, and the second certification would occur at the end of September 2009. Industrial Relations also stated that it would use this procedure in subsequent years. Until Industrial Relations implements this procedure, the awarding federal agency has less assurance that the personal services costs charged to the program were valid.

Questioned Costs

Unknown

Recommendation

Industrial Relations should implement its procedures for ensuring that it conducts semiannual certifications for its employees who work solely on that program.

Department's View and Corrective Action Plan

Industrial Relations stated that it agrees with the finding and will start the semiannual certifications by March 31, 2009.

Reference Number:	2008-3-12
Federal Catalog Number:	17.503
Federal Program Title:	Occupational Safety and Health—State Program
Federal Award Numbers and Years:	60F8-0090; 2008 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

(d) Reimbursement. Reimbursement shall be the preferred method when the requirements in paragraph (c) are not met.

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, Section 205.2—What Definitions Apply to This Part?

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

In our prior-year audit, we reported that Industrial Relations indicated that it used the reimbursement method to obtain federal funds for the California Occupational Safety and Health Program (program). However, based on the monthly drawdowns reviewed, 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. Finally, we reported that Industrial Relations' use of two separate accounting reports to determine monthly expenditures contributed to the discrepancies between the amounts requested and the actual amounts spent. By deviating from cash-management regulations, Industrial Relations risks being financially penalized by its federal oversight agency.

During our follow-up procedures for fiscal year 2007–08, we found that Industrial Relations partially corrected this finding. Specifically, for the two drawdowns we tested, Industrial Relations did not exceed its expenditures for the month. Further, Industrial Relations stated it discontinued using the second accounting report to determine its monthly expenditures in October 2007. However, although Industrial Relations asserted that it obtained verbal approval from the U.S. Department of Labor, it did not obtain written federal authorization for an advance payment of $1 million in October 2007. Industrial Relations stated that it did not correct this finding until August 2008 and that in the future it would request federal approval if advances were necessary.

Questioned Costs

Not applicable.

Recommendation

If Industrial Relations finds that it needs an advance of funds, it 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 stated that it agrees with the finding. It also stated that if an advance is needed, a Request for Advance or Reimbursement must first be submitted to the federal Department of Health and Human Services Division for approval before any drawdown is made. In addition, Industrial Relations stated that it will maintain proper documentation that shows the reconciliation of the advance with the actual expenditures for the period.

Reference Number:	2008-8-10
Federal Catalog Number:	17.503
Federal Program Title:	Occupational Safety and Health—State Program
Federal Award Numbers and Years:	60F8-0090; 2008 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

In our prior-year audit, we reported that Industrial Relations lacked adequate controls to ensure that it liquidated 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 were out of the period of availability for those funds.

During our follow-up procedures for fiscal year 2007–08, we found that Industrial Relations had partially corrected this finding. Specifically, we reviewed the Purchasing Authority Purchase Orders (purchase orders) for three of the 13 obligations associated with the 2007 federal award that were issued during August 2007 and September 2007. We found that Industrial Relations did not place the actual order for the items shown on one purchase order until October 10, 2007. Thus, a valid obligation did not exist during the funding period. Also, while performing our procedures, we also noted one transaction associated with its 2007 federal grant that Industrial Relations liquidated in April 2008, after the December 31, 2007 deadline. Thus, as previously reported, it appears that Industrial Relations is not in compliance with federal regulations regarding the period of availability.

Questioned Costs

Obligations of $4,042.79 for federal fiscal year 2007 that were not based on a valid order placed during the funding period.

Obligations of $10.42 for federal fiscal year 2007 paid after December 31, 2007.

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 stated that it agrees with the finding and will adhere to the established procedures to comply with federal requirements. Industrial Relations also stated that it will continue monitoring expenditures to ensure that only valid obligations are charged to the award costs for the proper funding period. In addition, Industrial Relations stated that it will ensure that all obligations are liquidated within 90 days from the end of the funding period.

Reference Number:	2008-9-1
Federal Catalog Numbers:	17.207; 17.801; 17.804
Federal Program Titles:	Wagner-Peyser Act; Disabled Veterans' Outreach Program (DVOP); Local Veterans' Employment Representative Program (LVER)
Federal Award Numbers and Year:	ES-16207-07-55-A-6; 2007 E-9-5-8-5085; 2007
Category of Finding:	Procurement, Suspension and Debarment
State Administering Department:	Employment Development Department (EDD)

Criteria

TITLE 29—LABOR, PART 98—GOVERNMENTWIDE DEBARMENT AND SUSPENSION (NONPROCUREMENT), Subpart B—Covered Transactions, Section 98.220—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 Section 98.210, and the amount of the contract is expected to equal or exceed $25,000.

TITLE 29—LABOR, PART 98—GOVERNMENTWIDE DEBARMENT AND SUSPENSION (NONPROCUREMENT), Subpart C—Responsibilities of Participants Regarding Transactions, Doing Business With Other Persons, Section 98.300—What Must I Do Before I Enter Into a Covered Transaction With Another Person at the Next Lower Tier?

When you enter into a covered transaction with another person at the next lower tier, you must verify that the person with whom you intend to do business is not excluded or disqualified. You do this by:

a) Checking the Excluded Parties List System (EPLS); or

b) Collecting a certification from that person if allowed by this rule; or

c) Adding a clause or condition to the covered transaction with that person.

Condition

EDD does not have adequate policies or procedures in place to comply with federal suspension and debarment requirements. Although EDD does ensure that service contracts over $25,000 include a suspension and debarment certification, it does not obtain such certification for the purchase of goods over $25,000. Additionally, EDD does not check the EPLS to verify that entities it purchases goods from are not suspended or debarred.

We reviewed 13 covered transactions, including six for the purchase of goods over $25,000. For four of these six purchases, EDD did not include a suspension and debarment certificate as required. The remaining two purchases contained the required certification; however, the Department of General Services conducted these procurements, not EDD. Additionally, EDD did not verify through the EPLS that the vendors supplying the purchased goods were not suspended or debarred. We reviewed the EPLS for the four vendors and noted that they were not in the database. According to EDD's chief, Office of Procurement, Contracting and Administration, EDD did not require suspension and debarment certifications or consult the EPLS prior to issuing contracts for goods purchases over $25,000 because they were not aware of this federal requirement.

By not obtaining suspension and debarment certifications or performing an independent check on the EPLS, EDD runs the risk of entering into a covered transaction with a party that is excluded from doing business with the federal government.

Questioned Costs

Not applicable.

Recommendation

EDD should establish policies and procedures to ensure that it is performing the required verifications for suspension and debarment when making goods purchases equal to or more than $25,000.

Department's View and Corrective Action Plan

The EDD agrees that it currently administers procurements subject to Title 29—Labor, Part 98—Government wide Debarment and Suspension Procedures (Nonprocurement), Subpart B—Covered transactions, Section 98.220. The EDD further agrees that it did not require suspension and debarment certifications or consult the Excluded Parties List System (EPLS) prior to issuing contracts for goods purchases over $25,000 because they were not aware of the requirement.

To come into compliance with this requirement, the EDD has implemented suspension and debarment procedures for goods purchases that fall into the above-noted category on Friday, February 13, 2009, through verbal instructions to buyers within the EDD. The EDD's desk procedures will be updated to reflect this requirement within 30 days. The EDD buyers are required to adhere to the following:

a. Query the EPLS for the proposed vendor's company.

b. If there is no record of the vendor, print out the findings and file a copy in the official procurement file and the procurement may be awarded to the proposed vendor.

c. If there is a record of the vendor, print out the findings and file a copy in the official procurement file, and the procurement will not be awarded to the proposed vendor.

In addition, because the dollar amount of these purchases exceed a buyers signature authority, compliance with the requirements will be verified by management staff who have been informed of the new requirement regarding suspension and debarment of purchases from vendors of items over $25,000.

Reference Number:	2008-12-9
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-9-5-7-5085; 2007
Category of Finding:	Reporting
State Administering Department:	Employment Development Department (EDD)

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 97.20—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 LVER SF 269A report;

- All expenditures for DVOP Activities and DVOP Special Initiatives will be reported on the DVOP SF 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 2007, EDD reported $1,810,983 in indirect costs for the program. However, using the methodology described by an EDD budget analyst, we calculated indirect costs to be $1,829,990, a difference of $19,007. In the LVER program's final SF 269A report for federal fiscal year 2007, EDD reported $1,813,140 of indirect costs and we calculated $1,825,519, a difference of $12,379.

EDD's budget analyst confirmed our figures and stated that the miscalculations occurred as the result of an error in a spreadsheet formula whereby special initiative costs were not subtracted as necessary. The analyst also stated that EDD had not yet put in place procedures for the reviewing analyst to follow. However, that analyst added that EDD has since updated its procedures for calculating indirect costs and reviewing the SF 269A reports. EDD made Federal Labor aware of these errors, and it did not require EDD to take any action.

Questioned Costs

Not applicable.

Recommendation

EDD should ensure that the written procedures describing its process for preparing, reviewing, and approving the SF 269A report are adhered to.

Department's View and Corrective Action Plan

The Bureau of State Audits' finding is correct in that the amounts for the indirect costs were underreported in the federal fiscal year (FFY) 2007 final Financial Status Report, Standard Form (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 (Federal Labor) for the DVOP and LVER programs were correct. The SF-269A categorizes the total costs into two subsets:

Direct charges and indirect charges. For FFY 2007, the indirect charges were underreported, but the amount underreported in the indirect charges category was reported in the direct charges category. Additionally, when the Employment Development Department (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 report was needed. The DVET advised EDD that an amended report was not necessary.

As additional clarification, the EDD, as of April 1, 2008, created written procedures to assist it to accurately complete the Expenditure Detail Report and the SF-269A. In addition to creating procedures for calculating direct and indirect cost for inclusion into the SF 269A report, the EDD has expanded the procedures to include such items as the description of the Veterans Quarterly Report; the components of the Veterans Quarterly Report (which includes the SF 269A); and collecting expenditure data.

The procedures will be updated on an as-needed basis to incorporate any changes to the SF 269A process, as mandated by Federal Labor.

In closing, it is the Employment Development Department's view that, although the current finding is being classified as a repeat finding, it should be noted that the finding was based on an SF-269A report that was completed prior to the 2007-12-11 audit finding being announced. As of April 1, 2008, approximately a month after the 2007-12-11 audit finding was announced, the EDD has place procedures detailing the steps necessary to complete the SF-269A documents accurately.

Auditor's Comments on Department's View

As stated in the Condition, our concern was not with total costs but with the appropriate classification of costs. As we note in the Criteria section, a state must expend and account for grant funds in accordance with state laws and procedures for expending and accounting for its own funds. This includes the proper classification of direct and indirect costs. Therefore, we stand by our finding.

Regardless of when we notified EDD of the prior year's finding, it is still EDD's responsibility to comply with all criteria related to the reporting of DVOP and LVER expenditures. In this case, EDD did not review prior reports for the type of error we brought to its attention.

Reference Number:	2008-12-10
Federal Catalog Number:	17.245
Federal Program Title:	Trade Adjustment Assistance (TAA)
Federal Award Numbers and Year:	TA-16788-08-55-A-6; 2008 UI-16735-08-88-A-6; 2008
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

In our prior year's audit, we reported that EDD lacked 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). We found that the ETA-563 report EDD submitted to Federal Labor for the quarter ending June 30, 2007, was not in compliance with Federal Labor's instructions for reporting training costs and participants, that EDD could not demonstrate the accuracy and completeness of the information it received from its field offices, and that EDD underreported the number of training waivers issued because of an error in summarizing data from its Unemployment Insurance Division's Special Claims Office.

Our follow-up procedures related to confirming whether EDD established controls that include supervisory review and approval of the data contained in the ETA-563 report it submits to Federal Labor revealed that EDD still does not have necessary controls in place. EDD told us that it has not fully implemented its corrective action plan.

According to the Audit and Evaluation Division chief, EDD is consolidating various data elements in its job training automation system to help ensure data reporting accuracy. The chief expects EDD to complete the consolidation's technical specifications by January 2009 and make its first report using consolidated data on August 15, 2009. The chief also asserted that the number of TAA participants is being reported in full to Federal Labor and that procedures are in place to separately count and sum training waivers.

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

EDD stated that it is in the process of consolidating the ETA-563 report into its job training automation system. The consolidation of the ETA-563 report is scheduled to be completed within the first/second calendar quarters of 2009. The consolidation allows a cross check with EDD's Fiscal Program Division's TAA ETA-9130 report to ensure data is accurately captured for both reports.

After the consolidation is complete, the Workforce Services Branch of EDD will be responsible for producing the ETA-563 report and will submit their first report to Federal Labor in August 2009.

Reference Number:	2008-12-11
Federal Catalog Number:	17.245
Federal Program Title:	Trade Adjustment Assistance (TAA)
Federal Award Numbers and Year:	TA-16788-08-55-A-6; 2008 UI-16735-08-88-A-6; 2008
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

1. 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

In our prior year's audit, we reported that EDD's TAPR for the first calendar quarter of 2007 contained errors. Specifically, we found that the TAPR included information on participants who exited the program in the fourth calendar quarter of 2005, that wage data for the "first quarter following exit" line item for one participant was underreported by $4,500, and the TAPR included instances where participants who had wages were reported as not having wages in the "third quarter following exit" line item.

Our follow-up procedures related to confirming whether EDD established adequate controls to ensure that it uses the appropriate data to prepare the TAPR. Based on information EDD provided, the problem was not corrected during fiscal year 2007–08, the year we were auditing.

According to the Audit and Evaluation Division chief, EDD consolidated all TAA performance data into its job training automation system as of July 1, 2008. The chief asserted that EDD will begin using the new reporting system when it prepares the July through September 2008 TAPR report.

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

EDD stated that it consolidated all TAA performance data into its job training automation (JTA) system on July 1, 2008. As of that date, TAA field specialists enter all TAA data into one data source (JTA) instead of three data sources (as was done prior to July 1, 2008). The consolidation helps ensure the accuracy of the data captured for the quarterly TAPR report.

The Workforce Services Branch of EDD is now responsible for producing the TAPR report and will submit the October through December 2008 report to Federal Labor in February 2009.

Reference Number:	2008-12-12
Federal Catalog Number:	17.260
Federal Program Title:	WIA Dislocated Workers
Federal Award Number and Year:	AA-16017-07-55-A-6; 2007
Category of Finding:	Reporting
State Administering Department:	Employment Development Department (EDD)

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 97.20—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.

U.S. DEPARTMENT OF LABOR, ETA FINANCIAL REPORT INSTRUCTIONS—WORKFORCE INVESTMENT ACT—LOCAL DISLOCATED WORKER (DW)

Line 11c—Expenditure of DW funds transferred to Adult program

Enter the amount of DW funds expended on the Adult program. This entry should be included in 10e, Total Expenditures.

Condition

Our review of the Dislocated Workers ETA-9130 report (round 1) EDD submitted to the U.S. Department of Labor (Federal Labor) revealed that EDD did not report Dislocated Worker funds it transferred to the Workforce Investment Act (WIA) Adult Program.

In the Dislocated Workers final ETA-9130 (round 1) for state fiscal year 2007–08, EDD reported $0.00 on the transfers to the WIA Adult Program line. However, using records obtained from EDD Financial Management Unit staff, we confirmed that $785,243 of Dislocated Worker funds were transferred into the WIA Adult Program between October and November 2007.

A manager in the Financial Management Unit confirmed EDD's error and stated that it occurred because data from the previous quarter's report was not carried forward. After we brought this error to EDD's attention, the manager contacted Federal Labor, and it noted the error in its records.

Questioned Costs

Not applicable.

Recommendation

EDD should ensure that all necessary information is carried forward from one financial report to the next.

Department's View and Corrective Action Plan

EDD stated that, as noted in the Condition section of this document, the manager of the Financial Management Unit (FMU) has acknowledged omission of the $785,243 transferred between the Workforce Investment Act Dislocated Worker and Adult programs. The FMU manager did contact the Department of Labor (DOL—Region VI) about the oversight and the DOL has noted the omission in their records. The corrective action plan is for the FMU manager to review subsequent reports closer to ensure the omission of such amounts does not occur.

Reference Number:	2008-12-14
Federal Catalog Number:	17.503
Federal Program Title:	Occupational Safety and Health—State Program
Federal Award Numbers and Years:	60F8-0090; 2008 60F7-0090; 2007
Category of Finding:	Reporting
State Administering Department:	Department of Industrial Relations (Industrial Relations)

Criteria

TITLE 29—LABOR, CHAPTER XVII—OCCUPATIONAL SAFETY AND HEALTH ADMINISTRATION, DEPARTMENT OF LABOR, PART 1954—PROCEDURES FOR THE EVALUATION AND MONITORING OF APPROVED STATE, Subpart B—State Monitoring Reports and Visits to State Agencies, Section 1954.10—Reports From the State.

(c) 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 include 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

In our prior-year audit, we reported that Industrial Relations had 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.

During our follow-up procedures for fiscal year 2007–08, we found that Industrial Relations has not fully corrected this finding. Specifically, on its 2007 federal fiscal year closeout report, Industrial Relations reported the federal share of net outlays as $23 million, which was the total amount of its 2007 federal award. In the "Remarks" section of the report, Industrial Relations reported that it had nearly $316,000 in obligations that were unliquidated and that would be paid fully with state funds. Industrial Relations was able to provide accounting records to support its total outlays, program income, and how it arrived at the nearly $316,000 in unliquidated obligations. However, it did not provide accounting records to demonstrate that the unliquidated obligations were paid with state funds. Thus, we are unable to verify that federal funds were not used to pay for the unliquidated obligations and that Industrial Relations has provided accurate information to the U.S. Department of Labor regarding this issue.

Questioned Costs

Not applicable.

Recommendation

Industrial Relations should ensure that it retains adequate documentation to support the information it submits on its Financial Status Report with the appropriate accounting records.

Department's View and Corrective Action Plan

Industrial Relations stated that it agrees with the finding and will develop a report that will support the information that unliquidated obligations were paid with state funds.

Reference Number:	2008-13-16
Federal Catalog Numbers:	17.258, 17.259, 17.260
Federal Program Titles:	Workforce Investment Act (WIA) Adult Program, WIA Youth Activities, WIA Dislocated Workers
Federal Award Number and Year:	AA-16017-07-55-A-6; 2007
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Employment Development Department (EDD)

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:

(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.

(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 20—EMPLOYEES' BENEFITS, PART 667—ADMINISTRATIVE PROVISIONS UNDER TITLE 1 OF THE WORKFORCE INVESTMENT ACT (WIA), Subpart D Oversight and Monitoring, Section 667.410—What Are the Oversight Roles and Responsibilities of Recipients and Subrecipients?

(a) Roles and responsibilities for all recipients and subrecipients of funds under WIA title 1 in general. Each recipient and subrecipient must conduct regular oversight and monitoring of its WIA activities and those of its subrecipients and contractor.

(b) State roles and responsibilities for grants under WIA sections 127 and 132.

(1) The Governor is responsible for the development of the State monitoring system. The Governor must be able to demonstrate, through a monitoring plan or otherwise, that the State monitoring system meets the requirements of paragraph (b)(2) of this section.

(2) The State monitoring system must:

i. Provide for annual on-site monitoring reviews of local areas' compliance with DOL uniform administrative requirements, as required by WIA section 184(a)(4);

ii. Ensure that established policies to achieve program quality and outcomes meet the objectives of the Act and the WIA regulations, including policies relating to: the provision of services by One-Stop Centers; eligible providers of training services; and eligible providers of youth activities;

iii. Enable the Governor to determine if subrecipients and contractors have demonstrated substantial compliance with WIA requirements;

iv. Enable the Governor to determine whether a local plan will be disapproved for failure to make acceptable progress in addressing deficiencies, as required in WIA section 118(d)(1); and

v. Enable the Governor to ensure compliance with the nondiscrimination and equal opportunity requirements of WIA section 188 and 29 CFR part 37. Requirements for these aspects of the monitoring system are set forth in 29 CFR 37.54(d)(2)(ii).

Condition

During-the-Award Monitoring

EDD allots WIA funds to both Local Workforce Investment Areas (LWIAs) and Community Based Organizations (CBOs). During fiscal year 2007–2008, EDD allotted $83.5 million to 38 CBOs. However, EDD's Compliance Monitoring Section (CMS), which is responsible for performing on-site monitoring reviews, did not conduct reviews of any CBOs during fiscal year 2007–2008. Although the CMS conducted on-site monitoring reviews of all 49 LWIAs that received funding during fiscal year 2007–08,

according to the chief of the CMS, it did not perform onsite monitoring of CBOs because of staffing limitations. By not conducting on-site monitoring of CBOs, EDD cannot ensure that CBOs are acting in compliance with laws, regulations, or provisions of grant agreements.

Issuance of Management Decisions

EDD did not issue the management decision on audit findings within six months after receipt of a subrecipient's audit report. The State has established a process whereby local governments submit copies of their OMB Circular A-133 reports to the State Controller's Office (SCO). The SCO will then 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. Because EDD is calculating the six-month period from the date it receives copies of the audit report from the SCO rather than from the date the SCO first receives the report, It did not issue a management decision on one finding identified during the 2006–2007 fiscal year within the required six-month time frame. As of January 15, 2009, the management decision had not been issued and was two weeks overdue. However, part of the delay in issuing the management decision can be attributed to the SCO since it did not forward the audit report to EDD until more than two and one-half months after it was received. As a result, the State cannot ensure that it issues its management decisions timely.

Questioned Costs

Not applicable.

Recommendations

EDD's CMS should implement a more effective during-the-award monitoring process to ensure that all recipients of WIA funds, including CBOs, use federal funds for authorized purposes. Additionally, EDD should coordinate with the SCO 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

EDD stated that it recognizes the importance of conducting on-site compliance monitoring reviews for CBOs that receive federal WIA funds. These monitoring reviews ensure that these organizations provide WIA services that are in accordance with program, administrative, and financial requirements. As noted in the audit, the EDD conducts annual monitoring reviews for all 49 Local Workforce Investment Areas that receive the majority of California's WIA grant. Conducting additional reviews will require dedicated staffing resources that have the program knowledge and skills needed to conduct on-site reviews, report findings or observations, and work with the CBOs to correct outstanding issues.

To address this finding, additional program analysts, at the staff services analyst/associate governmental program analyst classification, will need to be hired or redirected from performing other critical functions in order to perform monitor reviews. EDD stated that it will proceed with an internal budgetary or staffing redirection to provide the dedicated staffing resources the CMS needs to perform monitoring reviews of the CBOs that receive federal WIA funds. It is anticipated that the monitoring reviews will be initiated in state fiscal year 2009–10. EDD stated that it will also work with the SCO to ensure the timely transmission of single audits allowing for management decisions to be issued within the required six months.

U.S. DEPARTMENT OF TRANSPORTATION

Reference Number:	2008-7-2
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 2007–08
Category of Finding:	Matching
State Administering Department:	Department of Transportation (Caltrans)

Criteria

TITLE 49—TRANSPORTATION, SUBTITLE III—GENERAL AND INTERMODAL PROGRAMS, CHAPTER 53—PUBLIC 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

In our prior-year audit, we reported that Caltrans required 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, it did not have a process in place to ensure that the MPO local matches originated from only allowable sources and met the allowable cost/cost principles requirements. Specifically, neither the Caltrans Office of Regional Interagency Planning (ORIP) staff, which oversee the program for the State, nor the district offices verified that the MPO drew their local matches only from allowable sources that met the allowable cost/cost principles requirements. Additionally, Caltrans did not perform any incurred cost audits, which it generally performs on one MPO annually to ensure that the amounts and fund sources are allowable and supported properly. Consequently, Caltrans had no assurance that the MPOs complied with the local match requirements.

During our follow-up procedures for fiscal year 2007–08, we found that Caltrans had yet to establish policies and procedures that require its district offices to review periodically the MPOs' invoices and supporting financial records that detail the source of funds used to meet their local match obligation. Caltrans expects to implement new policies and procedures by April 2009.

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, pending its Legal Division's approval, ORIP will make changes to its Request for Reimbursement (RFR) form. Additionally, on a quarterly basis it will require MPOs to submit and district office staff to review receipts substantiating the source of the local match shown on the submitted RFRs. Caltrans will also require both MPOs and the district offices to retain the local match documentation and provide it to ORIP when requested.

Caltrans plans to revise the Regional Planning Handbook (RPH) to reflect the new RFR processes. ORIP will publish the RPH by the end of February 2009 and will provide additional training to the districts on the new procedures. All changes to policies and procedures that govern the monitoring of local match will be made by April 2009.

U.S. DEPARTMENT OF VETERANS AFFAIRS

Reference Number:	2008-12-8
Federal Catalog Number:	64.114
Federal Program Title:	Veterans Housing—Guaranteed and Insured Loans
Federal Award Number and Year:	None; State Fiscal Year 2007–08
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, Subpart B—Guaranty or Insurance Loans to Veterans, 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.

TITLE 38—PENSIONS, BONUSES, AND VETERAN'S RELIEF, PART 36—LOAN GUARANTY, Subpart B—Guaranty or Insurance Loans to Veterans, Section 4317—Notice of Intention to Foreclose

Except on 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 fiscal year 2007–08, Veterans Affairs held 51 department-guaranteed loans for which the homeowners became 60 days delinquent. However, for one homeowner, Veterans Affairs did not notify the department of the 60-day delinquency. Additionally, Veterans Affairs held 29 department-guaranteed loans for which the homeowners became 90 days delinquent, but it did not submit to the department a notice of intent to foreclose for one homeowner.

According to one of its managers, Veterans Affairs was unaware that the reporting requirements for the notice of default and notice of intent to foreclose were still applicable after the department required it to sign an indemnification agreement for this loan. The manager indicated that now that Veterans Affairs is aware of the continuing requirement it will continue to comply with this requirement for similar situations.

Questioned Costs

Not applicable.

Recommendations

Veterans Affairs should notify the department of each 60-day delinquency on department-guaranteed loans as required. 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 stated that this finding relates to one loan file on which the department would not allow it to file a claim. Once it was notified that it could not file a claim for this loan, it did not continue to send the paperwork to report on and/or file a claim for this one rejected loan. Since the department rejected the loan and it could no longer file a claim for reimbursement with the department, it did not file the 60-day delinquency notice and the 30-day foreclosure notice. It was not aware that it had to continue to send the department forms that updated progress for a loan that could no longer be filed as a claim.

Veterans Affairs also stated that now that it is aware of this requirement, it has notified staff of its policy to file all progress notices on all VA loans, even in the event of a loan on which it cannot file a claim.

THE CORPORATION FOR NATIONAL AND COMMUNITY SERVICE

Reference Number:	2008-7-9
Federal Catalog Number:	94.006
Federal Program Title:	AmeriCorps
Federal Award Numbers and Year:	06ACHCA001; 2006 06AFHCA001; 2006
Category of Finding:	Earmarking
State Administering Department:	CaliforniaVolunteers

Criteria

TITLE 45—PUBLIC WELFARE, PART 2521—ELIGIBLE AMERICORPS SUBTITLE C PROGRAM APPLICANTS AND TYPES OF GRANTS AVAILABLE FOR AWARD, Section 2521.95—To What Extent May I Use Grant Funds for Administrative Costs?

(a) Not more than five percent of the grant funds provided under this part for any fiscal year may be used to pay for administrative costs, as defined in Section 2510.20 of this chapter.

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.

AMERICORPS APPLICATION INSTRUCTIONS, State and Territory Competitive; State Education Award Program; National Direct; National Education Award Program; National Professional Corps; Indian Tribes; States, Territories, and Commonwealths Without Commissions; National Planning, APPENDIX E: Budget Instructions (Budget Section), Section III—Administrative/Indirect Costs, B. Options for Calculating Administrative/Indirect Costs

> State Commission 1% Set-Aside Share Option. Regardless of the method used to calculate administrative costs, state commissions may choose to set aside a portion of the Corporation share to use in administering its subgrantees. This amount must not exceed a one-fifth share of the maximum 5 percent Corporation share. When using this option, the subgrantee's portion must not exceed the remaining 4 percent portion of the maximum Corporation share.

Condition

In our prior-year audit, we reported that CaliforniaVolunteers lacked an adequate process to identify separately its administrative expenditures in its accounting records. Specifically, CaliforniaVolunteers did not track and allocate 1 percent of its administrative costs separately. We also reported that CaliforniaVolunteers' process for requesting funds from the Corporation for National and Community Service (corporation) lacked documentation of its review and approval of the request.

During our follow-up procedures for fiscal year 2007–08, we found that CaliforniaVolunteers implemented our recommendation to correct this finding. In October 2007 CaliforniaVolunteers established a new program cost account code to track the 1 percent administrative cost allocation separately in its accounting records. It also maintained documentation of its review and approval of requests for funds from the corporation.

However, while reviewing its process for calculating 1 percent of its administrative costs, we found that CaliforniaVolunteers' calculation was incorrect. According to the corporations' instructions, to allocate the commission share of the administrative costs, CaliforniaVolunteers must multiply the sum of the corporation shares of "program operating costs" (Section I) and "member costs" (Section II) by 1.05 percent. Based on our review of the calculations of its administrative costs related to payments it made to four subgrantees, CaliforniaVolunteers inappropriately included the "subgrantees administrative costs" in its calculations. By including "subgrantee administrative costs" in the calculation of its administrative costs, CaliforniaVolunteers overstates its share of the administrative costs by 4.2 percent.

However, we were unable to determine if CaliforniaVolunteers drew down more than 1 percent for its administrative costs because of the lag time between its calculation and actual drawdown. According to CaliforniaVolunteers' director of legislation, finance, and administration, she is working toward recalculating the administrative costs and verifying that the amount drawn down to date does not exceed the maximum allowable costs to date. Until CaliforniaVolunteers performs this analysis, it cannot demonstrate that it is in compliance with this requirement.

Questioned Costs

Unknown

Recommendations

CaliforniaVolunteers should revise its methodology for calculating its share of administrative costs. CaliforniaVolunteers should also complete its analysis aimed at ensuring that the amount it has drawn down to date for its administrative costs does not exceed the maximum allowed under the corporation's guidelines.

Department's View and Corrective Action Plan

CaliforniaVolunteers stated that it has performed a review of its records and determined that regardless of the incorrect calculation methodology identified by the auditor, to date, it has not drawn down more than the allowable 1 percent for administrative costs against the federal award.

CaliforniaVolunteers stated that it calculates the amount of available 1 percent administrative costs on a quarterly basis. This calculation is performed in coordination with the reconciling of its accounting records with the federal cash transaction system. This reconciliation provides a verification of the actual amount paid to subgrantees from the federal grant at a specific point in time. Therefore, it is also an appropriate point in time to identify the amount available for use by CaliforniaVolunteers' administrative costs, since these funds cannot be drawn down until after the subgrantees have expended funds against the grant.

In order to verify that CaliforniaVolunteers had not drawn down more than 1 percent of its administrative costs over the period of availability for the AmeriCorps Grants associated with this finding, CaliforniaVolunteers stated that it performed the following steps for all funds expended under the grants for the period July 10, 2006, through December 31, 2008:

1) CaliforniaVolunteers identified the amount of funds for "subgrantee administrative costs" paid to all subgrantees during the period.

2) CaliforniaVolunteers recalculated the base against which the 1 percent administrative costs can be incurred by subtracting the "subgrantee administrative costs" from the total amount paid to subgrantees over the period. This results in a remaining amount, which equals the "program operating costs" and "member costs."

3) CaliforniaVolunteers then recalculated the 1 percent administrative costs allowable for use on the new base that only included "program operating costs" and "member costs."

4) CaliforniaVolunteers then compared the recalculated amounts allowable to the actual amount of fees drawn against the federal awards to date.

The results of this review and recalculation are provided in the table below and the documents associated with this analysis are available for auditor review.

AWARD	ALLOWABLE FOR 1 PERCENT ADMINISTRATIVE COSTS	DRAWN FOR 1 PERCENT ADMINISTRATIVE COSTS AS OF DECEMBER 31, 2008	BALANCE REMAINING TO BE DRAWN
06ACHCA001	$287,926.56	$225,839.91	$62,086.65
06AFHCA001	197,228.39	147,204.38	50,024.01
Totals	**$485,154.95**	**$373,044.29**	**$112,110.66**

Beginning with the quarter ending March 31, 2009, CaliforniaVolunteers will use the new methodology, as outlined above, to calculate the amount of 1 percent administrative costs available to be drawn against the grant award, so as not to overstate the amount available and prevent the possibility of overdrawing these funds in the future.

Reference Number:	2008-7-10
Federal Catalog Number:	94.006
Federal Program Title:	AmeriCorps
Federal Award Numbers and Year:	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, Section 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, Section 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

In our prior-year audit, we reported that CaliforniaVolunteers' processes did 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 its 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. We also reported that CaliforniaVolunteers did not review the underlying documentation that supports the expenses used for matching as reported on the subgrantee's periodic expense report to ensure they are from allowable sources.

During our follow-up procedures for fiscal year 2007–08, we found that CaliforniaVolunteers partially corrected this finding. Specifically, for the five contracts we tested, its subgrantees obtained MOUs from all partners before entering into a contract with CaliforniaVolunteers. However, CaliforniaVolunteers did not review the underlying documentation that supports the expenses used to meet the matching requirement to ensure they are from allowable sources. According to CaliforniaVolunteers, although its current fiscal desk review process includes the collection and review of underlying documentation that supports the subgrantees' reported matching expenses and it reviews this documentation for accuracy and allowability of the type of expense made, it does not confirm that the source of the match is allowable under the grant during the review. Until it does so, CaliforniaVolunteers has no assurance that its subgrantees' matching contribution amounts, as reported on their periodic expense reports, are from allowable sources.

Questioned Costs

Unknown

Recommendation

CaliforniaVolunteers should strengthen its current policies and procedures regarding its fiscal desk review process to ensure matching contributions reported by its subgrantees are from allowable sources.

Department's View and Corrective Action Plan

CaliforniaVolunteers stated that although it reviews documentation regarding match commitments prior to entering into the grant and reviews accounting documents that show separation of match expenditures from federal expenditures from the grant, it does not review source documentation of the actual deposit of match funds into grantee accounts.

CaliforniaVolunteers also stated that it will update its policies and procedures for the fiscal desk review process to ensure that it includes the collection and review of source documents associated with the receipt and deposit of matching funds to ensure that they are coming from allowable sources. This will likely include the review of copies of checks deposited into accounts or documentation of automatic fund transfers to verify the source of funds. These policies will be implemented beginning with fiscal desk reviews done for grantees that have completed the 2007–08 program year.

Reference Number:	2008-13-15
Federal Catalog Number:	94.006
Federal Program Title:	AmeriCorps
Federal Award Numbers and Year:	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 NONPROFIT 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

In our prior-year audit, we reported that CaliforniaVolunteers lacked internal controls to ensure that the Catalog of Federal Domestic Assistance (CFDA) number was identified to its subgrantees at the time of the award. We also reported that records related to CaliforniaVolunteers' site visits of subgrantees did not contain evidence of its program operations manager's review or documentation to identify the

procedures performed during the visit and the records reviewed to arrive at its conclusions related to fiscal issues and fiscal compliance/fiscal management systems. Finally, we reported that desk reviews performed by CaliforniaVolunteers were not signed by preparers, lacked evidence of managerial review, and did not contain a fiscal monitoring component.

During our follow-up procedures for fiscal year 2007–08, we found that CaliforniaVolunteers partially corrected these conditions. For instance, on November 28, 2007, CaliforniaVolunteers adopted an interim policy to include the CFDA number on all of its contracts, award letters, and invoice forms. During fiscal year 2007–08, CaliforniaVolunteers sent letters to all of it subgrantees notifying them of the CFDA number. It also added the CFDA number to its invoice form and required subgrantees to use the new form beginning in January 2008. Further, on the five site visits we examined, we found evidence that supervisory reviews occurred. We also found that on December 6, 2007, CaliforniaVolunteers established an interim fiscal desk review policy and that both a preparer and supervisor signed the five desk reviews we examined.

However, CaliforniaVolunteers continues to review and evaluate its interim policy and procedures related to the review and documentation of fiscal information on site visits. CaliforniaVolunteers stated it has accessed technical assistance from the Corporation for National and Community Service and is utilizing the results of its fiscal desk reviews to determine the high-risk areas for programs. CaliforniaVolunteers also stated that it is in the process of entering into an agreement with the Department of Finance's Office of State Audits and Evaluations to assist it with the evaluation of its site visits. CaliforniaVolunteers expects implementation of its updated site visit policy and procedures during fiscal year 2008–09.

Questioned Costs

Not applicable.

Recommendation

CaliforniaVolunteers should continue its efforts to review and evaluate its interim policy and procedures related to site visits.

Department's View and Corrective Action Plan

CaliforniaVolunteers stated that in the initial audit it indicated that it was in the process of evaluating the current site visit policies and procedures and updating them 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 on a site visit. CaliforniaVolunteers also indicated that full implementation of changes identified will occur during fiscal year 2008–09.

CaliforniaVolunteers also stated it is continuing to review and update site visit procedures to address this issue. Since the initial audit, CaliforniaVolunteers has determined that a more comprehensive review of subgrantee fiscal monitoring is needed to ensure that comprehensive policies and procedures were developed. Toward this end, CaliforniaVolunteers entered into an interagency agreement with the Department of Finance, Office of State Audits and Evaluation to: 1) review CaliforniaVolunteers' Single Audit finding and provide recommendations for mitigating the issues identified; 2) assist CaliforniaVolunteers with developing and documenting an ongoing risk-based grant monitoring process for the federal AmeriCorps grants; 3) conduct a compliance review of at least one high-risk subgrantee, and; 4) allow CaliforniaVolunteers staff to accompany Department of Finance staff when they perform the compliance review of the high-risk subgrantee for training purposes. CaliforniaVolunteers stated that it is expected that the results of these activities will strengthen its overall subgrantee monitoring process as well as determine how, when, and what methods should be used for reviewing fiscal information on site visits. CaliforniaVolunteers also stated that these results will be used to finalize updated policies and procedures for site visit activities. CaliforniaVolunteers stated that work on this interagency agreement began in January 2009 and is expected to last approximately four months.

Finally, CaliforniaVolunteers stated that because this review is taking place during fiscal year 2008–09 and the results will not be available until near the end of that year, the final revision and full implementation of changes to the documentation of fiscal issues on site visits will likely not take place until fiscal year 2009–10.

U.S. ELECTION ASSISTANCE COMMISSION

Reference Number:	2008-7-1
Federal Catalog Number:	90.401
Federal Program Title:	Help America Vote Act (HAVA) Requirements Payments
Federal Award Numbers and Years:	None; 2005 None; 2004
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-A—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

In our prior-year audit, we reported that the Secretary of State did not comply with the HAVA MOE requirement because it failed to include all of the appropriate expenditures.

During our follow-up procedures for fiscal year 2007–08, we found that the Secretary of State continues to lack adequate internal controls to ensure that it calculates and reports properly the HAVA MOE requirement. Specifically, the Secretary of State calculated its MOE requirement and submitted it to the U.S. Elections Assistance Commission (EAC) on May 28, 2008. However, the Secretary of State was unable to provide documentation to support the MOE amounts it reported to the EAC. According to the deputy secretary of state of HAVA activities, he was unable to recreate the information used to prepare the report because the data included in the report contains calculation errors and county reporting errors. As a result, we were unable to determine if the Secretary of State met its baseline or subsequent years' MOE requirement for fiscal year 2007–08. The deputy Secretary of State of HAVA activities later noted that his staff recalculated the MOE requirement and resubmitted it to the EAC on December 3, 2008.

We also found that the Secretary of State only partially implemented our recommendation that it establish a process to obtain and validate county information, which it must use to establish its MOE calculation. Specifically, during fiscal year 2007–08, the Secretary of State collected county expenditure data and analyzed the reported data to ensure that counties were not claiming expenses that were reimbursed by the State. However, according to the deputy secretary of state of HAVA activities, it did not validate the county information because additional guidance on how to meet the requirement related to local government spending had not been provided by the EAC. He also pointed out that on April 30, 2008, the EAC voted to suspend the requirement to gather county data for MOE reporting purposes until a new advisory can be approved by the EAC.

Questioned Costs

Not applicable.

Recommendations

The Secretary of State should ensure that it retains documentation of the method it uses to calculate and report the base level and subsequent level of MOE expenditures reported to the EAC. The Secretary of State should also retain documentation to support the MOE expenditures it includes in its reports. If the EAC approves an advisory that reinstates the need to report the county data, the Secretary of State should establish a process to validate the county information it uses in its MOE calculation.

Department's View and Corrective Action Plan

The Secretary of State provided the Bureau of State Audits with the following response:

The EAC has modified its MOE policy three times over its history, which has led to challenges in accurately interpreting and fully implementing the policy. These changes, according to public testimony from EAC commissioners, have come due, in part, to the complexity of the policy and the difficulty in collecting data. As noted by the BSA above, the initial MOE policy required states to collect state and county expenditure data for six specific types of expenditures, some of which were open to interpretation, including: voting system purchases; operating voter registration databases; providing information to voters at the polling place; implementing provisional voting; verifying voter information; and "improving the administration of elections." The EAC adopted its first policy on May 1, 2007, and modified the policy on September 6, 2007, nearly eight years beyond the date for

establishing the 1999–2000 base year for MOE. Consequently, gathering both state and local data on expenditures has been difficult because past and current expenditures for the discrete activities was not accounted for in the manner prescribed by the MOE policy, and the 1999–2000 base year is beyond the records-retention schedule followed by state and local governments for most fiscal data. This lack of fiscal and accounting records for specific expenditures makes it difficult to validate data reconstructed by counties for reporting purposes. There also is no specific mandate in HAVA that requires the Secretary of State to validate county submissions. As a result the Secretary of State relied upon data submitted by the counties.

It should be noted that the lack of concrete eight-year-old county and state data is not limited to California. This fact may explain why the EAC suspended its MOE policy as it relates to county expenditures on April 30, 2008. The suspension of the policy is an indefinite one and is in place until such time as the EAC adopts a new policy. A new policy was proposed by EAC vice chair Donetta Davidson on December 2, 2008, and the Secretary of State intends to comment on this new policy and to ask specifically for guidance on what supporting documentation it can rely upon for reporting the MOE.

Therefore, the Secretary of State will continue to monitor EAC action with respect to adoption of an MOE policy and report data according to the policy in place at the time of reporting.

Reference Number:	2008-12-1
Federal Catalog Number:	90.401
Federal Program Title:	Help America Vote Act (HAVA) Requirements Payments
Federal Award Numbers and Years:	None; 2005 None; 2004
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.

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 105-71.141—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

In our prior-year audit, we reported that the Secretary of State did not accurately report the amounts in its annual Financial Status Report.

Our follow-up procedures related to the Secretary of State's amended Financial Status Report for federal fiscal year 2007 that it submitted to the U.S. Elections Assistance Commission (EAC) on May 28, 2008, found that the Secretary of State continues to not accurately report some amounts. Specifically, according to the EAC's guidance for completing the Financial Status Report, the recipient's share of net outlays should include the amount of the State's matching funds and the interest earned on those funds. Although the Secretary of State reported $111 million for its total recipient share of net outlays, it provided us with a July 9, 2008, letter it sent to the EAC stating that it had spent $37 million in matching funds. Thus, it appears the Secretary of State incorrectly reported its recipient share of net outlays. In addition to the incorrect amount, the Secretary of State also incorrectly reported the $111 million as third party in-kind contributions (noncash). Finally, the Secretary of State reported more than $88 million for the total recipient's share of unliquidated obligations but could not provide documentation to support this amount.

During the audit process it became clear to us that 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 because staff preparing and approving the report do not have the knowledge and experience necessary to complete it. Inaccurate reporting prevents the EAC from knowing the true status of the funding provided to the State for HAVA.

Questioned Costs

Not applicable.

Recommendations

The Secretary of State should ensure that staff who prepare and review the Financial Status Report are knowledgeable of the federal financial reporting requirements. Additionally, the Secretary of State should ensure that the amounts it reports are supported by its accounting records. Finally, the Secretary of State should retain the documentation used to prepare the reports it submits to the EAC.

Department's View and Corrective Action Plan

The Secretary of State has incorporated the Bureau of State Audits' (BSA) findings to improve the accuracy of the HAVA Financial Status Reports. Further, the Secretary of State has and continues to devote staff resources to ensure the accuracy of the HAVA expenditures, particularly due to the complex nature of the HAVA budgeting and accounting, and changes in EAC opinions.

The Secretary of State acknowledges that it made a clerical error and reported the recipient's share on the wrong line of the report; it plans to submit a corrected Financial Status Report to the EAC.

The $111.1 million represents the amount of money California has paid to counties from the Voting Modernization Bond Act of 2002 (Proposition 41), which approved $200 million in bonds to upgrade voting systems. The $88.9 million represents the balance of the Proposition 41 funds allocated, but not yet provided, to the counties by the Voting Modernization Board in July 2002. The funding allocations are detailed on the Voting Modernization Board's Web site at http://www.sos.ca.gov/elections/vma/home.html.

The $37 million figure, which the BSA identified as inconsistent with the $111.1 million figure, was discussed in a letter from the Secretary of State to the EAC dated July 9, 2008. That $37 million is a subset of the $111.1 million and was in response to a question from the EAC about interest earned on the State's 5 percent matching funds. The $37 million was identified in that July 9, 2008, response as funding that could be applied to the State's 5 percent matching requirement, which was expended from the Voting Modernization Bond Fund before the State received its first allocation of HAVA funds. As the Secretary of State informed the EAC, that funding, which is in excess of the required $13.9 million match, had been provided to counties for the purpose of purchasing voting equipment that complies with HAVA Title III requirements after the obligation for a 5 percent match was created, but prior to the State receiving its first allocation of HAVA funds. The cumulative amount exceeded the 5 percent match and was made prior to establishing the State Election Fund. Therefore, no interest was earned on the funds. California will report the appropriate amount of matching funds and retain supporting documentation to establish that it met its 5 percent matching requirement in the manner described in its response to the EAC.

The Secretary of State will continue its increased efforts for training of staff responsible for the preparation and review of the Financial Status Report to ensure they are knowledgeable of the federal financial reporting requirements.

To support the amounts reported, the Secretary of State will continue to retain the documentation used to support and prepare the Financial Status Report. Further, the Secretary of State will reassess accounting reports used to support the Financial Status Reports to make them more user friendly.

Reference Number:	2008-13-1
Federal Catalog Number:	90.401
Federal Program Title:	Help America Vote Act (HAVA) Requirements Payments
Federal Award Numbers and Years:	None; 2005 None; 2004
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 the 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

In our prior-year audit, we reported that 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 was 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.

During our follow-up procedures for fiscal year 2007–08, we found that the Secretary of State partially corrected this finding. Specifically, the Secretary of State amended its agreements with 34 of its 41 subrecipients by the end of the fiscal year, June 30, 2008. Our review of four of the 34 amendments found that the CFDA title and number and the name of the federal agency was present. According to the deputy secretary of state of HAVA activities, the remaining seven counties signed and returned their amendments by October 2008.

Questioned Costs

Not applicable.

Recommendation

The Secretary of State should continue to ensure that its agreements with its subrecipients include all of the required award identification information.

Department's View and Corrective Action Plan

The Secretary of State provided the Bureau of State Audits with the following response:

As noted above, all current county contracts now contain the CFDA title and number. While this information is important, it should be noted that this technical oversight did not otherwise impact the contract with the counties and information now provided in the contracts was previously provided to counties upon request. Delay in execution of the contract amendment to add this information probably resulted from counties devoting all resources to the conduct of three federal elections in 2008. This information will be included in future contracts with counties.

KPMG LLP

U.S. DEPARTMENT OF AGRICULTURE

Reference Number:	2008-3-1
Federal Catalog Number:	10.557
Federal Program Title:	Special Supplemental Nutrition Program for Women, Infants and Children (WIC)
Federal Award Numbers and Year:	7CA700CA7; 2008 7CA720CA7; 2008 7CA700CA1; 2008 8CA700029; 2008
Category of Finding:	Cash Management
State Administering Department:	Department of Public Health (Public Health)

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.

Condition

During our procedures performed over Public Health's payments made to contractors, we noted that it requests cash advances (drawdowns) from the federal government and then requests payments to be made to contractors by the State Controller's Office (SCO). The program falls under the Cash Management Improvement Act (CMIA) with a required funding technique of preissuance for payments to contractors. The preissuance technique requires the State to disburse payments to contractors not more than three days after the advance is deposited in the state account.

In our sample of 30 drawdowns totaling approximately $10 million, we noted one drawdown for $34,379 where the payment to the contractor was issued 15 days from the date of the drawdown request, which exceeds the three-day requirement per the CMIA agreement. By not issuing the warrant within three days from the date of the drawdown request, Public Health is not in compliance with the cash management requirements of the WIC program.

Questioned Costs

Not determined.

Recommendation

Public Health should enhance its current policies and procedures to ensure payments to contractors are issued within the three-day timing requirement.

Department's View and Corrective Action Plan

Public Health agrees with the audit finding and stated that accounting does follow the cash management procedures of a three-day drawdown. The Payables Unit submits a form to the drawdown federal funds desk indicating the date federal money should be drawn for each claim schedule. Public Health also stated that it attaches to the CMIA work sheet that it submits to the Department of Finance

(Finance) an explanation when schedules are drawn past 10 days. In the sample cited, claim schedule #2170885 was a claim cut by the SCO. The contractor was rescheduled on claim schedule #2170988. The federal money was drawn for the original claim schedule #2170885, but accounting was not aware of the claim cut by the SCO until the schedule was returned. The delay between the original claim and the rescheduled claim created the excess cash management days. An explanation for the 15-day drawdown was included in the CMIA working papers provided to Finance.

Reference Number:	2008-3-2
Federal Catalog Number:	10.557
Federal Program Title:	Special Supplemental Nutrition Program for Women, Infants and Children (WIC)
Federal Award Numbers and Year:	7CA700CA7; 2008 7CA720CA7; 2008 7CA700CA1; 2008 8CA700029; 2008
Category of Finding:	Cash Management
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 92.20—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 was no evidence of review or approval by someone other than the preparer for four of the 30 federal cash drawdown requests selected. We also noted that there was no evidence of review or approval on the related claim schedule for one of the 30 samples selected. Finally, we noted that there was no evidence of review or approval on the Cash Management Improvement Act (CMIA) local assistance work sheet for one of the two samples selected.

Without appropriately designed controls in place, there is a 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. Specifically, for effective control and accountability to safeguard the assets, someone other than the preparer should review and approve the federal draw request, which would include the claim schedules and CMIA local assistance work sheets.

Department's View and Corrective Action Plan

Public Health agrees with the audit finding that the drawdown was prepared and remittance advice was signed by the same person. Public Health stated there was a short period of time when employees with a classification of senior accounting officer and above could sign their own work. Since 2007, accounting procedures have been changed, and the supervisor will sign and review all work. Public Health also stated this type of finding should not occur in the future.

Public Health agrees that the claim schedule did not have evidence of review or approval. However, Public Health stated the original claim schedule was signed by a supervisor in order for it to be processed by the State Controller's Office.

Finally, Public Health agrees with the audit finding that there was no evidence of review or approval on the July 2007–September 2007 CMIA local assistance work sheet. Public Health stated this was an oversight made by a new supervisor, and procedures now are in place so that the CMIA local assistance work sheet is approved by the supervisor. Public Health also stated this type of finding should not occur in the future.

Reference Number:	2008-13-3
Federal Catalog Numbers:	10.553, 10.555, 10.556, and 10.559
Federal Program Titles:	Child Nutrition Cluster: School Breakfast Program, National School Lunch Program, Special Milk Program for Children, and Summer Food Service Program for Children
Federal Award Number and Year:	58-3198-7430; 1998
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Education (Education)

Criteria

TITLE 7—AGRICULTURE—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 3016.37, Subgrants

(a) 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. 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;

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 noted the program uses School Nutrition Annual Participation Statements (APS) as its means to communicate award identification to its Local Educational Agencies (LEAs). However, we also noted that Education supplies its LEAs with reports of donated commodities received during the fiscal year from its commodity distribution unit entitled Direct Shipment Information 2008-2007 Year. This additional communication of donated commodities does not contain award identification information to inform its LEAs that these are additional program awards of the National School Lunch Program (NSLP), Catalog of Federal Domestic Assistance (CFDA) Number 10.555, which are required to be included in the LEAs' total federal award expenditures that are subject to annual federal audit.

By not including the program award information for the donated commodities, LEAs may not be appropriately identifying these amounts as federal awards. Underreporting of federal awards could result in the funds not being audited as part of the LEAs' OMB Circular A-133 audit. As a result of this lack of federal award notification, Education disbursed more than $122 million of donated commodities for the fiscal year ended June 30, 2008, without assurances that LEAs were properly reporting these as federal awards.

Questioned Costs

Not applicable.

Recommendation

Education should implement policies and procedures to ensure that it provides complete award information to its subrecipient LEAs regarding donated commodities.

Department's View and Corrective Action Plan

Education does not concur with this finding and stated donated commodities are not part of the NSLP. Education also stated the auditors appear to have incorrectly combined two separate programs, the NSLP that is governed by 7 CFR, Part 210, and the Food Distribution Program (FDP) that is governed by 7 CFR, Part 250. Because the FDP is not part of the NSLP, and because the donated commodities under the FDP do not have a United States Department of Agriculture (USDA) assigned CFDA number, it would be inappropriate for Education to report the donated commodities with the reference of the NSLP CFDA number. However, Education will seek guidance from the USDA on providing LEAs with donated commodity information for purposes of reporting federal awards.

Auditor's Comments on Department's View

We reviewed the NSLP Program Facts Sheet dated July 2008 and noted it indicated, "In addition to cash reimbursements, schools are entitled by law to receive commodity foods, called 'entitlement' foods. Schools can also get 'bonus' commodities, as they are available from surplus agricultural stocks. States

select entitlement foods for their schools from a list of various foods purchased by USDA and offered through the school lunch program. Bonus foods are offered only as they become available through agricultural surplus." Also, we noted that the value of these donated commodities that are provided to its LEAs, as supplied by Education in its Entitlement/Bonus Summary Report, are included in the State of California's schedule of federal assistance in its OMB Circular A-133 audit report under the National School Lunch Program (CFDA 10.555). By indicating in its response that the donated commodities are not part of the National School Lunch Program, Education is inconsistent with the statewide reporting of these donated commodities.

Reference Number:	2008-13-4
Federal Catalog Number:	10.557
Federal Program Title:	Special Supplemental Nutrition Program for Women, Infants and Children (WIC)
Federal Award Numbers and Years:	7CA700CA7; 2008 7CA720CA7; 2008 7CA700CA1; 2008 8CA700029; 2007
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Public Health (Public Health)

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:

(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.

(h) The non-Federal entity shall transmit the reporting package, which shall include the non-Federal entity's financial statements, schedule of expenditures of Federal awards, corrective action plan defined under subsection (i), and auditor's reports developed pursuant to this section, to a Federal clearinghouse designated by the Director, and make it available for public inspection within the earlier of:

(1) 30 days after receipt of the auditor's report; or

(2) (B) 9 months after the end of the period audited, or within a longer time frame authorized by the Federal agency, determined under criteria issued under section 7504, when the 9-month time frame would place an undue burden on the non-Federal entity.

TITLE 7—AGRICULTURE, SUBPART B—REGULATIONS OF DEPARTMENT OF AGRICULTURE, PART 246—SPECIAL SUPPLEMENTAL NUTRITION PROGRAM FOR WOMEN, INFANTS AND CHILDREN, Subpart F—Monitoring and Review, Section 246.19—Management Evaluation and Monitoring Reviews

(b) State Agency Responsibilities

(1) The state agency shall establish an ongoing management evaluation system, which includes at least the monitoring of local agency operations, the review of local agency financial and participation reports, the development of corrective action plans to resolve program deficiencies, the monitoring of the implementation of corrective action plans, and on-site visits. The results of such actions shall be documented.

(2) Monitoring of local agencies must encompass evaluation of management, certification, nutrition education, participant services, civil rights compliance, accountability, financial management systems, and food delivery systems. If the state agency delegates the signing of vendor agreements, vendor training, or vendor monitoring to a local agency, it must evaluate the local agency's effectiveness in carrying out these responsibilities.

(3) The state agency shall conduct monitoring reviews of each local agency at least once every two years. Such reviews shall include on-site reviews of a minimum of 20 percent of the clinics in each local agency or one clinic, whichever is greater. The state agency may conduct such additional on-site reviews as the state agency determines to be necessary in the interest of the efficiency and effectiveness of the program.

(4) The state agency must promptly notify a local agency of any finding in a monitoring review that the local agency did not comply with program requirements. The state agency must require the local agency to submit a corrective action plan, including implementation time frames, within 60 days of receipt of a state agency report of a monitoring review containing a finding of program noncompliance. The state agency must monitor local agency implementation of corrective action plans.

Condition

1 During procedures performed over subrecipient monitoring of OMB Circular A-133 audits, we noted that Public Health's policy is to issue late notices to local agencies whose OMB Circular A-133 audits are not received by the due date. For one of the 30 samples selected, we noted that the OMB Circular A-133 audit report was not submitted by the local agency within nine months. However, Public Health did not issue a late notice to the subrecipient after being 30 days past due.

We noted that this subrecipient submitted an OMB Circular A-133 audit report on March 5, 2008, for fiscal year ended June 30, 2006, instead of for fiscal year ended June 30, 2007, which was due March 31, 2008. We reviewed a notice sent by Public Health on July 7, 2008, to the local agency requesting the correct fiscal year ended June 30, 2007, OMB Circular A-133 audit report, which it received on July 25, 2008.

2 During procedures performed over during-the-award monitoring, we noted that Public Health contracts with the State Controller's Office (SCO) to perform financial management reviews, which take place for all local agencies every two years. For issues identified during this review, the agency is required to submit a corrective action plan (CAP) within 60 days of the date of the finding letter. In our sample of 30 completed reviews, we noted the following:

- For two of the 30 reviews selected, we noted Public Health was not able to locate the CAP submitted by the local agencies to support that proper follow-up on corrective actions were taken.

- For one of the 30 reviews selected, there was no evidence of review and approval of the CAP by Public Health's WIC local agency support section.

Without properly designed processes and controls in place to notify, obtain, and review the required OMB Circular A-133 audits and CAPs, there is increased risk that subrecipient agencies may not be complying with federal program rules and regulations. Amounts paid to subrecipients totaled $36.6 million of the $952 million total WIC program expenditures for the fiscal year ended June 30, 2008.

Questioned Costs

Not determined.

Recommendations

Public Health should enhance its current policies and procedures to ensure OMB Circular A-133 audit reports are submitted within nine months after the agencies' year-end and that the reviews are completed for the correct year-end. Public Health should also implement controls for following up on findings related to the financial management reviews.

Department's View and Corrective Action Plan

Public Health stated this finding revealed a breakdown in communication between its two WIC sections, which resulted in inconsistent monitoring and follow-up, both in receiving and reviewing the local agency CAP. While previous findings were communicated among sections within WIC by mail, future monitoring will be accomplished by establishing a lead coordinator within the local agency support branch who will meet regularly with the WIC program integrity section representative and when necessary meet with the SCO representative to monitor the status and satisfactory completion of all audit-related activities within the required time frames. Additionally, a larger work group is forming to address the financial review coordination and separation of duties among staff within the WIC division. Upon approval of the local agency CAP, the local agency support branch coordinator will issue a letter of closure and make sure that all required documentation is located appropriately in the local agency file.

Public Health also stated this finding was caused by staff's inadvertent failure to identify that the OMB Circular A-133 audit report received was for the incorrect audit period. WIC staff obtained the correct report and processed it appropriately. The deficiency was not self-identified sooner due to a backlog in audit report processing at the SCO, which has been corrected. Future monitoring of report timeliness will occur during quarterly meetings already established with the SCO, whereby the SCO verifies that the OMB Circular A-133 audit reports have the appropriate minimum components and are not deficient. If an audit report is found to be deficient, the SCO will contact the WIC local agency or parent agency and obtain any missing components. Additionally, the SCO will obtain a CAP from local agencies with any findings or finance-related concerns, evaluate the acceptability of the CAP, and respond in writing with a management decision letter.

Reference Number:	2008-14-2
Federal Catalog Numbers:	10.553, 10.555, 10.556, and 10.559
Federal Program Titles:	Child Nutrition Cluster: School Breakfast Program, National School Lunch Program, Special Milk Program for Children, and Summer Food Service Program for Children
Federal Award Number and Year:	58-3198-7430; 1998
Category of Finding:	Special Tests and Provisions—Accountability for Commodities
State Administering Department:	Department of Education (Education)

Criteria

TITLE 7—AGRICULTURE, CHAPTER II—FOOD AND NUTRITION SERVICE, DEPARTMENT OF AGRICULTURE, PART 250—Donation of Food for Use in the United States, its Territories, Subpart B—General Operating Provisions, Section 250.14—Warehousing, Distribution, and Storage of Donated Foods

(e) Physical inventory. During the annual review required by paragraph (c) of this section, distributing agencies and subdistributing agencies shall take a physical inventory of their storage facilities. The physical inventory shall be reconciled with each storage facility's book inventory. The reconciliation records shall be maintained by the agency that contracted for or maintained the storage facility. Food items that have been lost, stolen, or found to be out of condition, shall be identified and recorded. Potential excessive inventory, as described in paragraph (f) of this section, shall be reported by the subdistributing agency to the distributing agency. Corrective action on each deficiency noted during these inventories shall be initiated immediately, and a written report of those corrective actions shall be forwarded to the distributing agency. Where applicable, the distributing agency shall pursue claims in accordance with Section 250.15(c).

Condition

During procedures performed over accountability for commodities, we noted that Education performs semiannual inventory counts of its commodities on June 30 and December 31 each year and reconciles those counts to its perpetual inventory system. We performed the procedure of selecting a sample of significant commodities physically on hand as of our audit date and rolling them back to the most recent semiannual inventory count, using purchase and shipping documentation to account for activity, in order to test the validity of the required annual physical inventory count.

In our procedures performed over those commodities, we noted two items where the physical quantity on hand did not reconcile to the adjusted quantity in Education's inventory tracking system. Those differences were as follows:

- Our physical count for item one (rice) totaled 345 units; however, the adjusted inventory tracking system count was 339, which resulted in an understatement of six units in its inventory tracking system. The unit cost for this item was $6.44, which would result in an understatement of $39 (6 X $6.44).

- Our physical count for item two (rolled oats) totaled 768 units; however, the adjusted inventory tracking system count was 761, which resulted in an understatement of seven units in its inventory tracking system. The unit cost for this item was $14.10, which would result in an understatement of $99 (7 X $14.10).

Total exceptions amounted to $138 of the $13,071 sampled of the total commodity inventory value of $1,184,778 as of June 30, 2008.

Questioned Costs

None

Recommendation

Education should enhance its current policies and procedures over the physical inventory process to ensure that counts are properly performed and reconciled to the inventory tracking system.

Department's View and Corrective Action Plan

Education stated that to enhance inventory processes and help minimize discrepancies between physical counts and book inventory, it has implemented an electronic bar coding system to track all donated commodities that are ordered, received, and distributed to recipient agencies.

U.S. DEPARTMENT OF EDUCATION

Reference Number:	2008-1-1
Federal Catalog Number:	84.048
Federal Program Title:	Career and Technical Education—Basic Grants to States
Federal Award Numbers and Years:	V048A070005; 2007 V048A060005; 2006 V048A050005; 2005
Category of Finding:	Activities Allowed
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 an application and plan that outlines the proposed activities that will be performed under the Carl D. Perkins Career and Technical Education Act of 2006. These applications and plans are reviewed by Education for the appropriateness of the proposed activities in connection with the allowable activities in the federal Career and Technical Education (CTE) program guidance. Education's review process consists of a program consultant approval, which is documented (signed by a consultant) on the front page of the CTE Application for Funding.

In our sample of subgrant awards made to LEAs, we noted no evidence of the review and approval process for two of the 30 LEA awards selected. Program staff stated that although the applications were not signed, they believed the applications had been reviewed. However, without a formal sign-off,

there is no evidence that these applications and plans have actually been reviewed and approved. Total subgrant awards amounted to $122 million of the $130 million program expenditures for the fiscal year ended June 30, 2008.

Questioned Costs

Not applicable.

Recommendation

Education should strengthen its controls to ensure evidence of reviews and approvals are retained for all LEA subgrants.

Department's View and Corrective Action Plan

Education stated it strives to ensure that all applications are approved and signed appropriately by requiring its LEAs to submit two copies of their application. The exception identified by the auditors occurred because the staff inadvertently discarded the signed instead of the unsigned duplicate copy of the application. Education stated that to enhance the approval signature process in the future, it will require staff to verify that all applications contain the appropriate approvals prior to data entry, funding, and filing.

Reference Number:	2008-1-2
Federal Catalog Number:	84.287
Federal Program Title:	Twenty-First Century Community Learning Centers
Federal Award Numbers and Years:	S287C070005; 2007 S287C060005; 2006 S287C050005; 2005
Category of Finding:	Activities Allowed
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 an application that outlines the proposed activities that will be performed under the No Child Left Behind program. Applications that meet the specified criteria are forwarded to community representatives for scoring based on a standardized scoring system. Applications must meet a minimum passing score and are ranked based on these scores with the top agencies being funded. This review and scoring process is evidenced by the Final Application Score Sheet (score sheet).

In our sample of subgrant awards that were made to LEAs, there was no evidence of a score sheet for 23 of the 60 samples selected. Through our discussion with the program staff, we noted that they did not retain all of the score sheets in an attempt to maintain confidentiality of the reviewer. However, without a formal sign-off and retention of the score sheet, there is no evidence that these applications have actually been reviewed and approved, and Education cannot demonstrate support for the proper approval of grants. Total subgrant awards amounted to $101 million of the $103 million program expenditures for the fiscal year ended June 30, 2008.

Questioned Costs

Not applicable.

Recommendation

Education should strengthen its controls to ensure evidence of reviews and approvals are retained for all LEA subgrants.

Department's View and Corrective Action Plan

Education stated it will retain the application score sheets as evidence of reviews and approvals.

Reference Number:	2008-2-1
Category of Finding:	Allowable Costs
State Administering Department:	Department of Education (Education)
Federal Catalog Number:	84.002
Federal Program Title:	Adult Education—Basic Grants to States
Federal Award Numbers and Years:	V002A070005; 2007 V002A060005; 2006 V002A050005; 2005

Federal Catalog Number:	84.048
Federal Program Title:	Career and Technical Education—Basic Grants to States
Federal Award Numbers and Years:	V048A070005; 2007 V048A060005; 2006 V048A050005; 2005

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

During our procedures performed over state administrative expenditures charged to the programs, we reviewed Education's process and controls for recording payroll expenditures charged to both the Adult and Career and Technical Education programs. We noted employees complete a monthly personnel activity report (time sheet) that must account for the total activity and be signed by the employee. At the end of each month, the signed time sheets are reviewed and approved by the program supervisor and then forwarded to the division attendance clerk who reviews the time sheets for completeness and accuracy. The attendance clerk forwards all of the time sheets to the fiscal accounting services division time accountant to be processed and entered into the time accounting system. The data entry is performed by a time accountant, without review for accuracy and completeness at the fiscal accounting services division level. A detailed time and effort labor distribution summary report is made available to the program division on a monthly basis. The program division is responsible for reviewing the labor distribution summary report to ascertain the accuracy of the payroll expenditures that are charged to their program.

During our audit procedures, we noted one of the 30 sampled employee time sheets for the Adult Education program indicated 121.6 hours should be charged to the Adult Education program and 54.4 hours to another program. However, the time accountant incorrectly keyed all 176 hours into the accounting system to be charged to the Adult Education program. As a result of this data entry error that was not reviewed for accuracy, 54.4 hours were incorrectly charged to the Adult Education program.

Based on our discussion with Education, the error was not detected by Education's control processes and was corrected only after the auditors identified it. Without appropriately designed controls in place, there is increased risk that expenditures could be charged to the incorrect program.

Total Adult Education program exceptions amounted to $1,197 of the $132,640 sample of payroll out of the total payroll expenditures of $3,117,319 for the fiscal year ended June 30, 2008.

Questioned Costs

Payroll expenditures of $1,197 (54.4 hours x $22 per hour) were incorrectly charged to the Adult Education program.

Recommendation

Education should strengthen its processes and controls to reduce the risk of inappropriate charges to its federal programs.

Department's View and Corrective Action Plan

Education stated that although the auditors identified a transcription error that was inadvertently not immediately corrected, this error has been subsequently corrected to reflect the hours charged as reported on the labor distribution summary for the referenced employee. However, to minimize the risk of undetected timekeeping errors, Education will remind appropriate staff to utilize the Administrative Cost Reporting System in reviewing and verifying labor distribution work sheets each month. If a discrepancy in the timekeeping key entry process is detected, the employee's leave status and time activity reports will be reviewed to determine the appropriate action that will resolve the discrepancy.

Reference Number:	2008-3-3
Category of Finding:	Cash Management
State Administering Department:	Department of Education (Education)
Federal Catalog Number:	84.002
Federal Program Title:	Adult Education—Basic Grants to States
Federal Award Numbers and Years:	V002A070005; 2007 V002A070005; 2006 V002A070005; 2005

Federal Catalog Number:	84.010
Federal Program Title:	Title I Grants to Local Educational Agencies
Federal Award Numbers and Years:	S010A070005; 2007 S010A060005; 2006 S010A050005; 2005

Federal Catalog Number:	84.186
Federal Program Title:	Safe and Drug-Free Schools and Communities—State Grants
Federal Award Numbers and Years:	Q186A070005; 2007 Q186A060005; 2006 Q186A050005; 2005

Federal Catalog Number:	84.287
Federal Program Title:	Twenty-First Century Community Learning Centers

Federal Award Numbers and Years:	S287C070005; 2007 S287C060005; 2006 S287C050005; 2005

Federal Catalog Number:	84.365
Federal Program Title:	English Language Acquisition Grants
Federal Award Numbers and Years:	T365A070005; 2007 T365A060005; 2006 T365A050005; 2005

Federal Catalog Number:	84.367
Federal Program Title:	Improving Teacher Quality State Grants
Federal Award Numbers and Years:	S367A070005; 2007 S367A060005; 2006 S367A050005; 2005

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.

Adult Education—Basic Grants to States

Education requests advance funds from the federal government and makes four quarterly payment advances to LEAs during the fiscal year. The first two 25 percent advances are made without input from the LEA as to expenditures incurred or cash needs. The third quarter advance is made to the LEA after it submits its midyear expenditure report. If the LEA has expended 40 percent of its total grant award, it is paid another full 25 percent advance (75 percent cumulative award advances). If the LEA reports less than 40 percent of the total grant award expended, it only receives an additional 10 percent advance (60 percent cumulative award advances). The final payment is made to the LEA after it submits the final expenditure report for the remaining amount expended.

The timing and amounts advanced to LEAs does not take their cash needs into consideration. As a result, Education disbursed over $81 million to LEAs during the fiscal year ended June 30, 2008, without ensuring they minimized the time between the receipt and disbursement of federal funds, which does not comply with federal guidelines.

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 receives some expenditure information reported on its annual two-part consolidated application (CONAPP); however, the expenditure information provided is not timely or frequent enough to provide adequate information to Education to effectively assess the cash needs of its LEAs. Part I of this CONAPP is due on the last day of each fiscal year and provides estimates of total program expenditures for that fiscal year. Part II of the CONAPP report contains the actual year-end expenditures but is not due to Education until seven months after the end of the fiscal year.

The timing of the advance payments made to LEAs does not adequately take their cash needs into consideration as minimal expenditure data or input was obtained from them during the award year. As a result, Education disbursed over $1.6 billion to LEAs during the fiscal year ended June 30, 2008, with no assurances that these subrecipients minimized the time between the receipt and disbursement of federal funds, which does 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 receives some expenditure information reported on its annual two-part CONAPP; however, the expenditure information provided is not timely or frequent enough to provide adequate information to Education to effectively assess the cash needs of its LEAs. Part I of this CONAPP is due on the last day of each fiscal year and provides estimates of total program expenditures for that fiscal year. Part II of the CONAPP report contains the actual year-end expenditures but is not due to Education until seven months after the end of the fiscal year.

The timing of the advance payments made to LEAs does not adequately take their cash needs into consideration as minimal expenditure data or input was obtained from them during the award year. As a result, Education disbursed over $35.8 million to LEAs during the fiscal year ended June 30, 2008, with no assurances that these subrecipients minimized the time between the receipt and disbursement of federal funds, which does not comply with federal guidelines.

Twenty-First Century Community Learning Centers

Education requests advance funds from the federal government and makes three predetermined payment advances to LEAs during the fiscal year. The first 25 percent is advanced at the beginning of the award upon receipt of the current year budget from the LEA. The second and third advances of 25 percent are paid in each subsequent quarter. The fourth quarter advance is 15 percent, leaving 10 percent held until receipt of the final expenditure report. This program requires quarterly expenditure reporting; however, the advanced amounts were not adjusted for amounts spent that were more or less than the advance provided. In order to gain a better understanding of Education's process, we reviewed the cash management process for a subrecipient and compared the amounts advanced and amounts expended at the end of the third quarter. We noted the LEA had received advances totaling 75 percent of the total grant award, but had only expended 27 percent of the total grant award.

The timing and amounts advanced to LEAs does not take their cash needs into consideration. As a result, Education disbursed over $101 million to LEAs during the fiscal year ended June 30, 2008, without ensuring they minimized the time between the receipt and disbursement of federal funds, which does not comply with federal guidelines.

English Language Acquisition Grants

Education requests advance funds from the federal government and makes three predetermined payment advances to LEAs during the fiscal year. Education receives some expenditure information reported on its annual two-part CONAPP; however, the expenditure information provided is not timely or frequent enough to provide adequate information to Education to effectively assess the cash needs of its LEAs. Part I of this CONAPP is due on the last day of each fiscal year and provides estimates of total program expenditures for that fiscal year. Part II of the CONAPP report contains the actual year-end expenditures but is not due to Education until seven months after the end of the fiscal year. In addition, the program requires an End-of-Year Expenditure Report, which is due by mid-October after the end of each fiscal year.

The timing of the advance payments made to LEAs does not adequately take their cash needs into consideration as minimal expenditure data or input was obtained from them during the award year. As a result, Education disbursed over $169 million to LEAs during the fiscal year ended June 30, 2008, with no assurances that these subrecipients minimized the time between the receipt and disbursement of federal funds, which does not comply with federal guidelines.

Improving Teacher Quality State Grants

Education requests advance funds from the federal government and makes three predetermined payment advances to LEAs during the fiscal year. Education receives some expenditure information reported on its annual two-part CONAPP; however, the expenditure information provided is not timely or frequent enough to provide adequate information to Education to effectively assess the cash needs of its LEAs. Part I of this CONAPP is due on the last day of each fiscal year and provides estimates of total program expenditures for that fiscal year. Part II of the CONAPP report contains the actual year-end expenditures but is not due to Education until seven months after the end of the fiscal year. In addition, the program requires an End-of-Year Expenditure Report, which is due by mid-October after the end of each fiscal year.

The timing of the advance payments made to LEAs does not adequately take their cash needs into consideration as minimal expenditure data or input was obtained from them during the award year. As a result, Education disbursed over $319 million to LEAs during the fiscal year ended June 30, 2008, with no assurances that these subrecipients minimized the time between the receipt and disbursement of federal funds, which does not comply with federal guidelines.

Questioned Costs

Not determined.

Recommendation

Education should revise its current policies and procedures over the issuance of cash advances to LEAs to include a more effective monitoring of their cash needs with the timing of advance payments to minimize the time elapsing between the advance of federal funds and expenditure by the LEAs.

Department's View and Corrective Action Plan

Education stated it is continually improving its cash management processes for disbursing federal program funds to subrecipients. To further strengthen its processes for disbursing and monitoring federal funds, Education stated it established an internal task force to develop a cash management improvement plan. Education's foremost cash management goals are to: (1) improve cash balance reporting, fiscal monitoring, and funding processes to minimize the time between subrecipients' receipt and disbursement of federal funds and (2) revert interest earned on unspent federal funds back to the U.S. Treasury. To bolster this endeavor, Education stated it is coordinating efforts with members of the U.S. Department of Education, Office of the Secretary, Risk Management Service (RMS), for advice and suggestions on improving cash management over federal funds.

Education's cash management improvement plan calls for subrecipients to submit fiscal information utilizing a Web-based system specifically designed for minimizing the time between a subrecipient's receipt and use of federal funds. The basic methodology behind this plan involves obtaining subrecipient fiscal information on a scheduled basis, disbursing funds in consideration of cash balances, and identifying interest on unspent federal funds. Education expects to commence the cash management improvement plan with a pilot federal program. Once the pilot program is functioning as intended and deemed successful, other federal funded programs will be systematically incorporated into the new cash management processes.

Reference Number:	2008-3-4
Category of Finding:	Cash Management
State Administering Department:	Department of Education (Education)
Federal Catalog Number:	84.002
Federal Program Title:	Adult Education—Basic Grants to States
Federal Award Numbers and Years:	V002A070005; 2007 V002A070005; 2006 V002A070005; 2005

Federal Catalog Number:	84.010
Federal Program Title:	Title I Grants to Local Educational Agencies
Federal Award Numbers and Years:	S010A070005; 2007 S010A060005; 2006 S010A050005; 2005

Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education—State Grant Program
Federal Award Numbers and Years:	S011A070005; 2007 S011A060005; 2006 S011A050005; 2005

Federal Catalog Number:	84.186
Federal Program Title:	Safe and Drug-Free Schools and Communities—State Grants
Federal Award Numbers and Years:	Q186A070005; 2007 Q186A060005; 2006 Q186A050005; 2005

Federal Catalog Number:	84.287

Federal Program Title:	Twenty-First Century Community Learning Centers
Federal Award Numbers and Years:	S287C070005; 2007 S287C060005; 2006 S287C050005; 2005

Federal Catalog Number:	84.357
Federal Program Title:	Reading First State Grants
Federal Award Numbers and Years:	S357C070005; 2007 S357C060005; 2006 S357C050005; 2005

Federal Catalog Number:	84.365
Federal Program Title:	English Language Acquisition Grants
Federal Award Numbers and Years:	T365A070005; 2007 T365A060005; 2006 T365A050005; 2005

Federal Catalog Number:	84.367
Federal Program Title:	Improving Teacher Quality State Grants
Federal Award Numbers and Years:	S367A070005; 2007 S367A060005; 2006 S367A050005; 2005

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

During our procedures performed over cash management, we noted Education had inconsistent policies and procedures in place to ensure its local educational agencies (LEAs) were properly notified of their requirement to return interest earned over $100 on program advances and to ensure that this interest was returned on at least a quarterly basis. Education forwards any LEA voluntary submissions of earned interest that it receives from its more than 1,000 LEAs to the federal government but does not monitor to ensure the LEAs are complying with this requirement. Based on inquiries with Education, we found that only a small number of LEAs are voluntarily sending it checks to be returned to the federal government. However, based on our review of Education's cash advances provided to the LEAs

and OMB Circular A-133 audit reports of its LEAs, it would appear that there are a significant number of LEAs that are not voluntarily complying with the requirement to return interest earned on federal cash advances.

Adult Education—Basic Grants to States

Education required the LEAs to certify on the midyear expenditure report that any interest earned on advances over $100 would be remitted to it. However, Education does not require the LEA to report interest earned on the expenditure report. Our review of the program expenditure reporting mechanisms noted that the midyear expenditure report is not adequately designed to require the LEAs to report the amount of interest earned to Education.

Without knowledge of the interest earned on the program advances, Education cannot properly monitor compliance with the LEAs' submission of interest that is required to be submitted to the U.S. Department of Education (ED) on a quarterly basis to comply with federal requirements. As a result, Education disbursed more than $81 million to LEAs during the fiscal year ended June 30, 2008, without ensuring interest earned over $100 on program advances was returned on at least a quarterly basis.

Title I Grants to Local Educational Agencies

Education did notify the LEAs of the requirement to return interest earned over $100 on program advances on its Notice of First Apportionment, as well as include mailing instructions on how to remit payments. LEAs voluntarily send a check to Education, which then forwards those payments to the ED. Through our review of the expenditure reporting mechanisms, we noted that the consolidated application (CONAPP) is not adequately designed to require the LEAs to report interest earned information to Education.

Without knowledge of the interest earned on the program advances, Education cannot properly monitor compliance with the LEAs' submission of interest that is required to be submitted to the ED on a quarterly basis to comply with federal requirements. As a result, Education disbursed more than $1.6 billion to LEAs during the fiscal year ended June 30, 2008, without ensuring interest earned over $100 on program advances was returned on at least a quarterly basis.

Migrant Education—State Grant Program

We noted Education did not notify the LEAs of the requirement to return interest earned over $100 on advances to the ED on its grant award notification. Additionally, there are no specific instructions as to where to send these interest payments or the frequency for when they must be sent. Through our review of the expenditure reporting mechanisms, we noted that the Migrant Education Program Expenditure Report Summary is not adequately designed to require the LEAs to report interest earned information to Education.

Without knowledge of the interest earned on the program advances, Education cannot properly monitor compliance with the LEAs' submission of interest that is required to be submitted to the ED on a quarterly basis to comply with federal requirements. As a result, Education disbursed more than $120 million to LEAs during the fiscal year ended June 30, 2008, without ensuring interest earned over $100 on program advances was returned on at least a quarterly basis.

Safe and Drug-Free Schools and Communities—State Grants

Education did notify the LEAs of the requirement to return interest earned over $100 on program advances on its Notice of First Apportionment, as well as include mailing instructions on how to remit payments. LEAs voluntarily send a check for any interest to Education, which then forwards those

payments to the ED. Through our review of the expenditure reporting mechanisms, we noted that the CONAPP is not adequately designed to require the LEAs to report interest earned information to Education.

Without knowledge of the interest earned on the program advances, Education cannot properly monitor compliance with the LEAs' submission of interest that is required to be submitted to the ED on a quarterly basis to comply with federal requirements. As a result, Education disbursed more than $35.8 million to LEAs during the fiscal year ended June 30, 2008, without ensuring interest earned over $100 on program advances was returned on at least a quarterly basis.

Twenty-First Century Community Learning Centers

We noted Education did notify the LEAs of the requirement to return interest earned over $100 on advances to the ED on its grant award notification. The award indicates "grantees should forward interest payment to the ED." However, there are no specific instructions as to where to send these interest payments or the frequency with which they must be sent. We also noted this program's instructions are inconsistent with Education's other programs. Other programs request interest to be sent to Education, which then forwards the payments to ED. We did not identify any monitoring controls in place by Education to determine that its LEAs are complying with this requirement.

Without knowledge of the interest earned on the program advances, Education cannot properly monitor compliance with the LEAs' submission of that interest that is required to be submitted to the ED on a quarterly basis to comply with federal requirements. As a result, Education disbursed more than $101 million to LEAs during the fiscal year ended June 30, 2008, without ensuring interest earned over $100 on program advances was returned on at least a quarterly basis.

Reading First State Grants

Education did notify the LEAs of the requirement to return interest earned over $100 on program advances on its Grant Award Notification (Form AO 400) as well as include mailing instructions on how to remit payments. LEAs voluntarily send a check for any interest to Education, which then forwards those payments to the ED. Through our review of the expenditure reporting mechanisms, we noted that neither the Interim Expenditure Report nor the Request for Payment of a Non-Formula Grant is adequately designed to require the LEAs to report interest earned information to Education.

Without knowledge of the interest earned on the program advances, Education cannot properly monitor compliance with the LEAs' submission of interest that is required to be submitted to the ED on a quarterly basis to comply with federal requirements. As a result, Education disbursed more than $101 million to LEAs during the fiscal year ended June 30, 2008, without ensuring interest earned over $100 on program advances was returned on at least a quarterly basis.

English Language Acquisition Grants

We noted that Education did notify the LEAs of their requirement to return any interest earned over $100 on program advances on its Notice of First Apportionment, as well as include the mailing instructions on how to remit payments. In addition, its End-of-Year Expenditure Report requires its LEAs to report any annual interest earned on the grant award. For any interest recorded on this report, Education submits a bill to the LEA to collect the interest and then returns the collected amounts to the ED.

Although it appears Education has a process for collecting and remitting interest earned by the LEAs for this program, it is not being done on a quarterly basis as indicated by the federal guidelines. As a result of its current policies and procedures, Education disbursed more than $169 million without collecting and remitting interest timely to the federal government.

Improving Teacher Quality State Grants

Education did notify the LEAs of the requirement to return interest earned over $100 on program advances on its Notice of First Apportionment, as well as include mailing instructions on how to remit payments. LEAs voluntarily send a check to Education, which then forwards those payments to the ED. Through our review of the expenditure reporting mechanisms, we noted that the CONAPP is not adequately designed to require the LEAs to report interest earned information to Education.

Without knowledge of the interest earned on the program advances, Education cannot properly monitor compliance with the LEAs' submission of that interest that is required to be submitted to the ED on a quarterly basis to comply with federal requirements. As a result, Education disbursed more than $319 million to LEAs during the fiscal year ended June 30, 2008, without ensuring interest earned over $100 on program advances was returned on at least a quarterly basis.

Questioned Costs

Not determined.

Recommendation

Education should enhance its monitoring processes and controls to ensure interest earned on federal program advances over the $100 allowable limit is returned promptly to the federal government on a quarterly basis, as applicable.

Department's View and Corrective Action Plan

Education includes the federal interest requirements as standard language in various program funding correspondence (apportionment and grant notification letters). As a result, during state fiscal years 2007–08 and 2008–09, Education remitted interest back to the federal treasury on behalf of over 70 LEAs. However, to further notify LEAs to calculate interest correctly and remit interest earned on federal cash advances promptly, Education stated that on December 24, 2008, it initiated written communication on the applicability of the federal requirements for interest earned on federal funds. The written communication will be disseminated to all county and district superintendents, county and district business officials, and charter school administrators.

To provide consistent and complete guidance for all federal education programs, Education stated it will also explore incorporating references to the federal interest requirements (Title 34, *Code of Federal Regulations*, Part 80.21) in other written guidance, such as the *California School Accounting Manual* and the audit guide used by independent certified public accountants conducting Single Audits of LEAs.

Reference Number:	2008-3-5
Federal Catalog Number:	84.010
Federal Program Title:	Title I Grants to Local Educational Agencies
Federal Award Number and Year:	S010A070005; 2007
Category of Finding:	Cash Management
State Administering Department:	Department of Education (Education)

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 U.S. Treasury and the State's payout of funds for federal assistance program purposes, whether the transfer occurs before or after the payout of funds.

Condition

During our procedures performed over Education's payments made to the subgrantees, we noted that Education requests cash advances (drawdowns) 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 (SCO). The program falls under the Cash Management Improvement Act (CMIA) with a required funding technique of preissuance for payments to local agencies. The preissuance 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 60 drawdowns totaling $633 million, we noted one drawdown for $187,500 made on February 15, 2008, that was paid four days after the cash was received by the SCO, which exceeds the three days allowed for preissuance. Education indicated the delay was caused by a new cash management system implementation.

Questioned Costs

Not determined.

Recommendation

Education and/or other state agencies review 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

Education stated it did not deviate from the CMIA policies and procedures that were established by the Department of Finance (Finance) in agreement with the SCO. Although the CMIA report that was submitted to Finance reflects delays as cited by the auditors, the delays were under 10 days. Education stated that Finance does not require it to explain the delays unless payment exceeds 10 days from the time of deposit.

Auditor's Comments on Department's View

The procedures we performed were based on requirements of the federal code of regulations and not based on the State's internal policies and procedures to gather information to prepare the CMIA work sheets for Finance. Although Education may have complied with the State's internal policies of reporting exceptions to Finance, the exception noted was based on tests of the compliance with the terms of the CMIA agreement, which requires disbursements being made within three days of receipt of the funds.

Reference Number:	2008-5-2
Federal Catalog Number:	84.357
Federal Program Title:	Reading First State Grants
Federal Award Numbers and Years:	S357C070005; 2007 S357C060005; 2006 S357C050005; 2005
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 I—IMPROVING THE ACADEMIC ACHIEVEMENT OF THE DISADVANTAGED, Part B—Student Reading Skills Improvement Grants, Subpart 1—Reading First, Section 6362—Formula Grants to State Educational Agencies

(c) Subgrants to local educational agencies

(6) Limitation to certain schools — In distributing subgrant funds under this subsection, an eligible local educational agency shall provide funds only to schools that both:

(A) are among the schools served by that eligible local educational agency with the highest percentages or numbers of students in kindergarten through grade three reading below grade level, based on the most currently available data; and

(B) (i) are identified for school improvement under Section 6316(b) of this title; or (ii) have the highest percentages or numbers of children counted under Section 6333(c) of this title.

Condition

During our procedures performed over eligibility of subrecipients, we noted Education determines whether the local educational agency (LEA) meets the "reading below grade level requirement" based on whether the LEA had the highest percentages or numbers of students (defined as 40 percent or 1,000 or more students) reading below or far below basic as reported on Standardized Testing and Reporting (STAR) results. However, we noted that STAR results only include second and third grade students and does not include kindergarten or first grade students. Since the eligible program participants include kindergarten through third grade, using the STAR results alone for its assessment of highest percentages of students that are reading below grade level would not provide sufficient evaluation criteria for the school because it does not include the levels of kindergarten and first grade readers.

Questioned Costs

Not determined.

Recommendation

Education should ensure that its grant award determination process provides for equal opportunity for schools with higher levels of kindergarten and first grade students who are reading below their grade level but are not captured in the STAR.

Department's View and Corrective Action Plan

Education stated it does not concur with this finding. Education's Reading First Plan delineates Education's program administration processes and was approved by the federal government. In addition to the STAR, which is a summative assessment of a student's English language development, Education also utilizes other criteria in determining eligibility. For example, to be eligible for Reading First State Grants program funding, a LEA must be a program improvement school or have 50 percent or more of its students counted for allocation of Title I, Part A, funding.

Education stated it believes that its existing procedures ensure funding is awarded to eligible LEAs with students who are most in need; any errors that may come to Education's attention are promptly addressed and resolved in a timely manner. Although California requires that only second graders and higher be tested through the STAR, once LEAs become eligible for the Reading First State Grants program, they are then required to administer formative assessments every six weeks to monitor the reading skills of students in kindergarten through the third grade.

Auditor's Comments on Department's View

The additional criteria indicated in Education's response regarding program improvement schools is an additional requirement for eligibility, which does not replace the requirement of providing awards to the schools with the highest number of kindergarten through third grade students reading below their grade level. Although Education indicates it administers assessments to kindergarten and first grade students at the schools selected for program participation, these are performed only after the awards are made to the schools. By focusing the assessment of reading below grant level on only 50 percent of the eligible population (for example, second and third grade students), Education does not appear to be ensuring the subgrants are awarded to the schools with the largest populations of students reading below grade level. The U.S. Department of Education (ED) had also noted an exception regarding the exclusion of the kindergarten and first grade students from the State's STAR reports in its Title III program. The ED required corrective action of the February 27, 2006, review finding, which was included as a special condition of the Title III grant award.

Reference Number:	2008-7-4
Federal Catalog Number:	84.002
Federal Program Title:	Adult Education—Basic Grants to States
Federal Award Numbers and Years:	V002A070005; 2007 V002A060005; 2006 V002A050005; 2005
Category of Finding:	Matching, Level of Effort—Maintenance of Effort
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—Financial Administration, Section 80.24—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 nonfederal grants or by other cash donations from nonfederal third parties.

(2) The value of third party in-kind contributions applicable to the period to which the cost sharing or matching requirements applies.

(b) Qualifications and exceptions:

(1) Costs borne by other federal grant agreements. Except as provided by federal statute, a cost sharing or matching requirement may not be met by costs borne by another federal grant. This prohibition does not apply to income earned by a grantee or subgrantee from a contract awarded under another federal grant.

(2) General revenue sharing. For the purpose of this section, general revenue sharing funds distributed under 31 U.S.C. 6702 are not considered federal grant funds.

(3) Cost or contributions counted toward other federal costs sharing requirements. Neither costs nor the values of third party in-kind contributions may count toward satisfying a cost sharing or matching requirement of a grant agreement if they have been or will be counted toward satisfying a cost sharing or matching requirement of another federal grant agreement, a federal procurement contract, or any other award of federal funds.

(6) Records. Costs and third-party in-kind contributions counting toward satisfying a cost sharing or matching requirement must be verifiable from the records of grantees and subgrantee or cost-type contractors.

Condition

In our procedures performed over reported matching contributions, we reviewed the amounts reported as matched on the Financial Status Reports (FSRs) and requested documentation to support the reported matched expenditures. We noted the program was required to match at least 25 percent of the total amount of federal funds expended for adult education and literacy activities in the State. In addition, there is a program maintenance of effort (MOE) requirement for the fiscal effort per student or the aggregate expenditures for adult education and literacy activities in the second preceding fiscal year to not be less than 90 percent of the fiscal effort per student or the aggregate expenditures in the third preceding fiscal year.

Education reported the same amount for its state match and the MOE on its FSRs. The amount reported exceeded the 25 percent required match; however, Education did not maintain documentation to support the reported amounts. In an effort to recreate the documentation, Education provided California State Accounting and Reporting System (CalSTARS) general ledger reports for three program cost accounts (PCAs), which totaled approximately $1.4 billion, $1.3 billion, and $1.2 billion, respectively, for the three preceding award years.

FSR REPORT HEADING	GRANT AWARD NUMBER	AWARD PERIOD	FSR TOTALS (TOTAL ALLOCATION)	CalSTARS GENERAL LEDGER TOTAL
Nonfederal share of outlays	V002A060005	July 1, 2006, to September 30, 2008	$628,321,255	$1,412,490,916
Nonfederal share of outlays	V002A050005	July 1, 2005, to September 30, 2007	593,779,422	1,318,562,098
Nonfederal share of outlays	V002A040005	July 1, 2004, to September 30, 2006	595,992,558	1,182,420,934

Education asserted the matched amounts were a subset of these PCAs but did not identify the subset of expenditures; therefore, we were unable to ascertain that the nature of these matching contributions were from an allowable source, supported adult education and literacy activities, and were not borne by another grant.

Questioned Costs

Not determined.

Recommendation

Education should enhance its policies and procedures to ensure appropriate documentation is maintained to support matching contributions.

Department's View and Corrective Action Plan

Education has implemented improvements to the Adult Education Office's MOE and matching documentation procedures. Each year in December an FSR with a MOE equal to the state apportionment budget amounts for the most recent completed fiscal year will be prepared. The state apportionment budget amount represents the amount of funds given to local educational agencies (LEAs) based on reported average daily attendance; however, the actual MOE may change if total LEA actual expenditures are not the same as budgeted amounts. Actual expenditure amounts are not certified and available for release until early March each year for the previous fiscal year. Therefore, in March of each year, after actual LEA expenditures are known, a revised FSR will be prepared to reflect the actual MOE. Education will maintain documentation to support the revised FSR, which will also support the state match contributions.

Reference Number:	2008-7-5
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:	S010A070005; 2007 S010A060005; 2006 S010A050005; 2005

Federal Catalog Number:	84.186
Federal Program Title:	Safe and Drug-Free Schools and Communities—State Grants
Federal Award Numbers and Years:	Q186A070005; 2007 Q186A060005; 2006 Q186A050005; 2005

Federal Catalog Number:	84.287

Federal Program Title:	Twenty-First Century Community Learning Centers
Federal Award Numbers and Years:	S287C070005; 2007 S287C060005; 2006 S287C050005; 2005

Federal Catalog Number:	84.365
Federal Program Title:	English Language Acquisition Grants
Federal Award Numbers and Years:	T365A070005; 2007 T365A060005; 2006 T365A050005; 2005

Federal Catalog Number:	84.367
Federal Program Title:	Improving Teacher Quality State Grants
Federal Award Numbers and Years:	S367A070005; 2007 S367A060005; 2006 S367A050005; 2005

Criteria

TITLE 34—EDUCATION, PART 299—GENERAL PROVISIONS, Subpart D—Fiscal Requirements, Section 299.5—What Maintenance of Effort Requirements Apply to ESEA Programs?

(a) General. A 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 percent of the combined fiscal effort per student or the aggregate expenditures for the second preceding fiscal year.

(d) Expenditures

(1) In determining an LEA's compliance with paragraph (a) of this section, the SEA shall consider only the LEA's 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 an LEA's 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.

TITLE 20—EDUCATION, CHAPTER 70—STRENGTHENING AND IMPROVEMENT OF ELEMENTARY AND SECONDARY SCHOOLS, SUBCHAPTER IX—GENERAL PROVISIONS, PART E—Uniform Provisions, Subpart 2—Other Provisions, Section 7901—Maintenance of Effort

(b) Reduction in Case of Failure to Meet

(1) In general, the state educational agency shall reduce the amount of the allocation of funds under a covered program in any fiscal year in the exact proportion by which a local educational agency fails to meet the requirement of subsection (a) of this section by falling below 90 percent of both the combined fiscal effort per student and aggregate expenditures (using the measure most favorable to the local agency).

Condition

1. Education was using unaudited local educational agency (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 15th 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 15th; 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. 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 (OMB) *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 or 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 accuracy of the information used by Education to prepare calculations to determine compliance over this requirement. This is of increased importance due to Education's use of unaudited information as indicated in condition 1.

3. In our procedures performed to determine if Education made appropriate reductions in entitlements for LEAs that did not meet the requirement, we obtained Education's calculations, which determined that eight schools did not meet their required MOE for the 2007–08 funding year. We noted that the MOE calculations are prepared centrally; however, the reductions to the LEAs are processed on the program level.

   We noted one of the five programs that were required to make reductions did not process these reductions for the 2007–08 entitlement calculations. This program provided funding to one of the eight schools that Education determined failed its MOE, which resulted in $51,216 being overawarded to one school for the Twenty-First Century Community Learning Centers Program.

   Total exceptions amounted to $51,216 of the $215,986 required reductions for MOE failures for the fiscal year ended June 30, 2008.

Questioned Costs

$51,216 ($271,499 program entitlement for funding year 2007–08 x 18.864% rate of failure).

Recommendations

Education should enhance its current MOE policies and procedures to ensure that they are compliant with required federal guidelines. Additionally, Education should establish controls to ensure that all required reductions for MOE failures are promptly processed.

Department's View and Corrective Action Plan

Condition 1: Education stated it concurs that, by using unaudited amounts, there is a risk that material adjustments or omissions may not adequately be reflected or computed in MOE calculations; however, Education considers this risk minimal. To further minimize the risk of material adjustments or omissions, Education recently proposed new procedures to be incorporated in the audit guide utilized by independent auditors conducting LEAs' Single Audits. If the proposed procedures are incorporated into the audit guide, auditors will be required to assess the impact of audit adjustments on the MOE calculation. Furthermore, in cases where the impact is material, the auditors will be required to quantify the impact in the audit report so that Education can then take material audit adjustments into account when calculating MOE.

Condition 2: Education stated it does not concur with this finding. The MOE calculation is based on expenditure data submitted by LEAs. Since LEAs have access to the preliminary MOE calculations in the SACS software, Education deems that there is no need to send the final calculation back to the LEA except in instances where the final MOE calculations differ from the preliminary MOE calculations.

Condition 3: Education stated it has procedures in place to appropriately reduce No Child Left Behind allocations to LEAs that fail the MOE requirement on formula-based awards. However, because the Twenty-First Century Community Learning Centers program grants are competitively awarded, as opposed to formula-based, funding adjustments may involve a longer adjustment process. To minimize this process, Education will seek guidance from the federal program office on how to appropriately and more promptly apply reductions or grant offsets on competitively awarded grants due to LEAs not meeting MOE requirements.

Auditor's Comments on Department's View

We disagree with Education's assessment that the LEAs have access to preliminary MOE calculations in the SACS software. Based on inquiries performed with Education's LEAs, they are not aware of how to obtain this specific information since the SACS submission is an entire trial balance of accounts. However, Education's proposed corrective action for condition 1 that includes adding the procedures into the audit guide for the independent auditors would appear to be sufficient to satisfy the deficiencies noted in both conditions 1 and 2 above.

Reference Number:	2008-7-6
Federal Catalog Number:	84.048
Federal Program Title:	Career and Technical Education—Basic Grants to States
Federal Award Numbers and Years:	V048A070005; 2007 V048A060005; 2006 V048A050005; 2005
Category of Finding:	Level of Effort—Maintenance of Effort
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 20—EDUCATION, CHAPTER 44—VOCATIONAL AND TECHNICAL EDUCATION, SUBCHAPTER III—GENERAL PROVISIONS, PART A—FEDERAL ADMINISTRATIVE PROVISIONS, Section 2391—Fiscal Requirements

(b) Maintenance of Effort

(1) Determination

(A) In general — Except as provided in subparagraphs (B) and (C), no payments shall be made under this chapter for any fiscal year to a State for vocational and technical education programs or tech-prep programs unless the Secretary determines that the fiscal effort per student or the aggregate expenditures of such State for vocational and technical education programs for the fiscal year preceding the fiscal year for which the determination is made, equaled or exceeded such effort or expenditures for vocational and technical education programs, for the second fiscal year preceding the fiscal year for which the determination is made.

(B) Computation — In computing the fiscal effort or aggregate expenditures pursuant to subparagraph (A), the Secretary shall exclude capital expenditures, special one-time project costs, and the cost of pilot programs.

(C) Decrease in Federal support — If the amount made available for vocational and technical education programs under this chapter for a fiscal year is less than the amount made available for vocational and technical education programs under this chapter for the preceding fiscal year, then the fiscal effort per student or the aggregate expenditures of a State required by subparagraph (B) for such preceding fiscal year shall be decreased by the same percentage as the percentage decrease in the amount so made available.

Condition

As part of our audit procedures, we reviewed Education's fiscal year 2007–08 maintenance-of-effort (MOE) requirement for the Career and Technical Education program and noted Education was required to maintain or exceed its level of state-funded expenditures used for career and technical education for the fiscal year 2006–07 compared with the fiscal year 2005–06 on either an aggregate or per-pupil basis.

In our procedures performed over the MOE calculations prepared by Education to support its compliance, we noted it had not included one of its state-funded Career and Technical Education programs for $6,215,259 in the fiscal year 2006–07 calculation that had been included in the fiscal year 2005–06 calculation. Although we noted that the error made in this calculation would not have caused Education to not achieve its fiscal year 2007–08 MOE requirement, it would have decreased the baseline for the fiscal year 2008–09 measurement by $6,215,259.

Total state funds expended for career and technical education amounted to $503,094,501 and $461,097,617 for the fiscal years ended June 30, 2006, and 2005, respectively.

Questioned Costs

Not applicable.

Recommendation

Education should strengthen its controls over the review and approval of its MOE calculation so that it can ensure the accuracy and completeness of the calculation and ensure compliance with the federal regulations.

Department's View and Corrective Action Plan

Education believes that appropriate controls over the review and approval of MOE calculations are already in place. Each year, Education program staff assemble source binders that include all the program cost accounts (PCAs) federally required to be included in the MOE calculations. In the fall, Education's program office gathers and compiles the MOE data and submits the information to Education's accounting office.

Upon notification of the error, Education corrected the MOE to include the missing PCA. Education ensured that both the program and accounting offices reflect the corrected calculation.

Auditor's Comments on Department's View

We disagree with Education's assessment that appropriate controls are already in place over the review and approval of the MOE calculation. This calculation was approved through Education's current review process and would have been incorrect had we not brought it to Education's attention.

Reference Number:	2008-7-7
Federal Catalog Number:	84.048
Federal Program Title:	Career and Technical Education—Basic Grants to States
Federal Award Numbers and Years:	V048A070005; 2007 V048A060005; 2006 V048A050005; 2005
Category of Finding:	Level of Effort—Supplement not Supplant
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 20—EDUCATION, CHAPTER 44—VOCATIONAL AND TECHNICAL EDUCATION, SUBCHAPTER III—GENERAL PROVISIONS, PART A—FEDERAL ADMINISTRATIVE PROVISIONS, Section 2391—Fiscal Requirements

(a) Supplement Not Supplant

Funds made available under this chapter for vocational and technical education activities shall supplement, and shall not supplant, nonfederal funds expended to carry out vocational and technical education activities and tech-prep activities.

Condition

Education does not have a system in place for monitoring its compliance with its requirement to use program funds to supplement rather than supplant existing funds for its state activities and operations expenditures. Education relies upon certifications from local educational agencies (LEAs) for its portion of expenditures that are subgranted to its LEAs.

In order to ascertain compliance with the required level of effort, we made inquiries with management and obtained expenditure information from Education's California State Accounting and Reporting System (CalSTARS) general ledger reports and tested a sample of expenditures for compliance. Based on the information provided, the expenditures sampled appeared to supplement and not supplant existing funds; however, there are no properly designed controls in place to monitor actual compliance with the requirement. Without policies and procedures in place, there is increased risk that Education may not identify potential noncompliance in a timely manner.

State operations and administrative expenditures subject to this requirement totaled $9,933,949 for the fiscal year ended June 30, 2008.

Questioned Costs

Not applicable.

Recommendation

Education should enhance its current policies and procedures to require an actual calculation of required earmarks be performed to ensure compliance with specified earmarking requirements.

Department's View and Corrective Action Plan

Education stated it does not concur with this condition. Education has processes in place to ensure that federal funds supplement rather than supplant nonfederal funded activities and program costs. On an annual basis, program and budget staff determine any changes in federal and state funding appropriations and the affected programs. Education's Budget Office utilizes this information in developing the department and division budgets, which are used to control and monitor funding by program cost accounts. By capturing the federal and state appropriation changes upfront in the budget processes, Education ensures that federal funds are not being used to supplant any reduction or elimination of nonfederal appropriated activities.

Both program and budget staff monitor the program cost accounts periodically throughout the year to ensure that expenditures do not exceed available funding. In addition, at least twice a year, more often if necessary, budget staff meet with program staff to discuss budget status and any concerns with spending patterns.

Auditor's Comments on Department's View

Education was unable to provide documentation to support that its budgeting assessment processes include consideration of nonsupplanting.

Reference Number:	2008-7-8
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:	S010A070005; 2007 S010A060005; 2006 S010A050005; 2005

Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education—State Grant Program
Federal Award Numbers and Years:	S011A070005; 2007 S011A060005; 2006 S011A050005; 2005

Federal Catalog Numbers:	84.027 and 84.173
Federal Program Titles:	Special Education Cluster: Special Education Grants to States and Special Education PreSchool Grants
Federal Award Numbers and Years:	H027A070116; 2007, H173A070120; 2007 H027A060116; 2006, H173A060120; 2006 H027A050116; 2005, H173A050120; 2005

Federal Catalog Number:	84.186
Federal Program Title:	Safe and Drug-Free Schools and Communities—State Grants
Federal Award Numbers and Years:	Q186A070005; 2007 Q186A060005; 2006 Q186A050005; 2005

Federal Catalog Number:	84.287
Federal Program Title:	Twenty-First Century Community Learning Centers
Federal Award Numbers and Years:	S287C070005; 2007 S287C060005; 2006 S287C050005; 2005

Federal Catalog Number:	84.357
Federal Program Title:	Reading First State Grants
Federal Award Numbers and Years:	S357C070005; 2007 S357C060005; 2006 S357C050005; 2005

Federal Catalog Numbers:	84.365
Federal Program Title:	English Language Acquisition Grants
Federal Award Numbers and Years:	T365A070005; 2007 T365A060005; 2006 T365A050005; 2005

Federal Catalog Number:	84.367
Federal Program Title:	Improving Teacher Quality State Grants
Federal Award Numbers and Years:	S367A070005; 2007 S367A060005; 2006 S367A050005; 2005

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. In addition, it does not perform actual calculations on required earmarks to ascertain if it has complied with required limitations.

In order to ascertain compliance with required earmarking, we obtained expenditure information from Education's California State Accounting and Reporting System (CalSTARS) general ledger reports and performed calculations to determine if they complied with the 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, 2006, appeared to fall within the required limitations; however, there are no properly designed controls in place to monitor actual compliance with earmarking requirements.

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 stated that in November 2007, it added a section to its grant award budget memorandums that identifies the appropriate percentages used to meet the earmarking requirements. This information can be utilized by the accounting office to calculate and verify grant award earmarking allocations. If it is determined that a subgrantee's actual expenditures significantly differ from the budget, follow-up will be performed to verify that the earmarking requirements have been met.

Auditor's Comments on Department's View

Because Education's budget memorandums are prepared at the beginning of the grant award and are not utilized to monitor budgeted to actual expenditures, this budget memorandum would not be designed appropriately for Education to capture and monitor actual expenditures to ascertain if it had met required earmarks based on actual expenditures and not the initial budgeted expenditures.

Reference Number:	2008-8-1
Category of Finding:	Period of Availability
State Administering Department:	Department of Education (Education)
Federal Catalog Number:	84.002
Federal Program Title:	Adult Education—Basic Grants to States
Federal Award Numbers and Years:	V002A070005; 2007 V002A060005; 2006 V002A050005; 2005

Federal Catalog Number:	84.010
Federal Program Title:	Title I Grants to Local Educational Agencies
Federal Award Numbers and Years:	S010A070005; 2007 S010A060005; 2006 S010A050005; 2005

Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education—State Grant Program
Federal Award Numbers and Years:	S011A070005; 2007 S011A060005; 2006 S011A050005; 2005

Federal Catalog Numbers:	84.027 and 84.173
Federal Program Titles:	Special Education Cluster: Special Education Grants to States and Special Education PreSchool Grants
Federal Award Numbers and Years:	H027A070116; 2007, H173A070120; 2007 H027A060116; 2006, H173A060120; 2006 H027A050116; 2005, H173A050120; 2005

Federal Catalog Number:	84.048
Federal Program Title:	Career and Technical Education—Basic Grants to States

Federal Award Numbers and Years:	V048A070005; 2007 V048A060005; 2006 V048A050005; 2005

Federal Catalog Number:	84.186
Federal Program Title:	Safe and Drug-Free Schools and Communities—State Grants
Federal Award Numbers and Years:	Q186A070005; 2007 Q186A060005; 2006 Q186A050005; 2005

Federal Catalog Number:	84.287
Federal Program Title:	Twenty-First Century Community Learning Centers
Federal Award Numbers and Years:	S287C070005; 2007 S287C060005; 2006 S287C050005; 2005

Federal Catalog Number:	84.357
Federal Program Title:	Reading First State Grants
Federal Award Numbers and Years:	S357C070005; 2007 S357C060005; 2006 S357C050005; 2005

Federal Catalog Number:	84.365
Federal Program Title:	English Language Acquisition Grants
Federal Award Numbers and Years:	T365A070005; 2007 T365A060005; 2006 T365A050005; 2005

Federal Catalog Number:	84.367
Federal Program Title:	Improving Teacher Quality State Grants
Federal Award Numbers and Years:	S367A070005; 2007 S367A060005; 2006 S367A050005; 2005

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:

(1) 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—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.

Condition

During our procedures performed over the period of availability requirement, we selected a sample of adjusting journal entries (entries) that were made during the fiscal year to determine if the entries were adequately supported and that the underlying obligations for those entries were allocated to a proper period. We noted Education allocates expenditures between multiple overlapping awards through its use of first in, first out (FIFO) entries. We tested a sample of 60 FIFO entries among multiple programs for our procedures.

We noted that all 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 independent review or approval of these entries. The support provided by Education identifies a listing of claim numbers with totals of expenditures. In tracing the claim numbers down to actual transactions, we generally noted numerous transactions that were paid with the claim numbers identified; however, Education did not indicate which specific transactions in the numerous listings made up the amount transferred.

Adult Education—Basic Grants to States

We selected a sample of three of the 11 FIFO entries made during the fiscal year and requested the supporting documentation of the underlying transactions for the entries recorded that carried back expenditures between award years and noted:

JOURNAL ENTRIES SAMPLED TYPE	QUANTITY	FISCAL YEARS TRANSFERRED BETWEEN	TRANSFERRED AMOUNT	SUPPORTING DOCUMENTATION
Total LEA subgrant entries not adequately supported	3	2006 to 2005	$1,664,456	$2,109,900

The three inadequately supported entries amounted to $1,664,456. The 11 FIFO entries totaled $2.8 million out of the $81 million of total local educational agency (LEA) expenditures for the fiscal year ended June 30, 2008.

Title I Grants to Local Educational Agencies

We selected a sample of five of the seven FIFO entries made during the fiscal year and requested the supporting documentation of the underlying transactions for the five entries recorded that carried back expenditures between award years and noted the following:

JOURNAL ENTRIES SAMPLED TYPE	QUANTITY	FISCAL YEARS TRANSFERRED BETWEEN	TRANSFERRED AMOUNT	SUPPORTING DOCUMENTATION
SEA administrative entries	2	2006 to 2005	$10,803,797	$10,803,797
LEA subgrant entry	1	2006 to 2005	27,611,629	27,611,629
Total entries adequately supported	3		38,415,426	38,415,426
Total LEA subgrant entries not adequately supported	2	2006 to 2005	49,142	241,720,495
Total journal entries sampled	5		38,464,568	280,135,921

The two inadequately supported entries amounted to $49,142. The seven FIFO entries totaled $38.5 million out of the $1.6 billion and $19.1 million of LEA and State Educational Agency (SEA) expenditures, respectively, for the fiscal year ended June 30, 2008.

Migrant Education—State Grant Program

We selected all three of the FIFO entries made during the fiscal year and requested the supporting documentation of the underlying transactions for the entries recorded that carried back expenditures between award years and noted the following:

JOURNAL ENTRIES SAMPLED TYPE	QUANTITY	FISCAL YEARS TRANSFERRED BETWEEN	TRANSFERRED AMOUNT	SUPPORTING DOCUMENTATION
SEA administrative entries adequately supported	2	2006 to 2005	$862,928	$862,928
LEA subgrant entries not adequately supported	1	2006 to 2005	131,598	1,741,766
Total journal entries sampled	3		994,526	2,604,694

The one inadequately supported entry amounted to $131,598. The three FIFO entries totaled approximately $1 million out of the $120 million and $1.6 million of LEA and SEA expenditures, respectively, for the fiscal year ended June 30, 2008.

Special Education Cluster

We selected a sample of seven of the 15 FIFO entries made during the fiscal year and requested the supporting documentation of the underlying transactions for the seven entries recorded that carried back expenditures between award years and noted the following:

JOURNAL ENTRIES SAMPLED TYPE	QUANTITY	FISCAL YEARS TRANSFERRED BETWEEN	TRANSFERRED AMOUNT	SUPPORTING DOCUMENTATION
SELPA subgrant entries	5	2006 to 2005	$2,392,939	$65,279,698
SEA administrative entries	2	2006 to 2005	4,941,358	61,494,219
Total entries sampled not adequately supported	7		7,334,297	126,773,917

The seven inadequately supported entries amounted to $7,334,297. The 15 FIFO entries totaled $11.5 million out of the $1.2 billion and $5.9 million of Special Education Local Plan Area Agency (SELPA) and SEA expenditures, respectively, for the fiscal year ended June 30, 2008.

Career and Technical Education—Basic Grants to States

We selected all four of the FIFO entries made during the fiscal year and requested the supporting documentation of the underlying transactions for the four entries recorded that carried back expenditures between award years and noted the following:

JOURNAL ENTRIES SAMPLED TYPE	QUANTITY	FISCAL YEARS TRANSFERRED BETWEEN	TRANSFERRED AMOUNT	SUPPORTING DOCUMENTATION
Total LEA subgrant entries not adequately supported	4	2006 to 2005	$6,650,625	$30,157,321

The four inadequately supported entries amounted to the $6,650,625 out of the $120 million of total LEA expenditures for the fiscal year ended June 30, 2008.

Safe and Drug-Free Schools and Communities—State Grants

We selected a sample of three of the nine FIFO entries made during the fiscal year and requested the supporting documentation of the underlying transactions for those three entries recorded that carried back expenditures between award years and noted the following:

JOURNAL ENTRIES SAMPLED TYPE	QUANTITY	FISCAL YEARS TRANSFERRED BETWEEN	TRANSFERRED AMOUNT	SUPPORTING DOCUMENTATION
LEA subgrants entry	1	2006 to 2005	$2,297,000	$2,454,659
LEA subgrants entry	1	2007 to 2006	2,000,000	3,201,970
SEA administrative entry	1	2007 to 2006	493,827	509,010
Total entries sampled not adequately supported	3		4,790,827	6,165,639

The three inadequately supported entries amounted to the $4,790,287. The nine FIFO entries totaled $5.9 million out of the $34 million and $1.5 million of LEA and SEA expenditures, respectively, for the fiscal year ended June 30, 2008.

Twenty-First Century Community Learning Centers

We selected a sample of four of the eight FIFO entries made during the fiscal year and requested the supporting documentation of the underlying transactions for the four entries recorded that carried back expenditures between award years and noted the following:

JOURNAL ENTRIES SAMPLED TYPE	QUANTITY	FISCAL YEARS TRANSFERRED BETWEEN	TRANSFERRED AMOUNT	SUPPORTING DOCUMENTATION
LEA subgrants entries	2	2006 to 2005	$16,978,194	$27,746,224
LEA subgrants entries	2	2007 to 2006	61,000,000	63,956,805
Total entries sampled not adequately supported	4		77,978,194	91,703,029

The four inadequately supported entries amounted to $77,978,194. The eight FIFO entries totaled $79 million out of the $101 million of total LEA expenditures for the fiscal year ended June 30, 2008.

Reading First State Grants

We selected a sample of four of the seven FIFO entries made during the fiscal year and requested the supporting documentation of the underlying transactions for the four entries recorded that carried back expenditures between award years and noted the following:

JOURNAL ENTRIES SAMPLED TYPE	QUANTITY	FISCAL YEARS TRANSFERRED BETWEEN	TRANSFERRED AMOUNT	SUPPORTING DOCUMENTATION
SEA administrative entries	2	2006 to 2005	$1,015,255	$1,863,000
LEA subgrants entries	2	2006 to 2005	25,686,283	30,205,248
Total entries sampled not adequately supported	4		26,701,538	32,068,248

The four inadequately supported entries amounted to $26,701,538. The seven FIFO entries totaled $26.8 million out of the $100.7 million and $1.6 million of total LEA and SEA expenditures, respectively, for the fiscal year ended June 30, 2008.

English Language Acquisition Grants

We selected all three of the FIFO entries made during the fiscal year and requested the supporting documentation of the underlying transactions for the entries recorded that carried back expenditures between award years and noted the following:

JOURNAL ENTRIES SAMPLED TYPE	QUANTITY	FISCAL YEARS TRANSFERRED BETWEEN	TRANSFERRED AMOUNT	SUPPORTING DOCUMENTATION
Total LEA subgrant entries not adequately supported	3	2006 to 2005	$5,945,421	$12,861,474

The three inadequately supported entries amounted to $5,945,421. The three FIFO entries totaled $5.9 million of the $163 million of total LEA expenditures for the fiscal year ended June 30, 2008.

Improving Teacher Quality State Grants

We selected a sample of six of the seven FIFO entries made during the fiscal year and requested the supporting documentation of the underlying transactions for the six entries recorded that carried back expenditures between award years and noted the following:

JOURNAL ENTRIES SAMPLED TYPE	QUANTITY	FISCAL YEARS TRANSFERRED BETWEEN	TRANSFERRED AMOUNT	SUPPORTING DOCUMENTATION
SEA administrative entries	2	2006 to 2005	$1,304,593	$1,304,593
SEA administrative entries	2	2007 to 2006	860,905	860,905
Total entries adequately supported	4		2,165,498	2,165,498
Total LEA subgrant entries not adequately supported	2	2006 to 2005	457,308	18,437,350
Total journal entries sampled	6		2,622,806	20,602,848

The two inadequately supported entries amounted to $457,308 out of the $319 million of total LEA expenditures for the fiscal year ended June 30, 2008.

Previous correspondence between Education and the U.S. Department of Education regarding exceptions in prior-year audits indicated that unambiguous support should be maintained to support the FIFO closeout 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 the 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's policies do not require journal entries to be independently 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 documentation be maintained to identify which specific LEAs or SEA expenditures are being adjusted within the FIFO adjustment. Education identifies pools of transactions that it believes are eligible and transfers amounts from those pools; however, since adjustments are made multiple times among multiple award years there is increased risk that LEA expenditures could be adjusted more than once or that those underlying obligations may not have been incurred within the eligible obligation period to which they were adjusted. Without this unambiguous detailed documentation that identifies the specific LEAs to support that they were incurred during the proper period, there is decreased transparency and accountability in the grant award closeout process.

Questioned Costs

Not applicable.

Recommendations

Education should strengthen its policies and procedures to ensure that appropriate segregation of duties is maintained and that adjusting FIFO entries are reviewed and approved. Education should also ensure appropriate documentation is maintained to adequately support adjusting transactions between federal funding years.

Department's View and Corrective Action Plan

Education stated it believes that appropriate segregation of duties and approval processes related to FIFO transactions are in place; however, it has strengthened procedures related to the adjusting FIFO entries by maintaining supporting documentation of the specific transactions with the claim schedules.

Auditor's Comments on Department's View

We disagree with Education's assessment that appropriate segregation of duties and approval processes are in place. Entries prepared and posted into the general ledger without evidence of independent review would not support that appropriate controls are in place. We also disagree with Education's assessment that the documentation now maintained is adequate. Although Education has made some progress in that it now maintains some level of supporting documentation of transactions that are being adjusted, the documentation is usually in material excess of the actual amounts that are transferred. In programs that transfer material amounts of expenditures between fiscal years, there is significant increased risk that transferred expenditures lose their identity and could be transferred more than once or in more than one fiscal year. Manual journal entries pose a significant fraud risk; therefore, strong controls should be in place and transparency in documentation needs to be maintained. Based on the transactions sampled this year, Education has demonstrated that it has the ability to adjust specific transactions and maintain appropriate documentation, but it has not applied that methodology consistently.

Reference Number:	2008-12-3
Category of Finding:	Reporting
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:	S010A070005; 2007 S010A060005; 2006 S010A050005; 2005

Federal Catalog Number:	84.365
Federal Program Title:	English Language Acquisition Grants
Federal Award Numbers and Years:	T365A070005; 2007 T365A060005; 2006 T365A050005; 2005

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:

(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 (CSPR). We noted that the report submission is centralized; however, the data is gathered from multiple divisions within Education. In order to test the accuracy of the data reported in Parts I and II of the CSPR for reporting on the 2006–07 school year, which were submitted in December 2007 and February 2008, respectively, we selected a sample of 60 line items that reported information regarding multiple programs and requested Education provide documentation to support the numbers that were reported. Education was unable to provide documentation for two of the programs sampled.

Title I Grants to Local Educational Agencies

We noted that Education does not maintain supporting documentation for its submitted CSPR reports. Upon our request to ascertain the accuracy of the information reported, Education recreated information for six of the 15 samples that did not support the numbers that were reported. In addition, Education was not able to provide support for nine of the 15 samples selected.

- The six line items sampled from page 24 of the CSPR with documentation that did not support the numbers reported included the numbers and percentages of its Title I schools and districts and their status on the achievement of adequate yearly progress for the 2006–07 school year.

- Six of the nine unsupported line items from page 27 of the CSPR contained information regarding the numbers of schools and various types of corrective actions implemented.

- The remaining three of the nine unsupported line items from page 27 of the CSRP contained information regarding the numbers of schools with various restructuring actions implemented.

Policies do not appear to be in place that require Education to maintain documentation for required reporting, which resulted in unsupported information reported on the CSPR.

English Language Acquisition Grants

We noted that Education does not maintain supporting documentation for its submitted CSPR reports. Upon our request to ascertain the accuracy of the information reported, Education was able to recreate the information for the five of the 15 samples selected for data that matched the information reported for this program. The information it recreated for four of the 15 samples did not support the numbers that were reported. It was not able to provide support for six of the 15 samples selected.

- The four line items sampled from page 41 of the CSPR with documentation that did not support the number reported contained information regarding the numbers of students with the most commonly spoken language in the State (for example, Spanish, Vietnamese, Filipino, and Cantonese).

- Three of the six unsupported line items from page 45 of the CSPR contained information regarding the English language proficiency results for totals of students who made progress, made no progress, or attained English language proficiency.

- The remaining three of the six unsupported line items from page 48 of the CSPR contained information regarding the numbers of limited English proficiency students in grades that did not achieve adequate yearly progress.

Policies do not appear to be in place that require Education to maintain documentation for required reporting, which resulted in unsupported information reported on the CSPR.

Questioned Costs

Not determined.

Recommendation

Education should enhance its current policies and procedures to require 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

Education stated it believes that appropriate review and approval processes related to CSPR data submissions are already in place. However, commencing with the December 2008 submission process, Education stated it further enhanced the collection, storage, and maintenance of CSPR data by requiring program offices to maintain supporting elements electronically for three years.

Auditor's Comments on Department's View

We disagree with Education's assessment that appropriate review and approval controls are already in place. Based on the results of our audit procedures, there are no document retention policies or procedures in place to ensure documentation to support required CSPR reporting is maintained.

Reference Number:	2008-12-4
Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education—State Grant Program
Federal Award Numbers and Years:	S011A070005; 2007 S011A060005; 2006 S011A050005; 2005
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—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.

(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 (CSPR), Part I, Migrant Child Counts. We noted that an outside subcontractor gathers the data used to prepare these required reports. Education relies upon the work performed by the outside subcontractor and does not perform any monitoring 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 monitoring of subcontractors increases the risk of inaccuracies going undetected. However, we noted during our follow-up regarding prior-year findings that Education has a proposed plan to enhance its monitoring of its subcontractor.

We also noted that Education does not maintain supporting documentation for its submitted reports. However, upon our request to determine the accuracy of the information reported, Education was able to obtain information for the samples selected from the outside subcontractor. In tracing the amounts reported on the CSPR to supporting documentation provided by that subcontractor, we noted the 12-month student count of eligible migrant children who can be counted for funding purposes that was reported on Part 1 of the 2006–07 CSPR was 240,942, but the data from the subcontractor report provided entitled "Migrant Student Information Network for 2006–07" indicated 240,907 students. Thus, Education overreported 35 eligible children. There does not appear to be an effective review process in place to ensure the data reported is accurately compiled from the source documentation. Without an effective review and approval process, there is increased risk of reporting errors and inconsistencies.

Questioned Costs

Not applicable.

Recommendations

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. In addition, Education should continue with its planned implementation of enhanced monitoring of its subcontractor to ensure accuracy and completeness of the data compiled and provided to it, which is then reported to the federal awarding agency.

Department's View and Corrective Action Plan

Education stated that although it has quality control processes in place, the error referred to by the auditors was a transcription error that was inadvertently not identified by the reviewer. However, to ensure accurate transcriptions in the future, Education will strengthen controls by requiring reviewers to proofread data, initial approval, and maintain hard copies of the CSPR used to support the child count reports.

In addition, Education will continue the planned implementation of enhanced monitoring of its subcontractor by doing the following:

1. Conducting preliminary reviews of final reports to check for accuracy by comparing subgrant reports with data from other student count information provided by each region.
2. Reviewing a sample selection of data submissions by region to check for completeness and accuracy. If discrepancies are identified during this process, the corresponding regional offices will be contacted for resolution. Education may also require regional offices to submit documentation supporting the resolution of identified data discrepancies.

To facilitate and document these enhanced monitoring procedures, Education developed a reporting and approval process and checklist form that will be implemented in state fiscal year 2008–09.

Reference Number:	2008-13-5
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 Numbers and Years:	S011A070005; 2007 S011A060005; 2006 S011A050005; 2005

Federal Catalog Numbers:	84.027 and 84.173
Federal Program Titles:	Special Education Cluster: Special Education Grants to States and Special Education PreSchool Grants
Federal Award Numbers and Years:	H027A070116; 2007, H173A070120; 2007 H027A060116; 2006, H173A060120; 2006 H027A050116; 2005, H173A050120; 2005

Federal Catalog Number:	84.287
Federal Program Title:	Twenty-First Century Community Learning Centers
Federal Award Numbers and Years:	S287C070005; 2007 S287C060005; 2006 S287C050005; 2005

Federal Catalog Number:	84.357
Federal Program Title:	Reading First State Grants
Federal Award Numbers and Years:	S357C070005; 2007 S357C060005; 2006 S357C050005; 2005

Federal Catalog Number:	84.365
Federal Program Title:	English Language Acquisition Grants
Federal Award Numbers and Years:	T365A070005; 2007 T365A060005; 2006 T365A050005; 2005

Federal Catalog Number:	84.367
Federal Program Title:	Improving Teacher Quality State Grants
Federal Award Numbers and Years:	S367A070005; 2007 S367A060005; 2006 S367A050005; 2005

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 80.37—Subgrants

(a) 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;

(B) 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 communicated to the Local Educational Agencies (LEAs) and Special Education Local Plan Area Agencies (SELPAs).

Migrant Education—State Grant Program

We noted the program uses Grant Award Notification (Form AO 400) as its means to communicate award identification to its LEAs. We noted the following errors or omissions in the communication:

- 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 of 34 CFR, Parts 76, 77, 80, 82, and 85 and 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.

As a result, Education disbursed more than $120 million to LEAs without communicating complete award information for the fiscal year ended June 30, 2008.

Special Education Cluster

We noted the program uses Form AO 400 as its means to communicate award identification to its SELPAs. We noted the following errors or omissions in the communication:

- Missing identification of federal agency as the U.S. Department of Education.
- Missing 34 CFR, Part 300, Assistance to States for the Education of Children with Disabilities.

As a result, Education disbursed more than $1.16 billion to SELPAs without communicating complete award information for the fiscal year ended June 30, 2008.

Twenty-First Century Community Learning Centers

We noted the program uses 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 Education Department General Administrative Regulations at 34 CFR, Parts 74, 76, 77, 79, 80, 81, 82, 85, and 86.

As a result, Education disbursed more than $101 million to LEAs without complete award identification for the fiscal year ended June 30, 2008.

Reading First State Grants

We noted the program uses Form AO 400 as its means to communicate award identification to its LEAs. We noted the following errors or omissions in the communication:

- Missing a statement that the Reading First program is authorized by Title I, Part B, Subpart 1, of the Elementary and Secondary Education Act of 1965, as amended by the No Child Left Behind Act of 2001 (20 USC 6361 et seq.).
- Missing a statement that the program is subject to the Department of Education's General Administrative Regulations at 34 CFR, Parts 76, 77, 80, 82, and 85.

As a result, Education disbursed more than $101 million to LEAs without communicating complete award information for the fiscal year ended June 30, 2008.

English Language Acquisition Grants

We noted the program uses the Notices of Apportionment, as opposed to Form AO 400, as its means to communicate award identification to its LEAs. We noted the following error or omission in the communication:

- Missing Education Department General Administrative Regulations at 34 CFR, Parts 76, 77, 81, and 82.

As a result, Education disbursed more than $169 million to LEAs without communicating complete award information for the fiscal year ended June 30, 2008.

Improving Teacher Quality State Grants

We noted the program uses the Notices of Apportionment, as opposed to Form AO 400, as its means to communicate award identification to its LEAs. We noted the following errors or omissions in the communication:

- Included only the name Teacher and Principal Training and Recruiting Fund but did not include the name from the grant award agreement, Improving Teacher Quality State Grants, which is the name that matches the Catalog of Federal Domestic Assistance (CFDA) number that LEAs use for audit identification.

- 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).

As a result, Education disbursed more than $319 million to LEAs without communicating complete award information for the fiscal year ended June 30, 2008.

Questioned Costs

Not applicable.

Recommendation

Education should implement policies and procedures to ensure that complete award information is communicated to its subrecipient LEAs.

Department's View and Corrective Action Plan

In August 2008, Education revised its Form AO 400 and Notice of Apportionment to more clearly identify the sections of the ESEA and Title 34 CFR that apply to federal programs; program-specific requirements are incorporated in the Request for Applications (RFA).

Auditor's Comments on Department's View

Although it is beneficial to incorporate the program-specific requirements into the RFA, this information should be included in the Grant Award Notification (for example, subgrant award document) that would be retained by the LEA.

Reference Number:	2008-13-6
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Education (Education)
Federal Catalog Number:	84.002
Federal Program Title:	Adult Education—Basic Grants to States
Federal Award Numbers and Years:	V002A070005; 2007 V002A060005; 2006 V002A050005; 2005

Federal Catalog Number:	84.010

Federal Program Title:	Title I Grants to Local Educational Agencies
Federal Award Numbers and Years:	S010A070005; 2007 S010A060005; 2006 S010A050005; 2005

Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education—State Grant Program
Federal Award Numbers and Years:	S011A070005; 2007 S011A060005; 2006 S011A050005; 2005

Federal Catalog Number:	84.048
Federal Program Title:	Career and Technical Education—Basic Grants to States
Federal Award Numbers and Years:	V048A070005; 2007 V048A060005; 2006 V048A050005; 2005

Federal Catalog Number:	84.186
Federal Program Title:	Safe and Drug-Free Schools and Communities—State Grants
Federal Award Numbers and Years:	Q186A070005; 2007 Q186A060005; 2006 Q186A050005; 2005

Federal Catalog Number:	84.287
Federal Program Title:	Twenty-First Century Community Learning Centers
Federal Award Numbers and Years:	S287C070005; 2007 S287C060005; 2006 S287C050005; 2005

Federal Catalog Number:	84.365
Federal Program Title:	English Language Acquisition Grants
Federal Award Numbers and Years:	T365A070005; 2007 T365A060005; 2006 T365A050005; 2005

Federal Catalog Number:	84.367
Federal Program Title:	Improving Teacher Quality State Grants
Federal Award Numbers and Years:	S367A070005; 2007 S367A060005; 2006 S367A050005; 2005

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—Financial Administration, 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 Education's Consolidated Program Monitoring (CPM) Unit monitors the program. This unit 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 programs. During the year ended June 30, 2008, Education performed CPM visits on 154, or approximately 15 percent, of its LEAs.

1. We reviewed Education's policies and procedures regarding its CPM site visits and noted the following:

   - 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. The CPM 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 checkmark 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 interviewed (for example, staff, parent, or student), and a checkmark next to "meets requirements."

   - 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.

- The design of the CPM monitoring instrument contains a section to document the evidence reviewed; however, it only contains check boxes 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.

- 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.

- Education does not have an adequate policy to ensure comprehensive documentation is maintained to support the CPM finding resolution process.

2. We selected a sample of 60 schools monitored between October 2007 and June 2008 and noted that 57 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 had been conducted in a timely manner. Education requires schools to respond with a proposed resolution or corrective action plan within 45 days of receipt of the Notification of Findings.

   a. For the 57 schools required to submit a proposed corrective action plan within 45 days, we noted that 31 submitted a plan between 46 and 116 days after the receipt of the Notification of Findings and that five schools submitted no action plan. We also noted no evidence that a CPM administrator or director reviewed 51 of the 60 reviews sampled.

   b. In reviewing the timeliness of the resolution of these proposed corrective action plans, we noted the following:

      - Of the 57 schools, 19 had either resolved all their outstanding issues in a timely manner or Education was able to provide sufficient documented evidence of follow-up made by its consultants.

      - One of the 57 schools visited had noncompliant findings documented in the corresponding CPM instrument that were not reflected in the Notice of Findings sent to the LEA. This resulted in noncompliant issues not being appropriately addressed.

      - Of the 57 schools, 37 had noncompliant findings that were either a) identified as resolved by CPM and program consultants but not supported, or b) remained unresolved issues with no evidence of follow-up performed by CPM in the last 30 days.

The untimely resolution of outstanding CPM findings appear to be due to a combination of untimely follow-up and ineffective sanctions imposed by Education on its LEAs for untimely implementation of corrective action plans. Without effective repercussions, the LEAs do not have incentive to implement corrective actions in a timely manner. As a result, Education disbursed more than $2.58 billion out of the total $2.64 billion in expenditures for the eight programs without adequately ensuring LEAs were expending funds in accordance with federal guidelines for the fiscal year ended June 30, 2008.

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 LEAs' proposed corrective actions from those visits are implemented promptly.

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 (Categorical Monitoring) advised reviewers to specifically identify the documents, interviews, and observations used as evidence of noncompliance. To further strengthen existing controls, Education is updating the CPM protocols for fiscal year 2008–09 to include instructions on documentation requirements for monitoring Notification of Findings during a CPM field visit.

Categorical Monitoring reviews the findings for each monitoring visit—On January 9, 2008, Categorical Monitoring initiated reviews of the Notifications of Findings for each monitoring visit. The objectives of these reviews are to verify that documentation of the procedures performed (for example, program and fiscal samples tested or interviews and observations) support the reported conclusions and that signed verification documents are maintained with the Notification of Findings. In addition, Education's fiscal year 2008–09 CPM protocols will include "Program Office Administrator Responsibilities," requiring program administrators to supervise the timely resolution of findings for each assigned CPM field visit.

Education has entered into an agreement with the California Comprehensive Center at WestEd to develop a Web-based compliance tracking system — On December 18, 2007, a meeting between representatives of Education and the California Comprehensive Center at WestEd resulted in the development of a Web-based computerized tracking system to support CPM. The new system will allow LEAs to prepare for CPM on-site visits by completing program instruments online and uploading documents as evidence of compliance. The system will also facilitate prompter follow-up of corrective action by the appropriate Education program manager when a LEA fails to resolve findings of noncompliance within the time period allowed. Education plans to pilot the online reporting system for categorical program monitoring with two regions (Region 4 and Region 10). In July and August 2008, Education sent letters to the county and district superintendents and charter school administrators of the pilot regions to provide notification and details of the new online reporting system.

Reference Number:	2008-13-7
Federal Catalog Numbers:	84.027 and 84.173
Federal Program Titles:	Special Education Cluster: Special Education Grants to States and Special Education PreSchool Grants
Federal Award Numbers and Years:	H027A070116; 2007, H173A070120; 2007 H027A060116; 2006, H173A060120; 2006 H027A050116; 2005, H173A060120; 2005
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—Financial Administration, 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 is monitored by Education's Focused Monitoring and Technical Assistance Unit (FMTA), which conducts site visits of its Special Education Local Plan Area Agencies (SELPAs). During the fiscal year ended June 30, 2008, Education performed FMTA visits on 18 of its approximately 1,100 school districts, or approximately 2 percent of the school districts within its SELPAs.

1. We reviewed Education's policies and procedures regarding its FMTA visits and noted the following:

   - These monitoring site visits consisted of programmatic procedures and did not include procedures over fiscal matters to gain assurance on compliance with fiscal requirements of the program.

   - Education requires the school districts to respond with evidence of corrective action within approximately one year of receipt of the Notification of Audit Results in the majority of instances. Allowing such an extended length of time to respond with support for corrective action increases the length of time for the school districts to enact corrective action, thus extending the period of noncompliance.

   - The number of FMTA visits performed does not appear to be sufficient in size to support that this was a representative sample of the population of school districts receiving special education funds. Education does require an annual self-review for 25 percent of its school districts, of which a portion may be selected for an Education follow-up verification review based on information reported in the self-review. However, these reviews also appear to focus on programmatic issues and exclude fiscal matters.

2. We selected a sample of school districts that had been monitored and noted these FTMA monitoring visits were performed between February 2007 and June 2007. We noted all 18 FTMA visits resulted in compliance findings that required corrective action and follow-up. We reviewed the support for the resolution follow-up that had been performed on those findings to ascertain

if it had been completed in a timely manner. Six of the 18 school districts had compliance findings that still were not resolved by November 2008, which is approximately 13 to 19 months from the date of the monitoring visit. For example, we noted the following:

- Education indicated that three of these six FTMAs' outstanding compliance findings from April 2007 related to issues that were noted at developmental centers regarding statewide standardized testing. Education continues to work with the Department of Developmental Services in establishing a process for including these centers as part of the statewide testing; however, this issue remains outstanding after 18 months, which does not appear to be timely corrective action.

- Another FTMA outstanding compliance finding was delayed due to the changeover in the consultant that was responsible for this review.

This untimely resolution of corrective actions appears to be the result of the follow-up schedule that is dictated by Education. Allowing an extended length of time to respond with support for corrective action increases the length of time to resolve findings. By not requiring timely follow-up on monitoring visit findings of noncompliance, the period of noncompliance for subrecipients is extended. As a result, Education disbursed more than $1.16 billion out of the total $1.19 billion of program expenditures to SELPAs without adequately ensuring they were expending funds in accordance with federal guidelines for the fiscal year ended June 30, 2008.

Questioned Costs

Not applicable.

Recommendation

Education should enhance its current policies and procedures over subrecipient monitoring, specifically during-the-award monitoring (for example, monitoring visits), to ensure that all material program elements are covered, including fiscal matters, and that resolution of corrective actions on deficiencies noted during the award monitoring is performed promptly.

Department's View and Corrective Action Plan

To improve the timeliness of corrective actions taken on reported monitoring deficiencies, Education plans to enhance subrecipient monitoring policies and procedures by establishing shorter resolution timelines. To ensure corrective actions are resolved within one calendar year, Education implemented during fiscal year 2008–09 a 45-day timeline for LEAs to resolve student-specific issues, and a 90-day timeline for LEAs to resolve, or implement a plan to resolve, systemic issues. Also, Education is awaiting upcoming federal guidance on incorporating fiscal compliance review procedures as part of special education site monitoring visits.

Education stated it continues to work with the Department of Developmental Services (Developmental Services) in resolving systemic-level monitoring issues at the developmental centers and in revising policies and procedures to align with changes in special education laws. In regard to the three outstanding issues concerning statewide standardized testing for developmental center students, Education is aware that these issues remain outstanding as it works with the Developmental Services in considering testing improvement options in this area. For example, Education is considering the option of school districts entering into memorandums of understanding with the developmental centers to include center students as part of the districts' statewide testing.

Federal Catalog Number:	84.357
Federal Program Title:	Reading First State Grants
Federal Award Numbers and Years:	S357A070005; 2007 S357A060005; 2006 S357A050005; 2005
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—Financial Administration, 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 outsources its monitoring to California Technical Assistance Centers (C-TAC). C-TAC performs program monitoring site reviews of the local educational agencies (LEAs). Per its contract with Education, C-TAC is required to perform three site visits per school district a year. We noted the following compliance issues with Education's monitoring process:

1. We obtained a copy of Education's contract with C-TAC and noted the responsibilities listed in the contract refer to program implementation and not program or fiscal subrecipient monitoring. C-TAC uses a standardized monitoring instrument similar to a checklist that details the areas required to be reviewed during a visit. We noted this monitoring instrument is focused on assisting with program implementation, but does not contain procedures to ensure that the LEAs comply with laws, regulations, and the provisions of contracts or grant agreements, achieve performance goals or comply with fiscal requirements.
2. C-TAC does not have any type of summary reports of findings to provide the LEAs or Education to document any issues noted or to convey deadlines to resolve any issues. C-TAC follows up on any implementation issues noted at its site review during its next scheduled site visit. Education is provided with a new monitoring instrument completed during the next visit.

3. Education requires that LEAs submit summarized final expenditure reports and program reports. Education reviews the summarized narratives in these reports as its evidence that LEAs are expending funds in accordance with federal guidelines. It has no processes in place to review any detail of reported expenditures on a sample basis to ensure that federal funds were expended in accordance with U.S. Office of Management and Budget, *Cost Principles for State and Local Governments* (OMB Circular A-87).

As a result, Education disbursed more than $101 million out of the total $102 million of program expenditures to LEAs without adequately ensuring LEAs were expending funds in accordance with federal guidelines for the fiscal year ended June 30, 2008.

Questioned Costs

Not applicable.

Recommendations

Education should enhance its current policies and procedures over subrecipient monitoring, specifically during-the-award monitoring (for example, monitoring visits), to ensure that all material program elements are covered, including fiscal, and a formalized process is set up to follow up on and resolve issues promptly. Education should also enhance its procedures to include a review of the expenditure reports to ensure program funds are used in accordance with authorized purposes.

Department's View and Corrective Action Plan

Education stated it will continue to effectively work with the C-TAC and Reading First Regional Technical Assistance Centers (R-TACs) in overseeing and in improving the monitoring of LEAs involved in the Reading First program. As part of the current monitoring process, Education and the R-TACs provide technical assistance to LEAs in building capacity to implement the Reading First program and to raise achievement gains. Education will enhance current monitoring procedures by requiring monitors to not only determine if all material program elements are covered, but also to determine that program funds are expended in accordance with authorized purposes. Education will work with the C-TAC and R-TACs in developing procedures that will facilitate the monitors in making reasonable fiscal determinations and promptly following up on known issues.

Reference Number:	2008-13-9
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Education (Education)
Federal Catalog Number:	84.002
Federal Program Title:	Adult Education—Basic Grants to States
Federal Award Numbers and Years:	V002A070005; 2007 V002A060005; 2006 V002A050005; 2005

Federal Catalog Number:	84.010
Federal Program Title:	Title I Grants to Local Educational Agencies

Federal Award Number and Years:	S010A070005; 2007 S010A060005; 2006 S010A050005; 2005

Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education—State Grant Program
Federal Award Numbers and Years:	S011A070005; 2007 S011A060005; 2006 S011A050005; 2005

Federal Catalog Numbers:	84.027 and 84.173
Federal Program Titles:	Special Education Cluster: Special Education Grants to States and Special Education PreSchool Grants
Federal Award Numbers and Years:	H027A070116; 2007, H173A070120; 2007 H027A060116; 2006, H173A060120; 2006 H027A050116; 2005, H173A060120; 2005

Federal Catalog Number:	84.048
Federal Program Title:	Career and Technical Education—Basic Grants to States
Federal Award Numbers and Years:	V048A070005; 2007 V048A060005; 2006 V048A050005; 2005

Federal Catalog Number:	84.186
Federal Program Title:	Safe and Drug-Free Schools and Communities—State Grants
Federal Award Numbers and Years:	Q186A070005; 2007 Q186A060005; 2006 Q186A050005; 2005

Federal Catalog Number:	84.287
Federal Program Title:	Twenty-First Century Community Learning Centers
Federal Award Numbers and Years:	S287C070005; 2007 S287C060005; 2006 S287C050005; 2005

Federal Catalog Number:	84.357
Federal Program Title:	Reading First State Grants
Federal Award Numbers and Years:	S357A070005; 2007 S357A060005; 2006 S357A050005; 2005

Federal Catalog Number:	84.365
Federal Program Title:	English Language Acquisition Grants
Federal Award Numbers and Years:	T365A070005; 2007 T365A060005; 2006 T365A050005; 2005

Federal Catalog Number:	84.367
Federal Program Title:	Improving Teacher Quality State Grants
Federal Award Numbers and Years:	S367A070005; 2007 S367A060005; 2006 S367A050005; 2005

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;

(2) Is not financially stable;

(3) Has a management system, which does not meet the management standards set forth in this part;

(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 policies and procedures regarding its monitoring of U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-profit Organizations* (OMB Circular A-133) audit reports received by its subrecipients, we noted it does not have an effective policy that addresses continued subrecipient noncompliance or other high-risk behavior either on a program-specific level or on a departmentwide level. In our review of OMB Circular A-133 audit reports received by Education, we noted some of its local educational agencies (LEAs) and Special Education Local Plan Area Agencies (SELPAs) reports contained findings of material noncompliance that were repeated over several years.

As the pass-through entity, Education is responsible for ensuring that its LEAs and SELPAs take appropriate and timely corrective action on all audit findings, using sanctions when appropriate to discourage continued noncompliance. This continued LEA/SELPA noncompliance appears to be a result of a lack of effective oversight by Education to either require these LEAs/SELPAs to obtain additional management or technical assistance or impose sanctions to encourage appropriate and timely corrective action to be implemented. Identification of higher-risk LEAs/SELPAs is a critical component in determining the extent of monitoring procedures to be performed by Education and by the LEAs' auditors in their OMB Circular A-133 audits.

Questioned Costs

Not applicable.

Recommendation

Education should enhance its policies and procedures for identifying and encouraging timely and appropriate corrective action for its LEAs/SELPAs that demonstrate continued uncorrected material noncompliance or other high-risk behaviors.

Department's View and Corrective Action Plan

Education stated its policy regarding subrecipients' OMB Circular A-133 audit findings is for subrecipients to clear audit findings as soon as reasonably possible. Education enhanced monitoring and evaluation procedures by posting LEAs' OMB Circular A-133 audit findings on its intranet. To further enhance monitoring and evaluation procedures, Education will also enhance its audit tracking system so that high-risk grantees, such as the LEAs with repeat material compliance audit findings, can be communicated to program staff. Program staff can utilize the OMB Circular A-133 audit finding information in assessing risk with regard to an LEA's operations, accounting systems, program compliance, or financial conditions. This information can also be used by program staff to offer training and impose special conditions or restrictions on LEAs to help ensure compliance with program regulations.

In consideration of the available sanctions and special conditions allowed by federal rules and regulations, Education will develop department-wide policies and procedures to assist program staff in selecting the most effective options in encouraging timely corrective action by LEAs.

Reference Number:	2008-14-3
Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education—State Grant Program
Federal Award Numbers and Years:	S011A070005; 2007 S011A060005; 2006 S011A050005; 2005
Category of Finding:	Special Tests and Provisions— Subgrant Process
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—Financial Administration, 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's 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, priority-for-services, and availability of other funding. We noted that an outside subcontractor prepares the funding formula. Education relies upon the work performed by the outside subcontractor and does not perform any monitoring to ensure the subcontractor's processes are in place and effective to help ensure the accuracy of the funding formula it supplies to Education.

Education does not have a policy in place to monitor the outside subcontractor or to test the information it provided during the fiscal year under audit. The absence of appropriate monitoring increases the risk of inaccuracies going undetected. However, we noted during our follow-up regarding prior-year findings that Education has a proposed plan to enhance its monitoring of its subcontractor.

Questioned Costs

Not applicable.

Recommendation

Education should implement its proposed plan to 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 stated it has strengthened quality control procedures over the reporting approval process by requiring regional offices to validate student count data. Once the prior year's student counts are established, Education meets with subcontractors to preliminarily review final reports for accuracy by comparing the subgrant reports with data from other reports provided by each region.

To further strengthen quality control processes, each year Education plans to select a sampling of data submissions by region to verify completeness and accuracy. If discrepancies are identified, corresponding regional offices will be contacted for resolution and Education will retain the source documents used to validate the selected data submissions.

Reference Number:	2008-14-4
Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education—State Grant Program
Federal Award Numbers and Years:	S011A070005; 2007 S011A060005; 2006 S011A050005; 2005
Category of Finding:	Special Tests and Provisions—Child Counts
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—Financial Administration, 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 review of the Consolidated State Performance Report (CSPR), Part I, Migrant Child Counts, 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 quality control process description indicated, "The State Categorical Program Monitoring (CPM) process includes random sampling and review of Certificates of Eligibility (COEs)." However, when we reviewed the monitoring instrument used by Education entitled "No Child Left Behind (NCLB), Title I, Part C: Education of Migrant Children and California Migrant Education (ME) Instrument for Categorical Program Monitoring (CPM): An Ongoing Monitoring Process (revision 9/19/07)", we noted it did not contain any planned procedures regarding sampling or review of participant COEs, as was indicated in the quality control process description in the CSPR.

Questioned Costs

Not applicable.

Recommendation

Education should update its CPM monitoring instrument to include its planned quality control procedures over participant COEs to ensure that all quality control processes reported are carried out as described.

Department's View and Corrective Action Plan

Education stated it will improve the CPM monitoring instrument in accordance with the upcoming final program determinations made by the U.S. Department of Education regarding the Office of Inspector General's 2006 audit entitled *California Department of Education's Migrant Education Program*. Education's planned monitoring improvements include implementation of annual statewide prospective re-interviews to validate current-year child eligibility determinations through the re-interview of a randomly selected sample of children currently identified as migratory to improve quality control processes and to ensure correct eligibility determinations.

U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Reference Number:	2008-1-3
Federal Catalog Number:	93.778
Federal Program Title:	Medicaid Cluster: Medical Assistance Program (Medi-Cal)
Federal Award Numbers and Years:	05-0805CA5028; 2008 05-0705CA5028; 2007
Category of Finding:	Activities Allowed/Allowable Costs
State Administering Department:	Department of Health Care Services (Health Care Services)

Criteria

TITLE 19, SOCIAL SECURITY ACT—GRANTS TO STATE FOR MEDICAL ASSISTANCE PROGRAMS, Section 1927—Payment for Covered Outpatient Drugs

(b) Terms of Rebate Agreement

(2) State Provision of Information

(A) 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, 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 of all covered outpatient drugs to the Centers for Medicare and Medicaid Services (CMS) and, on a quarterly basis, 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 third quarter 2007 (July to September 2007) drug data on December 13, 2007, and the fourth quarter 2007 (October to December 2007) drug data on March 5, 2008.

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. Thus, drug utilization data should have been mailed to the labelers by the State Medicaid Agency by November 29, 2007, for the third quarter of 2007 calendar year and by February 29, 2008, for the fourth quarter. However, in our procedures performed over 25 rebate invoices sampled related to the third and fourth quarters of 2007, we noted that Health Care Services provided the drug utilization data to labelers for the third quarter on December 13, 2007, which is 14 days late and mailed the data on March 5, 2008, for the fourth quarter, which is five days late.

Total combined federal and state drug rebates billed for the third and fourth quarters amounted to $175.7 million and $239 million, respectively, for the fiscal year ended June 30, 2008.

Questioned Costs

Not determined.

Recommendation

Health Care Services should ensure that drug utilization data are provided to drug manufacturers/labelers on a timely basis (for example, no later than 60 days after the end of the quarter) and to proactively monitor the receipt of payment from labelers.

Department's View and Corrective Action Plan

Health Care Services stated it continues to review the invoicing process and all potential areas in which it could reduce the time it takes to produce, review, and generate all invoices produced by the Rebate Accounting and Information System. Health Care Services is implementing a system logic change that will reduce the amount of manual review time required for blood factor claims by one week, thus allowing the invoices to be mailed more promptly. At this time, the system logic change is expected to be implemented in April 2009. In addition, Health Care Services has implemented a second printer so that the time required for printing the physical invoices is reduced by four days. Health Care Services recommends 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 and mail these reports to the drug manufacturers. Finally, Health Care Services believes CMS should consider changing the requirements to reflect working days rather than calendar days.

Reference Number:	2008-1-4
Federal Catalog Number:	93.778
Federal Program Title:	Medicaid Cluster: Medical Assistance Program (Medi-Cal)
Federal Award Numbers and Years:	05-0805CA5028; 2008 05-0705CA5028; 2007
Category of Finding:	Activities Allowed/Allowable Costs
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

In our procedures performed over expenditures charged to the program, we selected a sample of fee-for-service claims and utilized Health Care Services' Medical Review Branch of trained medical professionals to ascertain that each expenditure was for an allowable service rendered and was supported by medical records or other evidence, indicating that the service was actually provided and consistent with the medical diagnosis. In our sample of 50 fee-for-service claims, six did not appear to be for an allowable service. These exceptions are noted as follows:

- Five paid claims were not deemed medically necessary.
- One claim did not have sufficient documentation to support whether the required medical procedures were rendered to the beneficiary.

Questioned Costs

$17,828 of the $347,426 sampled fee-for-service Medi-Cal claims from the $9.8 billion fee-for-service claims paid during the fiscal year ended June 30, 2008.

Recommendations

Health Care Services should strengthen its internal controls to ensure only medically necessary claims and eligible providers are paid. Health Care Services should also strengthen its internal control process to detect providers in violation of record retention rules.

Department's View and Corrective Action Plan

Annually, 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.

In an effort to maximize claims monitoring efficiency, staff, and resources, Health Care Services has developed several pre- and post-payment reviews to identify violations and, if warranted, expand the scope of 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. Denial of payment and further reviews will be performed to verify the adequacy of supporting documentation for claims submitted based on results of RCR reviews.

Health Care Services has developed four different post-payment reviews: Self-Audits, Desk Audits, Field Audit Reviews, and Audits for Recovery. The type of review is based on materiality (for example, 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 (LEA). Based on the findings of the MPES, Health Care Services developed the Pharmacy Outreach Project, which consisted of 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. As a result of the MPES findings, an extended review of the LEA was conducted by the State Controller's Office and will be part of the MPES 2007 report.

Health Care Services has consistently and aggressively addressed the issues of monitoring and controls to ensure that 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 that there were exceptions for six of the claims: five of the claims were not deemed medically necessary and the services for one claim were not documented properly. Recoveries for the paid amounts will be requested from the six providers where exceptions were found. In addition, it will be determined if additional reviews are needed for the providers where exceptions were found.

Reference Number:	2008-2-2
Federal Catalog Number:	93.778
Federal Program Title:	Medicaid Cluster: Medical Assistance Program (Medi-Cal)
Federal Award Numbers and Years:	05-0805CA5028; 2008 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, PART 455—PROGRAM INTEGRITY: MEDICAID, Subpart A—Medicaid Agency Fraud Detection and Investigation Program, Section 455.18—Provider's Statements on Claims Forms

(a) Except as provided in Section 455.19, the agency must provide that all provider claims forms be imprinted in boldface type with the following statements, or with alternate wording that is approved by the Regional CMS Administrator:

(1) "This is to certify that the foregoing information is true, accurate, and complete."

(2) "I understand that payment of this claim will be from federal and state funds, and that any falsification, or concealment of a material fact, may be prosecuted under federal and state laws."

(b) The statements may be printed above the claimant's signature or, if they are printed on the reverse of the form, a reference to the statements must appear immediately preceding the claimant's signature.

Condition

Electronic Data Systems (EDS) is the fiscal intermediary that processes all fee-for-service provider claims submitted through the California Medicaid Management System. A requirement for billing claims to Medi-Cal is the certification of the claim. This certification is the provider's assertion that the facts in the claim are true and accurate. The agreement states, "The services were, to the best of the Provider's knowledge, medically indicated and necessary to the health of the patient . . . (and) all information submitted electronically is accurate and complete."

To verify certification of the claims, we obtained the Computer Media Claims (CMC) agreements for each of the 50 fee-for-service provider claims sampled and reviewed them for the proper signatures. We noted one of the 50 CMC agreements was missing the signature page for the drug sample selected.

Questioned Costs

$263 of the $347,426 fee-for-service provider claims sampled from the $9.8 billion total fee-for-service provider claims paid during the fiscal year ended June 30, 2008.

Recommendation

Health Care Services should strengthen its internal controls to ensure that it signs a CMC agreement with the provider.

Department's View and Corrective Action Plan

Health Care Services agrees that enhanced internal control efforts can ensure that a CMC agreement is signed between the provider and Health Care Services. The noted exception was the result of a failure to scan both sides of a CMC agreement.

All provider CMC agreements for electronic billing are submitted to EDS and it reviews CMC agreements for all required information based upon written protocols from Health Care Services. Once approved, the Provider Enrollment Division (PED) receives CMC provider-approved reports from EDS, where they undergo 100 percent review and are then used to update the Provider Master File.

The approved CMC agreements are batched and transported to PED, where PED staff separate each CMC agreement by provider National Provider Identifier and re-review the signature before scanning into an internal provider database.

Currently, PED is in discussions with EDS to modify the CMC agreement review process and potentially create a process whereby EDS will do on-site scanning of all CMC agreements.

Reference Number:	2008-2-3
Federal Catalog Number:	93.778
Federal Program Title:	Medicaid Cluster: Medical Assistance Program (Medi-Cal)

Federal Award Numbers and Years:	05-0805CA5028; 2008 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 OF 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 the Medi-Cal program, we reviewed available audit and investigation reports to the program that were published and released during the fiscal year ended June 30, 2008. The following is a summary of the findings cited in the third annual Medi-Cal Payment Error Study (MPES) performed during the fiscal year 2005–06:

> The sampling universe consists of Medi-Cal fee for service (FFS) claims paid through the fiscal intermediary, Electronic Data Systems (EDS), as well as dental claims paid, during the period of April 1, 2006, through June 30, 2006 . . . There are 1,147 claims in the sample. The sample size was extracted from a universe of 20,272,035 Medi-Cal claims . . . Proportional allocation of the sample size was used to determine the sample size from each stratum ensuring a minimum sample size of 50 claims for each stratum.
>
> (The results of the MPES indicated that) 7.27 percent of the total dollars paid had some indication that they contained a provider error . . . The 7.27 percent equates to $1.2 billion of the total $18 billion in annual payments made for FFS medical and dental services in calendar year 2006, and represents the percentage of payment error attributable to Medi-Cal program dollars "at risk" of being paid inappropriately due to findings related to such factors as a lack of medical necessity, abuse, or fraud . . . Of the total payments, 2.75 percent, or $445 million, were for claims submitted by providers that disclosed characteristics of potential fraud.
>
> Of the payments for claims with errors, 45 percent were for claims with insufficient documentation. This means that the documentation presented by the provider did not support the services claimed.
>
> A total of 41 percent of all payments for claims with errors were for claims in which the provider's documentation did not support medical necessity for the services billed, meaning the services did not need to be provided. There were no claims processing errors identified.
>
> (Unlike MPES 2005), the MPES 2006 did not include a review to determine if FFS beneficiaries were eligible for Medi-Cal at the time the beneficiary received services. A separate review to determine eligibility of Medi-Cal beneficiaries is being performed in accordance with the requirements of the federal Payment Error Rate Measurement (PERM) program.

Based on the error percentage related to Medi-Cal payments, the risk of noncompliance with allowable costs and activities is considered material.

Recommendations

Health Care Services should strengthen its internal controls to ensure only medically necessary claims are paid. Health Care Services should also strengthen its internal control process to detect providers in violation of record retention requirements.

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 MPES 2005–06.

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 2005–06 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 the following: 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 in the number of investigational and routine field compliance audits, an independent review of the Local Educational Agencies by the State Controller's Office, and development of a joint action plan with provider regulatory boards and provider associations to address providers claiming errors identified as potential fraud and abuse.

The MPES is available at: www.dhcs.ca.gov/individuals/pages/auditsinvestigations.aspx.

Reference Number:	2008-3-6
Category of Finding:	Cash Management
State Administering Department:	California Department of Public Health (Public Health)
Federal Catalog Number:	93.917
Federal Program Title:	HIV Care Formula Grants
Federal Award Numbers and Years:	2X07HA00041-18-00; 2008 6X07HA00041-17-02; 2007

Federal Catalog Number:	93.283
Federal Program Title:	Centers for Disease Control and Prevention—Investigations and Technical Assistance
Federal Award Numbers and Years:	5U90TP917016-08; 2007 5U90TP917016-07; 2006

Federal Catalog Number:	93.889
Federal Program Title:	National Bioterrorism Hospital Preparedness Program
Federal Award Numbers and Years:	U3REP070041-01-03; 2007 U3RHS007572-01-03; 2006 U3RHS05953-01-01; 2005 U3RHS03890-01-05; 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 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, 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.

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 92.21—Payment

(b) 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.

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 amount 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 received was indicated, we used the date the request was signed by the subrecipient/vendor, 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's Prompt Payment Act (Act) that addresses the minimization of timing of payments to certain types of grant award subrecipients. The Act encourages that payments be made within 45 days of receipt of the reimbursement request and states that the State Controller's Office (SCO) has not more than 15 calendar days to issue a warrant once it receives a correct claim schedule from the state agency. 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 provide an appropriate basis for determining the reasonableness for timing of payments.

HIV Care Formula Grants

In our sample of undisputed subrecipient invoices, we noted 28 out of the 30 tested, which totaled approximately $3.08 million, where invoices were reimbursed after more than 45 days. These untimely disbursements ranged from 48 to 291 days from the date of the subrecipient invoices.

We also noted 27 out of 30 undisputed invoices submitted by subrecipients, totaling approximately $3.07 million, were submitted to the SCO by Public Health after more than 30 days. These untimely submissions to the SCO ranged from 35 to 279 days.

Public Health does not have an adequate policy that addresses the minimization of timing of reimbursement payments to subrecipients. As a result, Public Health disbursed approximately $3.08 million of the $3.12 million sampled without minimizing the time between the receipt of reimbursement request (for example, subrecipient need) and disbursement of federal funds. Amounts paid to subrecipients totaled $10.3 million during the fiscal year ended June 30, 2008.

Centers for Disease Control and Prevention—Investigations and Technical Assistance

During our procedures performed over cash management, we noted Public Health utilizes two different payment methods for its subrecipients and vendors. It provides cash advances to its subrecipients and pays its vendors on a reimbursement basis. Therefore, we performed two separate procedures to ascertain compliance with cash management requirements.

1. Advance payments are made to local health departments/counties by Public Health's Emergency Preparedness Office (EPO). We noted that it does not have an adequate process in place for assessing the cash needs of its subrecipients. The EPO follows California Health and Safety Codes. Specifically, the California Health and Safety Code, Sections 101317(d)(1) and (2), require Public Health to disburse funds quarterly to local health department/counties (subrecipients) for the program contingent upon completion of certain tasks. Subsequent payments are 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 distributed throughout the year based on certain criteria being met by each 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 period between September 1st and August 31st. The fourth payment requires the subrecipient to have submitted the first three payment requirement items and additionally to submit its current mid-year progress report, which shows the actual expenditures for the first half (September 1—February 28) of the current fiscal year.

However, because EPO makes payments contingent on receipt of certain information from the subrecipients, these payments are not necessarily sent at the beginning of each quarter, and they may even 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 had not received their warrant payment from the SCO 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.

Further, Public Health does not have procedures in place to ensure that the program's subrecipients can demonstrate their 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 of funds expended by the subrecipient in order to monitor how the money is being spent or whether all of the prior advance was fully spent before issuing the next 25 percent payment. Public Health is required to have procedures in place that monitor the cash used by their subrecipients.

As a result, Public Health disbursed approximately $44 million to subrecipients during the state fiscal year ended June 30, 2008, with limited assurance that these subrecipients minimized the time between the receipt and disbursement of federal funds.

2. Additionally, during our procedures performed over payments to vendors, we noted that nine out of the 15 invoices sampled, which totaled approximately $176,882, were undisputed invoices submitted by subrecipients/vendors and were reimbursed after more than 45 days. These untimely disbursements ranged from 54 to 127 days from the date of the subrecipient reports.

   Additionally, in four out of 60 payments to vendors and to local health departments/counties sampled, totaling $262,593, federal funds were deposited in the state bank account and not disbursed to subrecipients within 15 calendar days of receipt in accordance with the Act. These untimely disbursements ranged from 20 to 34 days from the date of the draw.

   Public Health does not have an adequate policy that addresses minimizing the timing of reimbursement payments to vendors. As a result, Public Health disbursed $176,882 of the $188,168 sampled without minimizing the time between the receipt of invoice and disbursement of federal funds. Amounts paid to nonsubrecipient vendors totaled $17.9 million during the fiscal year ended June 30, 2008.

National Bioterrorism Hospital Preparedness Program

In 36 out of the 60 invoices sampled, totaling $239,743, undisputed invoices submitted by subrecipients/vendors took longer than 45 days to be reimbursed. These untimely disbursements ranged from 59 to 206 days from the date of the subrecipient invoices.

We also noted 15 out of the 60 invoices from the same sample, totaling $75,757, where the federal funds were deposited in the state bank account and not disbursed to subrecipients within 15 calendar days of receipt of the federal cash advance in accordance with policy for payments other than Cash Management Improvement Act (CMIA) payments. These untimely disbursements ranged from 16 to 45 days from the date of the draw.

Public Health does not have an adequate policy that addresses minimizing timing of reimbursement payments made to subrecipients. As a result, Public Health disbursed $239,743 (which includes the $75,757 noted above) of the $661,020 sampled disbursements without minimizing the time between the receipt of reimbursement request (for example, subrecipient need) and disbursement of federal funds. Amounts paid to subrecipients totaled $47 million during the fiscal year ended June 30, 2008.

Questioned Costs

Not determined.

Recommendation

Public Health should ensure policies and procedures are in place to minimize the time between the receipt of undisputed payment requests and the disbursement of funds, as well as policies and procedures to minimize the time between drawdown of federal funds and their subsequent disbursement in order to be in compliance with federal and state requirements.

Department's View and Corrective Action Plan

HIV Care Formula Grants

Public Health agrees with this finding. In December 2008, the Division of Office of AIDS (OA) created a Fiscal Management Unit and a Contracts Unit within the Administration Section in order to develop capacity and centralize functions that had been distributed to various units within OA, including processing invoices. The centralization of duties and responsibilities in processing invoices allows the two units to work together, and with program staff, to ensure invoices are processed more efficiently.

OA has implemented a system so that each fund source has an annual allocation plan that includes the budget, encumbrances, expenditures (invoices), and balance. OA is updating its current system so that individual expenditures are reviewed, approved, and charged to the appropriate funding source so as to eliminate invoice-processing errors. Desk procedures are being written to be sure that Administration Section staff understand the duties and responsibilities for processing invoices expeditiously and correctly to minimize invoice returns from Public Health Accounting.

Additionally, OA staff have met with Public Health Accounting to determine what we can do to ensure that invoices are processed in a timely manner. In addition to utilizing the Public Health Accounting Section Preliminary Invoice Screening Checklist to ensure that each invoice is submitted as a complete package, we have also implemented other procedures suggested by Accounting to facilitate the process through to SCO.

Public Health's Strategic Plan Goal 5, objectives 3 and 4, address increasing the percentage of invoices processed by Public Health Accounting within 30 days of receipt in the section. This is a high priority for Public Health.

Centers for Disease Control and Prevention—Investigation and Technical Assistance

Condition 1: Public Health agrees that EPO must expeditiously process invoices and that procedures must be in place to assure timely and accurate invoice documentation, tracking, and communication. EPO would note, however, that the auditor did not take into consideration the time frame for issuance by the Centers for Disease Control and Prevention (CDC) of grant awards in fiscal year 2007–08. Although the grant year began at the end of August 2007, CDC did not make awards to states until the beginning of December 2007. To cover expenditures during the period from the end of August until December, CDC awarded states 30 percent of their anticipated full award. Public Health thus functioned under two federal awards during this grant period, which made grant management challenging.

In contrast to local assistance claims described by the auditor above, services paid through state operations funds are invoiced in arrears for services that have been provided. All but one of the claims that auditors found to be untimely were for information technology (IT) services. Upon investigation, EPO has determined that staff engaged in extended vendor negotiation to obtain required documentation rather than return the invoices to the vendor with documentation of the cause for nonpayment. EPO is establishing new procedures for processing of all state operations invoices, which include significantly reduced turnaround times.

At the start of the 2008–09 grant year, EPO revised its procedures for processing and approving local health department (LHD) applications. As a result of these procedures, all agreements, work plans and budgets were approved by December 30, 2008, and as of February 11, 2009, EPO has processed all CDC first and second quarter payments. The new streamlined process enables EPO to standardize the time frames for processing LHD invoices, which must be based on completed applications. It did not change Public Health's condition for payment disbursement, yet enabled Public Health's EPO to exert greater control over the payment timeline to more closely align with quarterly periods.

Public Health disagrees, however, with the finding that its condition of making payments contingent on receipt of certain information from subrecipients fundamentally impedes the timely disbursement of quarterly payments. This condition strikes the balance between quarterly payments and the need for the State to assess LHD progress in meeting minimum standards for local-level emergency preparedness as required by federal grant guidance. Disparate disbursement schedules that may or may not align with quarterly periods depending on the timeliness of LHD responses do not reflect an inherently flawed approach; rather, the lag signifies the consequence of failure of LHDs to prioritize submittals according to the State's schedule.

Condition 2: Public Health concurs with the untimely disbursements and the federal funds being deposited into the state bank account but not disbursed within 15 calendar days. Public Health stated it does have policies regarding the timely payment of invoices. Public Health's Strategic Plan includes commitments for Accounting to improve the processing of invoices within 30 days. The goal for June 2009 is to pay at least 85 percent of invoices received in Accounting within the 30-day time frame. The goal for June 2010 increases the goal to 90 percent. Accounting has hired students and retired annuitants to process invoices. Public Health implemented an invoice-tracking system on December 1, 2008. The tracking system will offer various management reports that will show how well Accounting is doing in meeting the goals of the Strategic Plan. The tracking system will also allow Accounting to continuously track invoices that are aging and have not been processed. Public Health will concentrate its efforts to pay invoices on a timely basis. The Administration Division also has developed an 18-point plan that has steps identified that when followed will make Programs and Administration Division accountable for managing Public Health's fiscal aspects.

For the federal funds being deposited into the state bank account but not disbursed within 15 calendar days, Accounting will reiterate the importance of assembling, approving, and submitting claim schedules to the SCO within a short time frame so that the draw and disbursement of the funds occurs within 15 calendar days.

National Bioterrorism Hospital Preparedness Program

Public Health concurs with the finding. Public Health stated that it does have policies regarding the timely payment of invoices. Public Health's Strategic Plan includes commitments for Accounting to improve the processing of invoices within 30 days. The goal for June 2009 is to pay at least 85 percent of invoices received in Accounting within the 30-day time frame. The goal for June 2010 increases the goal to 90 percent. Accounting has hired students and retired annuitants to process invoices. Public Health implemented an invoice tracking system on December 1, 2008. The tracking system will offer various management reports that will show how well Accounting is doing in meeting the goals of the Strategic Plan. The tracking system will also allow Accounting to continuously track invoices that are aging and have not been processed. Public Health will concentrate its efforts to pay invoices on a timely basis.

The Administration Division also has developed an 18-point plan that has steps identified that when followed will make Programs and Administration Division accountable for managing Public Health's fiscal aspects.

For the federal funds being deposited into the state bank account but not disbursed within 15 calendar days, Accounting will reiterate the importance of assembling, approving and submitting claim schedules to the SCO within a short time frame so that the draw and disbursement of the funds occurs within 15 calendar days.

Public Health agrees that the EPO must expeditiously process invoices and that procedures must be in place to assure timely and accurate invoice documentation, tracking and communication and continuously strives to ensure that effective procedures are in place. Public Health disagrees with the audit findings that the issues identified represent the absence or inherent failure of an effective approach to minimize the time between the receipt of undisputed payment requests and the disbursement of funds in accordance with federal and state law.

All but one of the claims paid through state operations funds that auditors found to be untimely were for information technology services. Upon investigation, EPO has determined that staff engaged in extended vendor negotiation to obtain required documentation rather than return the invoices to the vendor with documentation of the cause for nonpayment. EPO is establishing new procedures for processing of all state operations invoices, which include significantly reduced turnaround times.

For claims paid from local assistance funds, at the start of the 2008–09 grant year, EPO revised its procedures for processing and approving local Hospital Preparedness Program (HPP) entity applications. As a result of these procedures, all agreements, work plans, and budgets were approved by December 30, 2008. This will enable Public Health's EPO to process invoices for local HPP entities as they are submitted, without having to wait for agreements to be submitted or work plans and budgets to be approved.

Auditor's Comment's on Department's View

Centers for Disease Control and Prevention—Investigation and Technical Assistance

Although we do not disagree with EPO's assessment of the importance to monitor program goals and achievements and hold local agencies accountable by requiring their submission of these items prior to receiving funding, the objective of the federal cash management requirement is to minimize the timing between cash drawdown of federal funds by EPO and the subsequent disbursement of that cash by the grantee. If EPO does not require local agencies to provide information regarding expenditures or projected cash disbursements, it cannot adequately assess the actual cash needs of those local agencies and plan its cash drawdowns to meet local agency needs.

National Bioterrorism Hospital Preparedness Program

Based on the documentation provided by EPO, we were unable to determine if payment delays were due to resolution of disputed claims or internal EPO delays. Thus, EPO should enhance its existing payment processing procedures to include that it document: dates received, resolution correspondence dates, and approved-for-payment dates to support that it attempted to ensure it was minimizing the timing between the cash needs and disbursement of funds.

Reference Number:	2008-3-7
Federal Catalog Numbers:	93.575 and 93.596

Federal Program Titles:	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
Federal Award Numbers and Years:	G-0801CACCDF; 2008, G996005; 2007 2008G999004; 2007, 2008G999005; 2007 G-0701CACCDF; 2007, G996005; 2006 2007G999004; 2006, 2007G999005; 2006 G-0601CACCDF; 2006, G996005; 2005 2006G999004; 2005, 2006G999005; 2005
Category of Finding:	Cash Management
State Administering Department:	Department of Education (Education)

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.

Condition

During our procedures performed over payments made for subgrantees, we noted that Education requests cash advances (drawdowns) 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 (SCO). This program falls under the Cash Management Improvement Act (CMIA) with required funding techniques of preissuance for payments to LEAs and various state departments, and monthly estimate/monthly draw for administrative costs and payments to child care subgrantees. The preissuance 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 or subgrantee contractors for the program, we noted two drawdowns of the 60 sampled that were for LEAs and a state department that were paid seven days after the cash was received by the SCO, which exceeds the days allowed for preissuance.

Total exceptions amounted to $327,345 of the $8.9 million drawdown sampled.

Questioned Costs

Not determined.

Recommendation

Education should review its current policies and procedures over the issuance of cash advances to minimize the time elapsing between its drawdown of federal funds and the payment of the advance to the LEAs.

Department's View and Corrective Action Plan

Education did not deviate from the CMIA policies and procedures that were established by the Department of Finance (Finance) in agreement with the SCO. Although the CMIA report that was submitted to Finance reflects delays as cited by the auditors, the delays were under 10 days. Finance does not require Education to explain delays unless payment exceeds 10 days from the time of deposit.

Auditor's Comments on Department's View

Our procedures were based on the requirements of the federal code of regulations and not based on the State's internal policies and procedures to gather information to prepare the CMIA work sheets for Finance. Although Education may have complied with the State's internal policies of reporting exceptions to Finance, the exception noted was based on tests of compliance with the terms of the CMIA agreement, which requires that disbursements be made within three days of receipt of the funds.

Reference Number:	2008-3-8
Federal Catalog Numbers:	93.575 and 93.596
Federal Program Titles:	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
Federal Award Numbers and Years:	G-0801CACCDF; 2008, G996005; 2007 2008G999004; 2007, 2008G999005; 2007 G-0701CACCDF; 2007, G996005; 2006 2007G999004; 2006, 2007G999005; 2006 G-0601CACCDF; 2006, G996005; 2005 2006G999004; 2005, 2006G999005; 2005
Category of Finding:	Cash Management
State Administering Department:	Department of Education (Education)

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, , *GRANTS AND COOPERATIVE AGREEMENTS WITH STATE AND LOCAL GOVERNMENTS* (OMB CIRCULAR A-102), Post-Award Policies—Cash Management

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.

Condition

During our procedures performed over cash management requirements, we reviewed a sample of local educational agency (LEA) and subgrantee contractor final expenditure reports (reports) for any reimbursement amounts due back to the LEA or the subcontractor to ascertain if Education was minimizing the time between the LEAs' expenditure of program funds and their subsequent reimbursement. We reviewed the dates the reports were received by Education, or if no date received was indicated, by the date the request was signed by the LEA, and compared those dates to the dates payments were actually disbursed to the LEAs.

As a basis for determining the reasonableness of Education's minimizing of payment timing, we reviewed the State of California's 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 this program is 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 provide an appropriate basis for determining the reasonableness for timing of payments.

In our sample of 60 reimbursement payments, 11 were made more than 45 days after the date of the request. These untimely payments ranged from 46 to 77 days from the date of the LEA or subcontractor report requesting payment. Education indicated that these exceptions were due to expenditure reports being submitted past the due date to Education by subrecipient contractors, which caused them to be held until another batch of payments was accumulated.

Current policies and procedures in place do not appear to be effective in minimizing the timing of reimbursement payments made to subrecipients. As a result, Education disbursed approximately $542,725 of the $8,938,702 sampled without minimizing the time between the receipt of reimbursement request (for example, subrecipient need) and disbursement of federal funds. Amounts paid to subrecipients totaled $578 million during the fiscal year ended June 30, 2008.

Questioned Costs

Not applicable.

Recommendation

Education should enhance its policies and procedures to ensure that reimbursement payments are made to its LEAs and subcontractors in a timely manner to ensure that it is minimizing the time between the expenditure of program funds and subsequent reimbursement.

Department's View and Corrective Action Plan

Education stated it 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 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, Education is continually seeking to improve its review and approval process to ensure timely payment of invoices. Education will strive to more expediently process invoices between internal divisions.

Auditor's Comments on Department's View

Based on the documentation provided by Education, we were unable to determine if payment delays were due to resolution of disputed claims or internal Education delays. Thus, Education should enhance its existing payment processing procedures to include that it document: dates received, resolution correspondence dates, and approved for payment dates to support that it attempted to ensure that it was minimizing the timing between the cash needs and disbursement of funds.

Reference Number:	2008-5-3
Federal Catalog Number:	93.917
Federal Program Title:	HIV Care Formula Grants
Federal Award Numbers and Years:	2X07HA00041-18-00; 2008 6X07HA00041-17-02; 2007
Category of Finding:	Eligibility
State Administering Department:	California 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:

1. have a medical diagnosis of HIV disease; and
2. be a low-income individual, as defined by the State.

Condition

1. Eligibility of individuals is determined at various local enrollment sites by enrollment workers. Eligibility packages containing all required documents to support the individuals' eligibility to receive funds under the AIDS Drug Assistance Program (ADAP) are maintained at the enrollment sites.

   We selected 30 ADAP participants to review the eligibility packages for eligibility documentation. Out of the 30 participants selected, Public Health was unable to provide documentation to support eligibility for one participant.

   Total exceptions amounted to $21,662 of the $473,183 that was paid to the 30 participants sampled for the fiscal year ended June 30, 2008. Total ADAP expenditures amounted to approximately $89 million of the $105 million of total program expenditures.

2. Program coordinators are required to visit 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 completed by program coordinators and reviewed by the program chief.

We selected all 10 site visit reports prepared by the ADAP coordinators during the fiscal year ended June 30, 2008, and noted that all reports had detailed several instances of noncompliance with eligibility requirements such as proof of income, proof of residency, proof of HIV status, up-to-date signed consent forms, and up-to-date CD4 orViral Load counts. Some examples of errors noted in the reports written by program coordinators are as follows:

- At one site where 82 files were reviewed, 24 percent of the files did not have proof of residency nor did they indicate that the clients were issued grace periods to provide the required documentation, and 33 percent of the files did not have proof of income. At this particular site, 96 percent of the files reviewed did not have documented proof of HIV status, and none of the files had documentation of current CD4 or Viral Load counts.

- At one site where 10 files were reviewed, 60 percent were missing proof of income documentation.

- At one site where 22 files were reviewed, 55 percent did not meet proof-of-income requirements as outlined in state guidelines.

- At one site where 10 files were reviewed, 60 percent did not have signed/dated ADAP consent forms, and 30 percent were missing proof-of-residency documentation.

Based on review of the site visit reports, it appears there may be material noncompliance regarding documentation to support the eligibility of the participants.

Questioned Costs

Paid $21,662 to the one undocumented participant for the fiscal year ended June 30, 2008.

Recommendation

Public Health should strengthen its internal controls over the eligibility process to ensure payments are only made to eligible recipients and that all required documentation to verify eligibility is maintained in the recipient's file.

Department's View and Corrective Action Plan

Public Health's Division of Office of AIDS (OA) is in agreement with the finding regarding the one missing client eligibility package. ADAP has numerous policies and procedures that define the client enrollment and eligibility process to ensure eligible recipients receive services. These policies and procedures are contained in the *State of California Enrollment Procedures and Guidelines for Determining ADAP Eligibility*. Responsibility for compliance with these is strengthened through a number of mechanisms, including the following: 1) mandatory annual eligibility training/recertification of all ADAP Enrollment Workers; 2) ADAP Enrollment Site Agreements; 3) Standard Agreements with all participating local health jurisdictions (LHJs) for the provision of ADAP services; and 4) enrollment site visits conducted by ADAP, including audits of client eligibility files, to further assure compliance with client eligibility requirements and documentation. These mechanisms are discussed below.

ADAP Eligibility Training for Enrollment Worker

All ADAP enrollment workers must attend initial and annual refresher eligibility training and receive certification from such trainings in order to conduct ADAP enrollment. It is the responsibility of the enrollment worker, the ADAP enrollment site and the LHJ to assure compliance with this requirement. Additionally, unique enrollment worker identification numbers are assigned to each individual, and annual training dates/certification are linked to that identification number and maintained/monitored by the ADAP pharmacy benefits management (PBM) service provider.

ADAP Enrollment Site Agreements

Require the enrollment site and workers to adhere to ADAP eligibility guidelines in implementing and administering ADAP services. Among the numerous requirements, the enrollment site agrees to maintain necessary program records to document ADAP client eligibility and ensure that all ADAP enrollment workers abide by current ADAP guidelines.

Standard Agreements

Require LHJs to adhere to ADAP eligibility guidelines in implementing and administering ADAP services. The LHJ agrees to designate an ADAP coordinator to carry out the requirements of the agreement, including ensuring enrollment sites are in compliance with ADAP guidelines and policies, and assure annual training/recertification of ADAP enrollment workers.

Enrollment Site Visits

ADAP plans and conducts enrollment site visits annually to assure compliance with ADAP eligibility requirements. With more than 200 enrollment sites statewide, ADAP must plan site visits based on program priorities and identified need. For state fiscal year 2008–09, ADAP is conducting 17 site visits, primarily to those sites that have had the longest interval since their last ADAP visit.

OA will take the following corrective steps to further ensure compliance with the *State of California Enrollment Procedures and Guidelines for Determining ADAP Eligibility*:

1). A site visit will be conducted at the ADAP enrollment site where auditors were unable to obtain a copy of the eligibility package for one of the participants selected. A minimum of 10 percent of the client eligibility files will be audited. This site will be monitored to ensure full compliance with ADAP standards, as mandated by state guidelines, enrollment site agreements, and LHJ Standard Agreements.

2). Technical assistance will be provided to the enrollment site and workers. ADAP staff will review ADAP eligibility and documentation requirements. Subsequent to the audit, the participant in question returned to the site on December 16, 2008, for an annual eligibility recertification. This file will be one of the files audited by program staff during the site visit.

3). ADAP contacted the enrollment site via telephone in January 2009 to ascertain the reason why the file was not available at the time of the audit. During the inquiry, it was determined that the ADAP enrollment worker who had previously recertified eligibility for the participant in question has not been employed at this site for over one year. Additionally, ADAP confirmed with the ADAP PBM that the enrollment worker's identification number is no longer active.

Reference Number:	2008-5-4
Federal Catalog Number:	93.778
Federal Program Title:	Medicaid Cluster: Medical Assistance Program (Medi-Cal)
Federal Award Numbers and Years:	05-0805CA5028; 2008 05-0705CA5028; 2007
Category of Finding:	Eligibility
State Administering Department:	Department of Health Care Services (Health Care Services)

Criteria

TITLE 42—PUBLIC HEALTH, 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:

The Medicaid Agency; or

(i) 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

(ii) 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, PART 435—ELIGIBILITY IN THE STATES, DISTRICT OF COLUMBIA, THE NORTHERN MARIANA ISLANDS, AND AMERICAN SAMOA, Subpart I—Specific Eligibility and Post-Eligibility Financial Requirements for the Medically Needy, Section 435.814—Medically Needy Income Standard: State Plan Requirements

(1) The plan must specify the income standard for the covered medically needy groups.

TITLE 42—PUBLIC HEALTH, PART 435—ELIGIBILITY IN THE STATES, DISTRICT OF COLUMBIA, THE NORTHERN MARIANA ISLANDS, AND AMERICAN SAMOA, Subpart I—Specific Eligibility and Post-Eligibility Financial Requirements for the Medically Needy, Section 435.831—Income Eligibility

(3)(d) Deduction of incurred medical expenses. If countable income exceeds the income standard, the agency must deduct from income medical expenses incurred by the individual or family or financially responsible relatives that are not subject to payment by a third party. An expense is incurred on the date liability for the expense arises.

TITLE 42—PUBLIC HEALTH, 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:

(i) Citizens;

(ii) Under a declaration required by Section 1137(d) of the Act that the individual is a citizen or national of the United States;

(iii) The individual has provided satisfactory documentary evidence of citizenship or national status, as described in Section 435.407; and

(iv) The individual 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, 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 issues 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

1. States are required to operate a Medicaid Eligibility Quality Control (MEQC) system in accordance with requirements established by the Center 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 program waiver differs from the traditional MEQC program by allowing for the performance of special studies, targeted reviews, or other activities that are designed to ensure program integrity or improve program administration. Health Care Services' MEQC process reviewed 3,039 cases from July 2007 to June 2008. Of the 3,039 cases sampled, Health Care Services determined that 179 cases were ineligible for Medi-Cal, resulting in a 5.89 percent error rate.

   We evaluated the accuracy of the MEQC system by obtaining a listing of all eligibility case reviews performed during the fiscal year and selected 60 cases in 10 different counties to reperform the MEQC review. Our sample of 60 Medicaid recipients included 57 who were deemed eligible and three who were deemed ineligible by the MEQC review process. The results of our review of the MEQC process found that four out of the 57 Medicaid case files where all recipients were deemed eligible by the MEQC process had at least one beneficiary who was actually ineligible for Medicaid benefits due to a failure to provide appropriate citizenship documentation.

2. Additionally, we selected 60 case files from the general population of the State's Medicaid beneficiaries in 10 different counties to reperform the counties' eligibility determination. The results are as follows:

   - We noted that two of the 60 cases tested from the general population of Medicaid beneficiaries had at least one nonexempt beneficiary who lacked appropriate citizenship documentation but received full-scope Medicaid benefits during the fiscal year ended June 30, 2008.

- We also noted that one of the 60 cases tested from the general population of Medicaid beneficiaries was erroneously reported in the county consortium system—California Work Opportunity and Responsibility to Kids Information Network (CALWIN)—as eligible for Medicaid benefits with a share of cost, when the beneficiaries were eligible for full-scope Medicaid benefits under Section 1931(b) of the Social Security Act (1931(b)). The error was due to the improper calculation of the family car's depreciated value based on Kelly Blue Book, which resulted in the family being erroneously disqualified in the county system for 1931(b) benefits due to excess property. However, the Medicaid Eligibility Database System (MEDS) properly indicated the beneficiaries as 1931(b) eligible in the period reviewed. This indicates a potential interface error between CALWIN and MEDS. Although the beneficiaries were aided under full-scope benefits in MEDS, system interface errors could result in beneficiaries being erroneously discontinued from Medicaid benefits, or individuals who are ineligible for Medicaid benefits may be erroneously aided.

Recommendations

Health Care Services should enhance its monitoring of implementation of the citizenship documentation requirements of 42 CFR, Part 435.406 and 42 CFR, Part 435.407, and take appropriate corrective action on all eligibility cases for which individuals cannot produce the appropriate citizenship documentation.

Health Care Services should also identify potential system interface issues between the consortium systems and MEDS, and take appropriate corrective action to resolve the potential problems in order to ensure that beneficiaries are receiving proper aid.

Department's View and Corrective Action Plan

Health Care Services implemented the citizenship documentation requirements in 2006. Counties are all fully operational and following state policy and procedures related to the federal requirements.

Health Care Services' MEQC efforts comprise two components:

- MEQC case reviews—Health Care Services' internal controls have been in effect for several years and continue to demonstrate effective corrective actions. Counties are consistently responsive to MEQC error findings and corrective action requirements. Shortly after the close of each base period, Medi-Cal Eligibility Division (MCED) staff review each MEQC dollar error and procedural error to determine whether the affected county has taken timely corrective action. These reviews have consistently demonstrated that counties correct 97 percent of the error findings on a timely basis.

- Focused Reviews (FRs)—Based on the prior-year findings related to the correction of FR issues, Health Care Services added enhanced language to each of its FR templates. The enhanced language requires counties to correct each FR error finding or issue on a timely basis. Health Care Services staff selectively follow up on county error correction efforts based on considerations of magnitude, materiality, and historical experience. Major counties have normally addressed each of their FR findings on a timely basis. In addition, when FR findings are not within standards, Health Care Services staff discuss issues and corrective actions with the subject county, seek agreement on remedial action, and schedule follow-up FRs to ensure appropriate corrective action.

Health Care Services continues to work with counties to provide assistance with the Deficit Reduction Act of 2005 (DRA) requirements. This is done through the publication of all county welfare directors' letters and the posting of information on the Health Care Services' DRA Web site. MCED staff is working with the counties to review the DRA cases that are the basis for the audit findings and to ensure that corrective action is taken and Medi-Cal eligibility is corrected, as necessary.

Health Care Services is reviewing the details of the Statewide Automated Welfare System (SAWS)/MEDS interface questions identified during this review to determine what, if any, corrective actions are needed. Health Care Services will report its findings and any necessary corrective action after the review is complete. Health Care Services expects to complete this review in early 2009.

Reference Number:	2008-5-5
Federal Catalog Number:	93.778
Federal Program Title:	Medicaid Cluster: Medical Assistance Program (Medi-Cal)
Federal Award Numbers and Years:	05-0805CA5028; 2008 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—Presumptive Eligibility for Pregnant Women

(a) A state plan approved under Section 1902 may provide for making ambulatory prenatal care available to a pregnant woman during a presumptive eligibility period.

(c)(1) 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.

(2) 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 five 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 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 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 under this program component are assigned a prenumbered identification card (obtained from Health Care Services by the provider) that begins with a county identification number and presumptive eligibility aid code. The paper documentation, including the application and a copy of the presumptive eligibility identification card, is 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 identification numbers issued to Health Care Services for retention. Health Care Services is required to retain 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 the presumed eligible recipients. The EDS mainframe processing is set to bypass the eligibility check if it recognizes the special sequencing of the presumptive eligibility identification number.

Consistent with the prior year, Health Care Services is unable to reconcile presumptive eligibility numbers with the enrollment listing filed with it at this time because of staffing limitations. However, Health Care Services is pursuing an automated process to post presumptive eligibility identifications to the Medi-Cal eligibility system so records for these recipients can be accessed to authenticate, reconcile, and prevent duplicate issuances of the presumptive eligibility number during the claims adjudication process. As such, there does not appear to be adequate tracking of presumptive eligibility numbers, and there is the risk that duplicate issuances of numbers or unauthorized use may occur as the existence of the recipient is not authenticated.

Questioned Costs

Not determined.

Recommendations

Health Care Services should strengthen its internal control process to obtain and track the enrollment presumptive eligibility identification numbers issued to prevent unauthorized use of identification numbers. Further, Health Care Services should perform procedures to authenticate the existence of the recipient, prevent duplicate issuances, and reconcile the presumptive eligibility numbers with the recipient enrollment listing filed during the claims adjudication process.

Department's View and Corrective Action Plan

Health Care Services stated it partially agrees.

Health Care Services is unable to reconcile the presumptive eligibility numbers with the enrollment listing 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 identifications to the Medi-Cal eligibility system so 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 released its final report on the Senate Bill 24 Prenatal Gateway with implementation solutions in June 2008. Health Care Services is participating in an Enterprise Enrollment Portal (EEP) Feasibility Study Report (FS report) on a Web-based application process to allow individuals to apply for healthcare and other public assistance programs through an electronic application. The EEP FS report will include the presumptive eligibility program for pregnant women.

Reference Number:	2008-8-2
Federal Catalog Number:	93.283
Federal Program Title:	Centers for Disease Control and Prevention—Investigations and Technical Assistance
Federal Award Numbers and Years:	5U90TP917016-08; 2007 5U90TP917016-07; 2006

Category of Finding:	Period of Availability
State Administering Department:	California Department of Public Health (Public Health)

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

(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).

Condition

During procedures performed over period of availability, we noted two exceptions out of 30 samples tested where the funds were not promptly liquidated. The two invoices, for $115,966 and $17,604, were properly obligated within the period of availability of August 31, 2006, through August 30, 2007, of the 2006 grant but were not liquidated within 90 days after the end of the funding period. The liquidation should have occurred before November 30, 2007, but instead the invoices were liquidated on December 14, 2007, and January 2, 2008, respectively, which was 105 and 124 days, respectively, after the end of the funding period.

The exceptions noted appeared to be due to a difference in the interpretation of the liquidation-of-obligation criteria used by Public Health. Specifically, Public Health indicated it believed the liquidation occurs when the invoice is received and the obligation is disencumbered, and not when the invoice is actually paid.

Questioned Costs

$133,570 of the $4.5 million sampled program disbursements from the $62 million total expenditures for the fiscal year ended June 30, 2008.

Recommendation

Public Health should enhance its current policies and procedures over its grant close-out process to ensure that all program funds are liquidated within the required time frames.

Department's View and Corrective Action Plan

Public Health agrees that the Emergency Preparedness Office (EPO) must expeditiously process invoices and that procedures must be in place to assure timely and accurate invoice documentation, tracking, and communication; it continuously strives to ensure that effective procedures are in place. Public Health disagrees with the audit findings that the issues identified represent the absence or inherent failure of an effective approach to minimize the time between the receipt of undisputed payment requests and the disbursement of funds in accordance with federal and state law, including the liquidation of all obligations not later than 90 days after the end of the funding period.

In researching one of the invoices in question under this finding, EPO has determined that staff engaged in extended vendor negotiation to obtain required documentation rather than return the invoices to the vendor with documentation of the cause for nonpayment. Public Health received the final required documentation for this invoice on November 1, 2007, (rather than the original submission date of September 20, 2007), which led to the payment being outside the 90-day liquidation period. EPO is establishing new procedures for processing all state operations invoices, which include significantly reduced turnaround times.

Auditor's Comments on Department's View

The period of availability of federal funds requires all obligations to be liquidated not later than 90 days after the end of the funding period. If additional time is required to liquidate remaining obligations, approval should be sought from the federal awarding agency to obtain an extension.

Reference Number:	2008-8-3
Federal Catalog Numbers:	93.575 and 93.596
Federal Program Titles:	Child Care Development Fund: Child Care and Development Block Grant and Child Care Mandatory and Matching Funds of the Child Care and Development Fund
Federal Award Numbers and Years:	G-0801CACCDF; 2008, G996005; 2007 2008G999004; 2007, 2008G999005; 2007 G-0701CACCDF; 2007, G996005; 2006 2007G999004; 2006, 2007G999005; 2006 G-601CACCDF; 2006, G996005; 2005 2006G999004; 2005, 2006G999005; 2005
Category of Finding:	Period of Availability
State Administering Department:	Department of Education (Education)

Criteria

TITLE 45—PUBLIC WELFARE 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 our procedures performed over period of availability, we selected a sample of adjusting journal entries (entries) that were made during the fiscal year to determine if the entries were adequately supported and that the underlying obligations for those entries were allocated to a proper period. We noted Education allocates expenditures between multiple overlapping awards through its use of first-in-first-out (FIFO) entries. We selected a sample of 22 of the 92 FIFO entries made during the fiscal year and present the following:

- We noted that all 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 entries.

- We requested the supporting documentation of the underlying transactions for those 22 entries that carried back expenditures between award years, and noted the support provided by Education identifies a listing of claim numbers with expenditure totals. In tracing the claim numbers down to

actual transactions, we generally noted numerous transactions that were paid with the identified claim numbers ; however, Education did not indicate which specific transactions in the numerous listings made up the amount transferred. The following is a summary of the entries that were sampled:

JOURNAL ENTRIES SAMPLED TYPE	QUANTITY	FISCAL YEARS TRANSFERRED BETWEEN	TRANSFERRED AMOUNTS	SUPPORTING DOCUMENTATION
Contractor subgrants	1	2005 to 2004	$96,809	$96,809
Contractor subgrants	3	2006 to 2005	170,744	170,744
Contractor subgrants	2	2007 to 2006	53,609,668	53,609,668
Total entries adequately supported	6		53,877,221	53,877,221
Contractor subgrants	1	2005 to 2004	381,401	1,700,426
Contractor subgrants	6	2006 to 2005	2,388,902	24,288,411
Contractor subgrants	9	2007 to 2006	11,242,285	31,270,799
Total entries not adequately supported	16		14,012,588	57,259,636
Total journal entries sampled	22		67,889,809	111,136,857

The 16 inadequately supported entries amounted to $14,012,588. The 92 FIFO entries totaled $464 million made to the $578 million of total subgrant expenditures for the fiscal year ended June 30, 2008.

Previous correspondence between Education and the U.S. Department of Education regarding exceptions noted in prior-year audits indicated that unambiguous documentation should be maintained to support the FIFO closeout 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 cutoff date."

Education's policies do not require journal entries to be independently 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 documentation be maintained to identify which specific local educational agencies (LEAs) are being adjusted within the FIFO adjustment. Education identifies pools of transactions that they believe are eligible and transfer amounts from those pools; however, since adjustments are made multiple times among multiple award years there is increased risk that LEA expenditures could be adjusted more than once or that those underlying obligations may not have been incurred within the eligible obligation period to which they were adjusted. Without unambiguous detailed documentation that identifies the specific LEAs to support that they were incurred during the proper period, there is decreased transparency and accountability in the grant award close out process.

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 documentation is maintained to adequately support adjusting transactions between federal funding years.

Department's View and Corrective Action Plan

Education stated that although it believes that appropriate segregation of duties and approval processes related to FIFO transactions are in place, it has strengthened its policy and procedures over FIFO entries by maintaining documentation of the specific transactions with the claim schedules related to the adjusting FIFO entries.

Auditor's Comments on Department's View

We disagree with Education's assessment that appropriate segregation of duties and approval processes are in place. Entries prepared and posted into the general ledger without evidence of independent review would not support that appropriate controls are in place. We also disagree with Education's assessment that the documentation now maintained is adequate. Although Education has made some progress in that it now maintains some level of supporting documentation of transactions that are being adjusted, the documentation is usually in material excess of the actual amounts that are transferred. In programs that transfer material amounts of expenditures between fiscal years, there is significant increased risk that transferred expenditures lose their identity and could be transferred more than once or in more than one fiscal year. Manual journal entries pose a significant fraud risk; therefore, strong controls should be in place, and transparency in documentation needs to be maintained. Based on the transactions sampled this year, Education has demonstrated that it has the ability to adjust specific transactions and maintain appropriate documentation, but it has not applied that methodology consistently.

Reference Number:	2008-8-4
Federal Catalog Numbers:	93.575 and 93.596
Federal Program Titles:	Child Care Development Fund: Child Care and Development Block Grant and Child Care Mandatory and Matching Funds of the Child Care and Development Fund
Federal Award Numbers and Years:	G-0801CACCDF; 2008, G996005; 2007 2008G999004; 2007, 2008G999005; 2007 G-0701CACCDF; 2007, G996005; 2006 2007G999004; 2006, 2007G999005; 2006 G-601CACCDF; 2006, G996005; 2005 2006G999004; 2005, 2006G999005; 2005
Category of Finding:	Period of Availability
State Administering Department:	Department of Education (Education)

Criteria

TITLE 45—PUBLIC WELFARE 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.

(2) (i) Mandatory Funds for states requesting Matching Funds per Section 98.53 shall be obligated in the fiscal year in which the funds are granted and are available until expended. (ii) Mandatory Funds for states that do not request Matching Funds are available until expended.

(3) Both the federal and nonfederal share of the Matching Funds shall be obligated in the fiscal year in which the funds are granted and liquidated no later than the end of the succeeding fiscal year.

(4) Except for paragraph (d)(5) of this section, determination of whether funds have been obligated and liquidated will be based on:(i) state or local law; or, (ii) If there is no applicable state or local law, the regulation at 45 CFR Part 92.3, Obligations and Outlays (expenditures).

(5) Obligations may include subgrants or contracts that require the payment of funds to a third party (for example, subgrantee or contractor). However, the following are not considered third-party subgrantees or contractors: (i) A local office of the Lead Agency; (ii) Another entity at the same level of government as the Lead Agency; or (iii) A local office of another entity at the same level of government as the Lead Agency.

(6) For purposes of the Child Care Development Fund (CCDF), funds for child care services provided through a child care certificate will be considered obligated when a child care certificate is issued to a family in writing that indicates:(i) The amount of funds that will be paid to a child care provider or family; and (ii) The specific length of time covered by the certificate, which is limited to the date established for redetermination of the family's eligibility, but shall be no later than the end of the liquidation period.

(7) Any funds not obligated during the obligation period specified in paragraph (d) of this section will revert to the federal government. Any funds not liquidated by the end of the applicable liquidation period specified in paragraph (d) of this section will also revert to the federal government.

Condition

During our procedures performed over the period of availability requirement, we sampled contractor payments and reviewed the dates the contracts became binding written commitments to obtain the services in order to ascertain if they were recorded in the proper obligation period and promptly liquidated. In our sample of 60 payments, we noted eight that were not obligated during the period of availability and one that was not liquidated during the liquidation period.

- Eight payments charged to a federal award were obligated before the first day available to obligate program funds. Seven of these were contract advances totaling $11,342,781 obligated between July 2007 and September 2007; however, they were charged against the award when the first available day to obligate was October 1, 2007. Another contract advance totaling $58,652 was obligated between July 2006 and September 2006; however, the first available day to obligate was October 1, 2006.

- One payment for $37,500 was charged to the award (0501CACCDF) and was liquidated on October 10, 2007; however, the last day to liquidate the payment (for example, a check issued to the contractor) was September 30, 2007.

This timing difference between obligation periods appears to be caused by a difference between the federal award period and Education's contractor award period. Education indicated it is following generally accepted accounting principles (GAAP) and recording obligations for contractor expenditures based on the service period. Our tests were performed in accordance with 34 CFR, Section 76.707, which indicates that an obligation for performance of work other than personal services is obligated on the date the state makes a binding written commitment to obtain the work. We also noted the general definition of an obligation at 45 CFR, Section 92.3, indicates "obligations means contracts and subgrants

awarded during a given period that will require payment by the grantee during the same or future period." Therefore, since these contracts were obligated as much as three months before the availability of the grant award, we have noted them as exceptions in accordance with the federal guidance.

Questioned Costs

$11,438,933 ($11,401,433 payments made to contractors outside of the federal program obligation period + $37,500 liquidated after the deadline) of the $59,000,396 sampled expenditures from the $578 million paid to LEAs and subgrantees during the fiscal year ended June 30, 2008.

Recommendations

Education should work with its federal awarding agency to clarify the appropriate obligation period and establish any necessary state policies or regulations as necessary to comply with applicable federal regulations. Education should also 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 stated that it does not concur with this condition. Service contracts for the Child Care and Development program are obligations to the State of California at the time they are mailed to the providers and 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. The first three months of the contracts were obligations as of July 1 and the last nine months as of October 1.

Auditor's Comments on Department's View

Education's position on when it considers these funds obligated is different from previous positions (for example, when contracts are signed and when services are provided) that were provided to the auditors during the audit. Both Education and the auditors have sought clarification from the federal awarding agency regarding when these types of agreements should be considered obligated.

Reference Number:	2008-8-5
Federal Catalog Number:	93.917
Federal Program Title:	HIV Care Formula Grants
Federal Award Numbers and Years:	2X07HA00041-18-00; 2008 6X07HA00041-17-02; 2007
Category of Finding:	Period of Availability
State Administering Department:	California Department of Public Health (Public Health)

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.

Condition

During procedures performed over period of availability, we noted one exception out of 30 sample items tested where the expenditure was not obligated during the appropriate period. The one expenditure for $85,930 was incurred in May 2008, but the period of availability of the grant award was April 1, 2007, through March 31, 2008.

There does not appear to be effective monitoring to ensure that expenditures charged to the grant award are obligated within the required time frames. As a result, an expenditure was incurred and charged to the grant past the period of availability.

Questioned Costs

$85,930 of the $2.2 million of sampled program disbursements from the $105 million total expenditures for the fiscal year ended June 30, 2008.

Recommendation

Public Health should strengthen its policies and procedures to ensure expenditures charged to the grant award were incurred within the appropriate period of availability.

Department's View and Corrective Action Plan

Public Health agrees with this finding. In December 2008, the Division of Office of AIDS (OA) created a Fiscal Management Unit and a Contracts Unit within the Administration Section in order to develop capacity and centralize functions that had been distributed to various units within the Division. The centralization of duties and responsibilities allows the two units to work together to ensure that funding is encumbered in a timely manner, as well as provide additional staff to manage the timelines.

OA has implemented a system so that each funding source has an annual allocation plan that includes the budget, expenditures, and balance. The plans are updated at least monthly to incorporate actual encumbrances and expenditures and to adjust projected encumbrances and expenditures. Administration, Program, and Division provide input to develop and modify the projections and review the balances. Desk procedures are being written to help ensure that staff understand the duties and responsibilities for correctly encumbering contract and grant funding.

While the necessary steps are being taken to ensure Public Health's response for encumbrance of funding is timely, OA occasionally receives invoices late from a contractor that still must be paid for services rendered. The Administration Section will work with program staff to support obtaining invoices more expeditiously from contractors, as well as work with Public Health Accounting to disencumber unspent funds and request any necessary corrections in the California State Accounting and Reporting System. This process will continue at least once each month.

Reference Number:	2008-12-5
Federal Catalog Number:	93.767
Federal Program Title:	State Children's Insurance Program (SCHIP)
Federal Award Numbers and Years:	05-0805CA5021; 2008 05-07A5CA5021; 2007
Category of Finding:	Reporting
State Administering Department:	Department of Health Care Services (Health Care Services)

Criteria

TITLE 45—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

Health Care Services does not ensure that amounts reported on its quarterly Children's Health Insurance Program Statement of Expenditures for Title XXI (CMS-21) report were classified correctly. Although amounts spent on the program reported by Health Care Services are accurate in total, 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. This is a repeat finding from the prior year.

Questioned Costs

Not applicable.

Recommendation

Health Care Services should continue to actively work with its 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 stated it agrees with the recommendation. Health Care Services accounting and the Fiscal Intermediary—Information Technology Management Branch (FI-ITMB) continue to work with EDS to create the capability to accurately report all program expenditures by category of service.

Health Care Services submitted a System Development Notice (SDN) 07040 to EDS for action in 2007, which included a requirement to install a new database and reporting system to automate the quarterly CMS-21 report, with the ability to verify the accuracy of the detailed expenditures reported by line item or category of service. Unfortunately, due to departmental budget reductions, related staffing constraints, and the upcoming reprocurement of the fiscal intermediary contract, Health Care Services had to postpone work on this SDN 07040. Recognizing the importance of complying with this recommendation, Health Care Services has initiated a new SDN (08041) that will allow for the appropriate federal participation percentage to be recorded on a claim's activity record at the time of claim adjudication. This will facilitate the ability to trace the federal participation percentage amounts on Health Care Services accounting's summary reports to the specific claims level, without having to incur the expense of creating a fully automated CMS-21 reporting system at this time. The estimated implementation date for SDN 08041 is September 2009.

Reference Number:	2008-12-6
Federal Catalog Number:	93.778
Federal Program Title:	Medicaid Cluster: Medical Assistance Program (Medi-Cal)
Federal Award Numbers and Years:	05-0805CA5048; 2008 05-0705CA5048; 2007
Category of Finding:	Reporting
State Administering Department:	Department of Health Care Services (Health Care Services)

Criteria

TITLE 42—PUBLIC HEALTH, 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 CMS-64, Quarterly Statement of Expenditures for the Medical Assistance Program, reports are supported by summary reports; however, they are not directly traceable to individual claims. Lack of traceability down to an individual claim level makes us unable to verify the accuracy of the classification of expenditures by line item or category of service (for example, Matching).

This is a repeat finding from the prior year.

Questioned Costs

Not determined.

Recommendation

Health Care Services should implement an audit trail such that funding sources for individual claims can be identified.

Department's View and Corrective Action Plan

Health Care Services stated that its Fiscal Intermediary and Contracts Oversight Division has submitted a Systems Development Notice (SDN) 07040 to redesign the system to incorporate the capability to trace summary reports back to individual claims. However, budget reductions and the upcoming Request for Proposal for replacement of the fiscal intermediary have resulted in the need to postpone work on the SDN. Recognizing the importance of complying with this recommendation, Health Care Services has instructed Electronic Data Systems to prepare an estimate for an alternate interim solution to achieve compliance. This estimate for an interim solution has been received, and Health Care Services has scheduled the interim-solution SDN for completion in September 2009.

Reference Number:	2008-12-7
Category of Finding:	Reporting
State Administering Department:	California Department of Public Health (Public Health)
Federal Catalog Number:	93.283
Federal Program Title:	Centers for Disease Control and Prevention—Investigations and Technical Assistance Program
Federal Award Numbers and Years:	5U90TP917016-08; 2007 5U90TP917016-07; 2006

Federal Catalog Number:	93.889
Federal Program Title:	National Bioterrorism Hospital Preparedness Program
Federal Award Numbers and Years:	U3REP070041-01-03; 2007 U3RHS007572-01-03; 2006 U3RHS05953-01-01; 2005 U3RHS03890-01-05; 2004

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

(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)(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 there do not appear to be adequately designed controls in place to ensure accuracy and completeness of required program reporting.

1. We noted no evidence of review and approval of the U.S. Health and Human Services Payment Management System's SF-272, Federal Cash Transactions Report or the PSC-272, Federal Cash Transactions Report—Status of Federal Cash. Public Health's current policies and procedures do not require that evidence of reviews and approvals of these reports be documented.
2. Public Health prepares one PSC-272, Federal Cash Transactions Report—Status of Federal Cash, that includes combined expenditure information for both the Centers for Disease Control and Prevention—Investigations and Technical Assistance Program and the National Bioterrorism Hospital Preparedness Program. We noted that three of the four PSC-272 reports submitted during the fiscal year had underreported expenditures, as follows:
   a. Second quarter PSC-272 (October 1, 2007 to December 31, 2007) underreported by $86,520.
   b. Third quarter PSC-272 (January 1, 2008 to March 31, 2008) underreported by $2,424,471.
   c. Fourth quarter PSC-272 (April 1, 2008 to June 30, 2008) underreported by $3,164,521.

   As these reports are cumulative, the total underreported expenditures for the fiscal year ended June 30, 2008, were $3,164,521. These exceptions were the result of the preparer not including certain expenditures from the Centers for Disease Control and Prevention—Investigations and Technical Assistance Program in the report, which went undetected due to the control deficiencies noted over required reporting.
3. We also noted that while Public Health does have policies in place that require the review and approval of the SF-269, Financial Status Report, it had incorrectly reported the federal share of net outlays of the final SF-269 for the 2004 National Bioterrorism Hospital Preparedness Program, Grant Award Number U3RHS03890, covering the period of December 2007 to April 2008. We noted line 10(j) was reported as $38,793,726 but should have been reported as $38,973,726, thus underreporting outlays by $180,000. This difference appears to have been caused by a transposition error made in the report preparation process that was not detected by Public Health.

Without appropriately designed controls in place, there is increased risk of inaccurate reporting.

Questioned Costs

Not applicable.

Recommendation

Public Health should enhance its current policies and procedures to ensure appropriately designed controls are in place to reduce the risk of material inaccurate reporting.

Department's View and Corrective Action Plan

Conditions 1 and 2: Public Health concurs with the findings. Recognizing the importance of accurate federal reporting, Public Health will continue to have a supervisor or manager review and approve the SF-272 and PSC-272. These review and approval processes were implemented midyear; therefore, some of the Federal Cash Transactions Reports sampled in the audit were prepared prior to the implementation of the review and approval processes.

Condition 3: Public Health concurs with the finding. Recognizing the importance of accurate federal reporting, Public Health will diligently continue to review and approve the final Financial Status Reports (FSRs) it prepares. This transposition of numbers should have been caught during our review and approval process for FSRs.

Reference Number:	2008-13-10
Federal Catalog Number:	93.917
Federal Program Title:	HIV Care Formula Grants
Federal Award Numbers and Years:	2X07HA00041-18-00; 2008 6X07HA00041-17-02; 2007
Category of Finding:	Subrecipient Monitoring
State Administering Department:	California Department of Public Health (Public Health)

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:

(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.

Condition

During our procedures performed over subrecipient monitoring, we noted that Public Health did not ensure collection and completeness of a U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-profit Organizations* (OMB Circular A-133) audit report required to be submitted for one of the 39 subrecipients subject to OMB Circular A-133 audits for the fiscal year ended June 30, 2007. Without appropriately designed processes and controls in place to ensure all required audit reports are received and reviewed, Public Health risks noncompliance noted in subrecipient OMB Circular A-133 audit reports not being promptly addressed and resolved to comply with federal regulations.

Total exceptions amounted to approximately $890,000 of the $5.4 million paid to contractor subrecipients subject to OMB Circular A-133 audits from the $105 million total expenditures during the fiscal year ended June 30, 2008.

Questioned Costs

Not determined.

Recommendation

Public Health should design and implement internal controls to ensure that management collects and verifies the completeness of subrecipients' OMB Circular A-133 audit reports and ensure that it issues management decisions within six months of the State's receipt of the subrecipient A-133 audit reports.

Department's View and Corrective Action Plan

The Care Services Program (CSP) provides services to counties and community-based organizations (CBOs) in the State of California. CSP is responsible for obtaining OMB Circular A-133 audit reports from subrecipients that are designated as CBOs that receive funding in excess of $500,000 from all federal resources. A formal branch-wide process has been implemented in the HIV Care Branch for addressing OMB Circular A-133 subrecipient monitoring requirements. CSP complies with this branch-wide process. CSP requests and follows up on any OMB Circular A-133 audit reports required from contracted CBOs. Therefore, CSP believes it has fulfilled its obligation under programmatic and compliance requirements for its subrecipient CBOs.

Collection of OMB Circular A-133 audits from governmental agencies such as the one cited are not currently required to be collected by CSP, but instead it is a requirement that these audits be sent to the State Controller's Office. Therefore, corrective action measures have not been identified for the CSP at this time.

It should be noted that the Ryan White HIV/AIDS Treatment Modernization Act of 2006 included language requiring that Part B Grantees (states) collect and submit to the Health Resources and Services Administration (HRSA) all audits from grantees within the state. That language is as follows: Section 2617. [300ff-27] STATE APPLICATION (b) (4) (E), "Every 2 years, collect and submit to the Secretary all audits, consistent with OMB Circular A-133, from grantees within the State, including audits regarding funds expended in accordance with this part;"

However, HRSA stated the following regarding this language: "The reauthorized legislation includes a requirement for part B grantees to collect and submit to HRSA all OMB Circular A-133 audits for Ryan White grants in their State. This will begin in fiscal year 2009. HRSA is working with colleagues to develop guidance on the process. Grantees will receive instructions at a later date."

The Office of AIDS, as state grantee of Part B funds, will develop a policy and procedure for complying with this requirement effective 2009 and upon receipt of guidance from HRSA.

Reference Number:	2008-13-11
Federal Catalog Numbers:	93.575 and 93.596
Federal Program Titles:	Child Care Development Fund: Child Care and Development Block Grant & Child Care Mandatory and Matching Funds of the Child Care and Development Fund
Federal Award Numbers and Years:	G-0801CACCDF; 2008, G996005; 2007 2008G999004; 2007, 2008G999005; 2007 G-0701CACCDF; 2007, G996005; 2006 2007G999004; 2006, 2007G999005; 2006 G-601CACCDF; 2006, G996005; 2005 2006G999004; 2005, 2006G999005; 2005
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, PART 92—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE, LOCAL, AND TRIBAL GOVERNMENTS, Subpart C—Post-Award Requirements, Section 92.40—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 Child Care Development Fund program local educational agencies (LEAs) are monitored by Education's Consolidated Program Monitoring (CPM) Unit and the other contractors are monitored by Education's Contract Monitoring Review (CMR).

1. During the year ended June 30, 2008, Education performed CPM visits on 154, or approximately 15 percent, of its LEAs. We reviewed Education's policies and procedures regarding its CPM site visits and noted the following:

   a. 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.

   b. The design of the CPM monitoring instrument(s) includes a section to document the evidence reviewed; however, it only contains check boxes 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.

   c. Education did not have an adequate policy to ensure comprehensive documentation is maintained to support the CPM finding resolution process.

2. We selected a sample of 44 schools monitored between October 2007 and June 2008 and noted 33 of those 44 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 schools to respond with a proposed resolution or corrective action plan within 45 days of receipt of the Notification of Findings.

   a. There was no evidence that a CPM administrator or director properly reviewed 36 of the 44 sampled reviews.

   b. For the 33 schools required to submit a proposed corrective action plan within 45 days, 24 submitted a plan between 46 and 116 days after the receipt of the Notification of Findings, and three schools submitted no action plan.

   c. In reviewing the timeliness of the resolution of these proposed corrective action plans, 17 of the 33 schools had noncompliant findings that were either: a) identified as resolved by CPM and program consultants but not properly/correctly supported, or b) remained unresolved issues with no evidence of follow-up performed by CPM in the last 30 days.

   The untimely resolution of outstanding CPM findings appears to be due to a combination of untimely follow-up and ineffective sanctions imposed by Education on its LEAs for failing to implement corrective action plans. Without effective repercussions, the LEAs do not have an incentive to implement corrective actions in a timely manner.

3. During the year ended June 30, 2008, Education completed CMR visits for 234 of its approximately 1,200 contractors. We selected a sample of 60 contractors that had been monitored and noted the following regarding the CMR policies and procedures:

   a. The standard forms used to document visits do not adequately support whether or not the contractor's use of federal awards were in accordance with authorized purposes and consistent with the laws, regulations, and provisions of the contract and grant agreements.

   b. Education did not have an adequate policy to ensure comprehensive documentation is maintained to support the CMR finding resolution process.

4. In our sample of 60 contractors monitored between November 2007 and June 2008, 49 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 contractors to resolve each finding within 45 calendar days of the review date. In instances where issues cannot be resolved within the required 45 day period, the contractor must respond with a proposed resolution or corrective action plan within 45 days of receipt of the Notification of Findings.

   a. We noted 33 of the 49 contractors that were issued Notification of Findings had no evidence of administrator review.

   b. For the 40 contractors required to submit a proposed corrective action plan within 45 days, we noted Education did not properly complete one of the Notification of Findings forms.

   c. Education did not require follow-up for nine of the 49 contractors with findings. These visits were performed by the Alternative Payment Monitoring Unit (APMU) and were for the purpose of completing a statistical sample of error rates for the U.S. Department of Education in four main areas: eligibility, certified hours of care, family fees, and provider reimbursement. Education indicated that since these visits were not part of its CMR process, no response or corrective action plan would be required, and the files were closed. However, we noted that there were significant error rates identified by APMU on these visits. One of the nine contractors had an error rate of 11 percent with the remaining eight contractors having error rates ranging from 36 percent to 78 percent. We also noted Education performed similar monitoring in the prior year and calculated an average error rate of 32 percent. By not requiring corrective action to be implemented for known errors, material noncompliance will go uncorrected for extended periods of time.

There does not appear to be a consistent comprehensive tracking mechanism (for example, a log) utilized by Education to assist in documenting follow-up correspondence regarding finding resolution to promote timely corrective action and ensure business continuity for staffing transitions. As a result, Education disbursed over $577 million out of a total $590 million of program expenditures without adequately ensuring LEAs and other contractors were expending funds in accordance with federal guidelines for the fiscal year ended June 30, 2008.

Questioned Costs

Not determined.

Recommendations

Education should enhance its current policies, procedures, and monitoring instruments to help ensure that adequate evidence is maintained for monitoring visits performed and that contractors' and LEAs' proposed corrective actions from those visits are implemented promptly. Education should also enhance policies and procedures to require its LEAs and contractors to implement corrective action for issues noted during its APMU visits.

Department's View and Corrective Action Plan

Education stated that to strengthen CPM processes, it entered into an agreement with the California Comprehensive Center at WestEd to develop a new Web-based compliance tracking system. The new system will allow LEAs to prepare for CPM on-site visits by completing program instruments online and uploading documents as evidence of compliance. The system will also facilitate more timely follow-up and corrective action by the appropriate Education program manager when a LEA fails to resolve findings of noncompliance within the time period allowed. Education plans to pilot the online reporting system for categorical program monitoring with two regions (Region 4 and Region 10). In July and August 2008, respectively, Education sent letters to the county and district superintendents and charter school administrators of the pilot regions to provide notification and details of the new online reporting system.

Current CPM protocols require all compliance reviewers to "identify the evidence analyzed to determine compliance or noncompliance." In January 2008, Education's Categorical Program Monitoring Unit (Categorical Monitoring) advised reviewers to specifically identify the documents, interviews, and observations used as evidence of noncompliance. Also, in January 2008, Categorical Monitoring initiated reviews of the Notifications of Findings for each monitoring visit. The objectives of these reviews are to verify that documentation of the procedures performed (for example, program and fiscal samples tested or interviews and observations) support the reported conclusions, and signed verification documents are maintained with the Notification of Findings. In addition, Education's fiscal year 2008–09 CPM protocols include Program Office Administrator Responsibilities requiring program administrators to supervise the timely resolution of findings for each assigned CPM field visit.

To strengthen existing controls over the CMR processes, in March 2008 Education updated the CMR processes by requiring documentation to be maintained as evidence of obtaining appropriate review and approvals of the written Summary of Findings. Education will also strengthen procedures to ensure that staff uses consistent methods for documenting follow-up contact with local contractors.

Education does not concur with the KPMG's inference of not having an effective process in place to ensure LEAs implement corrective actions to CPM and CMR findings in a timely manner. Education collegially works with LEAs and other entities in implementing corrective actions to CPM and CMR findings. In some circumstances, corrective action may take several months to fully develop and implement. However, if significant systemic or chronic conditions of noncompliance are found during the CPMs and CMRs, Education's Audits and Investigations Division is available to conduct limited-scope reviews in following up on those conditions. Continuing noncompliance may result

in further administrative action, such as a subrecipient being placed on conditional status or the subrecipient's contract being terminated. Evidence of Education's administrative action processes and results were provided to KPMG.

In regard to the KPMG's comments on the APMU visits, Education has established procedures for identifying high-risk errors. LEAs or contractors deemed to have significant estimated error rates will be required to prepare and implement error rate reduction plans.

Auditor's Comments on Department's View

Based on the results of the samples tested that were disclosed in part 2c and 4c of the audit finding, we believe Education did not have an effective follow-up process in place for the year under audit. Based on Education's response to the audit finding, it has now established processes to follow up on the APMU findings and is also working on a Web-based tracking system for the CPM findings. These corrective actions appear to adequately address our recommendations.

Reference Number:	2008-13-12
Federal Catalog Number:	93.778
Federal Program Title:	Medicaid Cluster: Medical Assistance Program (Medi-Cal)
Federal Award Numbers and Years:	05-0805CA5028; 2008 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 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;

Condition

Health Care Services is required to disclose the program information to its subrecipients (for example, program name and 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.

As a result, Health Care Services disbursed more than $1.5 billion to subrecipients without communicating complete award information for the fiscal year ended June 30, 2008.

Questioned Costs

Not determined.

Recommendation

Health Care Services should ensure that the identifying number of the federal program is included in each of its subgrant agreements.

Department's View and Corrective Action Plan

Health Care Services agrees with the recommendation. The identifying CFDA numbers were incorporated into the contract templates during the fiscal year ended June 30, 2008, based on the prior-year finding. All contracts will be brought up to date as they are amended.

Reference Number:	2008-13-13
Federal Catalog Number:	93.778
Federal Program Title:	Medicaid Cluster: Medical Assistance Program (Medi-Cal)
Federal Award Numbers and Years:	05-0805CA5028; 2008 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:

(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.

Condition

During our procedures performed over subrecipient monitoring, we noted that Health Care Services did not ensure collection and completeness of U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-profit Organizations* (OMB Circular A-133) audit reports required to be submitted for the four of the 48 counties and local government agency subrecipients subject to OMB Circular A-133 audits. In addition, we noted Health Care Services did not issue management decisions within six months of the receipt of the OMB Circular A-133 audit reports by the State for two of the 30 counties and local government agencies sampled. Without appropriately designed processes and controls in place to ensure all required audit reports are received and reviewed, Health Care Services risks noncompliance noted in subrecipient OMB Circular A-133 audit reports not being promptly addressed and resolved to comply with federal regulations.

Total exceptions amounted to $264.6 million of the $1.5 billion paid to counties and local government agency subrecipients subject to OMB Circular A-133 audits during the fiscal year ended June 30, 2008.

Questioned Costs

Not determined.

Recommendation

Health Care Services should design and implement internal controls to ensure that management collects and verifies the completeness of the subrecipient's OMB Circular A-133 audit reports and ensure that it issues management decisions within six months of the State's receipt of the audit reports.

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 that Health Care Services collects and verifies the completeness of subrecipients' OMB Circular A-133 audit reports.

The procedures are as follows:

- An annual list of counties and local government agency subrecipients subject to OMB Circular A-133 is developed to ensure that all such reports are received. The list is shared with the State Controller's Office (SCO) staff in order to ensure Health Care Services has a completed list for the year.

- 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 related to Medi-Cal are forwarded via a transmittal memo to the Health Care Services 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 Health Care Services program to follow up on the findings and to request a corrective action plan from the subrecipient. Once the corrective action plan is submitted to the Health Care Services program, a copy is forwarded to Health Care Services' Financial Audit Branch and Audit Review and Analysis Section (ARAS). Once ARAS receives a copy of the corrective action plan, it contacts the SCO and provides a copy of the subrecipient's corrective action plan. If the Health Care Services program or subrecipient fails to submit a corrective action plan within 60 days from the date of the memo, ARAS follows up with Health Care Services program staff to ensure a corrective action plan is submitted by the subrecipient.

In October 2008 Health Care Services contacted the SCO to inquire about the status of the four missing reports for the counties. Two of the counties are delinquent in submitting their reports to the SCO, and as a result, Health Care Services has not received the reports. Health Care Services is in the process of following up with the two counties to ensure their reports are submitted. The third county submitted its report to the SCO on April 10, 2008. The SCO reviewed and accepted the report on October 14, 2008, and is in the process of forwarding the report to Health Care Services. As for the fourth county, the report is pending rejection. Once the rejection is approved, the SCO will send out a rejection letter to that county and notify Health Care Services. The rejection letter will instruct the county and its Certified Public Accountant to revise and resubmit the OMB Circular A-133 report to the SCO within 30 days from the date of the rejection letter. Once the 30-day grace period expires, Health Care Services will follow up with the SCO and request a copy of the revised report.

Reference Number:	2008-14-5
Federal Catalog Number:	93.778
Federal Program Title:	Medicaid Cluster: Medical Assistance Program (Medi-Cal)
Federal Award Numbers and Years:	05-0805CA50001; 2008 05-0705CA50001; 2007
Category of Finding:	Special Tests and Provisions—Provider Eligibility
State Administering Department:	Department of Health Care Services (Health Care Services)

Criteria

TITLE 42—PUBLIC HEALTH, 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 Section 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 directive requirements for hospitals, nursing facilities, providers of home healthcare and personal care services, hospices, and HMOs specified in Part 489.

Condition

The determination of eligibility for Medi-Cal providers in the State of California is split between the Health Care Services' Provider Enrollment Division (PED) and the Department of Public Health's (Public Health) Licensing and Certification Program (L&C). The PED enrolls nonfacility providers, including doctors, pharmacies, and medical groups and the L&C is responsible for determining the eligibility of facility providers (for example, hospitals and long-term care facilities) within California.

We selected a sample of both facility and nonfacility providers and requested copies of the provider agreements from the PED and L&C. We noted the PED and L&C did not retain federally required provider agreements for 26 of the 50 providers. The breakdown of the providers and exceptions are as follows:

- Seven of the 20 nonfacility providers (for example optometrist, doctors, and pharmacies) selected for testing at Health Care Services did not have a provider agreement.

- Of the 30 facility providers (for example hospitals and long-term care facilities), 19 did not have a provider agreement at Public Health.

Total exceptions amounted to $305,542 of the $347,426 sampled from the total $9.8 billion paid for fee-for-service claims for the fiscal year ended June 30, 2008.

Questioned Costs

Not determined.

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 and agreements.

Department's View and Corrective Action Plan

Health Care Services stated it concurs with this recommendation. Health Care Services is continuing with its plan to reenroll all Medi-Cal providers as a continuous process, verifying and updating the original enrollment information and ensuring compliance with current state and federal regulations. As part of the reenrollment process, phases of reenrollment have been specifically dedicated to targeting providers who do not have a provider agreement on file.

In addition, the PED is continuing to collect provider agreements through applications submitted by providers requesting changes of location, addition of new locations, and other updates to their records.

The PED has entered into an agreement with L&C, which as of July 1, 2007, resides in the newly created California Department of Public Health, to delegate authority for the certification of health care facilities for participation in the Medi-Cal program, as authorized in Title XIX of the Social Security Act, and for the implementation of certain nursing home reform activities mandated by the Omnibus Budget Reconciliation Act (OBRA) of 1987 (PL 100-203) and the OBRA of 1989 (PL 101-239) for the Nurse Aide Training and Competency Evaluation Program. The scope of L&C's authority includes applying the certification requirements for participation as providers of health care services in the Title XIX Program as set forth in federal regulations. These health care facilities and agencies are as follows:

1. Skilled nursing facilities
2. Nursing facilities
3. Intermediate care facilities for the mentally retarded
4. Hospitals
5. Home health agencies
6. Hospices
7. Ambulatory surgical centers
8. End-stage renal dialysis centers
9. Rural health clinics
10. Comprehensive outpatient rehabilitation facilities

Currently, L&C has finalized a new provider agreement that meets the requirements under 42 CFR, Part 432.107, for health facilities. L&C has begun collecting and maintaining copies of agreements of the dually certified facilities. The anticipated date for completion is April 1, 2009.

Reference Number:	2008-14-6
Federal Catalog Number:	93.778
Federal Program Title:	Medicaid Cluster: Medical Assistance Program (Medi-Cal)
Federal Award Numbers and Years:	05-0805CA50001; 2008 05-0705CA50001; 2007
Category of Finding:	Special Tests and Provisions—Provider Eligibility
State Administering Department:	Department of Health Care Services (Health Care Services)

Criteria

TITLE 42—PUBLIC HEALTH, PART 440—SERVICES: GENERAL PROVISIONS, 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, PART 424—CONDITIONS FOR MEDICARE PAYMENT, Subpart D—To Whom Payment Is Ordinarily Made, Section 424.57—Special Payment Rules for Items Furnished by Durable Medical Equipment, Prosthetics, Orthotics, and Supplies (DMEPOS) Suppliers and Issuance of DMEPOS Supplier Billing Privileges

(a) Definitions. As used in this section, the following definitions apply:

- Accredited DMEPOS suppliers means suppliers that have been accredited by a recognized independent accreditation organization approved by Centers for Medicare and Medicaid Services (CMS) in accordance with the requirements at Section 424.58.
- CMS approved accreditation organization means a recognized independent accreditation organization approved by CMS under Section 424.58.
- DMEPOS stands for durable medical equipment, prosthetics, orthotics and supplies.
- DMEPOS supplier means an entity or individual, including a physician or a Part A provider, which sells or rents Part B covered items to Medicare beneficiaries and which meets the standards in paragraph (c) of this section.
- Independent accreditation organization means an accreditation organization that accredits a supplier of DMEPOS and other items and services for a specific DMEPOS product category or a full line of DMEPOS product categories.
- Medicare covered items means medical equipment and supplies as defined in Section 1834(j)(5) of the Act.

(b) General rule. A DMEPOS supplier must meet the following conditions in order to be eligible to receive payment for a Medicare-covered item:

(1) The supplier has submitted a completed application to CMS to furnish Medicare-covered items including required enrollment forms. (The supplier must enroll separate physical locations it uses to furnish Medicare-covered DMEPOS, with the exception of locations that it uses solely as warehouses or repair facilities.)

(2) The item was furnished on or after the date CMS issued to the supplier a DMEPOS supplier number conveying billing privileges. (CMS issues only one supplier number for each location.) This requirement does not apply to items furnished incident to a physician's service.

(3) CMS has not revoked or excluded the DMEPOS supplier's privileges during the period, which the item was furnished has not been revoked or excluded.

(4) A supplier that furnishes a drug used as a Medicare-covered supply with durable medical equipment or prosthetic devices must be licensed by the state to dispense drugs (A supplier of drugs must bill and receive payment for the drug in its own name. A physician, who is enrolled as a DMEPOS supplier, may dispense, and bill for, drugs under this standard if authorized by the state as part of the physician's license.)

Condition

The determination of the eligibility for Medi-Cal providers in California is split between the Health Care Services' Provider Enrollment Division (PED) and the Department of Public Health's Licensing and Certification Program (L&C). The PED enrolls nonfacility providers, including doctors, pharmacies, and medical groups and L&C is responsible for determining the eligibility of facility providers, including hospitals and long-term care facilities, within California.

We selected a sample of both facility and nonfacility providers and requested documentation to support an active license during the fiscal year ended June 30, 2008. We noted the PED was unable to locate documentation in the provider file to support active licenses for six of the 50 providers sampled. In order to ascertain if the six providers' licenses (three pharmacies and three physicians) were active, we independently confirmed the license status by accessing the licensing information through the California State Board of Pharmacy Web site and the Medical Board of California Web site. We were able to validate that all six providers did, in fact, maintain active licenses where the PED was unable to provide documentation.

We noted that the PED does not appear to have adequate controls to monitor provider license status. It does not have a system that automatically discontinues eligibility to receive Medicaid funds upon expiration of licenses. If no updated license has been received, there is risk that unlicensed medical providers will receive Medicaid funds.

Questioned Costs

Not determined.

Recommendation

Health Care Services should strengthen its controls to verify that provider licenses are current and active.

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 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 to be submitted when there is a change in the business entity. Health Care Services continually verifies provider information to ensure compliance with state and federal requirements in its ongoing reenrollment efforts.

Lastly, Health Care Services' Office of Legal Services (OLS) is notified of actions taken against licensed providers who 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 as suspended and adding the provider to the Suspended and Ineligible list. The PED utilizes this list and the U.S. Department of Health and Human Services' 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 is being 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.

U.S. DEPARTMENT OF HOMELAND SECURITY

Reference Number:	2008-3-9
Category of Finding:	Cash Management
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-1628-DR; 2006 FEMA-1505-DR; 2004 FEMA-1008-DR; 1994

Federal Catalog Number:	97.067
Federal Program Title:	Homeland Security Grant Program
Federal Award Numbers and Years:	GE-T7-0008; 2007 GE-T6-0071; 2006 GE-T5-0015; 2005

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.

TITLE 28—JUDICIAL ADMINISTRATION, PART 66—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE, Subpart C—Post-Award Requirements, Section 66.21—Payment

(a) 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.

(b) 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.

TITLE 44—EMERGENCY MANAGEMENT AND ASSISTANCE, PART 13—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE, Subpart C—Post-Award Requirements, Section 13.21—Payment

(a) 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.

(b) 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.

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 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 date the reports requesting reimbursement were received by Emergency Services and compared those dates with the dates payments were actually disbursed to the subrecipients.

Based on policies and procedures in place, Emergency Services has 30 days to process and review the subrecipients' reimbursement request with supporting documentation prior to forwarding the request to the State Controller's Office (SCO) for payment processing. We also noted that under normal circumstances, it takes the SCO up to 15 days to process the payment request and issue a warrant to the subgrantee. Therefore, under normal circumstances, reimbursement requests should be processed within 45 days from the date the request was received from the subrecipient to the date it was disbursed.

Disaster Grants—Public Assistance (Presidentially Declared Disasters)

In our sample of 30 subrecipient reimbursement requests, we noted that 14 of the 30 samples, totaling $19,949,048, were not processed and submitted by Emergency Services to the SCO within 30 days. This ultimately resulted in 13 out of the 30 sampled reimbursement requests, totaling $19,053,543, with total processing times greater than 45 days. These untimely disbursements ranged from 49 to 406 days. We did note that the State's fiscal year 2007–08 budget was not passed until the end of August 2007 and that payments could not be made by the SCO until the state budget was passed, which accounted for six of the 13 exceptions, totaling $5,718,020.

Current policies and procedures do not appear to be effective in minimizing the timing of reimbursement payments made to subrecipients. As a result, Emergency Services disbursed approximately $19,053,543 of the $51,607,413 sampled without minimizing the time between the receipt of reimbursement request (for example, subrecipient need) and disbursement of federal funds. Amounts paid to subrecipients totaled $167 million during the fiscal year ended June 30, 2008.

Homeland Security Grant Program

In our sample of 30 subrecipient reimbursement requests, we noted that 11 of the 30 samples, totaling $3,924,109, were not processed and submitted by Emergency Services to the SCO within 30 days. Additionally, 10 of the 30 samples, totaling $1,850,630, were not processed and a payment was not issued by the SCO within 15 days. Consequently, for 10 of the 30 samples, totaling $3,853,457, total processing times were in excess of 45 days from the date the request was received from the subrecipient to the date it was disbursed. These untimely disbursements ranged from 48 to 198 days. We did note that the State's fiscal year 2007–08 budget was not passed until the end of August 2007 and that payments could not be made by the SCO until the state budget was passed, which accounted for four of the 10 exceptions, totaling $1,765,366.

Current policies and procedures do not appear to be effective in minimizing the timing of reimbursement payments made to subrecipients. As a result, Emergency Services disbursed approximately $3,853,457 of the $5,121,397 sampled without minimizing the time between the receipt of reimbursement request (for example, subrecipient need) and disbursement of federal funds. Amounts paid to subrecipients totaled $156 million during the fiscal year ended June 30, 2008.

Questioned Costs

Not determined.

Recommendation

Emergency Services should enhance its policies and procedures to more effectively track and monitor processing time from the date of the reimbursement request to the payment date to ensure the timing of disbursement is reasonable and consistent with the applicable federal guidelines to reduce the risk of potential noncompliance.

Department's View and Corrective Action Plan

Emergency Services and Homeland Security (California Emergency Management Agency—CalEMA, as of January 1, 2009) noted the findings identified for each program regarding disbursements not being issued promptly from the date of the Request for Reimbursement. Emergency Services prioritizes timely payment of subrecipients' requests for reimbursement, and attempts to complete these transactions within the 45-day window specified, though not statutorily mandated, as reasonable, since neither the Public Assistance nor Homeland Security Grants are subject to the Prompt Payment Act.

Emergency Services must, prior to payment of reimbursement requests, assure that all issues related to the amount for reimbursement have been resolved and that reimbursement requests are compliant with grant requirements. If errors or discrepancies are found in the Request for Reimbursement, Emergency Services policy dictates a courtesy telephone call to the subrecipient, in an attempt to resolve any identified issues. On some occasions, this process causes the delay of request for reimbursement until the issues are resolved, adding additional days to the payment process and occasionally causing the reimbursement to be issued beyond 45 days from receipt of the request.

Our review of the Public Assistance subrecipients tested by the auditors indicated that seven of the late disbursements (five for the Public Assistance Program and two for the Homeland Security Grant Program) were related to errors in the initial reimbursement requests and available funding, which took additional time to resolve.

Additionally, the nature of Emergency Services operations dictates assistance with coordination of emergency response, reducing the number of available resources for payment processing, as well as increasing the number of requests for processing in periodic times of emergency or disaster.

Our review of the subrecipients sampled indicated that one of the Public Assistance subrecipient requests was late due to receipt of the reimbursement request during an ongoing emergency.

Finally, six of the Public Assistance disbursements and four of the Homeland Security disbursements were delayed because the State's budget was not passed until the end of August 2007 for the fiscal year 2008, and payments could not be made by the SCO until the state budget was passed.

Emergency Services has created a log to document issues and monitor timing and exceptions for disbursement of funds from reimbursement requests. The log has been in the testing process during December 2008, and will be implemented as soon as the agency is certain that it is working as intended. The deliverable is targeted to be implemented upon confirmation that it is functioning properly.

Reference Number:	2008-13-14
Category of Finding:	Subrecipient Monitoring

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-919-DR; 1991 FEMA-1008-DR; 1994 FEMA-1044-DR; 1995 FEMA-1046-DR; 1995 FEMA-1155-DR; 1996 FEMA-1203-DR; 1998 FEMA-1498-DR; 2003 FEMA-1505-DR; 2004 FEMA-1529-DR; 2004 FEMA-1577-DR; 2005 FEMA-1585-DR; 2005 FEMA-1628-DR; 2006 FEMA-1646-DR; 2006 FEMA-1731-DR; 2007

Federal Catalog Number:	97.046
Federal Program Title:	Fire Management Assistance Grant
Federal Award Numbers and Years:	FEMA-2763-FM-CA; 2008 FEMA-2766-FM-CA; 2008 FEMA-2770-FM-CA; 2008 FEMA-2771-FM-CA; 2008 FEMA-2772-FM-CA; 2008 FEMA-2776-FM-CA; 2008 FEMA-2706-FM-CA; 2007 FEMA-2708-FM-CA; 2007 FEMA-2728-FM-CA; 2007 FEMA-2729-FM-CA; 2007 FEMA-2700-FM-CA; 2007

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, 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, PART 13—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE, 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

Disaster Grants—Public Assistance (Presidentially Declared Disasters)

Emergency Services did not adequately monitor its subrecipients of funds for its Public Assistance program with small projects totaling $16,997,622 for the fiscal year ended June 30, 2008. Emergency Services performed during-the-award-process monitoring over its large projects through submission of quarterly reports to the Federal Emergency Management Agency, which are used to provide specific information and progress reports for large projects; however, this process is being followed and implemented for large projects only. Emergency Services should also perform during-the-award-process monitoring over its subrecipients with small projects in order to determine that all of its subrecipients are in compliance with federal program requirements and to work with the subrecipients to correct any deficiencies noted during the monitoring process.

Additionally, Emergency Services did not adequately perform monitoring procedures to ensure all of its subrecipients were completing required U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-profit Organizations* (OMB Circular A-133) audits. During the fiscal year ended June 30, 2008, Emergency Services began reviewing OMB Circular A-133 audits for subrecipients that received more than $500,000 directly from Emergency Services. However, it did not perform procedures over subrecipients that received less than $500,000 directly from Emergency Services in order to determine whether those same subrecipients may have received federal funds from other sources that, combined with the amount received from Emergency Services, exceeded the $500,000 threshold for the fiscal year, and therefore, are subject to OMB Circular A-133 audit requirements.

In our sample of 30 subrecipients that received funding from Emergency Services, we noted 20 were not adequately monitored:

- One entity received approximately $27 million from Emergency Services; however, the entity did not submit its OMB Circular A-133 audit report, and Emergency Services did not perform follow-up procedures to request a copy of the report.

- For 19 entities that individually did not receive greater than $500,000 from Emergency Services but in total received $1,566,785, there were no follow-up procedures made either to ask for a copy of an OMB Circular A-133 audit report or to verify that the entity was not required to submit such a report.

For the 19 entities mentioned above, we performed additional procedures to verify whether the entities were subject to the OMB Circular A-133 audit requirement. We downloaded the Federal Audit Clearinghouse Database for all entities that filed 2007 OMB Circular A-133 audit reports, and we verified whether any of the 19 entities were listed, noting that two entities were listed in the database, and therefore, should have submitted a copy of their OMB Circular A-133 audit report to Emergency Services. For the remaining 17 entities that were not included in the Federal Audit Clearinghouse Database, we accessed each of the entities' respective Web site and reviewed its financial statements in order to verify if the entity's financial statements indicated that it had received greater than $500,000 in federal funds. Of the remaining 17 entities, the financial statements of one entity indicated it received $12 million in "Grants" during the fiscal year ended June 30, 2007. Although the financial statements did not specify if the grants were federal or state grants, Emergency Services should have verified and performed follow-up procedures to determine if the entity was indeed subject to OMB Circular A-133 audit requirements.

Total exceptions, where sufficient follow-up was not performed to ensure required OMB Circular A-133 audits were being submitted amounted to $28,747,710 of the $70,622,329 sampled out of the total $167 million paid to subrecipients during the fiscal year ended June 30, 2008.

Fire Management Assistance Grant

Emergency Services did not adequately monitor that all of its subrecipients were completing the required OMB Circular A-133 audits. During the fiscal year ended June 30, 2008, Emergency Services began reviewing OMB Circular A-133 audits received for subrecipients that received more than $500,000 directly from Emergency Services. However, it did not perform procedures over subrecipients which received less than $500,000 directly from Emergency Services in order to determine whether those same subrecipients may have received federal funds from other sources that, combined with the amount received from Emergency Services, exceeded the $500,000 threshold for the fiscal year, and therefore, were subject to OMB Circular A-133 audit requirements.

We reviewed all 28 subrecipients that received funding from Emergency Services during the fiscal year ended June 30, 2007, as these were the subrecipients who should have submitted audit reports to Emergency Services during the fiscal year ended June 30, 2008, if applicable. These included entities that received more than $500,000 and entities that received less than $500,000 from Emergency Services.

In our sample of 28 subrecipients that received funding from Emergency Services, seven were not adequately monitored:

- For seven entities, totaling $271,470, no follow-up procedures were made to either ask for a copy of the OMB Circular A-133 audit report or verify that the entity was not required to submit such a report. Without performing the appropriate verification and follow-up procedures, Emergency Services could not ensure that all of its subrecipients were complying with federal program requirements.

Total exceptions, where sufficient follow-up was not performed to ensure that all required OMB Circular A-133 audits were being submitted amounted to $271,470 of the $3,537,245 sampled. The total paid to subrecipients during the fiscal year ended June 30, 2008, amounted to $59.2 million.

Questioned Costs

None determined.

Recommendations

Emergency Services should perform during-the-award monitoring procedures over its subrecipients with small projects in order to determine that all of its subrecipients are in compliance with federal program requirements and to work with the subrecipients to correct any deficiencies noted.

Further, Emergency Services should develop a process to ensure that all of its subrecipients who are subject to OMB Circular A-133 audit requirements are appropriately submitting their related audit reports for monitoring purposes. Emergency Services should also develop a process to verify if subrecipients receiving less than $500,000 from it during a fiscal year also receive federal funds from other sources, which in the aggregate would require them to have an OMB Circular A-133 audit.

Department's View and Corrective Action Plan

Two separate and distinct areas of deficiency related to Disaster Grants—Public Assistance and the Fire Management Assistance Program subrecipient monitoring are addressed in the BSA's finding related to the above grants. Emergency Services' response has been separated to address each of these areas of concern.

Disaster Grants—Public Assistance (Presidentially Declared Disasters)

Emergency Services concurs with the portion of the finding related to the inadequate monitoring of subrecipients who receive Public Assistance program funds for small projects. Historically, due to limited staffing Emergency Services has based monitoring reviews on payments made on large

Public Assistance projects in order to address the area of highest risk to Emergency Services. However, at this time, Emergency Services has implemented procedures to conduct desk reviews based on statistical sampling of ALL grant payments and considers the implementation of this process sufficient to resolve the issue.

Disaster Grants—Public Assistance (Presidentially Declared Disasters) and Fire Management Assistance Grant

Emergency Services concurs with the finding related to monitoring the receipt of subrecipient OMB Circular A-133 audit reports. Emergency Services has implemented procedures, whereby subrecipients receiving less than $500,000 in Emergency Services grant funds self-certify if they have expended greater than $500,000 in federal awards from all sources in a year. As of the implementation of this process, Emergency Services considers the condition corrected.

AUDITEE'S SECTION

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Schedule of Federal Assistance

Prepared by Department of Finance

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STATE OF CALIFORNIA
SCHEDULE OF FEDERAL ASSISTANCE
FISCAL YEAR ENDED JUNE 30, 2008

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Department of Agriculture		
Plant and Animal Disease, Pest Control, and Animal Care	10.025	$ 10,971
Wildlife Services	10.028	90,597
Market Protection and Promotion	10.163	303,117
Food Safety Cooperative Agreements	10.479	32,488
Special Supplemental Nutrition Program for Women, Infants, and Children	10.557	941,188,583
Child and Adult Care Food Program	10.558	252,237,883
State Administrative Expenses for Child Nutrition	10.560	19,023,467
Commodity Supplemental Food Program	10.565	15,639,355 *
WIC Farmers' Market Nutrition Program (FMNP)	10.572	2,303,054
Team Nutrition Grants	10.574	352,903
Senior Farmers Market Nutrition Program	10.576	621,298
Child Nutrition Discretionary Grants Limited Availability	10.579	142,773
Cooperative Forestry Assistance	10.664	9,120,570 ***
Schools and Roads - Grants to States	10.665	66,500,056
National Forest - Dependent Rural Communities	10.670	259,882
Rural Development, Foresry, and Communities	10.672	80,537
Urban and Community Forestry Program	10.675	1,202,519
Forest Legacy Program	10.676	2,007,314
Forest Land Enhancement Program	10.677	263,965
Forest Stewardship Program	10.678	376,752
Forest Health Protection	10.680	157,582
Environmental Quality Incentives Program	10.912	685,032
Other - U.S. Department of Agriculture	10.999	35,429,315
Total Excluding Clusters		1,348,030,013
Food Stamp Cluster		
Food Stamps	10.551	2,866,358,206 *
State Administrative Matching Grants for Food Stamp Program	10.561	503,519,518
Total Food Stamp Cluster		3,369,877,724
Child Nutrition Cluster		
School Breakfast Program	10.553	271,632,962
National School Lunch Program	10.555	1,169,692,760 *
Special Milk Program for Children	10.556	589,280
Summer Food Service Program for Children	10.559	14,229,280
Total Child Nutrition Cluster		1,456,144,283
Emergency Food Assistance Cluster		
Emergency Food Assistance Program (Administrative Costs)	10.568	7,880,230
Emergency Food Assistance Program (Food Commodities)	10.569	26,853,345 *
Total Emergency Food Assistance Cluster		34,733,575
Research & Development Cluster		
Plant and Animal Disease, Pest Control, and Animal Care	10.025	120,864
Total Research & Development Cluster		120,864
Total U.S. Department of Agriculture		6,208,906,459

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Department of Commerce		
Anadromous Fish Conservation Act Program	11.405	255,026
Interjurisdictional Fisheries Act of 1986	11.407	109,422
Coastal Zone Management Administration Awards	11.419	3,436,831
Coastal Zone Management Estuarine Research Reserves	11.420	1,577,280
Pacific Coast Salmon Recovery-Pacific Salmon Treaty Program	11.438	14,900,942
Unallied Management Projects	11.454	893,577
Coastal Services Center	11.473	26,001
Other - U.S. Department of Commerce	11.999	111,477
Total Excluding Cluster		21,310,557
Research & Development Cluster		
Coastal Zone Management Estuarine Research Reserves	11.420	146,944
Habitat Conservation	11.463	100,000
Total Research & Development Cluster		246,944
Total U.S. Department of Commerce		21,557,501
Department of Defense		
Planning Assistance to States	12.110	2,202,738
State Memorandum of Agreement Program for the Reimbursement of Technical Services	12.113	10,054,131
Military Construction, National Guard	12.400	15,102
National Guard Military Operations and Maintenance (O&M) Projects	12.401	53,505,698
National Guard Civilian Youth Opportunities	12.404	7,299,113
Community Economic Adjustment Assistance for Establishment, Expansion, Realignment or Closure of a Military Installation	12.607	128,087
Basic, Applied, and Advanced Research in Science and Engineering	12.630	18,933
Other - U.S. Department of Defense	12.999	1,595,851
Total U.S. Department of Defense		74,819,653
Department of Housing and Urban Development		
Manufactured Home Construction and Safety Standards	14.171	129,098
Community Development Block Grants/State's Program	14.228	71,613,912
Emergency Shelter Grants Program	14.231	7,231,024
Supportive Housing Program	14.235	2,473,074 **
HOME Investment Partnerships Program	14.239	127,246,005 **
Housing Opportunities for Persons with AIDS	14.241	2,680,493
Equal Opportunity in Housing	14.400	1,440,602
Section 8 Housing Choice Vouchers	14.871	4,436,755
Lead-Based Paint Hazard Control in Privately-Owned Housing	14.900	1,824,948
Total U.S. Department of Housing and Urban Development		219,075,910

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Department of Interior		
Distribution of Receipts to State and Local Governments	15.227	75,057,495
Small Reclamation Projects	15.503	212,282
Water 2025	15.507	173,314
Fish and Wildlife Coordination Act	15.517	57,446
California Water Security and Environmental Enhancement	15.533	(1,027,000)
Coastal Wetlands Planning, Protection and Restoration Act	15.614	500,001
Cooperative Endangered Species Conservation Fund	15.615	3,620,792
Clean Vessel Act	15.616	2,458,548
Sportfishing and Boating Safety Act	15.622	602,721
Landowner Incentive Program	15.633	486,274
State Wildlife Grants	15.634	2,772,897
Migratory Bird Conservation	15.647	229,461
Earthquake Hazards Reduction Program	15.807	72,995
U.S. Geological Survey-Research and Data Acquisition	15.808	828,389
Historic Preservation Fund Grants-In - Aid	15.904	1,242,535
Outdoor Recreation-Acquisition, Development and Planning	15.916	4,245,301
Other - U.S. Department of the Interior	15.999	8,831,917
Total Excluding Clusters		100,365,369
Fish and Wildlife Cluster		
Sport Fish Restoration Program	15.605	13,261,592
Wildlife Restoration	15.611	10,397,577
Total Fish and Wildlife Cluster		23,659,170
Research & Development Cluster		
California Water Security and Environmental Enhancement	15.533	1,027,000
Coastal Wetlands Planning, Protection and Restoration Act	15.614	120,201
Wildlife Restoration	15.611	178,707
U.S. Geological Survey-Research and Data Acquisition	15.808	24,390
Other - U.S. Department of the Interior	15.999	100,000
Total Research & Development Cluster		1,450,298
Total U.S. Department of Interior		125,474,836
Department of Justice		
Prisoner Reentry Initiative Demonstration (Offender Reentry)	16.202	178,047
Compreshensive Approaches to Sex Offender Management Discretionary Grant (CASOM)	16.203	133,389
Juvenile Accountability Block Grants	16.523	4,020,300
Juvenile Justice and Delinquency Prevention - Allocation to States	16.540	7,133,105
Title V - Delinquency Prevention Program	16.548	1,033,367
National Criminal History Improvement Program (NCHIP)	16.554	1,246,514
National Institute of Justice Research, Evaluation, and Development Project Grants	16.560	2,327,123
Crime Victim Assistance	16.575	41,410,505
Crime Victim Compensation	16.576	37,070,592
Edward Byrne Memorial Formula Grant Program	16.579	2,149,167
Edward Byrne Memorial State and Local Law Enforcement Assistance Discretionary Grants Program	16.580	2,302,324
Crime Victim Assistance/Discretionary Grants	16.582	128,170
Drug Court Discretionary Grant Program	16.585	71,655
Violent Offender Incarceration and Truth in Sentencing Incentive Grants	16.586	12,623,789
Violence Against Women Formula Grants	16.588	9,369,743

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Rural Domestic Violence, Dating Violence, Sexual Assault, and Stalking Grant Program	16.589	199,143
Residential Substance Abuse Treatment for State Prisoners	16.593	1,486,973
State Criminal Alien Assistance Program	16.606	211,916,569
Bulletproof Vest Partnership Program	16.607	167,632
Community Prosecution and Project Safe Neighborhoods	16.609	1,350,411
Regional Information Sharing Systems	16.610	5,387,154
Public Safety Partnership and Community Policing Grants	16.710	2,440,794
Enforcing Underage Drinking Laws Program	16.727	848,395
Protecting Inmates and Safeguarding Communities	16.735	700,343
Edward Byrne Memorial Justice Assistance Grant Program	16.738	32,659,437
Forensic DNA Capacity Enhancement Program	16.741	262,673
Paul Coverdell Forensic Sciences Improvement Grant Program	16.742	776,034
Anti-Gang Initiative	16.744	2,121,575
Other - U.S. Department of Justice	16.999	1,150,047
Total U.S. Department of Justice		382,664,970
Department of Labor		
Labor Force Statistics	17.002	7,364,843
Compensation and Working Conditions	17.005	642,476
Unemployment Insurance	17.225	6,265,563,886
Senior Community Service Employment Program	17.235	7,244,471
Trade Adjustment Assistance	17.245	22,571,537
WIA Pilots, Demonstrations, and Research Projects	17.261	5,554,300
Work Incentives Grant	17.266	1,719,135
Community Based Job Training Grants	17.269	277,753
Work Opportunity Tax Credit Program (WOTC)	17.271	1,762,709
Temporary Labor Certification for Foreign Workers	17.273	2,009,145
Occupational Safety and Health - State Program	17.503	22,022,900
Consultation Agreements	17.504	5,529,042
Mine Health and Safety Grants	17.600	322,217
Total Excluding Clusters		6,342,584,415
Employment Services Cluster		
Employment Service/Wagner-Peyser Funded Activities	17.207	82,460,000
Disabled Veterans' Outreach Program (DVOP)	17.801	11,010,452
Local Veterans' Employment Representative Program	17.804	6,989,674
Total Employment Services Cluster		100,460,127
WIA Cluster		
WIA Adult Program	17.258	113,332,140
WIA Youth Activities	17.259	124,936,192
WIA Dislocated Workers	17.260	169,572,846
Total WIA Cluster		407,841,177
Total U.S. Department of Labor		6,850,885,719
Department of Transportation		
Airport Improvement Program	20.106	97,485
Motor Carrier Safety	20.217	13,147,558
National Motor Carrier Safety	20.218	3,947,909
Border Enforcement Grants	20.233	664,643

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Fuel Tax Evasion-Intergovernmental Enforcement Effort	20.240	1,306
Federal Transit - Metropolitan Planning Grants	20.505	49,488,828
Formula Grants for Other Than Urbanized Areas	20.509	22,370,622
Pipeline Safety	20.700	1,657,483
Interagency Hazardous Materials Public Sector Training and Planning Grants	20.703	1,247,319
Others-Department of Transportation	20.999	199,744
Total Excluding Clusters		92,822,896
Highway Planning and Construction Cluster		**
Highway Planning and Construction	20.205	2,801,966,501
Federal Transit Cluster		
Federal Transit - Capital Investment Grants	20.500	12,917,517
Highway Safety Cluster		
State and Community Highway Safety	20.600	90,417,188
Research & Development Cluster		
Highway Planning and Construction	20.205	12,299,325
Formula Grants for Other Than Urbanized Areas	20.509	246,402
Total Research & Development Cluster		12,545,727
Total U.S. Department of Transportation		3,010,669,830
Equal Employment Opportunity Commission		
Employment Discrimination - State and Local Fair Employment Practices Agency Contracts	30.002	2,497,900
General Services Administration		
		**[1]
Donation of Federal Surplus Personal Property	39.003	7,386,334
National Foundation on the Arts and the Humanities		
Promotion of the Arts - Partnership Agreements	45.025	1,052,700
Grants to States	45.310	17,327,325
Total National Foundation on the Arts and Humanities		18,380,025
Department of Veterans Affairs		
Grants to States for Construction of State Home Facilities	64.005	43,545,377
Veterans State Domiciliary Care	64.014	10,198,456
Veterans State Nursing Home Care	64.015	13,288,783
Veterans State Hospital Care	64.016	64,296
Burial Expenses Allowance for Veterans	64.101	87,300 **[1]
Veterans Housing-Guaranteed and Insured Loans	64.114	102,784,359
All-Volunteer Force Educational Assistance	64.124	100,255

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
State Cemetery Grants	64.203	1,147,642
Other-U.S. Department of Veterans Affairs	64.999	1,490,863
Total U.S. Department of Veteran's Affairs		172,707,331
Environmental Protection Agency		
Air Pollution Control Program Support	66.001	6,287,478
State Indoor Radon Grants	66.032	51,792
Congressionally Mandated Projects	66.202	230,683
Water Pollution Control State, Interstate, and Tribal Program Support	66.419	5,954,559
State Public Water System Supervision	66.432	10,591,781
State Underground Water Source Protection	66.433	778,054
Surveys, Studies, Demonstrations, and Special Purpose Grants - Section 1442 of the Safe Drinking Water Act	66.436	513,497
Targeted Watersheds Grants	66.439	606,614
Water Quality Management Planning	66.454	407,510
National Estuary Program	66.456	37,646
Capitalization Grants for Clean Water State Revolving Funds	66.458	127,580,025
Nonpoint Source Implementation Grants	66.460	12,786,769
Regional Wetland Program Development Grants	66.461	0
Water Quality Cooperative Agreements	66.463	58,743
Capitalization Grants for Drinking Water State Revolving Fund	66.468	49,561,396
State Grants to Reimburse Operators of Small Water Systems for Training and Certification Costs	66.471	1,189,130
Beach Monitoring and Notification Program Implementation Grants	66.472	690,054
Water Protection Grants to the States	66.474	581,642
Wetland Program Grants - State/Tribal Environmental Outcome Wetland Demonstration Program	66.479	610,098
Environmental Information Exchange Network Grant Program and Related Assistance	66.608	193,498
Consolidated Pesticide Enforcement Cooperative Agreements	66.700	1,633,718
Toxic Substances Compliance Monitoring Cooperative Agreements	66.701	40,027
TSCA Title IV State Lead Grants Certification of Lead-Based Paint Professionals	66.707	413,463
Hazardous Waste Management State Program Support	66.801	7,251,326
Superfund State, Political Subdivision, and Indian Tribe Site-Specific Cooperative Agreements	66.802	1,127,946
State and Tribal Underground Storage Tanks Program	66.804	172,367
Leaking Underground Storage Tank Trust Fund Program	66.805	3,421,112
Solid Waste Management Assistance Grants	66.808	287
Superfund State and Indian Tribe Core Program Cooperative Agreements	66.809	30,000
State and Tribal Response Program Grants	66.817	1,547,846
Brownfields Assessment and Cleanup Cooperative Agreements	66.818	216,410
Total Excluding Cluster		234,565,473
Research & Development Cluster		
Regional Wetland Program Development Grants	66.461	108,472
Total U.S. Environmental Protection Agency		234,673,945

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Department of Energy		
State Energy Program	81.041	5,234,629
Weatherization Assistance for Low-Income Persons	81.042	5,604,797
Office of Science Financial Assistance Program	81.049	126,395
Office of Technology Development and Deployment for Environmental Management	81.104	162,633
Other - U.S. Department of Energy	81.999	1,775,772
Total U.S. Department of Energy		12,904,225
Department of Education		
Adult Education-Basic Grants to States	84.002	74,515,453
Title I Grants to Local Educational Agencies	84.010	1,647,979,320
Migrant Education-State Grant Program	84.011	140,166,777
Title I Program for Neglected and Delinquent Children	84.013	1,282,089 **
Federal Family Education Loans	84.032	34,273,780,420
Career and Technical Education--Basic Grants to States	84.048	141,754,079
Leveraging Educational Assistance Partnership	84.069	10,619,525
Rehabilitation Services - Vocational Rehabilitation Grants to States	84.126	263,411,216
Rehabilitation Services-Service Projects	84.128	1,151,845
Public Library Construction and Technology Enhancement	84.154	214,607
Independent Living-State Grants	84.169	2,129,066
Rehabilitation Services-Independent Living Services for Older Individuals Who are Blind	84.177	3,633,627
Special Education-Grants for Infants and Families with Disabilities	84.181	53,517,766
Byrd Honors Scholarships	84.185	4,898,188
Safe and Drug-Free Schools and Communities State Grants	84.186	52,420,686
Supported Employment Services for Individuals with Severe Disabilities	84.187	1,380,008
Education for Homeless Children and Youth	84.196	7,520,748
Even Start-State Educational Agencies	84.213	11,094,503
Assistive Technology	84.224	676,733
Rehabilitation Services Demonstration and Training Programs	84.235	268,293
Tech-Prep Education	84.243	11,102,277
Rehabilitation Training-State Vocational Rehabilitation Unit In-Service Training	84.265	332,438
Charter Schools	84.282	41,839,030
Twenty-First Century Community Learning Centers	84.287	111,281,888
State Grants for Innovative Programs	84.298	4,240,186
Education Technology State Grants	84.318	40,584,434
Special Education-State Personnel Development	84.323	1,168,719
Advanced Placement Program	84.330	3,133,361
Grants to States for Incarcerated Youth Offenders	84.331	2,460,433
Comprehensive School Reform Demonstration	84.332	945,869
Reading First State Grants	84.357	139,242,043
Rural Education	84.358	1,713,105
English Language Acquisition Grants	84.365	190,385,204
Mathematics and Science Partnerships	84.366	26,912,910
Improving Teacher Quality State Grants	84.367	262,154,041
Grants for State Assessments and Related Activities	84.369	25,084,508
Statewide Data Systems	84.372	151,092
Total Excluding Cluster		37,555,146,486

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Special Education Cluster		
Special Education -Grants to States	84.027	1,171,804,376
Special Education - Preschool Grants	84.173	40,344,637
Total Special Education Cluster		1,212,149,013
Total U.S. Department of Education		38,767,295,498
Department of Health and Human Services		
Public Health and Social Services Emergency Fund	93.003	31,673,634
Project Grants for Facilities to Improve the Health Status of Minority Populations	93.005	187,564
Strengthening Public Health Services at the Outreach Offices of the U.S.-Mexico Border Health Commission	93.018	139,442
Special Programs for the Aging - Title VII, Chapter 3 - Programs for Prevention of Elder Abuse, Neglect, and Exploitation	93.041	545,008
Special Programs for the Aging - Title VII, Chapter 2 - Long Term Care Ombudsman Services for Older Individuals	93.042	1,574,634
Special Programs for the Aging - Title III, Part D - Disease Prevention and Health Promotion Services	93.043	2,172,513
Special Programs for the Aging - Title IV - and Title II - Discretionary Projects	93.048	748,507
National Family Caregiver Support, Title III, Part E	93.052	15,837,109
Food and Drug Administration - Research	93.103	1,636,640
Maternal and Child Health Federal Consolidated Programs	93.110	297,350
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	93.116	8,152,329
Emergency Medical Services for Children	93.127	136,246
Cooperative Agreements to States/Territories for the Coordination and Development of Primary Care Offices	93.130	189,921
Injury Prevention and Control Research and State and Community Based Programs	93.136	7,857,075
Projects for Assistance in Transition from Homelessness (PATH)	93.150	6,194,785
Health Program for Toxic Substances and Disease Registry	93.161	781,876
Grants to States for Loan Repayment Program	93.165	1,212,714
Disabilities Prevention	93.184	268,119
Consolidated Knowledge Development and Application (KD&A) Program	93.230	1,915,343
Traumatic Brain Injury State Demonstration Grant Program	93.234	78,386
State Rural Hospital Flexibility Program	93.241	311,280
Substance Abuse and Mental Health Services - Projects of Regional and National Significance	93.243	3,755,174
Universal Newborn Hearing Screening	93.251	40,978
Immunization Grants	93.268	27,696,224
Substance Abuse and Mental Health Services - Access to Recovery	93.275	7,026,705
Centers for Disease Control and Prevention - Investigations and Technical Assistance	93.283	76,791,723
Small Rural Hospital Improvement Grant Program	93.301	687,447
Promoting Safe and Stable Families	93.556	51,892,603
Temporary Assistance for Needy Families	93.558	3,322,902,950
Child Support Enforcement	93.563	558,957,307
Child Support Enforcement Research	93.564	5,660
Refugee and Entrant Assistance - State Administered Programs	93.566	27,116,441
Low-Income Home Energy Assistance	93.568	107,204,337
Community Services Block Grant	93.569	55,323,701
Refugee and Entrant Assistance - Discretionary Grants	93.576	2,367,373

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
U.S. Repatriation Program	93.579	56,058
Refugee and Entrant Assistance - Targeted Assistance Grants	93.584	5,169,813
State Court Improvement Program	93.586	3,445,136
Community-Based Child Abuse Prevention Grants	93.590	4,047,837
Grants to States for Access and Visitation Programs	93.597	970,152
Chafee Education and Training Vouchers Program (ETV)	93.599	9,075,059
Head Start	93.600	225,459
Voting Access for Individuals with Disabilities - Grants to States	93.617	1,059,832
Developmental Disabilities Basic Support and Advocacy Grants	93.630	7,590,000
Children's Justice Grants to States	93.643	2,180,801
Child Welfare Services - State Grants	93.645	30,895,856
Adoption Opportunities	93.652	349,835
Foster Care - Title IV-E	93.658	1,282,909,192
Adoption Assistance	93.659	359,811,714
Social Services Block Grant	93.667	577,371,132
Child Abuse and Neglect State Grants	93.669	3,594,151
Family Violence Prevention and Services/Grants for Battered Women's Shelters - Grants to States and Indian Tribes	93.671	6,876,291
Chafee Foster Care Independence Program	93.674	22,013,226
State Children's Insurance Program	93.767	1,202,349,811
Health Insurance for the Aged - Supplementary Medical Insurance	93.774	1,680,833
Centers for Medicare and Medicaid Services (CMS) Research, Demonstrations and Evaluations	93.779	16,660,118
National Bioterrorism Hospital Preparedness Program	93.889	20,827,005
Grants to States for Operation of Offices of Rural Health	93.913	40,130
HIV Care Formula Grants	93.917	111,454,137
Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems	93.938	555,787
HIV Prevention Activities - Health Department Based	93.940	12,075,679
HIV Demonstration, Research, Public and Professional Education Projects	93.941	13,775
Human Immunodeficiency Virus (HIV) / Acquired Immunodeficiency Virus Syndrome (AIDS) Surveillance	93.944	3,874,993
Tuberculosis Demonstration, Research, Public and Professional Education	93.947	12,115
Block Grants for Community Mental Health Services	93.958	38,697,738
Block Grants for Prevention and Treatment of Substance Abuse	93.959	268,046,372
Preventive Health Services - Sexually Transmitted Diseases Control Grants	93.977	5,770,411
Preventive Health Services - Sexually Transmitted Diseases Research, Demonstrations, and Public Information and Education Grants	93.978	3,382,404
Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation of Surveillance Systems	93.988	1,423,462
Preventive Health and Health Services Block Grant	93.991	7,468,182
Maternal and Child Health Services Block Grant to the States	93.994	42,877,981
Other-Department of Health and Human Services	93.999	15,403,481
Substance Abuse & Mental Health Services (SAMHSA)	See Note 4c	355,526
Total Excluding Clusters		8,394,290,580
Aging Cluster		
Special Programs for the Aging - Title III, Part B - Grants for Supportive Services and Senior Centers	93.044	38,561,473
Special Programs for the Aging - Title III, Part C - Nutrition Services	93.045	56,943,198
Nutrition Services Incentive Program	93.053	11,352,523
Total Aging Cluster		106,857,194

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
CCDF Cluster		
Child Care and Development Block Grant	93.575	307,676,724
Child Care Mandatory and Matching Funds of the Child Care and Development Fund	93.596	433,527,519
Total Child Care Cluster		741,204,243
Medicaid Cluster		
State Medicaid Fraud Control Units	93.775	22,392,683
State Survey and Certification of Health Care Providers and Suppliers	93.777	36,677,481
Medical Assistance Program	93.778	21,216,501,365
Total Medicaid Cluster		21,275,571,529
Research & Development Cluster		
Substance Abuse and Mental Health Services - Projects of Regional and National Significance	93.243	142,000
Centers for Medicare and Medicaid Services (CMS) Research, Demonstrations and Evaluations	93.779	257,088
Total Research & Development Cluster		399,088
Total U.S. Department of Health and Human Services		30,518,322,635
Corporation for National and Community Service		
State Commissions	94.003	1,386,631
Learn and Serve America - School and Community Based Programs	94.004	2,205,840
AmeriCorps	94.006	26,738,234 *
Volunteers in Service to America	94.013	546,904
Total Excluding Clusters		30,877,609
Foster Grandparent/Senior Companion Cluster		
Foster Grandparent Program	94.011	1,644,943
Total U.S. Corporation for National and Community Service		32,522,552
Social Security Administration		
Social Security - Work Incentives Planning and Assistance Program	96.008	356,651
Disability Insurance/SSI Cluster		
Social Security - Disability Insurance	96.001	194,238,306
Total Social Security Administration		194,594,956
Department of Homeland Security		
Urban Areas Security Initiative	97.008	596,532
Boating Safety Financial Assistance	97.012	4,683,821
Pre-Disaster Mitigation (PDM) Competitive Grants	97.017	14,551,254
Community Assistance Program-State Support Services Element (CAP-SSSE)	97.023	703,759
Flood Mitigation Assistance	97.029	952,909
Crisis Counseling	97.032	1,013,908

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Disaster Unemployment Assistance	97.034	639,962
Disaster Grants - Public Assistance (Presidentially Declared Disasters)	97.036	166,438,973
Hazard Mitigation Grant	97.039	32,572,692
Emergency Management Performance Grants	97.042	13,753,594
Fire Management Assistance Grant	97.046	62,431,357
Map Modernization Management Support	97.070	135,915
Rail and Transit Security Grant Program	97.075	9,793,913
Buffer Zone Protection Program (BZPP)	97.078	9,346,947
Total Excluding Cluster		317,615,537
Homeland Security Cluster:		
State Domestic Preparedness Equipment Support Program	97.004	4,334,319
Homeland Security Grant Program	97.067	191,653,591
Total Homeland Security Cluster		195,987,909
Total Department of Homeland Security		513,603,447
Office of National Drug Control Policy		
High Intensity Drug Trafficking Area	See Note 4a	4,068,810
Miscellaneous Grants and Contracts		
Shared Revenue-Flood Control Lands	99.002	226,471
Shared Revenue-Grazing Land	99.004	137,358
U.S. Department of the Interior-Fire Prevention/Suppression Agreement	99.014	134,000
U.S. Department of Agriculture and Various Other U.S. Department-Fire Prevention/Suppression	99.016	15,019,631
Miscellaneous Federal Receipts	99.099	47,323
Miscellaneous Federal Receipts	99.999	913,590
Total Miscellaneous		16,478,374
Total Federal Awards Received		**$ 87,389,490,908**

* Amount includes value of commodities or food stamps.
** Amount includes loans and/or loan guarantees outstanding as of June 30, 2008.
*** Amount includes loaned federal excess property.
**** Amount includes insurance in-force as of June 30, 2008.

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Notes to the Schedule of Federal Assistance

Fiscal Year Ended June 30, 2008

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, 2008. 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 $87,389,490,908 in total federal assistance consists of the following:

Cash assistance received	$49,926,923,636
Non-cash federal awards	3,037,247,984
Loans and/or loan guarantees outstanding	34,322,534,929
Insurance in-force	102,784,359
Total	$87,389,490,908

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 awards 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 fiscal year ended June 30, 2008.

3. UNEMPLOYMENT INSURANCE

Of the $6,265,563,886 in total unemployment insurance funds (federal catalog number 17.225) received by the Employment Development Department during fiscal year 2007–08, $5,854,076,873 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 (Justice) 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, 2007 through June 30, 2008, Justice 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	I7PLAP534	$710,488
	LA Clear/LA Police Chief's Association/City of Monrovia	17PLAP534	181,449
	LA Clear/LA Police Chief's Association/City of Monrovia	DC07177350	58,822
	NC HIDTA/LA Police Chief's Association	I5PSFP501Z	7,138
	NC HIDTA/LA Police Chief's Association	I6PSFP501Z	43,385
	NC HIDTA/LA Police Chief's Association	I7PSFP501Z	253,376
	NC HIDTA/LA Police Chief's Association	I8PSFP501Z	25,243
	CV HIDTA/LA Police Chief's Association/Stanislaus County	I6PCVP501Z	661,066
	CV HIDTA/LA Police Chief's Association/Stanislaus County	I7PCVP501Z	96,169
	INCH/LA Police Chief's Association/Riverside County	I7PLAP540Z	71,251
	NV HIDTA/LA Police Chief's Association/Las Vegas Metro PD	I7PNVP501Z	35,767
	CA Border Alliance Group/City of San Diego/San Diego PD	I4PSCP503Z	2,625
	CA Border Alliance Group/City of San Diego/San Diego PD	I5PSCP503Z	39,255
	CA Border Alliance Group/City of San Diego/San Diego PD	I6PSCP501Z	238,558
	CA Border Alliance Group/City of San Diego/San Diego PD	I7PSCP501Z	1,544,148
	CA Border Alliance Group/City of San Diego/San Diego PD	I7PSCP503Z	41,494
	Northwest HIDTA/Washington State	16PNWP505Z	11,625
	Northwest HIDTA/Washington State	17PNWP505Z	38,750
	Clallum Co Sheriff's Office	WASPCM106107	8,201
	Total		$4,068,810

b. The State was also loaned Federal Excess Personal Property (FEPP) from the U.S. Forest Service during the period July 1, 2007 to June 30, 2008. According to the California Department of Forestry and Fire Protection, the amount loaned from July 1, 2007 to June 30, 2008, was $1,915,591. The U.S. Forest Service and the State maintain the FEPP program at federal acquisition costs of the property.

c. The following trial court of the Judicial Council of California received a federal award from a local government agency. During the period July 1, 2007 through June 30, 2008, the trial court received the following award:

Program	Pass-Through Entity	Grant Number	Amount
Substance Abuse & Mental Health Services (SAMHSA)	Riverside County	5-H79-T17507-02	$355,526
		Total	$355,526

Summary Schedule of Prior Audit Findings

Prepared by Department of Finance

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SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

Reference Number:	**2007-12-14**
Federal Program:	All Programs
State Administering Department:	Department of Finance (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 Office of Management and Budget *Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations* (OMB Circular A-133) requiring auditees to prepare a schedule of federal expenditures of federal awards that includes the total federal awards expended for each federal program.
Status of Corrective Action:	Remains uncorrected. 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' 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:	**2007-3-5**
Federal Program:	All programs subject to the Treasury-State Agreement
State Administering Department:	Department of Finance (Finance)
Fiscal Year Initially Reported:	2006-07
Audit Finding:	Cash Management. Finance lacks adequate written policies and procedures instructing staff on how to calculate the state and federal interest liabilities by program. Finance incorrectly calculated the federal interest liability, the interest liability related to disbursements without warrants, and the Medi-Cal refund interest liability. Also, 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 Treasury-State Agreement (TSA).

Status of Corrective Action:

Lack of Written Procedures: Finance believes that including a narrative describing how to calculate the state and federal interest liabilities would enhance its procedures manual. Finance will prepare the narrative and incorporate it into the procedures manual; it anticipates this will be accomplished by June 1, 2009.

Federal Interest Liability: Finance is reevaluating its interpretation of the procedure for calculating federal interest liabilities contained in the TSA. Finance plans to discuss this with the federal Financial Management Service (FMS) to reach an agreement on the correct method for calculating federal interest liabilities and to implement any necessary changes. Finance anticipates this will be accomplished by June 1, 2009.

Disbursements Without Warrants: Finance plans to discuss this with the federal FMS to reach an agreement on the correct method for calculating federal interest liabilities for disbursement without warrants and to implement any necessary changes. Finance anticipates this will be accomplished by June 1, 2009.

Medi-Cal Refund Interest Liability: Finance stated the TSA language needs to be clarified. Finance will draft revised language and work with the federal FMS to incorporate the revision in the next TSA. Finance anticipates this will be accomplished by June 1, 2009.

Clearance Patterns: In January 2008, Finance verified the methodology used by the SCO for developing the clearance patterns. In addition, Finance will develop a certification form that incorporates a description of the methodology contained in the written documentation and request the SCO to certify that this methodology was used for developing the clearance patterns. Finance will request that the SCO provide the certification along with the clearance pattern reports that it forwards to Finance semiannually.

Finance anticipates that development of the certification form and reaching an agreement with the SCO to begin certifying the methodology will be accomplished by May 1, 2009. [2]

Reference Number:	**2007-1-6**
Federal Program:	84.181
State Administering Department:	Department of Developmental Services (Developmental Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Activities Allowed/Allowable Costs. 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.
Status of Corrective Action:	Partially corrected. To address this finding, Developmental Services will implement a monthly program claim review procedure by regional centers, and program claim files will be retained for a two-year period. [3]

Reference Number:	**2007-1-7**
Federal Program:	84.181
State Administering Department:	Department of Developmental Services (Developmental Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Activities Allowed/Allowable Costs. 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.
Status of Corrective Action:	Partially corrected. Developmental Services amended its contract with WestEd after both parties met and agreed upon new invoicing and personnel services reporting procedures, which include those recommended by the Bureau of State Audits (BSA). The amended contract was implemented beginning fiscal year 2008–09.[4]

Reference Number:	**2007-1-9**
Federal Program:	84.186
State Administering Department:	Department of Alcohol and Drug Programs (ADP)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Activities Allowed/Allowable Costs; Subrecipient Monitoring. ADP does not ensure that Safe and Drug-Free Schools and Communities—State Grants program expenditures are made only for allowable activities and costs.
Status of Corrective Action:	Remains uncorrected/disagree with finding. It is ADP's position that it monitors its subrecipients in compliance with Title 34, CFR 80.20, and Title 34, CFR 80.40. ADP meets (and exceeds) these standards. ADP will resolve these issues with the U.S. Department of Education. [5]

Reference Number:	**2007-2-4**
Federal Program:	84.186
State Administering Department:	Department of Alcohol and Drug Programs (ADP)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Activities Allowed/Allowable Costs. ADP needs to improve its controls to ensure that its accounting records match the hours recorded on its employees' time sheets.
Status of Corrective Action:	Fully corrected.[6]

Reference Number:	**2007-3-4**
Federal Program:	84.186
State Administering Department:	Department of Alcohol and Drug Programs (ADP)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Cash Management. ADP's accounting procedures related to the drawdown of federal funds did not require the accounting administrator to sign all three

	copies of the remittance advices prior to sending them to the California State Treasurer's Office.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2007-7-9**
Federal Program:	84.181
State Administering Department:	Department of Developmental Services (Developmental Services)
Fiscal Year Initially Reported:	2005–06
Audit Finding:	Level of Effort—Maintenance of Effort. Developmental Services did not provide sufficient information to demonstrate its compliance with the program's maintenance-of-effort requirement.
Status of Corrective Action:	Partially corrected. Developmental Services has restructured its federal grant funding allocation to its 21 contracted regional centers for improved tracking of expenditures. Anticipated correction date is October 31, 2008.[7]

Reference Number:	**2007-8-5**
Federal Program:	84.186
State Administering Department:	Department of Alcohol and Drug Programs (ADP)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Period of Availability. ADP lacks written procedures to ensure that it uses Safe and Drug-Free Schools and Communities—State Grants (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.
Status of Corrective Action:	Remains uncorrected/agree with finding. ADP is reviewing and updating its written procedures for period of availability and will assure that staff follow the procedures.

	Remains uncorrected/disagree with finding. The auditor requested a copy of the grant tracking log, which is not designed or to be used for complying with period of availability. The use of the log was described by ADP staff to the auditor. ADP cannot make the grant-tracking log comply with a purpose for which it was not designed.[8]

Reference Number:	**2007-9-2**
Federal Program:	84.181
State Administering Department:	Department of Developmental Services (Developmental Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Procurement, and Suspension and Debarment. In its contract with one state agency, Developmental Services 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 it has with three state agencies, the contracts are also missing the required suspension and debarment language.
Status of Corrective Action:	Partially corrected. Developmental Services has developed the appropriate dispute resolution language, and submitted contract amendments that include this language to the applicable state agencies. Additionally, Developmental Services has forwarded the federal suspension and debarment language form to the applicable state-level agencies for signature. It is anticipated that all affected state agencies will complete, sign, and return the form by December 2008.

Reference Number:	**2007-12-8**
Federal Program:	84.032
State Administering Department:	California Student Aid Commission (Student Aid)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Reporting. Our review of a sample of loans submitted to the National Student Loan Data System as of

	September 30, 2007, found several inaccuracies related to the reporting of the amount of claims paid to lenders.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2007-13-6**
Federal Program:	84.181
State Administering Department:	Department of Developmental Services (Developmental Services)
Fiscal Year Initially Reported:	2003–04
Audit Finding:	Subrecipient Monitoring. Developmental Services did not adequately fulfill its subrecipient monitoring responsibilities for the program.
Status of Corrective Action:	Fully corrected.[9]

Reference Number:	**2007-13-10**
Federal Program:	84.186
State Administering Department:	Department of Alcohol and Drug Programs (ADP)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Subrecipient Monitoring. Condition 1: ADP used an incorrect Catalog of Federal Domestic Assistance (CFDA) title in its award documents and contracts for seven of its subrecipients. ADP also did not include the name of the federal agency and the requirements imposed by federal laws and regulations in the Notice of Grant Agreement updates for four of the five counties in the audit sample. Condition 2: ADP did not follow its procedures for initiating written and verbal contact with those counties that had delinquent OMB Circular A-133 audits.
Status of Corrective Action:	Condition 1: Remains uncorrected/disagree with finding: Because ADP passes down the federal statute, regulations, and guidance through its agreements with the counties, ADP already informs

	subrecipients of the requirements imposed upon them, which was the recommendation of the auditor. ADP will resolve the issue with the U.S. Department of Education. Condition 2: Fully corrected. [10]

Reference Number:	**2007-14-3**
Federal Program:	84.032
State Administering Department:	California Student Aid Commission (Student Aid)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Special Tests and Provisions. EDFUND, the Student Aid auxiliary organization that administers the Federal Family Education Loan 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.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2007-14-4**
Federal Program:	84.032
State Administering Department:	California Student Aid Commission (Student Aid)
Fiscal Year Initially Reported:	2001–02
Audit Finding:	Special Tests and Provisions. Condition 1: 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 entity-wide security program plan. Condition 2: In past years we also found weaknesses in EDFUND'S electronic access controls designed to restrict access to data files. The implementation of EDFUND's project to address these weaknesses did not begin until October 2007 and the estimated completion date is April 2008.
Status of Corrective Action:	Condition 1: Partially corrected. As part of EDFUND's continuous improvement to the security program, the following items are scheduled for

completion by June 30, 2009:

- enhancement of the security testing process over enterprise applications
- unifying password standards across capable enterprise systems[11]

Condition 2: Fully corrected.

Reference Number:	**2007-1-2**
Federal Program:	93.958
State Administering Department:	Department of Mental Health (Mental Health)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Activities Allowed/Allowable Costs. Mental Health does not ensure that subgrantees' expenditures are only for allowable activities and costs.
Status of Corrective Action:	Partially corrected. Mental Health will strengthen the current review process and will add clarifying language to the state fiscal year 2009–10 Planning Estimate and Renewal Application to ensure counties are charging allowable costs and activities to the Substance Abuse and Mental Health Services Administration's Block Grants for Community Mental Health Services. Anticipated completion date is March 2009.[12]

Reference Number:	**2007-1-5**
Federal Program:	93.568
State Administering Department:	Department of Community Services and Development (CSD)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Allowed Activities/Allowable Costs; Subrecipient Monitoring. CSD's processes do not ensure that subgrantees' expenses are only for allowable activities and costs.
Status of Corrective Action:	Partially corrected. CSD has instituted some immediate changes to the field monitoring procedures. CSD field staff are also evaluating expenditure reports, selecting direct program activities

and support cost line items, and requesting the agency to provide support documentation to substantiate the claims they submit to CSD.

Reference Number:	**2007-1-8**
Federal Program:	93.558
State Administering Department:	Department of Social Services (Social Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Activities Allowed/Allowable Costs. 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.
Status of Corrective Action:	Remains uncorrected/disagree with finding. Social Services does not concur with the recommendation that county assistance claims do not include adequate documentation to determine if costs are allowable for the following reasons:

1. According to OMB Circular A-133 and the Single Audit Act Amendments of 1996, counties are required to have a Single Audit conducted by an independent certified auditor to ensure compliance with federal fund requirements in accordance with generally accepted government auditing standards.

2. The counties can only claim reimbursement on the county assistance claim for the actual expenditures paid in the claiming month and are instructed to retain all supporting documentation and backup information of expenditures made/claimed for audit purposes. (CFL 04/05-47 dated May 23, 2005)

3. The county welfare director certifies under penalty of perjury that the aid payments and adjustments claimed are in accordance with all provisions of the Welfare and Institutions Code and the rules and regulations of Social Services.

4. The county auditor certifies under penalty of perjury that the amounts claimed on the assistance claim are in accordance with

authorizations for the public assistance programs made by the county, that said amounts correctly reflect state and county shares in the aid payments claimed, and that the warrants therefore have been issued according to law and the rules and regulations of Social Services.

5. Additionally, it is in the best interest of the county to claim reimbursement only for allowable costs, since the county share is 2.5 percent of these costs.[13]

Reference Number:	**2007-2-2**
Federal Program:	93.563
State Administering Department:	Department of Child Support Services (Child Support Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Allowable Costs/Cost Principles. 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 Child Support Enforcement program.
Status of Corrective Action:	Fully corrected.[14]

Reference Number:	**2007-2-3**
Federal Program:	93.566
State Administering Department:	Department of Social Services (Social Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Allowable Costs/Cost Principles. Social Services cannot substantiate the payroll expenditures it charged to the Refugee Program in fiscal year 2006-07.
Status of Corrective Action:	Partially corrected. Social Services' Refugee Programs Bureau (RPB) will continue the time study process for a period of one year from March 2008 through March 2009, using the results from the study

for comparison to the percentages reported on the 2006–07 Time Reporting Summaries.

However, Social Services RPB does not concur that the $1,200,087 in questioned costs is an accurate amount since not all staff are required to complete time studies (RPB's chief and support staff positions, which totaled $88,918 for fiscal year 2006–07, are charged 100 percent to the Cash, Medical Administration grant, per 45 CFR, 400.13 (c)).[15]

Reference Number:	**2007-2-5**
Federal Program:	93.778
State Administering Department:	Department of Health Care Services (Health Care Services)
Fiscal Year Initially Reported:	2005-06
Audit Finding:	Allowable Costs/Cost Principles. Because a Health Care Services contractor 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. 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.
Status of Corrective Action:	Partially corrected. Health Care Services has requested an estimate for the creation of a new report that will consolidate and track the progress of Erroneous Payment Correction actions in an easily accessible format.[16]

Reference Number:	**2007-3-2**
Federal Program:	93.958
State Administering Department:	Department of Mental Health (Mental Health)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Cash Management. Mental Health's procedures for monitoring each county's Substance Abuse and Mental Health Services Administration's Block Grants for Community Mental Health Services do not

	adequately ensure that the advances made to the counties are appropriate.
Status of Corrective Action:	Fully corrected.[17]

Reference Number:	**2007-3-3**
Federal Program:	93.563
State Administering Department:	Department of Child Support Services (Child Support Services)
Fiscal Year Initially Reported:	2005–06
Audit Finding:	Cash Management. Child Support Services lacks adequate policies and procedures to provide reasonable assurance that cash management requirements are met for the Child Support Enforcement program.
Status of Corrective Action:	Fully corrected.[18]

Reference Number:	**2007-7-4**
Federal Program:	93.958
State Administering Department:	Department of Mental Health (Mental Health)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Earmarking. 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's Block Grants for Community Mental Health Services appropriately.
Status of Corrective Action:	Partially corrected. Mental Health Local Program Financial Support and Budgets staff are working to establish policy, process, and procedures to ensure that only allowable costs are used.[19]

Reference Number:	**2007-7-5**
Federal Program:	93.958
State Administering Department:	Department of Mental Health (Mental Health)

Fiscal Year Initially Reported:	2006-07
Audit Finding:	Level of Effort-Maintenance of Effort. Mental Health lacks processes and procedures to ensure that it complies with the maintenance-of-effort requirement for the Substance Abuse and Mental Health Services Administration's Block Grants for Community Mental Health Services program.
Status of Corrective Action:	Fully corrected.[20]

Reference Number:	**2007-7-6**
Federal Programs:	93.044; 93.045; 93.053
State Administering Department:	Department of Aging (Aging)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Matching, Level of Effort, and Earmarking. 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.
Status of Corrective Action:	Partially corrected. Aging is currently in the process of adapting and expanding existing documentation to include complete step-by-step instructions that will identify the roles and responsibilities of program, budget, and accounting staff to make sure that all requirements are met during each step of the award process. Also, Aging is currently establishing a periodic review process to ensure that expenditures meet requirements throughout the year and is working on a mechanism that will provide accounting staff with additional information in order to verify that expenditures are allowable and in compliance with requirements before funds are transferred.[21]

Reference Number:	**2007-7-8**
Federal Program:	93.568
State Administering Department:	Department of Community Services and Development (CSD)

Fiscal Year Initially Reported:	2006–07
Audit Finding:	Earmarking. CSD lacks a process to demonstrate that it met the earmarking requirement for identifying and developing leveraging programs.
Status of Corrective Action:	Partially corrected. CSD assigned new program cost accounts (PCAs) on July 1, 2007, to earmark the additional leveraging allocation (when and if received from the funding federal agency) separately from the regular LIHEAP allocation. Written desk procedures for documentation of the process should be in place by July 1, 2009.[22]

Reference Number:	**2007-7-10**
Federal Program:	93.556
State Administering Department:	Department of Social Services (Social Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Level of Effort—Maintenance of Effort. Social Services lacks adequate processes and procedures to ensure that it has met the maintenance-of-effort requirement.
Status of Corrective Action:	Remains uncorrected/agree with finding. Social Services, Children and Family Services Division, Office of Child Abuse Prevention, has contacted the federal Administration for Children and Families (ACF) regarding exemption on this requirement. ACF agreed to check with its Central Office in Washington for a possible resolution; Social Services follow-up action will depend on the ACF's Central Office's response.

Reference Number:	**2007-8-3**
Federal Program:	93.958
State Administering Department:	Department of Mental Health (Mental Health)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Period of Availability. Mental Health does not have an adequate process to establish obligations of federal awards to counties for a predetermined time period. Mental Health also does not ensure that the federal

	award is expended within the period of availability.
Status of Corrective Action:	Fully corrected.[23]

Reference Number:	**2007-8-4**
Federal Program:	93.044
State Administering Department:	Department of Aging (Aging)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Period of Availability. During our review, we noted two federal drawdowns that were not related to obligations for the federal fiscal year 2007 award.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2007-9-1**
Federal Program:	93.958
State Administering Department:	Department of Mental Health (Mental Health)
Fiscal Year Initially Reported:	2005–06
Audit Finding:	Procurement and Suspension and Debarment. Menta 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 this requirement down to each person with whom they enter into a covered transaction.
Status of Corrective Action:	Partially corrected. Mental Health will add language to next year's county performance contract relative to suspension and debarment for county staff and their subcontractors.[24]

Reference Number:	**2007-9-3**
Federal Programs:	93.558; 93.566; 93.556; 93.645
State Administering Department:	Department of Social Services (Social Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Procurement, Suspension and Debarment. Social

	Services did not comply with either of the suspension and debarment requirements included in the Administration for Children and Families 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.
Status of Corrective Action:	Partially corrected. Social Services corrected the suspension and debarment boilerplate language for use in its contracts and in the California counties' three-year System Improvement Plan, including the Promoting Safe and Stable Families (PSSF) federal program. Additionally, Office of Child Abuse Prevention staff has consulted with Children and Family Services Division audit staff regarding the drafting of processes and procedures to ensure that specified procurement, suspension and debarment procedures are clearly and appropriately established.[25]

Reference Number:	**2007-12-6**
Federal Program:	93.958
State Administering Department:	Department of Mental Health (Mental Health)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Reporting. Mental Health does not have processes and procedures in place to ensure that the annual Standard Form 269A (SF-269A), Financial Status Report, is accurate and submitted on a timely basis.
Status of Corrective Action:	Fully corrected.[26]

Reference Number:	**2007-12-7**
Federal Programs:	93.044; 93.045; 93.053
State Administering Department:	Department of Aging (Aging)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Reporting. 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.
Status of Corrective Action:	Partially corrected. Aging has completed the draft of the procedures addressed by this finding. The drafted procedures include written step-by-step instructions on how to complete the SF-269 and the PSC-272. The draft procedures will be circulated for review and revised to reflect comments as necessary. The draft procedures are in use.[27]

Reference Number:	**2007-12-12**
Federal Program:	93.568
State Administering Department:	Department of Community Services and Development (CSD)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Reporting. CSD lacks adequate internal controls to ensure certain federal reporting requirements are met.
Status of Corrective Action:	Partially corrected. CSD Financial Services Unit has currently written a draft outlining the basic process of reporting to the federal agency. Formal written desk procedures should be in place by July 1, 2009.[28]

Reference Number:	**2007-12-13**
Federal Program:	93.566
State Administering Department:	Department of Social Services (Social Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Reporting. Social Services submitted its second quarter federal fiscal year 2007 ORR-6 report to the federal Office of Refugee Resettlement despite the report containing several errors.
Status of Corrective Action:	Fully corrected.[29]

Reference Number:	**2007-13-3**
Federal Program:	93.958

State Administering Department:	Department of Mental Health (Mental Health)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Subrecipient Monitoring. Condition 1: Mental Health used the incorrect CFDA title in its correspondence to the counties. Condition 2: Mental Health does not have procedure in place to follow up when counties have not submitted their OMB Circular A-133 audits.
Status of Corrective Action:	Condition 1: Fully corrected. Condition 2: Mental Health is currently evaluating the feasibility of the recommendation to establish procedures for following up with counties that have not submitted their OMB Circular A-133 audits.[30]

Reference Number:	**2007-13-4**
Federal Program:	93.563
State Administering Department:	Department of Child Support Services (Child Support Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Subrecipient Monitoring. Child Support Services did not completely fulfill its subrecipient monitoring responsibilities for its Child Support Enforcement program.
Status of Corrective Action:	Fully corrected.[31]

Reference Number:	**2007-13-5**
Federal Program:	93.568
State Administering Department:	Department of Community Services and Developmer (CSD)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Subrecipient Monitoring. 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.
Status of Corrective Action:	Fully corrected.[32]

Reference Number:	**2007-13-7**
Federal Program:	93.556
State Administering Department:	Department of Social Services (Social Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Subrecipient Monitoring. Social Services does not have processes and procedures to ensure that its noncounty subrecipients have met the OMB Circular A-133 audit requirements.
Status of Corrective Action:	Partially corrected. Social Services' Contracts and Financial Analysis Bureau is updating contract language to reflect OMB Circular A-133 audit requirements.[33]

Reference Number:	**2007-13-8**
Federal Programs:	93.558; 93.566; 93.556; 93.645
State Administering Department:	Department of Social Services (Social Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Subrecipient Monitoring. Social Services did not include all required federal award information in its award letter to counties or in two contracts with its noncounty subrecipients.
Status of Corrective Action:	Partially corrected. Social Services' Office of Child Abuse Prevention (OCAP) has instructed staff administering grants to ensure all grant awards include the CFDA title and number on all federal award documents. OCAP is also developing internal policies and procedures to ensure that the CFDA title and number will be reflected on all future federal award documents.[34]

Reference Number:	**2007-13-9**
Federal Programs:	93-558; 93.556

State Administering Department:	Department of Social Services (Social Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Subrecipient Monitoring. 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.
Status of Corrective Action:	Partially corrected. The internal audit coordinator has completed the 25 fiscal year 2005–06 OMB Circular A-133 findings concerning Temporary Assistance for Needy Families eligibility and PSSF subrecipient monitoring and will complete the remaining desk procedures and cross-training tasks by December 1, 2008.[35]

Reference Number:	**2007-14-1**
Federal Program:	93.958
State Administering Department:	Department of Mental Health (Mental Health)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Special Tests and Provisions. Mental Health did not facilitate peer reviews. The lack of peer reviews further diminishes Mental Health's oversight of the programs offered by the counties using the Substance Abuse and Mental Health Services Administration's Block Grants for Community Mental Health Services funds.
Status of Corrective Action:	Partially corrected. Draft county visit guidelines have been developed and are due to begin this fiscal year.[36]

Reference Number:	**2007-14-2**
Federal Program:	93.053
State Administering Department:	Department of Aging (Aging)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Special Tests and Provisions. Aging lacks adequate

	procedures to provide reasonable assurance that cash received in lieu of commodities is distributed equitably.
Status of Corrective Action:	Fully corrected.[37]

Reference Number:	**2007-14-5**
Federal Program:	93.563
State Administering Department:	Department of Child Support Services (Child Support Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Special Tests and Provisions. Child Support Service lacks adequate controls to ensure that it fulfills its responsibilities for responding to interstate case requests and status review requests within the time required.
Status of Corrective Action:	Fully corrected.[38]

Reference Number:	**2007-1-3**
Federal Program:	17.245
State Administering Department:	Employment Development Department (EDD)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Activities Allowed/Allowable Costs; Eligibility. EDD lacks adequate controls to ensure that its field offices make appropriate eligibility determinations for the Trade Adjustment Assistance program. Specifically, EDD has not appropriately monitored its field offices' eligibility determinations.
Status of Corrective Action:	Partially corrected. EDD's Unemployment Insurance Branch wrote and released an Unemployment Insurance Program Notice that included the policies and procedures related to the approval of the Trade Act Training Agreement, DE 8751, to include instructions that the Job Service field office managers review the Training Plan for completeness prior to approval. The revised training agreement is expecte to be available on September 5, 2008.[39]

Reference Number:	**2007-1-4**
Federal Program:	17.207
State Administering Department:	Employment Development Department (EDD)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Activities Allowed/Allowable Costs. EDD needs to improve its controls to ensure that employee time sheets agree with the payroll data recorded in its accounting records.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2007-2-1**
Federal Program:	17.503
State Administering Department:	Department of Industrial Relations (Industrial Relations)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Allowable Costs/Cost Principles. Industrial Relations lacks adequate controls to ensure that the personal services costs it charges to the California Occupational Safety and Health program are allowable.
Status of Corrective Action:	Partially corrected. Industrial Relations' personnel transactions staff have been retrained on processing Additional Time Worked Reports. In addition, Industrial Relations spoke with an auditor from the U.S. Department of Labor, Occupational Safety & Health Administration, and it was agreed tha Industrial Relations' procedure requiring divisions to submit to the department's Accounting Office Calstars Home Base Coding Data forms approved by Division Headquarters to report staff additions, changes, or deletions was sufficient to comply with OMB Circular A-87.[40]

Reference Number:	**2007-3-1**
Federal Program:	17.503

State Administering Department:	Department of Industrial Relations (Industrial Relations)
Fiscal Year Initially Reported:	2006-07
Audit Finding:	Cash Management. Industrial Relations requested federal funds for the California Occupational Safety and Health program that exceeded the actual amounts spent.
Status of Corrective Action:	Fully corrected.[41]

Reference Number:	**2007-8-2**
Federal Program:	17.503
State Administering Department:	Department of Industrial Relations (Industrial Relations)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Period of Availability. 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.
Status of Corrective Action:	Fully corrected.[42]

Reference Number:	**2007-12-4**
Federal Program:	17.503
State Administering Department:	Department of Industrial Relations (Industrial Relations)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Reporting. Industrial Relations submitted an inaccurate closeout report for the 2006 federal award associated with the California Occupational Safety and Health program.
Status of Corrective Action:	Fully corrected.[43]

Reference Number:	**2007-12-9**
Federal Program:	17.245

State Administering Department:	Employment Development Department (EDD)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Reporting. 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). The ETA-563 report it submitted to Federal Labor for the quarter ending June 30, 2007, was not in compliance with federal requirements.
Status of Corrective Action:	The revised DE 8748—Certification of Waiver of Trade Act Training Requirement has been reviewed and will be written in English and in Spanish. The date for formal release will depend on getting the Spanish version completed. Remains uncorrected/agree with finding. The DE 8751—Training Plan has been revised to be a more comprehensive documentation and will require more documentation to be entered by staff.[44]

Reference Number:	**2007-12-10**
Federal Program:	17.245
State Administering Department:	Employment Development Department (EDD)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Reporting. Federal Labor requires EDD to submit electronic Trade Act Participant Report files no later than 45 calendar days after the end of each quarter o reporting. Our review found that EDD's report for the first calendar quarter of 2007 contained errors.
Status of Corrective Action:	Fully corrected.[45]

Reference Number:	**2007-12-11**
Federal Programs:	17.801; 17.804
State Administering Department:	Employment Development Department (EDD)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Reporting. Our review of two SF-269A reports EDD submitted to Federal Labor revealed errors in calculating indirect costs for the Disabled Veterans'

	Outreach Program and the Local Veterans' Employment Representative program. In addition, EDD has no written procedures for completing the SF-269A report, and verifying the indirect cost calculations before submitting it to Federal Labor was not part of the regular management review of the SF-269A.
Status of Corrective Action:	Fully corrected.[46]

Reference Number:	**2007-7-7**
Federal Program:	20.505
State Administering Department:	Department of Transportation (Caltrans)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Matching. Caltrans does not have a process in place to ensure that metropolitan planning organization local matches originate only from allowable sources and meet the allowable cost/cost principles requirements.
Status of Corrective Action:	Remains uncorrected/agree with finding. Caltrans' Division of Transportation Planning has assigned a staff person to take the lead and establish policies and procedures by working cooperatively with the districts. Caltrans expects to have new policies and procedures in place by January 2009.[47]

Reference Number:	**2007-12-1**
Federal Program:	64.114
State Administering Department:	California Department of Veterans Affairs (Veterans Affairs)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Reporting. 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 the U.S. Department of Veterans Affairs of eight of these delinquencies.
Status of Corrective Action:	Fully corrected.[48]

Reference Number:	**2007-12-2**
Federal Program:	64.114
State Administering Department:	California Department of Veterans Affairs (Veterans Affairs)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Reporting. 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 U.S. Department of Veterans Affairs with notice of two of these foreclosures.
Status of Corrective Action:	Fully corrected.[49]

Reference Number:	**2007-1-1**
Federal Program:	94.006
State Administering Department:	CaliforniaVolunteers
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Activities Allowed/Allowable Costs. CaliforniaVolunteers' processes do not ensure that subgrantees' expenses are only for allowable activities and costs. 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 its subgrantees during fiscal year 2006–07.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2007-7-1**
Federal Program:	94.006
State Administering Department:	CaliforniaVolunteers
Fiscal Year Initially Reported:	2006–07

Audit Finding:	Earmarking. CaliforniaVolunteers lacks an adequate process to identify separately its administrative expenditures in its accounting records.
Status of Corrective Action:	Fully corrected.[50]

Reference Number:	**2007-7-2**
Federal Program:	94.006
State Administering Department:	CaliforniaVolunteers
Fiscal Year Initially Reported:	2003–04
Audit Finding:	Matching. CaliforniaVolunteers processes do not adequately ensure that only allowable sources were used by its subgrantees to meet the matching requirements.
Status of Corrective Action:	Fully corrected.[51]

Reference Number:	**2007-8-1**
Federal Program:	94.006
State Administering Department:	CaliforniaVolunteers
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Period of Availability. Thirteen invoices totaling $2.2 million were paid more than 90 days after the end of the grant-funding period.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2007-12-3**
Federal Program:	94.006
State Administering Department:	CaliforniaVolunteers
Fiscal Year Initially Reported:	2005–06
Audit Finding:	Reporting. CaliforniaVolunteers lacks adequate processes to ensure that it meets federal reporting requirements.

Status of Corrective Action:	Fully corrected.

Reference Number:	**2007-13-1**
Federal Program:	94.006
State Administering Department:	CaliforniaVolunteers
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Subrecipient Monitoring. Condition 1: CaliforniaVolunteers' award letter and contract review and approval process lack internal controls to ensure the CFDA number is identified to its subgrantees at the time of the award. Condition 2: CaliforniaVolunteers' desk reviews are not signed by a preparer, and there is no evidence of a review by a manager. Condition 3: There is no evidence on the site visit assessment instrument or final report to demonstrate the program operations manager's review.
Status of Corrective Action:	Partially corrected. Condition 1: Fully corrected. Condition 2: Fully corrected. Condition 3: Partially corrected. CaliforniaVolunteers is continuing to review and evaluate the policies and procedures related to the review and documentation of fiscal information on a site visit. It also continues to expect full implementation of updated site visit policies and procedures during the 2008–09 fiscal year.[52]

Reference Number:	**2007-7-3**
Federal Program:	90.401
State Administering Department:	Office of the Secretary of State (Secretary of State)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Level of Effort-Maintenance of Effort (MOE). The Secretary of State did not comply with the Help

	America Vote Act MOE requirement because it failed to include all of the appropriate expenditures.
Status of Corrective Action:	Fully corrected.[53]

Reference Number:	**2007-12-5**
Federal Program:	90.401
State Administering Department:	Office of the Secretary of State (Secretary of State)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Reporting. The Secretary of State did not accurately report the amounts in its annual Financial Status Report.
Status of Corrective Action:	Fully corrected.[54]

Reference Number:	**2007-13-2**
Federal Program:	90.401
State Administering Department:	Office of the Secretary of State (Secretary of State)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Subrecipient Monitoring. The Secretary of State did not include all required federal award information pertaining to Help America Vote Act when it awarded funds to its subrecipients.
Status of Corrective Action:	Partially corrected. The Secretary of State has initiated 40 contract amendments that incorporated the CFDA title and/or number. The Secretary of State is confident that the amendments will be fully executed by October 2008. In addition, the contracts included explicit language (Exhibit D, A. 3.) explaining the provisions of OMB Circular A-133. Also, the Secretary of State has developed a formal process to ensure prompt notification directly from the State Controller's Office alerting it of those counties, cities, and special districts that have not fully complied with the Single Audit Requirement (OMB Circular A-133).[55]

Reference Number:	**2007-14-6**

Federal Program:	10.557
State Administering Department:	Department of Public Health (Public Health)
Fiscal Year Initially Reported:	2005–06
Audit Finding:	Special Tests and Provisions. Public Health is not in compliance with the record-keeping requirements of Special Supplemental Nutrition Program for Women, Infants and Children (WIC) by not retaining copies or having the ability to obtain copies of the redeemed food instruments for the three-year retention period. WIC is only able to retrieve copies of the food instruments redeemed from one year ago.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2007-7-11**
Federal Program:	16.575
State Administering Department:	Governor's Office of Emergency Services (Emergency Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Earmarking. Emergency Services exceeded the allowed amount to be expended on state administration costs for the 2003 Crime Victim Assistance grant award.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2007-12-15**
Federal Program:	16.575
State Administering Department:	Governor's Office of Emergency Services (Emergency Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Reporting. Emergency Services failed to comply with the special reports requirement to notify the Office of Victims of Crime of subawards made within 90 days of the subgrant.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2007-12-16**
Federal Program:	16.575
State Administering Department:	Governor's Office of Emergency Services (Emergency Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	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. Additionally, Emergency Services does not have adequate controls in place to ensure accurate reporting.
Status of Corrective Action:	Partially corrected. Emergency Services has developed and is in the process of implementing corrective actions to assure that amounts reported on FSRs are traceable to supporting documentation and its accounting records. Additionally, as of August 10, 2008, Emergency Services has drafted detailed policies and procedures for SF-269 preparation.

Reference Number:	**2007-13-11**
Federal Program:	16.575
State Administering Department:	Governor's Office of Emergency Services (Emergency Services)
Fiscal Year Initially Reported:	2001–02
Audit Finding:	Subrecipient Monitoring. Emergency Services did not adequately monitor its subrecipients of funds for the Crime Victim Assistance program for the fiscal year ending June 30, 2007.
Status of Corrective Action:	Partially corrected. Emergency Services' Local Assistance Monitoring Unit states that it is in the process of developing policies and procedures for review and receipt tracking of subrecipient audits.

Reference Number:	**2007-2-6**

Federal Programs:	84.027; 84.173
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2006-07
Audit Finding:	Allowable Costs. Education's monitoring of salaries charged to the program may not be at a detailed enough level to identify the appropriateness of the charges. Exception 1: A 100 percent dedication of warehouse manager salary charged to the federal program is inappropriate because the warehouse is not 100 percent dedicated to the federal program. Exception 2: For an employee charged to the program, the time sheet supported more hours than what the employee was paid.
Status of Corrective Action:	Exception 1: Remains uncorrected/disagree with finding. Education maintains its position of nonconcurrence with the finding and believes no corrective action is necessary. Exception 2: Fully corrected.

Reference Number:	**2007-2-7**
Federal Program:	84.367
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Allowable Costs. There was no evidence of approval on the Summary Cover Memos for two of the 30 samples selected. 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.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2007-3-6**
Federal Programs:	84.010; 84.011; 84.027; 84.173; 84.186; 84.282;

	84.318; 84.365; 84.367; 84.369
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Cash Management. The package of supporting documentation used to compile the amount paid to Special Education Local Plan Areas Agencies (SELPAs) and local educational agencies (LEAs) does not include evidence to support the review and approval of the advance amount made for the federal program.
Status of Corrective Action:	Remains uncorrected/disagree with finding. Processes and controls are in place to reduce the risk of advances of federal funds.[56]

Reference Number:	**2007-3-7**
Federal Programs:	84.010; 84.027; 84.173; 84.186; 84.282; 84.318; 84.365; 84.367
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2001–02
Audit Finding:	Cash Management. Education does not have an adequate process in place for assessing the cash needs of its subrecipients.
Status of Corrective Action:	Partially corrected. Education continues to work with the U.S. Department of Education, Office of Secretary, Risk Management Service, in determining and implementing the cash management process improvements that are deemed practical and achievable within Education's available resources.[57]

Reference Number:	**2007-3-8**
Federal Programs:	84.010; 84.282; 84.186; 84.318; 84.365; 84.367
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2005–06
Audit Finding:	Cash Management. For four programs, Education did notify the LEAs of the requirement to return interest earned on advances; however, it did not require the

	interest to be reported nor did it identify any processes or put controls in place to collect and return the interest earned over $100 to the U.S. Department of Education. For two programs, Education did not collect interest earned by the LEAs on a quarterly basis as indicated by federal requirements.
Status of Corrective Action:	Partially corrected. Education continues to work with the U.S. Department of Education, Office of Secretary, Risk Management Service, in determining and implementing the cash management process improvements that are deemed practical and achievable within Education's available resources.[58]

Reference Number:	**2007-3-9**
Federal Programs:	84.027; 84.173; 84.318; 84.365; 84.369
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Cash Management. Education does not have a policy that addresses the minimization of timing of reimbursement payments made to SELPAs, LEAs, and Educations' subcontractors.
Status of Corrective Action:	Partially corrected. Education continues to collegially work with the U.S. Department of Education, Office of Secretary, Risk Management Service, in determining and implementing the cash management process improvements that are deemed practical and achievable within Education's available resources.

Reference Number:	**2007-3-10**
Federal Program:	84.282
State Administering Department:	California School Finance Authority (Authority)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Cash Management. The Authority does not have an adequate process in place for assessing the cash needs of its subrecipients. Also, 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.
Status of Corrective Action:	Partially corrected. The Authority will ensure all subgrantees are notified by December 2008.

Reference Number:	**2007-5-1**
Federal Program:	84.367
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2005–06
Audit Finding:	Eligibility. There was no documented evidence of reviews or approvals of LEA calculation work sheets before the awards were granted.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2007-7-12**
Federal Programs:	84.010; 84.318; 84.186; 84.365; 84.367
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2005–06
Audit Finding:	Level of Effort-Maintenance of Effort. Condition 1: Education was using unaudited LEAs' expenditure figures to calculate compliance with the MOE requirements instead of using the final audited expenditures. Condition 2: 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. Condition 3: Education does not send the final MOE calculations to each LEA annually.
Status of Corrective Action:	Condition 1: Remains uncorrected/disagree with finding. Education has submitted a proposal to the Audit Guide Committee to require LEA auditors to assess the impact of audit adjustments on the MOE

calculation and, where the impact is material, to quantify the impact in the LEA audit report in sufficient detail to enable Education to take the adjustment into account when calculating MOE. The Audit Guide Committee will consider Education's proposal in the fall of 2009.

Condition 2: Fully corrected.

Condition 3: Remains uncorrected/disagree with finding. Education does not concur with the condition. Education continues to send final MOE calculations back to the LEAs if the final calculations differ from the LEAs' preliminary calculations.[59]

Reference Number:	**2007-7-13**
Federal Program:	84.282
State Administering Department:	California School Finance Authority (Authority)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Level of Effort-Supplement not Supplant. 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.
Status of Corrective Action:	Remains uncorrected/disagree with finding. The Authority is confident that it is in compliance with the supplementing requirement.[60]

Reference Number:	**2007-7-14**
Federal Program:	84.010; 84.011; 84.027; 84.173; 84.186; 84.282; 84.318; 84.365
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2005–06
Audit Finding:	Earmarking. 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 with the required limitations.

Status of Corrective Action:	Fully corrected.[61]

Reference Number:	**2007-7-15**
Federal Program:	84.282
State Administering Department:	California School Finance Authority (Authority)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Earmarking. 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 with the required limitations.
Status of Corrective Action:	Partially corrected. The Authority will continue to work with the State Treasurer's Office's Administrative Division to address issues by December 2008.

Reference Number:	**2007-8-6**
Federal Programs:	84.010; 84.011; 84.027; 84.173; 84.186; 84.282; 84.318; 84.365; 84.367; 84.369
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2005–06
Audit Finding:	Period of Availability. Education does not require journal entries to be reviewed and approved, nor does it require segregation of duties between the preparer and recorder of the entry.
Status of Corrective Action:	Fully corrected.[62]

Reference Number:	**2007-8-7**
Federal Program:	84.318
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Period of Availability. There does not appear to be

	effective monitoring of liquidation deadlines to ensure that final payments are made before the 90-day deadline.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2007-9-4**
Federal Program:	84.282
State Administering Department:	California School Finance Authority (Authority)
Fiscal Year Initially Reported:	2005–06
Audit Finding:	Procurement, Suspension and Debarment. 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.
Status of Corrective Action:	Partially corrected. Verification of potential subgrantee status in EPLS will be completed by December 2008. Also, program regulations are being amended and approval is expected prior to the start of the next funding round.

Reference Number:	**2007-12-17**
Federal Program:	84.010
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Reporting. There is no policy or procedure in place to review and reconcile the unaudited Standard Account Code Structure (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 final balance for prior-year adjustments.
Status of Corrective Action:	Remains uncorrected/disagree with finding. 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 considers the potential impact on statewide data insignificant for performance reporting purposes.[63]

Reference Number:	**2007-12-18**
Federal Program:	84.282
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Reporting. Education did not review the information included on its Public Charter School Grant Program Fiscal Year 2006 Grant Performance Report with the detail documentation that was used to prepare the report to ensure accuracy.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2007-12-19**
Federal Program:	84.282
State Administering Department:	California School Finance Authority (Authority)
Fiscal Year Initially Reported:	2006-07
Audit Finding:	Reporting. There does not appear to be an adequate control process in place to ensure accuracy in the amounts reported on the Authority's Annual Performance Report.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2007-12-20**
Federal Program:	84.186
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2005–06
Audit Finding:	Reporting. There was no evidence noted of a review and approval of the data reported on Education's Consolidated State Performance Report.

Status of Corrective Action:	Fully corrected.

Reference Number:	**2007-12-21**
Federal Program:	84.011
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2005–06
Audit Finding:	Reporting. Education does not perform any monitoring controls to ensure the subcontractor's controls in place to gather and compile the information are effective to ensure the accuracy and completeness of the data supplied to Education. Additionally, Education does not maintain supporting documentation for its submitted reports.
Status of Corrective Action:	Partially corrected. Education has strengthened quality control procedures over the reporting approval process by requiring regional offices to validate student count data. By December 31, 2008, Education plans to select a sampling of data submissions by region and check the data for completeness and accuracy.[64]

Reference Number:	**2007-12-22**
Federal Programs:	84.027; 84.173
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2005–06
Audit Finding:	Reporting. Education included duplicate students in its submitted reports.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2007-13-12**
Federal Programs:	84.011; 84.282; 84.318; 84.365; 84.367
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2005–06
Audit Finding:	Subrecipient Monitoring. We were unable to identify

	controls to ensure that award information was properly identified to the LEAs.
Status of Corrective Action:	Fully corrected.[65]

Reference Number:	**2007-13-13**
Federal Programs:	84.010; 84.011; 84.186; 84.365; 84.367
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2005–06
Audit Finding:	Subrecipient Monitoring. 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. Additionally, Education does not appear to impose effective sanctions on LEAs for untimely implementation of their corrective action plans.
Status of Corrective Action:	Fully corrected.[66]

Reference Number:	**2007-13-14**
Federal Programs:	84.027; 84.173
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2005–06
Audit Finding:	Subrecipient Monitoring. Education's 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. Further, Education's follow-up schedule results in the untimely resolution of the LEAs' corrective actions.
Status of Corrective Action:	Fully corrected.[67]

Reference Number:	**2007-13-15**
Federal Program:	84.282
State Administering Department:	Department of Education (Education)

Fiscal Year Initially Reported:	2006–07
Audit Finding:	Subrecipient Monitoring. Education does not retain detail work paper documentation of the scope of the procedures that are performed to support the conclusions reached.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2007-13-16**
Federal Program:	84.282
State Administering Department:	California School Finance Authority (Authority)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Subrecipient Monitoring. Condition 1: We were unable to identify controls to ensure the Authority discloses complete grant award information to its subrecipient charter schools, which increases the risk of their noncompliance with appropriate federal requirements. Condition 2: The Authority's monitoring policies do not include any site visits. Condition 3: The Authority 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.
Status of Corrective Action:	All conditions: partially corrected. The Authority will ensure all subgrantees have received appropriate notifications by December 2008.

Reference Number:	**2007-13-17**
Federal Program:	84.318
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2005–06
Audit Finding:	Subrecipient Monitoring. Education did not perform monitoring procedures over fiscal requirements.
Status of Corrective Action:	Partially corrected. To strengthen the monitoring of

	subrecipients, Education is hiring a retired annuitant to be the subrecipient monitoring coordinator. The start date of the retired annuitant has been delayed pending approval of the fiscal year 2008–09 California State Budget.

Reference Number:	**2007-13-18**
Federal Programs:	84.010; 84.011; 84.186; 84.318; 84.365; 84.367
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2005–06
Audit Finding:	Subrecipient Monitoring. Education does not have policies or procedures for assessing SELPA and LEA subrecipients as high-risk either on the individual program level or on the overall SELPA and LEA level.
Status of Corrective Action:	Fully corrected.[68]

Reference Number:	**2007-14-7**
Federal Program:	84.010
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Special Tests and Provisions. Title I program used the Notices of Apportionment, as opposed to the Grant Award Notifications, as its means to communicate award identification to its LEAs.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2007-14-8**
Federal Program:	84.010
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2005–06
Audit Finding:	Special Tests and Provisions. We were unable to obtain documentation to support that comparability assessments were performed as of June 30, 2006, or June 30, 2007.

Status of Corrective Action:	Partially corrected. In fiscal year 2007–08, Education began implementing new procedures for meeting Title I, Part A, comparability requirements. For the fiscal year 2008–09, Education will withhold apportionments of Title I, Part A, funds for those LEAs who do not submit their comparability reports promptly.

Reference Number:	**2007-14-9**
Federal Program:	84.010
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Special Tests and Provisions. Some sampled charter schools did not receive payments within the required five months. Education was unable to provide the charter school surveys to support that the initial apportionments were based on estimated enrollment.
Status of Corrective Action:	Remains uncorrected/disagree with finding. Education considers existing policies and procedures adequate in ensuring compliance with the five-month requirement to accurately and promptly make payments to new or expanding charter schools.[69]

Reference Number:	**2007-14-10**
Federal Program:	84.011
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2005–06
Audit Finding:	Special Tests and Provisions. Education relies upon the work performed by an 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.
Status of Corrective Action:	Partially corrected. Education has strengthened quality control procedures over the reporting approval process by requiring regional offices to validate student count data. By December 31, 2008, Education plans to select a sampling of data

	submissions by region and check the data for completeness and accuracy.[70]

Reference Number:	**2007-14-11**
Federal Program:	84.011
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Special Tests and Provisions. Education was unable to provide evidence that the consultant reviewed the reports submitted by the vendors, as indicated in the quality control process.
Status of Corrective Action:	Partially corrected. Education has strengthened quality control procedures over the reporting approval process by requiring regional offices to validate student count data. By December 31, 2008, Education plans to select a sampling of data submissions by region and check the data for completeness and accuracy.[71]

Reference Number:	**2007-1-10**
Federal Program:	93.778
State Administering Department:	Department of Health Care Services (Health Care Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Activities Allowed. We were unable to determine the medical necessity of five of the 50 fee-for-service claims sampled.
Status of Corrective Action:	Partially corrected. Health Care Services has consistently and aggressively addressed the issues of monitoring and internal controls to ensure only medically necessary claims and eligible providers are paid and that the providers are observing the records retention rules. Health Care Services is in the process of drafting letters requesting repayment from the providers for the five noted exceptions. In addition, civil money penalty letters will be issued to all five providers citing the findings of the Bureau of State Audits' review.

	Subsequent reviews are also planned for three of the providers to ensure they are properly billing the program.[72]

Reference Number:	**2007-1-11**
Federal Program:	93.778
State Administering Department:	Department of Health Care Services (Health Care 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.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2007-2-8**
Federal Program:	93.917
State Administering Department:	Department of Public Health (Public Health)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Allowable Costs/Cost Principles. We reviewed available audit and investigation reports that were published and released during fiscal year ended June 30, 2007. We found that, based on the error percentage noted in the reports, the risk of noncompliance with allowable costs is considered material.
Status of Corrective Action:	Partially corrected. The AIDS Drug Assistance Program (ADAP) has implemented an enhanced third-party-payer screening process, as well as other procedures to monitor for Medi-Cal eligibility. ADAP is also close to having an interagency agreement with the Department of Health Care Services to perform a monthly data exchange with it to monitor ADAP clients for possible Medi-Cal eligibility.

Reference Number:	**2007-2-9**

Federal Program:	93.778
State Administering Department:	Department of Health Care Services (Health Care Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Allowable Costs/Cost Principles. Electronic Data System (EDS), the State's fiscal intermediary, did not consistently retain the necessary documentation to demonstrate that approval and testing of changes to the program had been obtained. EDS also did not consistently communicate expiration dates of guidelines or retain approval of edit criteria updates.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2007-2-10**
Federal Program:	93.778
State Administering Department:	Department of Health Care Services (Health Care Services)
Fiscal Year Initially Reported:	2005–06
Audit Finding:	Allowable Costs/Cost Principles. We reviewed the summary of findings cited in the second annual Medi-Cal Payment Error Study (MPES) performed during fiscal year 2004–05. We found that, 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 material.
Status of Corrective Action:	Partially corrected. The MPES has aided Health Care Services in determining the areas most vulnerable to abuse and has aided in the allocation of resources to the vulnerable areas, increasing their oversight. Health Care Services has continuously implemented the corrective action steps outlined in the MPES from 2005. Based on those findings, vulnerable providers have been identified, and new procedures have been developed to ensure payments are made for allowable services and for eligible beneficiaries.[73]

Reference Number:	**2007-2-11**

Federal Program:	93.778
State Administering Department:	Department of Health Care Services (Health Care Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Allowable Costs/Cost Principles. Drug utilization data was mailed to labelers 14 days late.
Status of Corrective Action:	Remains uncorrected/agree with finding. There exists a potential system logic change which will reduce the amount of manual review required for blood factor claims. The change is expected to be implemented in April 2009. In addition, Health Care Services has implemented a second printer so that the time required for printing the physical invoices is reduced by four days.[74]

Reference Number:	**2007-2-12**
Federal Program:	93.794
State Administering Department:	Department of Health Care Services (Health Care Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Allowable Costs/Cost Principles/Eligibility. Of the 2,734 cases sampled, Health Care Services determined that 244 were ineligible for Medicaid, resulting in a 9 percent error rate.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2007-3-11**
Federal Programs:	93.283; 93.889; 93.566
State Administering Department:	Department of Public Health (Public Health)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Cash Management. There is no evidence of review or approval on the federal cash drawdown requests by someone other than the preparer.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2007-3-12**
Federal Program:	93.283
State Administering Department:	Department of Public Health (Public Health)
Fiscal Year Initially Reported:	2004–05
Audit Finding:	Cash Management. Public Health paid several subrecipients 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. 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.
Status of Corrective Action:	Partially corrected. Public Health continues to improve the processing times for invoices. Payments are within 45 days of receipt of the required application, except for instances involving extenuating circumstances.[75]

Reference Number:	**2007-3-13**
Federal Programs:	93.889; 93.917; 93.566
State Administering Department:	Department of Public Health (Public Health)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Cash Management. Public Health does not have a policy that addresses (or adequately controls) the minimization of timing of reimbursement payments made to subrecipients.
Status of Corrective Action:	Partially corrected. Toward the end of the fiscal year, Public Health does not have sufficient funds to pay invoices from its general fund clearing account. Public Health is seeking a general fund loan to be in effect by July 2010. Public Health has also hired temporary staff to reduce the backlog of invoices.[75]

Reference Number:	**2007-3-14**
Federal Programs:	93.575; 93.596
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2005–06
Audit Finding:	Cash Management. Education's control process for making payments to program contractors does not include a signed copy of the approved claims schedule to be retained as evidence of the review and approval process for the claim.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2007-3-15**
Federal Programs:	93.575; 93.596
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Cash Management. One drawdown was paid eight days after the cash was received by the SCO, which exceeds the days allowed for pre-issuance funding technique.
Status of Corrective Action:	Partially corrected. Education complied with the policy and procedures established by Finance with agreement by the SCO when processing the claim noted in this finding. However, Education continues to work with the Risk Management Service in determining and implementing the cash management process improvements that are deemed practical and achievable within Education's available resources.[76]

Reference Number:	**2007-5-2**
Federal Program:	93.917
State Administering Department:	Department of Public Health (Public Health)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Eligibility. Four of the 30 site visit reports reviewed were completed six months after the site visit date.

Status of Corrective Action:	Partially corrected. ADAP continues to use the recently implemented enhanced Third-Party-Payer screening process. ADAP is also close to instituting an interagency agreement with the Department of Health Care Services in order to perform a monthly data exchange, which will allow ADAP staff to monitor any changes in client status with respect to Medi-Cal eligibility. Additionally, the program has initiated procedures to ensure timely site visit reports.[77]

Reference Number:	**2007-5-3**
Federal Program:	93.566
State Administering Department:	Department of Health Care Services (Health Care Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Eligibility. No program review had been performed over the counties' determination of eligibility of applicants for Refugee Medical Assistance (RMA) funding.
Status of Corrective Action:	Partially corrected. Health Care Services has received federal approval of the review guidelines for its three-year review of RMA eligibility determinations. The review is expected to begin before the end of 2008 and should be completed six to seven months from the start date. The annual RMA case review has not yet been done but is expected to be completed by July 1, 2009. The error cases identified during the federal review have been compiled, and Health Care Services has begun communicating with counties to correct those cases of erroneous eligibility. All of the error cases are expected to be corrected by January 1, 2009. The all county welfare directors letter is expected to be completed by July 1, 2009. Health Care Services has written an all county welfare directors letter to implement Medi-Cal Eligibility Data System changes that will automatically terminate RMA cases at the end of their eight-month period of eligibility. This letter is in final sign-off.

	Health Care Services expects it to be published in September 2008. The related system changes will be installed before the end of 2008 and will be fully implemented by early 2009.

Reference Number:	**2007-5-4**
Federal Program:	93.778
State Administering Department:	Department of Health Care Services (Health Care Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Eligibility. Of the 120 case files reviewed, 12 had at least one nonexempt beneficiary who lacked appropriate citizenship documentation but received full-scope Medi-Cal benefits.
Status of Corrective Action:	Fully corrected.[78]

Reference Number:	**2007-5-5**
Federal Program:	93.778
State Administering Department:	Department of Health Care Services (Health Care Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Eligibility. Some Medicaid recipients deemed eligible by the Medicaid Eligibility Quality Control process were actually ineligible for Medi-Cal benefits. Some cases tested from the general population of Medicaid beneficiaries were erroneously transferred to Transitional Medi-Cal.
Status of Corrective Action:	Remains uncorrected/agree with finding. Health Care Services is working with LEADER and CalWIN system experts to identify and correct any interface issues between the county eligibility systems and the Medicaid Eligibility Database System (MEDS). Health Care Services expects to complete its review in early 2009.[78]

Reference Number:	**2007-5-6**
Federal Program:	93.778

State Administering Department:	Department of Health Care Services (Health Care Services)
Fiscal Year Initially Reported:	2005–06
Audit Finding:	Eligibility. Health Care Services is unable to reconcile the presumptive eligibility number against the enrollment listing filed with Health Care Services.
Status of Corrective Action:	Remains uncorrected/agree with finding. Health Care Services is pursuing an automated process to post the presumptive eligibility identification to the State's MEDS 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.[79]

Reference Number:	**2007-7-16**
Federal Programs:	93.575; 93.596
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Earmarking. Education does not have appropriately designed controls in place to monitor mandated program earmarking requirements. Additionally, Education does not perform calculations on required earmarks to ascertain if it has complied with the required limitations.
Status of Corrective Action:	Remains uncorrected/disagree with finding. Education does monitor earmarking and other compliance requirements throughout the grant period.[80]

Reference Number:	**2007-7-17**
Federal Program:	93.994
State Administering Department:	Department of Public Health (Public Health)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Earmarking. Maternal and Child Health Services Block Grant did not track the 30 percent spending requirement for (a) preventive and primary care for

children or (b) children with special health care needs.

Status of Corrective Action: Partially corrected. Based on time surveys received from local health jurisdictions after one fiscal year, Public Health will have accounting information that will properly track and provide timely reporting of grant fund expenditures for the earmarking requirements.

Reference Number: **2007-8-8**

Federal Program: 93.566

State Administering Department: Department of Public Health (Public Health)

Fiscal Year Initially Reported: 2006–07

Audit Finding: Period of Availability. 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.

Status of Corrective Action: Fully corrected.

Reference Number: **2007-8-9**

Federal Programs: 93.575; 93.596

State Administering Department: Department of Education (Education)

Fiscal Year Initially Reported: 2005–06

Audit Finding: Period of Availability. 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. Education's current policies and procedures do not require that detailed transaction supporting documentation be maintained to support first-in-first-out amounts adjusted.

Status of Corrective Action: Fully corrected.[81]

Reference Number: **2007-8-10**

Federal Programs: 93.575; 93.596

State Administering Department: Department of Education (Education)

Fiscal Year Initially Reported:	2006–07
Audit Finding:	Period of Availability. Condition 1: 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, which increases the risk that material amounts would be recorded in the improper period. Condition 2: Four advances were made to one contractor before the contracts were executed.
Status of Corrective Action:	Condition 1: Partially corrected. Education is reviewing existing contract contingency language regarding the conditions of obligation, and if necessary, will add clarifying language for fiscal year 2008–09 contracts. Condition 2: Remains uncorrected/disagree with finding. Education contends that contractor payments are processed only after the contractor signs and returns the contracts to Education.[82]

Reference Number:	**2007-12-23**
Federal Programs:	93.566; 93.889
State Administering Department:	Department of Public Health (Public Health)
Fiscal Year Initially Reported:	2003–04
Audit Finding:	Reporting. There is no evidence of review or approval of the SF-272—Federal Cash Transactions Report. Public Health did not prepare and submit two of its four quarterly Financial Status Reports as required by the special terms and conditions section in the grant extension letter.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2007-12-24**
Federal Program:	93.767
State Administering Department:	Department of Health Care Services (Health Care Services)

Fiscal Year Initially Reported:	2005–06
Audit Finding:	Reporting. We were unable to verify the accuracy of detailed expenditures reported by line item or category of service.
Status of Corrective Action:	Partially corrected. CMS 21 accounting system design meetings have been ongoing, and system requirements have been identified. Design and development will continue until system is finalized and implemented.

Reference Number:	**2007-12-25**
Federal Programs:	93.575; 93.596
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2005–06
Audit Finding:	Reporting. Education did not maintain supporting documentation for the allocation to nondirect services, which was reported in the Discretionary Fund. Education also had overreported the amounts expended in the Discretionary Fund's Direct and Non-Direct Services line items. Finally, Education had reported the total approved amount of the Temporary Assistance to Needy Families funds to be transferred, but this did not match the total expenditures that were recorded in the CalSTARS general ledger.
Status of Corrective Action:	Remains uncorrected/disagree with finding. Education did not overreport the Direct and Non-Direct Services amounts on the ACF-696. The general ledger PCAs totaled by the auditors did not include all the activity within the PCAs that Education used to compile the amounts reported on the ACF-696.

Reference Number:	**2007-12-26**
Federal Program:	93.778
State Administering Department:	Department of Health Care Services (Health Care Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Reporting. 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.
Status of Corrective Action:	Remains uncorrected/agree with finding. The Fiscal Intermediary and Contracts Oversight Division has submitted a Systems Development Notice to redesign the system to incorporate the capability to trace summary reports back to individual claims. However, Health Care Services has instructed EDS to prepare an estimate for an alternate interim solution to achieve compliance.[83]

Reference Number:	**2007-13-19**
Federal Programs:	93.575; 93.596
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2003–04
Audit Finding:	Subrecipient Monitoring. The monitoring procedures contained limited fiscal procedures and do not cover all major functions and activities of the program. There was no documented sign-off of approval for the procedures performed and conclusions reached for the monitoring visit on the Cross-Program Instrument by someone other than the preparer. Further, Education does not maintain adequate documentation of the procedures performed or ensure that the appropriate reviews and approvals are performed. Finally, there does not appear to be effective sanctions imposed by Education on the LEAs for the untimely implementation of their corrective action plans.
Status of Corrective Action:	Fully corrected.[84]

Reference Number:	**2007-13-20**
Federal Program:	93.778
State Administering Department:	Department of Health Care Services (Health Care Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Subrecipient Monitoring. 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.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2007-13-21**
Federal Program:	93.778
State Administering Department:	Department of Health Care Services (Health Care Services)
Fiscal Year Initially Reported:	2005–06
Audit Finding:	Subrecipient Monitoring. 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.
Status of Corrective Action:	Fully corrected.[85]

Reference Number:	**2007-13-22**
Federal Program:	93.994
State Administering Department:	Department of Public Health (Public Health)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Subrecipient Monitoring. 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.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2007-14-12**
Federal Program:	93.777
State Administering Department:	Department of Health Care Services (Health Care Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Special Tests and Provisions. Health Care Services'

	Provider Enrollment Division (PED) did not retain federally required provider agreements and its related disclosures for some of the providers selected.
Status of Corrective Action:	Partially corrected. PED continues its plan to re-enroll all Medi-Cal providers as a continuous process and continues to work in conjunction with Audits and Investigations Division to re-enroll providers identified as high-risk, including the re-enrollment of identified pre-1999 providers. California Department of Public Health, Licensing and Certification Division, in partnership with PED, implemented the new provider agreement for all health facilities that participate in Medi-Cal, effective August 2008.[86]

Reference Number:	**2007-14-13**
Federal Program:	93.777
State Administering Department:	Department of Health Care Services (Health Care Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Special Tests and Provisions. 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.
Status of Corrective Action:	Partially corrected. PED continues to explore the possibility of participating in database file matches with the California Medical Board that would allow automated updates to physician records.[87]

Reference Number:	**2007-14-14**
Federal Program:	93.778
State Administering Department:	Department of Health Care Services (Health Care Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Special Tests and Provisions. 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.
Status of Corrective Action:	Partially corrected. Health Care Services Medical Review Branch has implemented a Quality Assurance Review Committee, which randomly selects files throughout the branch and reviews the files for consistency and quality.

Reference Number:	**2007-3-16**
Federal Programs:	97.004; 97.008; 97.036; 97.039
State Administering Departments:	Governor's Office of Emergency Services (Emergency Services) Governor's Office of Homeland Security (Homeland Security)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Cash Management. It does not appear that Emergency Services minimized the number of days between the receipt of the reimbursement request and disbursement to the subrecipient.
Status of Corrective Action:	Partially corrected. KPMG agreed that if Emergency Services documents the problems incurred with subrecipients' errors and lack of response that subsequent audits may adjust the number of days considered reasonable for reimbursement. Emergency Services' Information Technology added a correspondence log to facilitate recording of communications with subrecipients to document any payment contacts or problems. The log is currently in draft and will be tested. Homeland Security has worked diligently with Emergency Services to minimize all payment delays related to these federal programs. Both agencies will continue this process until grantees are reimbursed in as timely a manner as possible.[88]

Reference Number:	**2007-9-5**
Federal Programs:	97.036; 97.039

State Administering Department:	Governor's Office of Emergency Services (Emergency Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Procurement, Suspension and Debarment. For a number of subrecipients participating in the Public Assistance and Hazard Mitigation Grant programs, there are no signed certifications (Project Application for Federal Assistance—Form 89) on file to comply with the suspension and debarment requirement.
Status of Corrective Action:	Partially corrected. The Emergency Services Grants Processing Unit has initiated a project to assure that Form 89 certifications are updated and that updates are contained in Emergency Services' ALS database. Project completion is anticipated to be September 5, 2008.

Reference Number:	**2007-12-27**
Federal Program:	97.004
State Administering Department:	Governor's Office of Emergency Services (Emergency Services)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	Reporting. We were unable to trace amounts on the FSR to supporting documentation or accounting records. Additionally, we noted that there is no general rule for how Emergency Services calculates the total unliquidated obligations it reports.
Status of Corrective Action:	Partially corrected. Emergency Services has developed and is in the process of implementing corrective actions to assure that amounts reported on FSRs are traceable to supporting documentation and accounting records. Additionally, as of August 10, 2008, Emergency Services has drafted detailed policies and procedures on how to prepare the FSR.

Reference Number:	**2007-13-23**
Federal Programs:	97.036; 97.039

State Administering Department:	Governor's Office of Emergency Services (Emergency Services)
Fiscal Year Initially Reported:	2001–02
Audit Finding:	Subrecipient Monitoring. 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.
Status of Corrective Action:	Partially corrected. Emergency Services' local assistance monitoring branch states that it is in the process of developing policies and procedures for review and receipt tracking of subrecipient audits.[89]

Endnotes—Auditor Comments

1 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-12-17.
2 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-3-14.
3 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-1-6.
4 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-1-7.
5 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-1-10.
6 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-2-6.
7 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-7-11.
8 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-8-8.
9 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-13-17.
10 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-13-21.
11 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-14-7.
12 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-1-12.
13 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-1-13.
14 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-2-4.
15 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-2-9.
16 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-2-5.
17 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-3-13.
18 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-3-10.
19 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-7-13.
20 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-7-14.
21 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-7-3.
22 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-7-12.
23 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-8-11.
24 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-9-2.
25 We reported similar findings in our audit of fiscal year 2007–08. Please refer to reference numbers 2008-9-3 and 2008-9-4.
26 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-12-15.
27 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-12-2.
28 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-12-13.
29 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-12-16.
30 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-13-23.
31 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-13-20.
32 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-13-19.
33 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-13-25.
34 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-13-26.
35 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-13-28.
36 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-14-10.
37 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-14-1.
38 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-14-9.
39 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-1-5.
40 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-2-8.
41 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-3-12.
42 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-8-10.
43 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-12-14.
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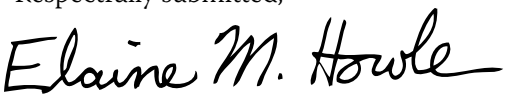
46 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-12-9.
47 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-7-2.
48 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-12-8.
49 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-12-8.
50 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-7-9.
51 We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-7-10.

[52] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-13-15.
[53] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-7-1.
[54] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-12-1.
[55] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-13-1.
[56] This finding is no longer valid. KPMG stated that this finding was related to a central FASD process that was tested in other major programs during the fiscal year 2007–08 audit and considered no longer an issue.
[57] We reported similar findings in our audit of fiscal year 2007–08. Please refer to reference numbers 2008-3-3 and 2008-3-4.
[58] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-3-4.
[59] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-7-5.
[60] KPMG stated that as of December 17, 2008, the Authority had not received any guidance from its cognizant agency to resolve or clarify this issue.
[61] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-7-8.
[62] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-8-1.
[63] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-12-3.
[64] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-12-4.
[65] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-13-5.
[66] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-13-6.
[67] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-13-7.
[68] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-13-9.
[69] This finding is no longer valid. KPMG found no exceptions during its testing for the fiscal year 2007–08 audit.
[70] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-14-3.
[71] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-14-4.
[72] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-1-4.
[73] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-2-3.
[74] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-1-3.
[75] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-3-6.
[76] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-3-7.
[77] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-5-3.
[78] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-5-4.
[79] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-5-5.
[80] This finding is no longer valid. KPMG identified mitigating controls during its testing of fiscal year 2007–08 and did not issue a finding.
[81] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-8-3.
[82] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-8-4.
[83] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-12-6.
[84] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-13-11.
[85] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-13-13.
[86] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-14-5.
[87] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-14-6.
[88] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-3-9.
[89] We reported a similar finding in our audit of fiscal year 2007–08. Please refer to reference number 2008-13-14.

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, CPA
State Auditor

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Contractor: KPMG, LLP

(Agency response provided as text only.)

Department of Finance
State Capitol
Room 1145
Sacramento, CA 95814-4998

May 8, 2009

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, 2008. 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, 2008, 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 20 qualified opinions for the 39 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 one of the largest and most complex 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 2007-08 Single Audit will be issued to remind all departments of their responsibility for implementing corrective action plans for their single audit findings.

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 no longer meets the FISMA requirements. Finance

Ms. Elaine M. Howle
May 8, 2009
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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 consider the single audit findings during audit work conducted in those departments that received a qualified 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,

(Signed by: Michael C. Genest)

MICHAEL C. GENEST
Director

cc: Members of the Legislature
Office of the Lieutenant Governor
Milton Marks Commission on California State Government Organization and Economy
Department of Finance
Attorney General
State Controller
State Treasurer
Legislative Analyst
Senate Office of Research
California Research Bureau
Capitol Press