

Interim Reporting: Fiscal Year 2008–09 Single Audit

Aging
Child Support Services
Education
Employment Development

January 2010 Report 2009-002.3



Independent NONPARTISAN
TRANSPARENT Accountability

The first five copies of each California State Auditor report are free. Additional copies are \$3 each, payable by check or money order. You can obtain reports by contacting the Bureau of State Audits at the following address:

California State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, California 95814
916.445.0255 or TTY 916.445.0033

OR

This report is also available on the World Wide Web <http://www.bsa.ca.gov>

The California State Auditor is pleased to announce the availability of an on-line subscription service. For information on how to subscribe, please contact the Information Technology Unit at 916.445.0255, ext. 456, or visit our Web site at www.bsa.ca.gov.

Alternate format reports available upon request.

Permission is granted to reproduce reports.

For questions regarding the contents of this report, please contact Margarita Fernández, Chief of Public Affairs, at 916.445.0255.

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

January 26, 2010

2009-002.3

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

Dear Governor and Legislative Leaders:

Pursuant to guidance issued by the U.S. Office of Management and Budget (OMB), the California State Auditor's Office (State Auditor's Office) presents its interim report concerning various state departments' administration of federal programs during fiscal year 2008–09. With the passage of the American Recovery and Reinvestment Act of 2009 (Recovery Act) comes a renewed emphasis on accountability and public transparency to ensure federal funds are spent properly. A key component of such accountability and transparency is the annual report from the State Auditor's Office on internal control and compliance with federal laws and regulations. OMB's June 2009 guidance stresses the importance of auditors communicating promptly any identified internal control deficiencies to management and those charged with governance. In addition, the guidance states that it is imperative that deficiencies in internal control be corrected by management as soon as possible to ensure proper accountability and transparency for expenditures of Recovery Act awards.

This interim report summarizes audit results pertaining to 10 federal programs administered by four departments. The State Auditor's Office has currently identified 12 findings regarding the departments' administration of these federal programs during fiscal year 2008–09. In many cases the findings are recurring issues we identified in past audits. In general, the findings focused on federal requirements regarding cash management, reporting, and monitoring subrecipients—such as cities and counties—use of federal funds. The specific federal programs, and their administering state departments, are listed in the table of contents. In some cases, the State Auditor's Office performed a preliminary review of state departments' methodology for reporting the number of jobs created or retained with Recovery Act funds. Of these four departments, the State Auditor's Office performed a preliminary review of the methodology used by the departments of Education (Education) and Aging (Aging) to report the number of jobs created or retained. Based on this preliminary review, it appears that Education followed appropriate federal guidance when it reported that 18,878 jobs were created or retained. Aging did not report jobs data because it did not have confidence in the accuracy of the numbers provided by its subgrantees.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

Contents

Page	Department/Program	Federal Catalog Number
5	Aging	
	Aging Cluster	
	Special Programs for the Aging, Title III, Part B, Grants for Supportive Services and Senior Centers	93.044
	Special Programs for the Aging, Title III, Part C, Nutrition Services	93.045
	Nutrition Services Incentive Program	93.053
	ARRA—Aging Home-Delivered Nutrition Services for States	93.705
	ARRA—Aging Congregate Nutrition Services for States	93.707
17	Child Support Services	
	Child Support Enforcement	93.563
23	Education	
	State Fiscal Stabilization Fund—Education State Grants, Recovery Act	84.394
25	Employment Development	
	Workforce Investment Act (WIA) Cluster	
	WIA Adult Program	17.258
	WIA Youth Activities	17.259
	WIA Dislocated Workers	17.260

Summary

Results in Brief

On February 17, 2009, the federal government enacted the American Recovery and Reinvestment Act of 2009 (Recovery Act) to help fight the negative effects of the United States' economic recession. California expects to receive \$85 billion in Recovery Act funding for both new and existing programs. With this increased funding comes a strong emphasis on accountability and public transparency to ensure federal funds are spent properly. A key component of such accountability and public transparency is the California State Auditor's Office (State Auditor's Office) annual report on the State's compliance with federal requirements, such as those identified in the Recovery Act.

The State Auditor's Office prepares its annual report in accordance with the requirements described in the U.S. Office of Management and Budget's (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. In June 2009 OMB encouraged auditors to communicate promptly any identified internal control deficiencies to management and those charged with governance. By encouraging prompt communication, OMB intends for recipients, including states, to correct these findings as soon as possible to ensure proper accountability and transparency for expenditures of Recovery Act awards. Based on OMB's June 2009 guidance, the State Auditor's Office presents its interim report concerning the State's administration of selected federal programs receiving Recovery Act funds.

This interim report summarizes audit results pertaining to 10 federal programs administered by four departments. The State Auditor's Office has currently identified 12 findings regarding the departments' administration of these federal programs during fiscal year 2008-09. In many cases the findings are recurring issues we identified in past audits. In general, the findings focused on federal requirements regarding cash management, reporting, and monitoring subrecipients'—such as cities and counties—use of federal funds. In some cases, the State Auditor's Office also performed a preliminary review of state departments' methodology for reporting the number of jobs created or retained with Recovery Act funds. Finally, we made numerous recommendations to the respective departments.

The Department of Aging (Aging) administers the Aging Cluster of programs which includes: Special Programs for the Aging—Title III, Part B—Grants for Supportive Services and Senior Centers (Federal Catalog Number 93.044); Special Programs for the Aging—Title III, Part C—Nutrition Services (Federal Catalog Number 93.045); Nutrition Services Incentive Program (Federal Catalog Number 93.053); ARRA—Aging Home-Delivered Nutrition Services for States (Federal Catalog Number 93.705); and ARRA—Aging Congregate Nutrition Services for States (Federal Catalog Number 93.707). For the period October 1, 2007 through September 30, 2008, Aging was awarded \$104.4 million for these programs, excluding the Recovery Act programs. On March 18, 2009, Aging was awarded Recovery Act funds totaling \$9.8 million. Aging distributes funds for these programs to 33 area agencies (subgrantees) that provide services and meals to seniors.

The State Auditor's Office identified six findings as of December 16, 2009, that pertain to Aging's administration of the Aging Cluster. Of these six findings, five are repeat findings we have disclosed in our previous annual audit report. The audit findings generally focused on Aging's lack of internal controls to properly administer the Aging Cluster. Additionally, we identified issues with Aging's compliance with federal requirements pertaining to eligibility, level of effort—maintenance of effort (MOE), reporting, subrecipient monitoring, and special tests and provisions. For example, for the eligibility requirement we could not determine whether its awards to its subgrantees were for

the appropriate amounts because Aging lacked necessary supporting documentation. Furthermore, for the MOE requirement we determined that Aging's methodology for calculating its MOE departs from federal law and regulation. Finally, in keeping with OMB's emphasis on early communication of issues to management, we conducted a high-level review of Aging's report under the Recovery Act, Section 1512, and found that Aging did not include any jobs data. Aging told us it lacked confidence in the jobs data its subgrantees reported.

The Department of Child Support Services (Child Support Services) administers the Child Support Enforcement program (Federal Catalog Number 93.563). Program objectives include such activities as locating absent parents and enforcing support obligations owed by absent parents to their children. During fiscal year 2008–09, Child Support Services received \$580.2 million in federal funds for this program, including \$28.9 million in Recovery Act funds. The State Auditor's Office identified four findings as of December 31, 2009, that pertain to Child Support Services' administration of the Child Support Enforcement program. The findings concerned a variety of federal requirements relating to subrecipient monitoring and allowable costs. For example, Child Support Services did not provide required information concerning the award and disbursement of Recovery Act funds to its subrecipients. Additionally, it has not ensured that its subrecipients are sufficiently monitored. Beginning in 2004, Child Support Services contracted with the Department of Finance to conduct audits of its subrecipients' child support functions. Child Support Services considered these audits to be a central part of its oversight efforts. However, this contract has resulted in a limited number of audits being conducted. Two audits were completed during fiscal year 2008–09, and only 18 of 52 subrecipients have been audited since 2004. Child Support Services plans to use a new approach, using its own department staff, to increase its monitoring efforts in the future.

The Department of Education (Education) administers a portion of the State Fiscal Stabilization Fund (Federal Catalog Number 84.394), which was authorized by the Recovery Act. The objective of this program is to support and restore funding for elementary, secondary, and postsecondary education and, as applicable, early childhood education programs and services in states and Local Educational Agencies (LEAs), such as school districts and county offices of education. The Governor's Office of Planning and Research (Planning and Research) is the official state recipient of these funds; however, it entered into an interagency agreement with Education to disburse stabilization funds to LEAs to restore funding to K-12 education. In fiscal year 2008–09, Planning and Research received \$2.1 billion under this program, providing approximately \$1.6 billion in Recovery Act funds to Education. The remaining \$537 million was designated to restore funding to the University of California and the California State University.

The State Auditor's Office identified one finding as of December 15, 2009, that pertained to Education's administration of this federal program. Specifically, Education lacks adequate policies and procedures to ensure LEAs who earn interest in excess of \$100 on federal advances remit such interest to Education, who then remits the interest back to the federal government. Although Education notifies LEAs of this responsibility in its award notices, it does not have a process to monitor whether LEAs are adhering to this requirement. It appears that LEAs may have earned substantial interest on federal funds because Education advanced \$1.6 billion in program funds to LEAs by June 30, 2009. However, Education reported that these LEAs had spent only \$571.2 million as of September 30, 2009. As a result, LEAs have likely earned interest on over \$1 billion on unspent federal funds. After applying a conservative annualized interest rate of 1 percent, we would expect that LEAs earned approximately \$2.5 million in interest from July through September 2009.

The State Auditor's Office also performed a preliminary review of Education's reporting of jobs-related data under Section 1512 of the Recovery Act. Based on this preliminary review and Education's description of its methodology, it appears that Education followed applicable federal guidance when it reported 18,878 jobs created or retained.

The Employment Development Department (EDD) administers the Workforce Investment Act (WIA) cluster of federal programs, which include: the WIA Adult Program (Federal Catalog Number 17.258), WIA Youth Activities (Federal Catalog Number 17.259), and WIA Dislocated Workers (Federal Catalog Number 17.260). These programs are administered by statewide and local organizations and are primarily intended to provide workforce development activities to several groups of job seekers, including laid-off workers, youth, and persons with disabilities. During fiscal year 2008–09, EDD allocated more than \$320 million to 49 Local Workforce Investment Areas (LWIAs) and \$41 million to 51 non-LWIAs for these workforce development activities. Further, the Recovery Act authorized an additional \$388 million that was allocated to LWIAs in April 2009 and \$6 million that was allocated to non-LWIAs in June 2009. The State Auditor's Office identified one repeat finding that pertains to these programs that we first reported in our fiscal year 2007–08 federal compliance audit. EDD's Compliance Monitoring Section is required to monitor all recipients of program funds; however, although it monitored all 49 LWIAs, it only monitored five of the 51 non-LWIAs during fiscal year 2008–09. As a result, EDD cannot ensure that all recipients of Workforce Investment Act funds are spending these funds in accordance with requirements and administering workforce development activities properly.

Agency Comments

We summarized the departments' responses. In general, the state departments concurred with the audit findings discussed in this interim report and plan to take corrective action. To the extent that the departments disagreed with our conclusions, we have summarized the department's perspective on these issues, as well as our response, in this interim report.

Blank page inserted for reproduction purposes only.

Department of Aging

AGING CLUSTER

**SPECIAL PROGRAMS FOR THE AGING, TITLE III, PART B, GRANTS FOR SUPPORTIVE SERVICES AND SENIOR CENTERS
FEDERAL CATALOG NUMBER 93.044**

**SPECIAL PROGRAMS FOR THE AGING, TITLE III, PART C, NUTRITION SERVICES
FEDERAL CATALOG NUMBER 93.045**

**NUTRITION SERVICES INCENTIVE PROGRAM
FEDERAL CATALOG NUMBER 93.053**

**ARRA—AGING HOME-DELIVERED NUTRITION SERVICES FOR STATES
FEDERAL CATALOG NUMBER 93.705**

**ARRA—AGING CONGREGATE NUTRITION SERVICES FOR STATES
FEDERAL CATALOG NUMBER 93.707**

Based on the U.S. Office of Management and Budget's (OMB) June 2009 guidance, the California State Auditor's Office (State Auditor's Office) presents its interim report concerning the Department of Aging's (Aging) administration of the Aging Cluster of federal programs during fiscal year 2008–09. For the period October 1, 2007 through September 30, 2008, Aging was awarded \$104.4 million for these programs, excluding the American Recovery and Reinvestment Act of 2009 (Recovery Act) programs. On March 18, 2009, Aging was awarded Recovery Act funds totaling \$9.8 million. Aging distributes funds for these programs to 33 area agencies (subgrantees) that provide services and meals to seniors.

The issues contained in this interim report represent the results of our internal control and compliance audit that require Aging's corrective action. The State Auditor's Office identified six findings as of December 16, 2009, that pertain to Aging's administration of these federal programs. Of these six findings, five are findings we have disclosed in our previous annual audit report.

Aging Needs to Make Significant Improvements to Its Oversight of Its Subgrantees' Use of Federal Funds

OMB Circular A-133 establishes responsibilities for pass-through entities such as Aging when they make federal awards to subgrantees. Additionally, federal law and regulations impose certain requirements for awarding and using federal funds. We found several weaknesses in Aging's internal control processes and its monitoring activities. Because Aging plans to use its long-established programs, systems, and controls to disburse and administer Recovery Act funds, it needs to resolve quickly the weaknesses in its internal control processes as they extend to its oversight of Recovery Act funds.

Aging's Pre-Award Internal Controls Are Weak and It Did Not Comply With All Recovery Act Award Requirements

Aging lacks internal controls to ensure it identifies required federal award information at the time it awards funds to its subgrantees. OMB Circular A-133 requires pass-through entities to identify federal awards made by informing each subrecipient of the catalog of federal domestic assistance title and number; award name and number; award year; if the award is for research and development; and the name of the federal agency. However, Aging's contract review and approval process does not ensure that its staff include specific references to the federal award year and name of the federal agency—the U.S. Department of Health and Human Services—on the standard agreement it sends annually to each of its 33 subgrantees. Consequently, Aging is not in compliance with this federal requirement. We reported this issue in our annual audit report for fiscal year 2007–08.

Additionally, Aging lacks internal controls to ensure it identifies required federal award information to its subgrantees at the time it awards Recovery Act funds. Specifically, on March 18, 2009, Aging was awarded roughly \$9.8 million in Recovery Act funds for its nutrition services program. Aging awarded these funds to its 33 subgrantees. However, our review of the standard agreement it sent to each of its subgrantees indicates that it did not ensure staff included specific language requiring the subgrantees to provide the identification of the Recovery Act awards on their forms used to report data to the OMB, as its grant agreements require.

Further, Recovery Act regulations require award recipients to maintain at all times current registration in the federal Central Contractor Registration database. The federal government intends to use this information to help meet the Recovery Act's reporting requirements such as the number of jobs created or retained and to provide transparency in how Recovery Act funds are spent. However, before the award of Recovery Act funds, Aging did not check the database to determine whether the subgrantees were registered. In fact, as of late October 2009, Aging had not communicated the registration requirement to its subgrantees. According to Aging's deputy director of administration, Aging became aware of the additional Recovery Act requirements after it had already contracted with the subgrantees for the Recovery Act funds. The deputy director stated Aging would notify the subgrantees of such requirements when it issued contract amendments to reallocate fiscal year 2008–09 funds for use in fiscal year 2009–10. In mid-November 2009 Aging issued a program memo to its subgrantees that included a reference to the registration requirement.

We recommended that Aging modify its contract review and approval process to ensure that it includes specific references to the federal award name and number, award year, and name of the federal agency—the U.S. Department of Health and Human Services—on the standard agreement it sends annually to each of its 33 subgrantees. Further, Aging should modify its contract review and approval process to ensure that it includes on the standard agreement specific language requiring the subgrantees to provide the identification of the Recovery Act awards on forms used to report data to OMB. Finally, before awarding future Recovery Act funds, Aging should inform the subgrantees of the registration requirement and check the Central Contractor Registration database to determine whether they are registered.

Aging stated that it will include the required federal award information in its program memos to subgrantees for the fiscal year 2009–10 contract amendments. Additionally, by March 2010, Aging stated it will revise its procedures for preparing program memos to include sample language for communicating federal award information. Further, Aging stated that by January 31, 2010, it will provide instructions to its subgrantees about reporting Recovery Act awards on their forms used

to report data to OMB. Finally, Aging stated it notified its subgrantees of the Central Contractor Registration requirement in a fiscal year 2009–10 program memo and that it will ensure it has a procedure in place to check their registration.

Aging's Procedures for Monitoring Need Strengthening

Federal regulation makes award recipients, like Aging, responsible for monitoring grant- and subgrant-supported activities to assure compliance with applicable federal requirements and that performance goals are being achieved.

In our annual audit report for fiscal year 2007–08, we reported that although Aging has a process in place for monitoring subgrantees' use of funds, which includes site visits by its fiscal and contract team (team), it lacks adequate procedures that require staff to record the specific procedures they performed or the documents they reviewed to support their conclusions. Aging stated that it would develop written procedures documenting the fiscal monitoring process and would 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. However, as of November 2009, Aging had developed written procedures documenting its fiscal monitoring process, but had not developed a requirement to retain supporting documents. According to its policy manager, Aging will address this procedure as part of its monitoring redesign project by March 2010.

Additionally, one of Aging's monitoring tools does not ensure that its subgrantees are complying with all relevant federal requirements. While on site, the team uses Aging's administrative review tool that is designed to assess its subgrantees' compliance with various federal requirements, including those related to their procurement and contracting processes. However, our assessment of Aging's review tool found that it does not contain procedures to determine if its subgrantees are making awards to debarred or suspended parties or if its subgrantees' contract or grant agreements with their service providers include provisions related to the federal suspension and debarment requirements. The policy manager stated that Aging includes this requirement in its contracts, but did not include it in the team's monitoring tool. He also stated that Aging will address this omission as part of its monitoring redesign project.

Furthermore, Aging's policy requires its audit staff to conduct on-site audit compliance reviews of its 33 subgrantees at least once every three years. However, during fiscal year 2008–09, Aging's audit branch completed only six reviews instead of the 11 planned. According to its deputy director of administration, Aging's goal of conducting reviews of all subgrantees every three years has not changed. However, due to significant staff turnover and periods without an audit manager, Aging has not met its goal. The deputy director also stated that Aging will strive to eliminate its backlog of reviews.

Finally, Aging's policy requires its program staff to conduct on-site comprehensive assessments of each subgrantee every four years, as resources permit. As part of this assessment process, Aging requires its staff to issue their final reports and corrective action plans to the subgrantees 75 [calendar] days after the meeting it holds at the conclusion of the on-site assessment. The subgrantees have 30 days to respond to the final report and corrective action plan. During fiscal year 2008–09 Aging conducted five on-site comprehensive assessments. Our review of one of these assessments found that Aging did not issue its final report and corrective action plan within 75 days and did not obtain the subgrantee's response within 30 days. Although Aging's procedure does not say *working* days, according to its

policy manager, the team interprets the 75 days as such. Thus, Aging will revise its procedure to clarify that the corrective action plans are due to the subgrantees 75 working days after the meeting it holds at the conclusion of the on-site assessment.

Without adequate documentation to support conclusions reached during its reviews, monitoring tools that include all relevant federal requirements, timely audit compliance reviews and follow-up on deficiencies it identifies, Aging cannot demonstrate that it effectively monitors its subgrantees and ensures that they are using program funds in accordance with all applicable federal requirements.

We recommended that Aging develop a written requirement for retaining copies of all documents obtained from its subgrantees as part of the official monitoring file. Aging should also revise its administrative review tool to include procedures to determine if its subgrantees are making awards to debarred or suspended parties or if its subgrantees' contract or grant agreements with their service providers include provisions related to the federal suspension and debarment requirements. Furthermore, for its on-site assessments, Aging should revise its procedure to clarify that the corrective action plans are due to the subgrantees 75 working days after the meeting it holds at the conclusion of the on-site assessment and ensure that it receives subgrantees' responses within 30 days. Finally, Aging should ensure that it eliminates its backlog of audit compliance reviews.

Aging stated that, by March 2010, it will revise its procedures to include detailed written processes for fiscal review and document retention, and it will revise its administrative review tool and monitoring procedures to reference federal citations regarding debarred or suspended parties. Aging also stated that, by March 2010, it will modify its procedures to specify that corrective action plans will be issued within 75 working days. Finally, Aging stated it is committed to striving to eliminate the backlog of on-site audit compliance reviews.

Subrecipient Audits

Aging's process does not ensure timely receipt of subgrantees' Single Audit reports (audit report). OMB Circular A-133 places responsibility on pass-through entities such as Aging to ensure that its subgrantees expending \$500,000 or more in federal awards during their fiscal year have met certain audit requirements. One such requirement is that subgrantees submit an audit report within the earlier of 30 days after they receive such a report or nine months after the end of their fiscal year.

Aging's annual contracts require subgrantees to send a copy of their audit reports directly to it. Aging's staff use a tracking sheet to capture information including the date it receives the audit reports, the status of its review of the audit reports, and its issuance of management decisions. Our review found that the subgrantees did not submit their audit reports to Aging within the prescribed time frames. In fact, Aging received all of the three audit reports we reviewed more than nine months after the end of its subgrantees' fiscal year. The deputy director of administration stated that Aging plans to continue to follow up with the subgrantees and work with them to determine and resolve the reasons for submitting late reports. When Aging does not receive its subgrantees' audit reports timely, it cannot ensure that they promptly address the issues contained in the reports. We recommended that Aging ensure that the subgrantees submit their audit reports in accordance with OMB Circular A-133.

Aging stated it will institute a process of contacting each subgrantee before the audit report due date to determine the status of the report and to reinforce the importance of submitting the report timely. Aging also stated that its audit manager is consulting with legal staff about additional measures that can be taken to facilitate subgrantees' timely completion and submission of their audit reports.

Due to Aging's Lack of Supporting Documentation, We Were Unable to Determine if Awards to Its Subgrantees Were for the Appropriate Amounts

The OMB's *Circular A-133 Compliance Supplement* (A-133 Compliance Supplement) issued in March 2009 suggests auditors perform procedures to verify amounts awarded to subrecipients were appropriate. 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 ombudsman program. The goals of the ombudsman program at the state and local levels include advocating for the rights of residents of long-term care facilities by receiving and resolving complaints, and advocating for laws, policies, regulations, and administration in the long-term care system. In calculating its fiscal year 2008–09 allocation, Aging deducted \$889,000 and \$1.2 million from its federal fiscal year 2008 grant for the state and local ombudsman programs, respectively, but could not provide supporting documentation for these amounts. In our annual audit report for fiscal year 2007–08, we reported a similar finding. In response to our prior year finding, Aging indicated that it was in the process of documenting the methodology used to determine the federal portion of its ombudsman program. Aging also stated that it would prepare procedures that identify what supporting documentation must be retained in the file in order to ensure that the federal requirements have been met. However, Aging did not complete these tasks in fiscal year 2008–09.

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 60 and above and by assigning various weighting factors for individuals who are low income, minority, and residing in nonurban areas (geographic isolation). However, Aging could not provide the supporting documentation for the geographic isolation and low-income data it used to calculate the weighted factor for each of its subgrantees. According to the deputy director of its Long-Term Care and Aging Services Division, Aging did not retain the original source documents and recreating the data would require additional staff and monetary resources. Due to the lack of supporting documentation related to the ombudsman programs and the geographic isolation and low-income data used in its fiscal year 2008–09 allocation, we were unable to determine whether the amounts Aging awarded to its subgrantees were appropriate.

On March 18, 2009, Aging was awarded roughly \$9.8 million in Recovery Act funds for its nutrition services program. Aging used its weighting factors from the intrastate funding formula for its fiscal year 2009–10 allocation to calculate awards of Recovery Act funds to its subgrantees. Between March 18, 2009 and June 30, 2009, Aging made payments to its subgrantees totaling roughly \$535,000. However, in our review of the weighting factors Aging used to allocate Recovery Act funds, we found the same lack of supporting documentation for the geographic isolation and low-income data that we identified for Aging's fiscal year 2008–09 allocation.

We recommended that Aging establish a policy and procedures for determining the federal portion of the state and local ombudsman programs and retain the supporting documentation for the amounts that it includes in its annual allocations. Additionally, Aging should ensure that it retains the appropriate documentation to support the weighting factors it uses in its annual allocations, such as the geographic isolation and low-income data.

Aging stated that it will document its policy of continuing the state and local ombudsman programs at their baseline allocations of \$889,000 and \$1.2 million, respectively. Aging also stated it will properly support and document any future changes to the baseline allocations. Finally, Aging stated that it has revised its funding allocation procedures to require staff to retain copies of the actual raw demographic data used to calculate weighting factors and that it will immediately begin to follow the procedures.

Aging Does Not Ensure Staff Follow Its Established Procedures for Approving Subgrantees' Requests for Funds

Federal regulation requires Aging to spend and account for grant funds in accordance with state laws and procedures for spending and accounting for its own funds. However, Aging does not consistently follow its procedures for the review and authorization of subgrantees' requests for funds. Specifically, Aging requires its analysts and manager to review and approve the subgrantees' requests for funds prior to forwarding the requests to accounting for payment. However, although the manager did not approve one of the 42 requests we reviewed, accounting processed the request for payment. The accounting administrator stated that the accounting unit overlooked the fact that the request lacked the necessary approval.

As stated previously, Aging plans to use its long-established programs, systems, and controls to disburse and administer Recovery Act funds. However, if established internal controls are not followed, Aging cannot ensure that funds are being spent in accordance with federal requirements. We recommended that Aging establish a quality control process to ensure that its staff follow its procedures for processing subgrantees' requests for funds. Aging stated that it has updated its accounting procedures to ensure that all requests for funds have been approved before the processing of payments.

Aging's Internal Controls Over Matching, Level of Effort, and Earmarking Are Inadequate and Its Methodology for Calculating Level of Effort Departs From Federal Law and Regulation

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. We reported a similar finding in our annual audit report for fiscal year 2007–08. According to its deputy director of administration, Aging has drafted written procedures that include controls to avoid errors and to maintain appropriate accounting documentation to support calculations; however, the procedures have not been finalized and approved. Aging anticipates

approved procedures will be in place by March 2010. Until Aging completes the tasks outlined by its deputy director, the absence of controls will continue to hinder Aging's ability to prevent errors or promptly detect any errors that may exist.

Aging also lacks adequate policies and procedures to ensure that it reviews its subgrantees' CDA-180 financial closeout reports (closeout reports) promptly. Aging requires subgrantees to submit their closeout reports within 60 days after the end of the state fiscal year. According to its fiscal review tool, Aging reviews the reports to ensure that the subgrantees have met their matching and earmarking requirements such as minimum spending percentages for access, in-home services, and legal assistance. However, Aging has no formal policy or procedures that specify when its staff must complete their reviews of the subgrantees' closeout reports. As of December 8, 2009, Aging had not completed any reviews of the subgrantees' closeout reports, even though the subgrantees were to submit the reports by September 1, 2009. According to its policy manager, Aging will develop such policies and procedures by March 2010.

Definitions of Matching, Level of Effort, and Earmarking Requirements Applicable to the Aging Cluster

- **Matching or cost sharing** requires that contributions (usually nonfederal) of a specified amount or percentage be made to match federal awards. Matching may be in the form of allowable costs incurred or in-kind contributions.
- **Level of effort** requires that a specified level of spending from nonfederal sources be maintained for specified activities from period to period.
- **Earmarking** requires the minimum and/or maximum amount or percentage of the program's funding that must or may be used for specified activities, including funds provided to subrecipients.

Source: OMB's *Circular A-133 Compliance Supplement*.

Between March 18, 2009 and June 30, 2009, Aging made payments of Recovery Act funds to its subgrantees totaling roughly \$535,000. According to Aging's grant agreements with the U.S. Department of Health and Human Services' Administration on Aging (AoA), the State has a matching requirement of 15 percent of total service costs, including the services of the subgrantees and their providers. Because Aging plans to use its long-established programs, systems, and controls to disburse and administer Recovery Act funds, slow or delayed reviews of the closeout reports will limit Aging's ability to ensure that the subgrantees are meeting their portion of the federal matching requirement.

Finally, we are unable to conclude on whether or not Aging met its level of effort—maintenance of effort (MOE) requirement. Federal law and regulation state that to meet the MOE requirement, a state must spend at least the average amount of state funds it spent under the plan for administration and services as it did for the three previous fiscal years. However, Aging's MOE certification is based on factors it applies to budgeted expenditures based on its federal award rather than its actual expenditures. Further, Aging was unable to provide documentation to support its actual local assistance expenditures. Aging's deputy director of administration stated that she received verbal guidance from a federal representative that the AoA accepts its methodology.

We also spoke with the federal representative. Specifically, according to the AoA financial operations specialist, the AoA agrees with the method Aging is using to calculate its MOE certification because it is based on Section 8 of the AoA's May 2004 fiscal guide that states "The maintenance of effort for Title III expenditures from state sources must not be less than the average of the three previous fiscal years' certifications. Any amount of state resources included in Title III maintenance of effort certification that exceeds the minimum amount mandated becomes part of the permanent maintenance of effort. Excess state match does not become part of the maintenance of effort unless

the state certifies it as such.” The financial operations specialist also stated that the fiscal guide does not supersede the law, but is AoA’s interpretation of the law. Further, the financial operations specialist stated that the AoA has discussed the differences between its fiscal guide and federal law, regulation, and annual program instructions and that these discussions have involved the possibility of issuing clarifying language. Nevertheless, because the AoA’s certification instructions, which are consistent with federal law and regulation, are sent to the states by its deputy assistant secretary for policy and management, we believe Aging’s methodology, as well as the verbal guidance received from the AoA’s federal representative, are incorrect because Aging is not reporting actual expenditures.

We recommended that Aging establish policies and procedures to ensure that it complies with the matching, level of effort, and earmarking requirements of the programs it administers. Additionally, Aging should establish policies and procedures to specify when its staff must complete their reviews of the subgrantees’ closeout reports. Finally, Aging should obtain written approval from AoA’s deputy assistant secretary for policy and management allowing it to follow the AoA 2004 fiscal guide, which contains a methodology that is not described in federal law, regulation, or the AoA’s certification instructions.

Aging stated that, by March 2010, it will ensure that the draft accounting policies and procedures related to matching, level of effort, and earmarking are finalized and approved by the deputy director. The policies and procedures will include an appropriate review and approval process. Also, by March 2010, Aging stated it will update its fiscal procedures to include its undocumented policy of allowing staff to process closeout reports within four to six weeks from November 1st of the fiscal year that they receive the closeout reports. Finally, Aging stated it will seek an official written determination from the AoA regarding its MOE certification procedures. According to Aging, if after receipt of an official written determination from the AoA it becomes evident that procedural changes are needed, it will make whatever policy revisions are necessary to meet federal requirements and will document them in writing.

Aging’s Inadequate Policies and Procedures Have Led to Undetected Errors and the Late Submission of Federal Fiscal Reports

Aging lacks adequate policies and procedures to provide reasonable assurance that the Financial Status Report and AoA Supplemental Form (financial status report) it submits to the federal government includes all activities, is supported by accounting records, and is fairly presented. In our annual audit report for fiscal year 2007–08, we reported a similar finding. 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 reports’ content. Thus, Aging was unable to prevent errors in its reports. In fact, Aging submitted several financial status reports that were not adequately supported by the accounting records used by its accounting specialist to prepare them. In response to our prior year’s finding, Aging indicated that it was in the process of establishing policies and procedures that would include the verification of content and accounting record support, management review and approval, and a system to track due dates.

However, Aging did not complete these tasks in fiscal year 2008–09. For example, although Aging developed draft procedures, it did not include a system to track due dates or establish deadlines for management reviews. Also, Aging’s management has yet to approve the draft procedures. Further, similar to our audit finding for fiscal year 2007–08, we found errors in the final financial status report that Aging submitted for the federal fiscal year 2006 grant concerning the Title III portion of the

Aging Cluster. When we review the final financial status report a department was required to submit during the fiscal year we are auditing, it may be for an award the State received two or three fiscal years ago, as was the case here. Although Aging reported \$239 million for total program outlays less program income, according to its accounting records, the amount should have been \$246 million. Aging also underreported its in-kind contributions by \$887,538 and its other recipient outlays by \$5.9 million. These errors occurred because, when Aging prepared the report, it inappropriately excluded certain expenditures reflected in its accounting records. According to the deputy director of administration, Aging will approve and issue its policies and procedures by March 2010.

Aging also did not submit either of the two financial status reports we reviewed by their due dates. Specifically, we reviewed the financial status reports that included Title III, Parts B and C for the federal fiscal year 2006 grant. The report was due at the end of December 2008, but Aging submitted it in July 2009—seven months late. Similarly, Aging submitted its financial status report for the Nutrition Services Incentive Program (NSIP) in April 2009, five months after the due date of October 2008. According to the accounting administrator, Aging submitted the Title III financial status report late because of errors it needed to correct and because the staff person responsible for preparing the report retired in October 2008. The accounting administrator stated that, although new staff were hired and directed to prepare the report, delays continued because of workload from other position vacancies. The accounting administrator also cited staff turnover as the reason Aging submitted the financial status report for NSIP late. Until Aging implements effective reporting procedures, it will continue to be unable to detect errors in its reports and miss federal reporting deadlines.

We recommended that Aging establish policies and procedures to ensure that its financial status 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 report due dates. Finally, Aging should examine its accounting records and submit a corrected financial status report for the federal fiscal year 2006 grant concerning the Title III portion of the Aging Cluster to the AoA.

Aging stated that, by March 2010, it will ensure that management formally approves the updated federal reporting procedures that were developed in response to last year's audit finding. Aging also stated the procedures will include a mechanism for monitoring due dates and will provide for management review and approval of reports to ensure they include all activities, are supported by accounting records, and are fairly presented. Further, Aging stated that it is reviewing its 2006 federal grant accounting records and will submit a corrected financial status report to the AoA as appropriate.

Procedures for Allocating the Nutrition Services Incentive Program Award Are Inconsistent With Aging's Published Policy and Distributions Are Not Made Promptly

Federal law sets the requirements for obtaining commodities from the federal government and requires Aging to promptly and equitably disburse any funding amounts it receives in lieu of commodities to its subgrantees. The subgrantees can only use the funds to purchase domestically produced foods for their nutrition projects. Aging lacks adequate procedures to provide reasonable assurance that it equitably distributes the cash it receives in lieu of commodities. Specifically, although its 2003 policy issued to its subgrantees states that NSIP funding to subgrantees 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 2008–09 Aging lacked adequate procedures to ensure staff follow the policy. The lack of adequate procedures hinders Aging’s ability to prevent errors or to promptly detect any errors that may exist in the allocation.

Aging’s draft procedures issued in January 2009 direct analysts to use the actual number of meals served in the most recently documented year (prior-prior year) based on the timing of the allocation and its reporting to the AoA. According to Aging, in practice, the most recently documented meal counts are those most recently certified as accurate by the AoA and reported for the prior-prior state fiscal year for the next year’s allocation. However, Aging’s 2003 policy specifies the use of meal counts from the prior year. This is inconsistent. Our analysis found that Aging’s departure from the methodology described in the 2003 policy resulted in discrepancies in the amounts subgrantees would have received. Specifically, we found that the total NSIP allocation for one of the three subgrantees we reviewed would have been 31 percent greater if the calculation was based on Aging’s 2003 policy and used the fiscal year 2007–08 meal counts for the fiscal year 2008–09 allocation instead of the fiscal year 2005–06 meal counts. In our annual audit report for fiscal year 2007–08, we reported a similar finding. Aging stated at that time that its procedures had been updated to be consistent with its current methodology and that it would issue a policy memo update to its subgrantees to remind them of its policy and procedures. As previously stated, Aging issued draft procedures in January 2009 and these procedures are consistent with its current methodology. However, Aging has not officially approved these procedures. Further, Aging did not issue a policy memo update to notify its subgrantees that it would be using the meal counts to calculate the fiscal year 2008–09 allocation. According to its deputy director of administration, Aging will approve and issue its policy and procedures by February 2010. The deputy director also stated that Aging notified its subgrantees about the use of the meal counts in its calculation of the fiscal year 2009–10 allocation because it was the next policy memo Aging issued on the subject.

Additionally, Aging did not distribute the NSIP allocations promptly according to its procedures. The procedures specify that NSIP payments will be made quarterly starting with the first quarter in July, the second quarter in October, the third quarter in January, and the fourth quarter in April. However, the payments to three of the 33 subgrantees we reviewed were made 30 or 60 days late. According to the accounting administrator, these payments were made late due to staff vacancies. Nevertheless, Aging is not in compliance with this federal requirement.

We recommended that Aging finalize its draft procedures so that it can ensure that it equitably distributes NSIP funds. Moreover, Aging should ensure that its procedures are consistent with its policy and issue policy memo updates annually to the subgrantees to remind them of its policy and procedures for distributing NSIP funds. Finally, Aging should ensure that it follows its procedure for promptly making NSIP payments.

Aging stated that, by March 2010, it will approve and issue revised NSIP allocation procedures, which clarify that allocations are based on the meal counts most recently certified by the AoA. Aging also stated that it will remind subgrantees of its policy in its annual program memo that accompanies the NSIP allocations. Further, Aging stated that early in fiscal year 2009–10 it implemented steps to ensure NSIP payments are made timely and accurately by adding program and accounting staff reviews of the payment documents. Aging will also provide its accounting staff with additional training to ensure they follow the procedures for prompt payment.

Aging Did Not Include Jobs Data in Its Recovery Act Reporting

Section 1512 of the Recovery Act requires certain entities that receive Recovery Act funds from the federal government to provide, not later than 10 days after the end of each calendar quarter, information concerning how it used the funds. According to Aging's grant agreements with the U.S. Department of Health and Human Services, reporting would begin with the quarter ending September 30, 2009. Among the items to be reported is an estimate of the number of jobs created and the number of jobs retained by the project or activity. However, in its report for the quarter ending September 30, 2009, Aging reported that no jobs were created or retained.

Federal guidelines do not currently require us to, nor did we, audit the information Aging must report under Section 1512. Because Aging submitted its first Section 1512 report on September 28, 2009, our subsequent audit of fiscal year 2009–10 expenditures of federal funds will likely examine these reports in more detail. Nevertheless, in keeping with OMB's emphasis on early communication of issues to management, we conducted a high-level review of Aging's report and found that it did not include any jobs data.

According to Aging's deputy director of administration, Aging did not report jobs data because it did not have confidence in the accuracy of the numbers the subgrantees reported, nor did it have time to resolve the issues before the reporting due date. Further, the deputy director stated that Aging believed the jobs data would not have been significant because it included information only through August 2009. Finally, according to the deputy director, in order to develop and report accurate jobs data, Aging is now requesting that its subgrantees report the actual hours worked rather than full-time equivalents (FTEs) to avoid having them individually interpret how to calculate FTEs. Aging will then use their hours to calculate the FTEs for the report. Based on our high-level review, the guidance Aging provided to its subgrantees on how to identify *jobs created* or *retained* appeared consistent with OMB's guidance for the first Section 1512 reporting period.

Blank page inserted for reproduction purposes only.

Department of Child Support Services

CHILD SUPPORT ENFORCEMENT FEDERAL CATALOG NUMBER 93.563

Based on the U.S. Office of Management and Budget's (OMB) June 2009 guidance, the California State Auditor's Office (State Auditor's Office) presents its interim report concerning the Department of Child Support Services' (Child Support Services) administration of the Child Support Enforcement program (Federal Catalog Number 93.563) during fiscal year 2008–09. Child Support Services received \$580.2 million in federal funds for this program during fiscal year 2008–09, including \$28.9 million in Recovery Act funds. The issues contained in this report represent the interim results of our internal control and compliance audit that require Child Support Services' corrective action.

The State Auditor's Office identified four findings as of December 31, 2009, that pertain to Child Support Services' administration of the Child Support Enforcement program. These four findings, for the most part, were disclosed in last year's annual audit report. A portion of one finding relates to requirements that only came into existence in fiscal year 2008–09 when the federal government began awarding American Recovery and Reinvestment Act of 2009 (Recovery Act) funds. Our audit revealed that Child Support Services has taken a number of corrective actions; however, further actions are necessary.

Child Support Services Did Not Always Inform Subrecipients of Federal Award Information as Required

OMB requires Child Support Services, as the recipient of federal awards, to provide certain information to subrecipients, including the Catalog of Federal Domestic Assistance (CFDA) program title and number, and the award name and number. This information is to be provided to subrecipients at the time they are awarded funding. Similarly, federal regulations require that Child Support Services, at the time it awards and disburses Recovery Act funds to its subrecipients, inform them of their CFDA number, award number, and amount of Recovery Act funds. Additionally, Child Support Services is to require its subrecipients to include on their Schedules of Expenditures of Federal Awards (SEFAs) information to specifically identify Recovery Act funding.

In the prior year, we reported that Child Support Services did not provide the required award identification information in the agreement, effective June 2008, that it executed with each local child support agency (LCSA). We also reported that Child Support Services sent the LCSAs an e-mail in September 2008 notifying them of the CFDA title and number, as well as the awarding agency. However, this was more than three months after the effective date of the 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 its corrective action plan to the prior year finding, Child Support Services stated that it would provide all required information to the LCSAs at the beginning of their agreements. However, Child Support Services has not yet entered into a new agreement with the LCSAs. Instead, it extended the existing agreement. In September 2009, shortly after the agreement was extended, Child Support Services addressed the concern by sending the LCSAs an e-mail notifying them of the required information, including the federal award numbers, for fiscal year 2009–10.

Although Child Support Services took subsequent steps to provide the necessary award identification information for its regular program funding, it did not provide the required information concerning the award and disbursement of Recovery Act funds to the LCSAs. Specifically, Child Support Services did not identify to LCSAs the amount of Recovery Act funds awarded and disbursed, and it did not provide the federal award number of Recovery Act awards. In addition, Child Support Services did not require LCSAs to specifically identify Recovery Act funding on their SEFAs. By not identifying Recovery Act funds and communicating requirements for proper reporting to its subrecipients, Child Support Services cannot ensure that its subrecipients use and report these funds as required by the Recovery Act.

We recommended that Child Support Services ensure that it provides all required award information to subrecipients for its regular program funding. Additionally, we recommended that Child Support Services provide subrecipients with the required Recovery Act information at the time of the award and disbursement of funds. Child Support Services agrees with the recommendations. For awards that it has already made to subrecipients dating back to fiscal year 2008–09, Child Support Services plans to send out letters that disclose all the required information, including the amount of Recovery Act funds included in the awards. Future letters will also include language requiring the subrecipients to specifically identify Recovery Act funding on their SEFAs. Additionally, Child Support Services plans to revise the form accompanying the disbursement of funds to subrecipients to identify the amount of Recovery Act funds that are included.

Child Support Services Has Not Ensured That Its Subrecipients Are Sufficiently Monitored

OMB requires Child Support Services, as the recipient of federal awards, to monitor the activities of subrecipients as necessary to ensure that federal awards are used for authorized purposes and that performance goals are achieved. Additionally, federal regulations require Child Support Services' staff to conduct regular planned examinations and evaluations of operations in local offices.

In the prior year, we reported that Child Support Services did not effectively monitor the LCSAs' use of federal funds. Specifically, we reported 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 OMB Circulars A-133 and A-87, state codes and regulations applicable to their claiming of funds, and related internal controls. We reported that Child Support Services completed fiscal audits of only three LCSAs during fiscal year 2007–08, and only 16 of 52 LCSAs had been audited since 2004. In its corrective action plan, Child Support Services reported that it intended to use a new approach to increase its monitoring of LCSAs. However, in fiscal year 2008–09 Child Support Services continued to rely on the audits conducted by the Department of Finance, and only two audits were completed during the fiscal year. Further, we reported in the prior year that Child Support Services did not request follow-up documentation for several findings. During this year's audit, we found that it followed up on findings for one of the two audits completed during the fiscal year. However, as of December 2009, more than six months after the audit was completed, Child Support Services had yet to request follow-up documentation for findings related to the remaining audit.

These audits were central to Child Support Services' oversight of the LCSAs' compliance with federal requirements, and according to Child Support Services, were the key control for allowability of costs at the LCSA level. Without audits such as these, 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. Child Support Services told us that in June 2009 it chose to discontinue its contract with the Department of Finance to conduct fiscal audits and has begun to implement a new method of monitoring subrecipients for compliance with federal requirements. As of November 2009, Child Support Services planned to have department staff audit 12 to 14 LCSAs each year, beginning in fiscal year 2009–10.

We recommended that Child Support Services continue to implement its new plan to audit LCSAs and assess this new plan to ensure that it provides Child Support Services with sufficient oversight over LCSAs' use of federal funds. Once audits are completed, Child Support Services should promptly follow up to request documentation to verify whether corrective action has been taken. In its corrective action plan, Child Support Services indicated that it had begun to conduct reviews of the LCSAs in accordance with its new plan. Additionally, Child Support Services stated that it will follow up within 15 days after the due date if requested information is not received.

Although Not in Full Compliance With Federal Requirements, Child Support Services Has Improved Its Timeliness in Issuing Management Decisions

We reported 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 audit findings within six months of receipt of the report from the subrecipient. The State has established a process in which 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. The SCO then sends copies of OMB Circular A-133 audit reports to state agencies, which are responsible for reviewing findings and issuing management decisions as to the adequacy of the corrective action taken.

In the prior year, Child Support Services received four of five audits requiring a management decision more than six months after the State initially received them, and the fifth was received days before the deadline. As a result, no management decisions were issued within six months of receipt of the audit. Further, Child Support Services did not promptly issue management decisions once it received the audits. When it does not issue management decisions promptly, Child Support Services lacks assurance that its subrecipients are taking timely and appropriate corrective action to address audit findings.

In fiscal year 2008–09, the SCO certified and provided copies of audits with findings to Child Support Services more quickly than in the prior year, with an average time of a little more than two months between the State's initial receipt of the audit and Child Support Services' receipt of the audit. Additionally, Child Support Services stated that it began the follow-up process more quickly after receiving the audits. As a result, Child Support Services issued management decisions for seven of the eight subrecipient audits that required follow-up within the required time frame. It issued a management decision for the remaining audit 11 days after the required six-month period had passed.

We recommended that Child Support Services ensure that it issues management decisions regarding audit findings within six months of the date the State receives the report from the subrecipient. In its corrective action plan, Child Support Services agreed to implement our recommendation.

Child Support Services Lacked Controls to Ensure That It Met Federal Requirements for Allowable Costs

Although Child Support Services has now taken steps to fully resolve this issue, during fiscal year 2008–09 it lacked adequate written policies and procedures to ensure that its expenditures met the requirements of OMB Circular A-87. OMB Circular A-87 specifies the types of costs that are allowable when states administer federal programs. Federal regulations require Child Support Services to have written procedures for determining costs in accordance with the circular.

This lack of adequate policies and procedures was the subject of a finding we reported for fiscal year 2007–08, and Child Support Services asserted that it concurred with our recommendations. In its corrective action plan, Child Support Services stated that it would provide all staff that review and approve contracts, invoices, and purchase orders with a list of allowable and unallowable expenditures and establish written procedures requiring these staff to use the list to ensure that expenditures are allowable. Further, Child Support Services stated that it would provide training to these staff on the allowability of costs under OMB Circular A-87. Comparing expenditures to OMB Circular A-87 is particularly important because it contains specific instructions on costs that are allowable and unallowable.

During this year's audit, we found that Child Support Services completed the steps included in its corrective action plan. However, most of these changes took place after fiscal year 2008–09, the year we audited. Specifically, Child Support Services provided a training class in August 2009 that summarized requirements included in OMB Circular A-87 and instructed staff to test allowability of costs against OMB Circular A-87 when reviewing invoices or contracts. Child Support Services stated that, during this class, it distributed copies of OMB Circular A-87 to all staff that review and approve contracts, invoices, and purchase orders.

Child Support Services has also established new procedures for processing invoices to ensure that expenditures meet federal requirements for allowability. In March 2009 Child Support Services established a procedure requiring that the accounting staff who perform the final review and approval of expenditures verify invoice charges against OMB Circular A-87 to ensure that they are allowable. As we reported in the prior year, Child Support Services stated that it had previously distributed OMB Circular A-87 to accounting staff and that it was used during their review of invoices. However, we noted that there was no written procedure directing staff to compare charges to the circular and we could not verify that such a comparison was performed. In November 2009, Child Support Services established a similar procedure for the contracts fiscal support section, which performs a preliminary review of any invoices related to contracts. At that time, Child Support Services also updated the contracts fiscal support section's Invoice Approval Sheet, which is a checklist used to confirm that each invoice is appropriate for payment, with a check box to indicate that the review against OMB Circular A-87 has been completed. These procedures, if followed, will improve Child Support Services' ability to ensure that all expenditures are allowable and meet the requirements of OMB Circular A-87.

Further, Child Support Services has updated its contract approval process to ensure that, prior to a contract's approval, staff verify the allowability of activities and services required by each of Child Support Services' contracts. Specifically, in October 2009, Child Support Services updated its contract checklist, which department staff complete before approving any contracts, with a check box instructing staff to verify as allowable all expenses and ensure that each contract includes a clause relating to OMB Circular A-87. Establishing this procedure will help ensure that Child Support

Services is verifying the allowability of its expenditures early in the contract approval process, rather than delaying the verification until the invoices are approved by accounting and the contracts fiscal support section.

We recommended that Child Support Services continue to provide a copy of OMB Circular A-87 to appropriate staff and conduct training when necessary. We also recommended that Child Support Services continue using the written policies and procedures it developed for all staff that review and approve contracts, invoices, and purchase orders. Child Support Services agreed to implement both recommendations.

Blank page inserted for reproduction purposes only.

Department of Education

STATE FISCAL STABILIZATION FUND—EDUCATION STATE GRANTS, RECOVERY ACT FEDERAL CATALOG NUMBER 84.394

Based on the U.S. Office of Management and Budget's (OMB) June 2009 guidance, the California State Auditor's Office (State Auditor's Office) presents its interim report concerning the Department of Education's (Education) administration of the State Fiscal Stabilization Fund (Federal Catalog Number 84.394) during fiscal year 2008–09. The official state recipient of this funding is the Governor's Office of Planning and Research (Planning and Research); however, Planning and Research entered into an interagency agreement with Education to disburse stabilization funds to Local Educational Agencies (LEAs)—such as school districts and county offices of education—to restore funding to K-12 education. In fiscal year 2008–09, Planning and Research received \$2.1 billion under this program, providing approximately \$1.6 billion in American Recovery and Reinvestment Act of 2009 (Recovery Act) funds to Education. The issues contained in this interim report represent the results of our internal control and compliance audit that require Education's corrective action. The State Auditor's Office identified one finding as of December 15, 2009, that pertains to Education's administration of this federal program.

Further, in October 2009, Planning and Research submitted its first quarterly report under Section 1512 of the Recovery Act. This report was based on information provided by Education. Section 1512 requires certain entities that receive Recovery Act funds directly from the federal government to provide, not later than 10 days after the end of each calendar quarter, information concerning how it used the funds. For example, the Recovery Act requires such direct recipients to provide data on the total amount of funds they have received and expended, as well as information on the projects or activities supported with such funding. For the quarter ending September 30, 2009, Planning and Research reported that LEAs had spent \$571.2 million and that 18,878 jobs were created or retained.

Federal guidelines do not currently require us to, nor did we, audit the information recipients must report under Section 1512. Since Planning and Research submitted its first Section 1512 report in October 2009, our subsequent audit of fiscal year 2009–10 expenditures of federal funds will likely examine these reports. Nevertheless, in keeping with OMB's emphasis on early communication of issues to management, we conducted a high-level review of the methodology Education used to report to Planning and Research the number of jobs created or retained with Recovery Act funds. Based on our preliminary review, it appears that Education's methodology was consistent with federal guidelines.

Education Lacks Adequate Controls to Ensure All Interest Earnings on Program Advances Are Appropriately Remitted to the Federal Government

Federal regulations require grantees and subgrantees to promptly remit interest amounts earned on program advances that are greater than \$100 to the federal government. These amounts must be remitted to the federal agency on at least a quarterly basis.

Education lacks formal policies and procedures to ensure LEAs who earn interest in excess of \$100 on federal advances remit such interest to Education; Education then remits the interest back to the federal government. Although Education requires LEAs, as part of the application process for funding, to certify that they will comply with federal regulations pertaining to the submission of

interest earnings on advances in excess of \$100, it does not have a process to monitor whether LEAs are adhering to this requirement. Based on our analysis of advances and expenditures, it appears that LEAs may have earned substantial interest on federal funds. Specifically, Education advanced \$1.6 billion in program funds to LEAs as of June 30, 2009; however, Education reported that these LEAs had spent only \$571.2 million as of September 30, 2009. As a result, LEAs have likely earned interest on over \$1 billion in unspent federal funds. After applying a conservative annualized interest rate of 1 percent, we estimate that LEAs may have earned nearly \$2.5 million in interest from July through September 2009. Thus, given LEAs likely earned interest on these unexpended funds and that Education lacks procedures to ensure LEAs are properly submitting interest earnings, the potential exists that the federal government has not received all of the interest earnings it was due.

To ensure that all LEAs are appropriately submitting interest earnings greater than \$100 and that it remits all interest earnings due to the federal government, we recommended that Education establish and implement policies and procedures that allow for the monitoring and tracking of LEAs' interest earnings on program advances. In response to this finding, Education indicated that it has implemented new monitoring and tracking processes to facilitate LEAs' compliance with federal interest requirements. In July 2009 Education dedicated one staff person to work full-time on cash management issues with LEAs. In addition, Education reported that it is in the process of redesigning its monitoring procedures to include new fiscal components relating to cash management. Finally, Education stated that it worked with the U.S. Department of Education to develop guidance for LEAs regarding federal interest requirements. Education plans to provide this guidance to LEAs in late-January 2010.

Employment Development Department

WORKFORCE INVESTMENT ACT (WIA) CLUSTER

**WIA ADULT PROGRAM
FEDERAL CATALOG NUMBER 17.258**

**WIA YOUTH ACTIVITIES
FEDERAL CATALOG NUMBER 17.259**

**WIA DISLOCATED WORKERS
FEDERAL CATALOG NUMBER 17.260**

Based on the U.S. Office of Management and Budget's (OMB) June 2009 guidance, the California State Auditor's Office (State Auditor's Office) presents its interim report concerning the Employment Development Department's (EDD) administration of the Workforce Investment Act (WIA) Cluster of federal programs during fiscal year 2008–09. These programs collectively spent \$421 million, including American Recovery and Reinvestment Act of 2009 (Recovery Act) funds totaling \$10 million during fiscal year 2008–09. The issue contained in this interim report represents the results of our internal control and compliance audit that require EDD's corrective action.

The State Auditor's Office identified one repeat finding as of December 23, 2009, that pertains to EDD's administration of this cluster of federal programs that we first reported in our fiscal year 2007–08 federal compliance audit. This finding relates to expenditures made prior to the enactment of the Recovery Act. However, if EDD does not correct this internal control deficiency, Recovery Act expenditures will not be adequately monitored.

EDD Has Repeatedly Failed to Perform Required Monitoring of Subrecipients

EDD allocates WIA funds to both Local Workforce Investment Areas (LWIAs) and non-LWIAs for use in a range of workforce development activities. However, during the past two fiscal years, EDD has only conducted the required monitoring for LWIAs. The purpose of the WIA is to promote an increase in the employment, job retention, earnings, and occupational skills of participants. LWIAs include both cities and counties and non-LWIAs include community-based organizations (CBOs) and various state entities including the California Department of Corrections and Rehabilitation and the California Community Colleges Chancellor's Office. For fiscal year 2008–09, EDD allocated more than \$320 million to 49 LWIAs and \$41 million to 51 non-LWIAs for these workforce development activities. Further, the Recovery Act authorized an additional \$388 million that was allocated to LWIAs in April 2009 and \$6 million that was allocated to non-LWIAs in June 2009.

In our prior year federal compliance audit, we reported that EDD did not monitor any CBOs. During our follow-up procedures for fiscal year 2008–09, we found that EDD has not fully corrected this finding. Specifically, although EDD's Compliance Monitoring Section (CMS) monitored all LWIAs, monitoring was performed at only five of the non-LWIAs. Because of the failure to conduct the required monitoring of all non-LWIAs, EDD cannot ensure that they are complying with federal laws, regulations, and provisions of grant agreements.

OMB's *Circular A-133 Compliance Supplement* requires that pass-through entities such as EDD monitor the activities of subrecipients 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. Additionally, federal regulations require that the State monitoring system provide for annual on-site monitoring reviews of local areas' compliance with the U.S. Department of Labor uniform administrative requirements. According to the chief of the CMS (chief), the failure to monitor all non-LWIAs is due to the lack of available staff. EDD has received Recovery Act funds it plans to use for four new positions and is currently making efforts to fill them. Once these new staff members are in place, the chief stated that EDD plans to schedule annual on-site reviews of all non-LWIAs. Additionally, according to the chief, because non-LWIAs and LWIAs did not receive Recovery Act funds until late in fiscal year 2008–09, the CMS began monitoring the use of Recovery Act funds during fiscal year 2009–10 for both LWIAs and non-LWIAs. According to the chief, the four new positions are currently limited term and are solely funded by the Recovery Act. In order to ensure that these positions become permanent when Recovery Act funds run out, the CMS plans to request that the positions be made permanent during fiscal year 2009–10. However, the CMS previously made similar requests but was unsuccessful in getting approval for additional positions. If these positions do not become permanent, EDD will once again risk that monitoring of WIA recipients will be inadequate due to a lack of available staff. If EDD is unable to monitor all LWIAs and non-LWIAs, it cannot effectively oversee the expenditure of Recovery Act funds.

In order to comply with federal regulations, we recommended that EDD continue its efforts to hire sufficient staff and implement a more effective monitoring process to ensure that all recipients use federal funds, including Recovery Act funds, for authorized purposes.

EDD Adequately Resolved Two Prior Year Findings

During our follow-up procedures for fiscal year 2008–09, we verified that EDD had resolved two prior year audit findings. We interviewed department staff and collected pertinent documentation to confirm that EDD had successfully addressed our recommendations and implemented corrective action plans for these two findings.

In our fiscal year 2007–08 federal compliance audit, we reported that EDD did not report to the U.S. Department of Labor WIA Dislocated Worker funds it transferred to the WIA Adult program. A manager in the Financial Management Unit acknowledged that this error occurred because data from the previous quarter's report was not carried forward. We recommended that EDD ensure all necessary information is carried forward from one financial report to the next. During our follow-up procedures for fiscal year 2008–09, we confirmed that EDD contacted the U.S. Department of Labor in an attempt to correct the report. EDD indicated the reports to the U.S. Department of Labor are now reviewed by two managers within the Financial Management Unit prior to submission. Additionally, we found no errors during our review of the fiscal year 2008–09 report.

A second finding from our fiscal year 2007–08 federal compliance audit concerned the tardy issuance of a management decision as to the adequacy of a subrecipient's corrective action taken in response to audit findings. Specifically, we reported that EDD did not issue its management decision within the required six-month time frame because it was calculating the six-month period from the date it received copies of the audit reports from the State Controller's Office (Controller's Office) rather than from the date the Controller's Office first received the report from the subrecipient. We recommended that EDD coordinate with the Controller's Office to ensure that required management decisions are issued within

January 2010

Employment Development Department

six months of the Controller's Office's receipt of the audit report. During our follow-up procedures for fiscal year 2008–09, we verified that management decisions were issued within the six-month time frame. Additionally, we confirmed that EDD communicated with the Controller's Office regarding this issue. Specifically, EDD attended a Single Audit Conference with the Controller's Office in which options were discussed on how to meet the six-month timeline. Further, EDD stated that it modified its internal tracking report to identify the date the Controller's Office receives a subrecipient's audit report as the start date in calculating the required six-month time frame for issuing a management decision.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

Date: January 26, 2010

For questions regarding the contents of this report, please contact Margarita Fernández, Chief of Public Affairs, at 916.445.0255.

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