

California State Auditor

B U R E A U O F S T A T E A U D I T S

Capitalization Grants for Drinking Water State Revolving Fund:

*Federal Compliance and Internal Control Audit
Report for the Fiscal Year Ended June 30, 1999*



May 2000
99002.1

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CALIFORNIA STATE AUDITOR

MARY P. NOBLE
ACTING STATE AUDITOR

STEVEN M. HENDRICKSON
CHIEF DEPUTY STATE AUDITOR

May 5, 2000

99002.1

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 8542, et. seq., the Bureau of State Audits (bureau) presents its audit report concerning our review of the Department of Health Services' (department) compliance with federal laws and regulations applicable to the Capitalization Grants for Drinking Water State Revolving Fund program (program) for the fiscal year ended June 30, 1999. The department contracted with the bureau to perform this audit to satisfy a federal audit requirement.

This report concludes that the department did not always comply with federal laws and regulations governing allowable costs and cost principles. Although none of the problems we identified are significant to the program, when the department does not comply with the requirements, it risks incurring costs that the federal government may later disallow.

Respectfully submitted,

MARY P. NOBLE
Acting State Auditor

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CALIFORNIA STATE AUDITOR

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Independent Auditor's Report on Compliance With Requirements Applicable to the Federal Program and on Internal Control Over Compliance in Accordance With the Program-Specific Audit Option Under OMB Circular A-133

Department of Health Services
State of California

COMPLIANCE

We have audited the compliance of the Department of Health Services 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 the Capitalization Grants for Drinking Water State Revolving Fund program for the year ended June 30, 1999. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of the Department of Health Services' management. Our responsibility is to express an opinion on the Department of Health Services' compliance based on our audit.

We conducted our audit of compliance in accordance with generally accepted auditing standards; 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, *Audits of States, Local Governments, and Non-Profit Organizations*. 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 the Capitalization Grants for Drinking Water State Revolving Fund program occurred. An audit includes examining, on a test basis, evidence about the Department of Health Services' compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Department of Health Services' compliance with those requirements.

In our opinion, the Department of Health Services complied, in all material respects, with the requirements referred to above that are applicable to its Capitalization Grants for Drinking Water State Revolving Fund program for the year ended June 30, 1999. 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 Item 99-B-1.

INTERNAL CONTROL OVER COMPLIANCE

The management of the Department of Health Services is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Department of Health Services' internal control over compliance with requirements that could have a direct and material effect on its Capitalization Grants for Drinking Water State Revolving Fund program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the audit committee, management, State Legislature, and the federal awarding agency 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

March 31, 2000

**DEPARTMENT OF HEALTH SERVICES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 1999**

Summary of Auditor's Results

Financial Statements

As of June 30, 1999, the Safe Drinking Water State Revolving Fund (fund), the fund the State established to account for loans and other financial assistance provided under the Capitalization Grants for Drinking Water State Revolving Fund program (program), had no loan activity. Accordingly, we did not perform an audit of the fund's financial statements.

Federal Award

Internal control over the program:

Material weaknesses identified?	No
Reportable conditions identified that are not considered to be material weaknesses?	No
Type of report the auditor issued on compliance for the program	Unqualified
Any audit findings disclosed that are required to be reported in accordance with Section .510(a) of OMB Circular A-133?	Yes
Auditee qualified as low-risk auditee?	No

Identification of the program:

CFDA Number	Name of Federal Program
66.468	Capitalization Grants for Drinking Water State Revolving Fund

U.S. ENVIRONMENTAL PROTECTION AGENCY

Reference Number:	99-B-1
Federal Catalog Number:	66.468
Federal Program Title:	Capitalization Grants for Drinking Water State Revolving Fund
Federal Award Number and Calendar Year Awarded:	FS989124-01-0; 1998
Category of Finding:	Allowable Costs and Cost Principles
State Administering Department:	Department of Health Services

CRITERIA

In our review of the Capitalization Grants for Drinking Water State Revolving Fund program (program), we identified the following requirements related to allowable costs and cost principles:

The U.S. Office of Management and Budget Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments* (OMB Circular A-87), establishes the principles and standards for determining allowable costs for federal awards. OMB Circular A-87, Attachment A, Section C (1)(d), states that program costs must conform to the terms and conditions of each federal award. According to the grant agreement for the program, any equipment purchase in excess of \$5,000, including computer hardware and software, must receive prior approval from the U.S. Environmental Protection Agency (EPA) project officer.

In addition, OMB Circular A-87, Attachment B, Section 11h, establishes the standards for time distributions that support salaries and wages. Section 11h(3) requires that, when employees are expected to work only on one federal award, their agencies must periodically certify that the employees did indeed work only on that program. The agencies use these certifications to support program salary charges. They must prepare the certifications at least semiannually and have them signed by the employee or a supervisor with first-hand knowledge of the work performed. If employees work on multiple cost objectives or programs, Section 11h(4), requires their agencies to support with personnel activity reports any salaries and wages charged to a federal award.

CONDITION

The Department of Health Services (Health Services) did not always obtain required EPA approval before purchasing equipment. In addition, it did not always maintain adequate support for personnel costs charged to the program.

We reviewed four equipment purchase orders exceeding \$5,000. For three purchase orders totaling approximately \$38,670, \$53,620, and \$26,010, respectively, Health Services did not obtain the EPA project officer approval before purchasing computer hardware and software. Although EPA told Health Services that it must get approval for equipment purchases over \$5,000, Health Services believes that it is only required to obtain EPA approval for purchases greater than \$5,000 per

unit of equipment. The EPA regional office agrees that the grant agreement is unclear. As a result, it is seeking clarification from EPA headquarters. When Health Services does not obtain required approvals, it risks incurring costs that EPA may later disallow.

In addition, the department did not always receive time reports from employees, and in cases where it did, it did not always distribute these costs properly to the program. Although 10 of the 16 employees we selected for review said they worked on the program 100 percent of the time, neither they nor their supervisors submitted the required semiannual time certifications. The remaining six employees stated that they worked on different programs or cost objectives within the program, but only three had completed activity reports. Cost objectives represent functions or activities for which costs are incurred, such as administration or technical assistance. Health Services tracks costs by cost objective to ensure it meets federally imposed spending limits. However, for two of the three employees that submitted activity reports, Health Services did not base the costs it charged to the program on these reports. As a result, it overcharged the program more than \$11,800. When Health Services does not maintain adequate records to support personnel costs for the program, it risks incurring costs that EPA may later disallow. Furthermore, when it does not appropriately track the related personnel costs and distribute them to the program's various cost objectives, it cannot ensure that it is complying with program spending limits.

RECOMMENDATION

Health Services should ensure that it obtains the required federal approval on equipment purchases and adheres to the principles and standards in OMB Circular A-87 for supporting salaries charged to federal awards.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION

Health Services disagrees with one of our findings but agrees with the other. Specifically, it disagrees with our finding that it did not always obtain EPA approval for equipment purchases when required. Once EPA headquarters issues its determination on equipment purchases over \$5,000, Health Services states that it will abide by EPA's decision.

Health Services agrees with our finding regarding charges for personnel costs and has taken some corrective action. As of January 2000, program employees have been signing semiannual certifications when working 100 percent on a single program or cost objective and have been completing activity reports when working on more than one program or cost objective. Furthermore, Health Services states that it will charge personnel costs to the program based on the actual hours worked, as reported by employees on their activity reports.

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Agency's comments provided as text only.

California Health and Human Services Agency
Office of the Secretary
1600 Ninth Street, Room 460
Sacramento, CA 95814
(916) 654-3454

April 27, 2000

Mary P. Noble
Acting State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Dear Ms. Noble:

Thank you for forwarding, for my review and comment, a draft copy of the Bureau of State Audits' report entitled, "*Capitalization Grants for Drinking Water State Revolving Fund: Federal Compliance and Internal Control Audit Report for the Fiscal Year Ended June 30, 1999.*" I am pleased that the Bureau found the Department of Health Services ("DHS") to be "in material compliance" with the applicable requirements of the capitalization grants for the Drinking Water State Revolving Fund.

Following my review of the findings, I concur with the Department of Health Services' feedback on the results and understand that DHS has already begun taking steps to address some of the issues raised in the Bureau's report.

Thank you once again for sharing a draft copy of your findings. If you require further information concerning DHS' Drinking Water State Revolving Fund activities, please do not hesitate to contact me directly. You may also feel free to contact Diana Bontá, the Director for the Department of Health Services.

Sincerely,

(Signed by: Grantland Johnson)

Grantland Johnson
Secretary
California Health & Human Services Agency

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Agency's comments provided as text only.

Department of Health Services
714/744 P Street
P.O. BOX 942732
Sacramento, CA 94234-7320
(916) 657-1425

April 27, 2000

Ms. Mary P. Noble
Acting State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Dear Ms. Noble:

We are in receipt of the recent letter and audit report your staff prepared on the Department of Health Services' (DHS) Drinking Water State Revolving Fund (SRF). The report was prepared under contract to DHS. You request in your letter that a written response be provided to the audit report findings which are to be included in the final report.

DHS is in concurrence with the findings in the audit report. We found the State Auditor's staff to be very professional and helpful in assisting DHS staff in identifying issues during the audit that will ensure that the SRF program maintains compliance with applicable requirements.

If you have questions, please call me at (916) 657-1425.

Sincerely,

(Signed by: Diana Bontá)

Diana M. Bontá, R.N., Dr.P.H.
Director