

**FOOD AND NUTRITION SERVICE  
CHILD AND ADULT CARE FOOD PROGRAM  
REVIEW OF STATE AGENCY OVERSIGHT  
STATE OF CALIFORNIA  
AUDIT REPORT NO. 27601-6-SF**

**MARCH 1999**

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DATE: March 16, 1999

REPLY TO

ATTN OF: 27601-6-SF

SUBJECT: Child and Adult Care Food Program  
Review of State Agency Oversight  
State of California

TO: Allen Ng  
Regional Administrator  
Western Region  
Food and Nutrition Service

This report presents the results of our audit of the State of California oversight of the Child and Adult Care Food Program. Your written response to the draft report is included as exhibit F to the report. For acceptance of your management decisions on the report's recommendations, please provide the information described in the OIG Position sections of the report.

In accordance with Departmental Regulations 1720-1, please furnish a reply within 60 days describing the corrective action taken or planned and the timeframes for implementation of these recommendations. Please note that the regulation requires a management decision to be reached on all findings and recommendations within a maximum of 6 months from report issuance.

The Office of the Chief Financial Officer (OCFO), U.S. Department of Agriculture, has responsibility for monitoring and tracking final action for the findings and recommendations. Follow your internal agency procedures in forwarding final action correspondence to OCFO.

We appreciate the cooperation and assistance provided by your staff during our audit.

SAM W. CURRIE  
Regional Inspector General  
for Audit

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## EXECUTIVE SUMMARY

### FOOD AND NUTRITION SERVICE CHILD AND ADULT CARE FOOD PROGRAM REVIEW OF STATE AGENCY OVERSIGHT STATE OF CALIFORNIA AUDIT REPORT NO. 27601-6-SF

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#### PURPOSE

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This report presents the results of our review of the State of California's oversight of the Child and Adult Care Food Program (CACFP). Our purpose was to determine why the State's oversight function had not detected and prevented the significant program abuses by CACFP sponsors that had been disclosed in a series of OIG audits and investigations.

Due to the serious problems found in the CACFP in California we are issuing this report at this time to alert the Food and Nutrition Service (FNS) that it needs to increase its oversight and presence in the State to ensure that the State agency is capable of restoring integrity to the CACFP. We plan to issue additional State agency reports including a review of 2-percent fund expenditures charged to the CACFP by the State agency and a review of the quality of the audit and review work conducted by the State agency.

In California, the FNS Western Regional Office administers the program through an agreement with the California Department of Education (CDE). Program regulations require CDE to provide sufficient consultative, technical, and managerial personnel to administer the program, provide sufficient technical assistance to institutions, and monitor performance to facilitate operation of the program. CDE's oversight responsibilities include reviewing and approving sponsors' budgets, conducting administrative reviews of sponsor activities, and conducting audits or reviewing audit reports conducted by independent CPA firms.

As of February 16, 1999, we had in process or had completed audits or investigations of 10 sponsors of providers and day care centers participating in the CACFP. These sponsors were selected for review based on a problem sponsor profile we developed and referrals from FNS, CDE, or other sources (whistleblower complaints, audit leads, etc.) In FY 1996, the 10 sponsors received about 20 percent of California CACFP

funds expended for provider/center meal reimbursement, program administration, and cash in lieu of commodities.

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## RESULTS IN BRIEF

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Based on our completed and ongoing audits and investigations, we concluded that CDE has been negligent in its administration of the CACFP. We found a high incidence of fraud and abuse in the program in California. Some cases we investigated have already resulted in prosecutions and the sentencing of the sponsor officials. In one case, a Field Services Unit manager for CDE was directly involved in the fraud. We concluded that FNS needs to increase its presence in the State program to ensure that the CDE is capable of restoring integrity to the CACFP.

We found serious program irregularities at all 10 sponsors we reviewed. These irregularities included submission of false information to the State agency, failure to maintain adequate records, failure to disburse payments to facilities in accordance with management plans, and various schemes to divert program funds to the personal enrichment of the sponsors.

It was CDE's responsibility to review the activities of sponsors and to enforce compliance with program regulations. CDE was required to declare that non-compliant sponsors were seriously deficient and terminate the sponsor from the program if the sponsor could not bring the program into compliance. CDE had not found any of the ten sponsors to be seriously deficient. However, we concluded that all 10 sponsors were seriously deficient, and to date four have been terminated as a result of our work.

Eight of the ten sponsors also have been or are being investigated for program fraud. Suspected fraudulent activities include charging ineligible costs to the program, listing fictitious employees and providers, and diverting program funds for nonprogram purposes. Participants at three sponsors have already admitted to or have been convicted of program fraud:

- A husband and wife who owned and operated a sponsorship were arrested and charged in a 23-count Federal indictment charging conspiracy, perjury, obstruction of justice, and mail fraud. Also, three of their employees pled guilty to mail fraud and have been sentenced.
- The husband and wife who owned and operated another sponsorship were sentenced to over 2 years in Federal prison for program fraud and ordered to pay the Government \$2.2 million in restitution.

- A former program manager for another sponsor and her accomplice pled guilty to conspiring to create a fictitious child care provider and illegally obtain over \$23,000 in CACFP funds. They were each sentenced to 3 years probation and 6 months in a home detention program.

As part of our individual sponsor audits, we also completed unannounced reviews at 752 homes and day care centers. We attempted over 1,000 reviews but many sites were no longer participating in the CACFP even though CDE records indicated that they were still active. Of the 752 sites visited, 66 percent had discrepancies of some form. In some cases, the sites claimed meals served to more children than were present during our visits. In most cases, the sites' meal service records were too unreliable to support the claims. Because of the poor conditions of these records, it was impossible for us to determine if the CACFP was accomplishing its intended purpose: to provide nutritious meals to children in day care. We also reported health and safety issues to the local authorities.

We concluded that many of the problems we found with the sponsors should have been detected by CDE. The three management tools used by CDE to provide oversight of sponsor activities--budget review and approval, administrative review, and sponsor audits--had not been used effectively. For example, suspicious budgetary information provided by sponsors was not questioned, CDE audits did not find discrepancies that were readily detectable, and no followup actions were taken when questionable activities were noted during administrative reviews or audits.

One primary cause of CDE's lack of effectiveness in preventing and detecting problems in the CACFP is the organizational structure of its oversight function. We found that the units within CDE responsible for the CACFP displayed a lack of coordination necessary to properly administer the program. The External Audit Unit did not use the results of the administrative reviews conducted by the Field Services Unit during its audits, and the External Audit and Field Services Units did not issue their audit and administrative reports to the Programs Unit who would normally act on the audit findings and recommendations.

One reform we believe CDE can make to improve its oversight is to establish a universe of high-risk sponsors based on a "profile" or set of characteristics shared by sponsors found engaging in irregularities. We developed such a profile during our fieldwork and were able to target those sponsors we regarded as potential problems. With such a profile, CDE can likewise concentrate its resources to intensify oversight where it is most needed.

During our audit, CDE submitted a list to FNS of 29 key actions which, if implemented, CDE believed would address some of our issues reported during our audit. While we support the action plan, we believe additional steps must be taken to improve CDE's oversight of the CACFP. At the time of our audit, many of the 29 points had not been implemented, and many of the planned actions did not directly address the CACFP.

In our opinion, several recent steps taken by CDE should help improve the CACFP in California. Effective October 1, 1998, CDE reduced the maximum allowable amount that sponsors of day care centers' food reimbursement to cover the sponsors' administrative costs. Previously the maximum was 30 percent but it has been reduced to 15 percent. Also, CDE reorganized its audit function. The audit unit is now independent from the Child Nutrition and Food Distribution Division. The Audits and Investigations Division reports directly to the CDE General Counsel who reports to the Chief Superintendent of Public Instruction.

Audits and investigations are continuing on some of these sponsors, and individual audit reports will be issued for all of them. Although audit and investigative work on some sponsors has not been completed, we are issuing this audit report at this time to facilitate timely improvements to this important feeding program.

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**KEY RECOMMENDATIONS**

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We recommend that FNS work with CDE to identify its high-risk sponsor universe and direct its resources to those sponsors who fit the problem sponsor profile presented in this report. Also, instruct the CDE to establish a process which ensures coordination between the Child and Adult Care Food Program units. In addition, FNS should instruct CDE to develop formal procedures to ensure corrective actions recommended in administrative reviews and audit reports are implemented by the sponsors, thoroughly review each sponsor's budget and obtain support for all questionable amounts listed on the budget, and allow only one day care home agreement per sponsor.

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**AGENCY POSITION**

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In its February 3, 1999, written response to the draft report, FNS agreed with our audit results and recommendations. The response is incorporated, along with our position, in the Findings and Recommendations section of this report. The full text of FNS' response is included as exhibit F.

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## TABLE OF CONTENTS

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<b>EXECUTIVE SUMMARY</b> . . . . .	i
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<b>INTRODUCTION</b> . . . . .	1
BACKGROUND . . . . .	1
OBJECTIVES . . . . .	2
SCOPE . . . . .	2
METHODOLOGY . . . . .	3

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<b>FINDINGS AND RECOMMENDATIONS</b> . . . . .	4
<b>I. FNS NEEDS TO TAKE IMMEDIATE ACTION TO RESTORE INTEGRITY TO CALIFORNIA'S CHILD AND ADULT CARE FOOD PROGRAM</b> . . . . .	4
FINDING NO. 1 <b>Unscrupulous Sponsors Eluded CDE Detection for Years</b> . . . . .	5
Recommendations . . . . .	15
FINDING NO. 2 <b>CDE Was Negligent in Fulfilling its CACFP Oversight Responsibilities</b> . . . . .	16
Recommendations . . . . .	28

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<b>EXHIBITS</b>	
A - SUMMARY OF AUDITS AND INVESTIGATIONS IN CALIFORNIA . . . . .	31
B - CHARACTERISTICS OF SPONSORS DETERMINED TO BE SERIOUSLY DEFICIENT . . . . .	32
C - CACFP MANAGEMENT ALERTS ISSUED . . . . .	33
D - RESULTS OF PROVIDER VISITS . . . . .	34

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## TABLE OF CONTENTS

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E -	CDE'S KEY ACTIONS . . . . .	35
F -	FNS' WRITTEN RESPONSE TO THE DRAFT REPORT . . . . .	37



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## INTRODUCTION

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### BACKGROUND

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The Child and Adult Care Food Program (CACFP) is designed to ensure that children and senior citizens in day care facilities receive nutritious meals. Program funding nationwide for fiscal year 1996 was \$1.58 billion. For fiscal year 1997, the appropriation was increased by about 10 percent to \$1.74 billion.

The program is administered at the Federal level by the Food and Nutrition Service (FNS) and at the State level by a State agency, except in Virginia, where it is directly administered by FNS. State agencies administer their programs through public or nonprofit sponsoring organizations which act as a liaison between the State agency and participating day care facilities. Sponsors are ultimately responsible for program operations in those facilities.

Day care facilities participating in the program receive reimbursement for meals meeting specified nutritional requirements. Facilities eligible to participate include day care homes (homes) or child care centers (centers). A home is a day care facility located in a private residence. The operator of the home is referred to as the "provider." A child care center is operated by a public or private nonprofit organization, is licensed to provide child care, and primarily serves pre-school children. Homes and centers must be licensed by a State or local licensing authority.

Under Title 7 Code of Federal Regulations (CFR) 226.4(h) funding is authorized to States specifically for the purpose of conducting audits and administrative reviews of institutions. These funds are designated to pay the cost of required organizationwide or program-specific audits of institutions. 7 CFR 226.6(1) also specifies that State agencies perform administrative reviews of sponsors on a periodic basis.

Administrative reviews and audits examine some of the same program compliance areas. An administrative review performed by the California Department of Education (CDE) Field Services Unit evaluates eligibility and meal requirement compliance. However, an audit is performed by the External Audit Unit or an independent certified public accountant (CPA) in accordance with Government auditing standards (GAS) and is larger in scope than an administrative review.

The CDE had the responsibility to monitor the CACFP on behalf of FNS. Within CDE, the External Audits Unit, Field Services Unit, and Program Unit were all involved in the monitoring process. The External Audit Unit conducted audits to determine sponsor's compliance with program requirements. The Field Services Unit performed administrative reviews to verify the sponsor's latest meal claim reimbursement and review the most current month of operations. In addition to budget approval, the Programs Unit approved sponsor applications, interacted with sponsors on a daily basis, provided technical assistance, and had the authority to take administrative action against a sponsor.

In terms of program expenditures, California has the largest CACFP program in the nation. In fiscal year 1996, program expenditures in California were about \$176 million of total program expenditures of about \$1.46 billion, or about 12 percent of the program. As of March 1997, California had direct agreements with 503 day care centers, 14 sponsors of after school care, 100 sponsors of day care homes only, 6 sponsors of day care centers only, and 10 sponsors of both homes and centers. Approximately 400,000 children are enrolled in the CACFP in California.

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**OBJECTIVES**

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Our audit objectives were to (1) report the serious sponsor abuses prevalent in the CACFP in California, and (2) determine why the State's oversight function had not detected and prevented the significant program abuses that had been disclosed in a series of OIG audits and investigations.

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**SCOPE**

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The scope of our review was the CDE oversight of sponsors participating in the CACFP. As of February 16, 1999, we had in process or had completed audits and/or investigations of 10 sponsors of providers and day care centers participating in the CACFP. These 10 sponsors received \$45.3 million of the total \$246.7 million in meal reimbursement, administrative program funds, and cash in lieu of commodities for fiscal years 1996 and 1997 paid to sponsors of day care homes and centers. The sponsors were selected for an audit, and if necessary, an investigation based on a problem sponsor profile we developed and referrals from FNS, CDE, or other sources (whistleblower complaints, audit leads, etc.).

We selected audit reports and administrative review reports for these ten sponsors to determine if CDE and/or CPA's

discovered the same type of problems we encountered with these sponsors.

Audit work was performed from January 1996 through August 1998 at the FNS Regional Office in San Francisco, California; the CDE in Sacramento, California; at sponsors offices in Visalia, Long Beach, Pasadena, Inglewood, Yucca Valley, Diamond Bar, Reedley, Fallbrook, Pomona, and Thousand Oaks, California.

The audit was conducted in accordance with the U.S. General Accounting Office's "Government Auditing Standards (1994 Revision)."

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## METHODOLOGY

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To accomplish our objectives and support our findings, we performed the following steps:

- At the CDE, we evaluated program oversight to determine the effectiveness of the budget process, administrative reviews, and audits.
- At the CDE, we also (1) reviewed program files for each of the ten sponsors, and (2) interviewed program staff to determine the universe of sponsor data.
- We examined audit reports and administrative reviews to determine if the CDE and/or CPA discovered the same types of problems we discovered in our audits.
- We interviewed the sponsor's staff to obtain an understanding of their operating procedures. We also reviewed their supporting documentation for claims for meal reimbursement and administrative expenditures.
- We judgmentally selected homes or centers operating under the sponsor and completed reviews at the provider sites. Criteria for the judgmental sample were as follows: (1) providers with a high reimbursement, (2) providers with high enrollment, and (3) providers who consistently claim the same number of children for meals.
- At each of the homes or centers, we interviewed providers or other persons present, and reviewed their records.

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## FINDINGS AND RECOMMENDATIONS

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<p><b>I. FNS NEEDS TO TAKE IMMEDIATE ACTION TO RESTORE INTEGRITY TO CALIFORNIA'S CHILD AND ADULT CARE FOOD PROGRAM</b></p>
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Based on our completed and ongoing audits and investigations of individual day care sponsors, we concluded that CDE has been negligent in its administration of the CACFP. We found a high incidence of fraud and abuse in the program in California. Some cases we investigated have already resulted in prosecutions and the sentencing of the sponsor officials. In one case, a Field Services Unit manager for CDE was directly involved in the fraud. We concluded that FNS needs to increase its presence in the State program to ensure that the CDE is capable of restoring integrity to the CACFP.

We found serious program irregularities at all 10 sponsors we reviewed. Serious deficiencies are considered grounds for termination from the program. These deficiencies include submission of false information to the State agency, failure to maintain adequate records, and failure to disburse payments to facilities in accordance with management plans.<sup>1</sup>

Four of the ten sponsors we audited have been terminated from participating in the CACFP, and the State agency is initiating the termination of a fifth sponsor. Additionally, eight of these sponsors are being investigated for program fraud. Fourteen individuals have been indicted for program fraud, and 9 of the 14 have pled guilty.

Most of the problems we found with the sponsors should have been detected by CDE. CDE was not fulfilling its oversight responsibilities to maintain the integrity of the program. CDE had at its disposal several management tools--including budget reviews, administrative reviews, and sponsor audits--that could have been used to alert State managers to potential problem areas. However, these tools were either not used or were not used to any consequence.

For the 10 sponsors we audited, the reviews and audit that CDE performed and the audits it had contracted with CPA firms to perform consistently found few problems in sponsor operations, even though the irregularities we found were readily

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<sup>1</sup> 7 CFR 226.6 (c), dated January 1, 1995.

detectable through normal auditing procedures and had been ongoing for years under CDE's oversight. In those cases we reviewed, in which CDE did detect irregularities, it failed to act.

We are recommending that FNS involve itself directly in CDE's program activities to increase the effectiveness of the State's oversight. One measure we believe FNS and CDE can take to reform State oversight is to establish a universe of high-risk sponsors based on the characteristics we observed in the sponsors we found engaged in irregularities. With such a universe, CDE can concentrate its resources to intensify oversight where it is most needed.

In the following two findings, we (1) summarize the results of the CACFP audits we performed in California and describe the sponsor characteristics or "profile" that emerged from those audits, and (2) identify the tools CDE had at its disposal but failed to use to enforce program integrity.

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**FINDING NO. 1**

**UNSCRUPULOUS SPONSORS  
ELUDED CDE DETECTION FOR  
YEARS**

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OIG audits and investigations disclosed widespread fraud and abuse in the CACFP in California. Much of the abuse had existed for a number of years. This was caused in part because of ineffective reviews and audits being conducted by either CDE or the CPA firms that CDE had contracted with. We concluded that CDE needs to develop a profile of

the characteristics common to problem sponsors and target these sponsors for indepth audits. We developed such a profile during our review and found that all 10 of the sponsors met one or more of the elements of the profile.

In 1996, we initiated an extensive audit of private, nonprofit sponsors participating in the CACFP in California. This audit was conducted because a review of another sponsor we performed in response to a whistleblower complaint demonstrated that the potential existed in the State for other sponsors to be seriously deficient. The work in California was the precursor of our national initiative (Operation Kiddie Care) to identify problem sponsors participating in this program.

So far, the results of our sponsor audits and investigations in California have been significant. As stated previously, we found program irregularities at all 10 sponsors we reviewed. These 10 sponsors annually received approximately \$22.6 million in meal reimbursement, administrative program funds, and cash in lieu of commodities. The deficiencies included lack of recordkeeping, claims for unsupported and ineligible costs, lack of provider training and monitoring, and numerous

health and safety violations which were reported to the local authorities.

The results of each sponsor audit will be reported in individual audit and/or investigation reports. While some of these reports are not yet final, and more audits are anticipated, the following audit reports have been issued or are in process of being issued at this time:

<b>Audit Number</b>	<b>Sponsor</b>	<b>Audit Report Issued</b>
27010-02-SF	Angela's Angels Preschool, Inc.	Yes
27010-04-SF	Pacific Asian American Family Care, Inc.	Yes
27010-09-SF	Community Business Improvement Association, Inc.	Yes
27010-11-SF	Aladdin Child Care Services, Inc.	Yes
27010-13-SF	Children's Spectrum Child Care Services, Inc.	Yes
27010-14-SF	A Perfect Balance, Inc.	Yes
27010-15-SF	Sponsor A.	No
27010-16-SF	Sponsor B.	No
27010-17-SF	Sponsor C.	No
Unassigned	Sponsor D.	No

The sponsors were able to abuse the program in several ways, including submitting false claims for fictitious providers, employees, and businesses, and by using program funds to pay for personal expenses such as vacations, food, clothing, tuition, and vehicles. Additionally, administrative funds were inappropriately used to pay rent for buildings owned by related parties.

We developed a profile because some sponsors that engaged in irregular activities exhibited certain shared characteristics. They were more apt to be family-run operations than organizations that employed nonfamily members. Seven of the ten sponsors we found deficient were family-run operations.

Similarly, we found problems with sponsors whose officials held outside employment, or whose only source of funding was the CACFP. Officials with outside employment have been found to neglect their sponsorship duties while claiming their

salaries as sponsor officials. Officials for 6 of the 10 sponsors with serious program irregularities held outside employment; 9 of the 10 sponsors derived their income solely from CACFP funding.

Another characteristic that problem sponsors often seem to have in common is their claim for the maximum administrative expenses allowable for sponsoring child care centers. The State of California allows sponsors of child care centers to reimburse themselves for administrative expenses by withholding up to 30 percent of the centers' food cost reimbursements. Five of the ten sponsors we reported on were withholding the full 30 percent.

Exhibit B identifies the common characteristics that the problem sponsors exhibited.

The following is a summary of the individual audits and investigations of CACFP sponsors in California:

**Angela's Angels Preschool, Inc.** (Report Issued August 1996)

Angela's Angels Preschool, Inc. (Angela's Angels) of Visalia, California, was the first CACFP sponsor we reviewed and was the precursor to our nationwide review of CACFP sponsors. FNS referred this sponsor to us based on an anonymous complaint received by another State agency and passed along to CDE. During our review we noted that the sponsor was a family-run operation, received only CACFP funding, and was claiming 30 percent of its centers' food costs for administrative expenses.

Based on our audit results, the sponsor was found to be seriously deficient in administration of the CACFP and was terminated from the program. The sponsor's onsite reviews of its providers were not thorough, were always announced in advance, and all required reviews were not conducted. The sponsor did not keep accurate and complete records and did not adequately review and verify the provider's claims for reimbursement prior to payment. The sponsor also did not timely disburse program funds to providers as required.

This sponsor is under investigation for defrauding the program of over \$340,000 from USDA and CDE. The husband and wife who owned and operated the business were arrested and charged in a 23-count Federal indictment. The charges included conspiracy, perjury, obstruction of justice, and mail fraud.

It is alleged that the couple paid themselves reimbursements for meals claimed on behalf of providers who no longer participated in the program, paid meal reimbursements to full-time employees based on false claims

which the employees submitted, and created false home inspection reports to conceal the fact that employees were not making required home inspection visits.

Three of Angela's Angels employees have pled guilty to mail fraud associated with the submission of false day care home provider claims. They were sentenced to 5 years probation and 90 days home detention, and also ordered to pay USDA \$12,000 in restitution.

Angela's Angels had been engaging in the activities with which it is charged since 1989. In September 1995, CDE issued an audit report on this entity covering fiscal years (FY) 1992-1993 and issued an unqualified opinion.

**Pacific Asian American Family Care, Inc.** (Report Issued in August 1997)

We reviewed Pacific Asian American Family Care, Inc. (PAAM) of Long Beach, California at the request of the CDE, which had expressed concerns about the sponsor's operation of the program. This sponsor exhibited all the characteristics of a problem sponsor: it was a family-run operation, it received only CACFP funding, it claimed 30 percent of its centers' food costs, and its officers engaged in outside employment.

Based on the results of our audit, the sponsor was found seriously deficient in administration of the CACFP and was terminated from the program. Specifically, the sponsor failed to provide support for the administrative costs it claimed. Furthermore, the limited records we were provided indicated that excessive and unallowable personal expenses may have been charged to the program.

Criminal charges were filed against the husband and wife who owned and operated PAAM. The couple was charged with defrauding the program of approximately \$2.2 million by submitting inflated budgets and by diverting CACFP funds to themselves through "payments" to nonexistent employees and bogus business entities. The couple was also charged with using numerous aliases to conceal their interest in the sponsor. The wife was also a manager for the CDE, which was responsible for administering the program. As a manager for the CDE, the wife was responsible for overseeing this and other sponsors in Southern California.

PAAM's former executive director and program director engaged in a separate fraud scheme. They submitted false claims for nonparticipating providers, and, as a result, PAAM was reimbursed in excess of \$60,000 for these claims. The executive director and program director used these funds for their own personal use.



The husband was sentenced to 2 years in Federal prison and the wife to 3 years. They were ordered to pay the Government \$2.2 million in restitution and had already forfeited four residential properties they owned, including their 5,000 square-foot home in an exclusive neighborhood in Southern California. USDA has received over \$1 million from the sale of the four properties. Also, the former executive director and program director were convicted and sentenced to 7 months in prison and 5 months in a community correctional facility. They were ordered to pay \$60,000 restitution.

PAAM had been defrauding the CACFP for over 5 years. The CPA who performed the FY 1995 audit for PAAM issued an unqualified opinion. As a result of our audit, CDE referred the CPA to the California Department of Consumer Affairs Division of Investigations.

**Community Business Improvement Association, Inc.** (Report Issued September 1998)

Community Business Improvement Association, Inc. (CBIA) of Pasadena, California was selected based on a whistleblower complaint received from a source other than CDE. CBIA is currently under investigation for fraud. Like PAAM, CBIA exhibited all the traits of a problem sponsor: it was a family-run operation, it received only CACFP funding, it claimed 30 percent of its centers' food costs, and its officers engaged in outside employment.

We issued three management alerts to FNS notifying them of the following: 1) a key employee of the sponsor had admitted participating in a scheme to misappropriate CACFP funds by submitting false claims for a nonexistent provider, 2) CDE had taken funds which were owed to child care centers for their food expenses to settle the debt owed by the sponsor, and 3) the sponsor had consistently been late in reimbursing its providers and centers for the cost of meals served to the children. The sponsor also admitted to falsifying home inspection reports for 20 to 50 percent of the required home inspection visits.

Based on the results of our audit, the sponsor was found seriously deficient in administration of the CACFP. We found that the sponsor claimed unsupported payroll costs, most of which was paid to the executive director and three other key employees, all of whom were related. The sponsor claimed rent that was unallowable because the property was owned by the executive director and her husband. The sponsor also failed to perform a number of monitoring visits, and failed to pay all its providers and centers within the time period allowed.

The former manager for CBIA and her accomplice pled guilty to making a false statement in connection with CACFP provider claims. They conspired to create a fictitious child care provider and illegally obtained over \$23,000 in CACFP funds.

They were each sentenced to 3 years probation and 6 months in a home detention program, and ordered to pay a \$100 fine. They were also ordered to pay the total restitution amount of \$23,340. In addition, the investigation disclosed that a former California Health Department employee furnished the former manager with a fictitious state child care license.

CBIA's fraud had been ongoing since 1994. As of December 31, 1994, the CPA issued an unqualified audit opinion for all three of CBIA's agreements with the CDE.

**Aladdin Child Care Services, Inc.** (Report Issued February 1999)

We selected Aladdin Child Care Services, Inc. (Aladdin) after an OIG auditor pursued a lead on a complaint made against the sponsor. CDE had adverse information about Aladdin, but it did not share that information with us. We obtained Aladdin's records with a subpoena when we found out that the sponsor was removing itself from program participation while still owing its day care centers thousands of dollars in food reimbursements.

Like PAAM and CBIA, Aladdin was a family-run operation, received only CACFP funding, and claimed 30 percent of its centers' food costs. Also, three of Aladdin's officials received salaries both as sponsor officials and as operators of an independent day care center.

We found that this sponsor, before terminating itself from participation in the CACFP, used funds for unsupported and unallowable purposes. Although an absence of records prevented us from quantifying all of its questionable activities, we still identified about \$800,000 in questionable costs and payments. The majority of day care centers were not paid for all meal reimbursements they were entitled to, and if they were paid, they were not paid on time. While the sponsor underpaid many of its day care centers, it usually overpaid the day care center that it owned. We found a large amount of unexplained payments to the sponsor's own day care center. The sponsor also used CACFP funds to pay for questionable administrative costs, such as construction costs, overdraft charges, and attorney fees.

In October 1997, CDE issued an audit report on this entity covering FYs 1994-1996 and issued a qualified opinion because of "... a material overpayment of reimbursements to the centers and agency" and "material noncompliance". However, the CDE did not believe the findings were material enough to terminate the sponsor from the CACFP.

Even though CDE knew about Aladdin's questionable activities as early as January 1997, it did not take the necessary steps to correct these deficiencies or terminate Aladdin's participation in the CACFP. In fact, Aladdin received approximately \$460,000 in program funds after CDE became aware of these deficiencies. We also found that Aladdin began paying centers even less of the total meal reimbursements due them after CDE became aware of the sponsor's problems.

This sponsor is currently under investigation for program fraud.

**Children's Spectrum Child Care Services, Inc.** (Report Issued July 1998)

Children's Spectrum Child Care Services, Inc. (Children's Spectrum) of Yucca Valley, California was originally selected by OIG based on its size and because it fit our profile of a sponsor using 30 percent of day care center food reimbursements to cover administrative costs. Subsequently, in response to our request to each of the States for potential review candidates, CDE suggested this sponsor for review. According to CDE, one of the reasons they suggested this sponsor was that the executive director was "not accessible."

The sponsor is currently under investigation for program fraud. While residing and working in Wisconsin, the executive director claimed a salary and had the exclusive use of a leased vehicle which was charged to the CACFP. We also determined that for a 6-month period, the executive director received Unemployment Compensation Benefits from Wisconsin despite receiving his salary from the sponsor in California.

On March 5, 1998, we issued a Management Alert recommending that FNS instruct the State agency to withhold any payments to this individual for salary and for the leased vehicle, and to recover \$231,371 in program funds already paid for these purposes.

Subsequently, a Criminal Complaint was filed in Wisconsin for "False Statements to Obtain Unemployment Benefits" against the executive director for allegedly receiving unemployment benefits in Wisconsin while being employed

full-time in California as the executive director of a CACFP sponsor.

The problems with Children's Spectrum date back to 1994. The CPA who performed the 1995 and 1996 audits for Children's Spectrum issued an unqualified opinion. We referred the CPA to the California Department of Consumer Affairs Division of Investigations for substandard audit work.

**A Perfect Balance, Inc.** (Report Issued in December 1998)

A Perfect Balance, Inc. (A Perfect Balance) of Diamond Bar, California was selected because, like Children's Spectrum, it used day care center food reimbursements to cover administrative costs. We also noted that the sponsor received only CACFP funding and that its officers engaged in outside employment.

This sponsor is not under investigation for fraud, but we found its administration of the program to be seriously deficient. The sponsor delayed meal reimbursement to its day care centers and day care homes, used CACFP funds to pay for unallowable and unsupported administrative costs, and had not paid creditors for bills associated with the program. The sponsor also did not properly staff the office during normal business hours.

Activities at this sponsor had been deficient since 1992. For FY 1996, the CPA issued an unqualified opinion for this sponsor.

**Sponsor A.**

This sponsor was selected for review based on a whistleblower complaint received by our investigative staff. The whistleblower alleged fiscal irregularities and based on our initial review of the allegations, these irregularities appear valid. We noted that this sponsor was a family-run operation and received only CACFP funding.

We questioned program funds that were used for personal and non-CACFP related expenditures. In addition, the sponsor used program funds to purchase equipment without the State agency's approval, and the sponsor could not always support its expenditures. We also found that the sponsor did not provide adequate oversight of day care home providers. This lack of oversight may explain, at least in part, why most providers we visited had not complied with important program requirements. CDE has initiated the termination of this sponsor.

This sponsor had been engaging in irregular activities since 1994. For FYs 1995 and 1996, the CPA issued an unqualified opinion for this sponsor.

We have referred Sponsor A to OIG Investigations for program fraud.

**Sponsor B.**

This sponsor was selected for review based on the audit reports issued by the CPA. The CPA reports disclosed that Sponsor B had an overall negative fund balance and there were multiple "related party" (less-than-arms-length) loan transactions.

Preliminary results showed more than half of the day care home providers we visited did not have current attendance or meal count records. The sponsor also purchased \$2,000 of computer equipment which was not approved by the CDE.

In addition, the sponsor advanced funds to employees who traveled to conferences. We determined that the sponsor claimed reimbursement for the amount advanced to the employees, not the amount spent by the employees. However, we were unable to determine if the funds returned by the employees were actually deposited and recorded as credits against program expenses.

For FYs ended June 30, 1995, 1996, and 1997, the CPA issued an unqualified opinion.

**Sponsor C.**

This sponsor was selected for review based on our review of their budgets submitted to CDE. Preliminary results have shown serious potential program irregularities. We determined that during the 11 months we reviewed, the sponsor claimed numerous unallowable, unsupported, and unreasonable expenditures totaling \$115,397. These expenditures included about \$15,000 in automobile lease payments for vehicles which were used for personal reasons and other unallowable administrative expenditures of almost \$30,000. Thousands of dollars were also expended for unreasonable administrative costs.

Records showed that the sponsor was a family-run operation and that it received only CACFP funding. We also found evidence that its officials may have been engaged in outside employment.

It appears that this sponsor has engaged in irregular activities since 1992. For FY 1995, the CPA issued an unqualified audit opinion.

Sponsor D.

This sponsor, a family-run operation that receives only CACFP funding, is currently not participating in the CACFP and is being investigated for program fraud. It appears that the sponsor fraudulently claimed administrative funds. CDE initiated the investigation by seizing the sponsor's records through a search warrant.

The CDE had conducted a compliance review in 1996, and determined Sponsor D was not in compliance with CACFP regulations. OIG initiated an investigation of this sponsor based on a request for assistance from the CDE.

Criminal charges were filed against the husband, wife, and daughter who owned and operated this sponsorship. A 10-count indictment for mail fraud was filed against the three defendants for fraudulently obtaining over \$95,000 from the CDE and the CACFP. The defendants used various schemes to inflate claims for reimbursement and also falsified reports to make it appear that they were properly monitoring approximately 1,000 day care homes which they sponsored.

For FY 1995, the CPA issued an unqualified opinion for this sponsor.

As part of the above audits, we visited or attempted to visit 1,009 day care homes and day care centers operating under eight of the ten California sponsors. For the other two sponsors we were unable to visit any sites because of ongoing investigations. We completed reviews at 752 of these sites. Two hundred and fifty-seven visits were not completed largely because there was nothing to review: no one was on the premises during the stated food service hours, or the home was no longer in the program. However, CDE records showed that these providers were still participating in the program.

Of the 752 day care homes and centers we were able to visit, 66 percent had discrepancies of some form. In some cases, the homes recorded meals served to more children than were present during our visits. In most cases, the homes' meal service records were too unreliable to support the claims (see exhibit D).

We found that sponsors gave little or no help to providers in terms of nutritional awareness. Additionally, for the sponsors of child care centers, the misappropriated program funds directly reduced the money available to purchase food for needy children. We also identified health and safety problems at numerous locations, including unsanitary feeding sites, the presence of dangerous animals, and inadequate supervision of children.

We found serious program irregularities for the 10 sponsors selected for review. Exhibit A illustrates the types of program deficiencies identified and the results of our audits and investigations.

We concluded that because CDE's audits and administrative reviews identified few, if any, of the problems we observed in these sponsors, CDE should target its oversight of sponsors which exhibit characteristics such as those listed in exhibit B and concentrate its resources on the sponsors targeted. In addition, CDE did not always take action on the problems identified. Consequently, CDE needs to determine which sponsors are high risk. We recommend this determination be based on an analysis of common characteristics, such as those we encountered during our review of the 10 sponsors we reported on. CDE should identify its high-risk sponsor universe and target these sponsors for limited scope audits if they fall below the OMB Circular A-133 threshold of Federal awards totaling \$300,000 or more.

Recommendations to address the individual conditions we found at the sponsors are specified in their respective audit reports.

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#### **RECOMMENDATION NO. 1a**

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FNS should work with the CDE to identify its high-risk sponsor universe and direct its resources to those sponsors who fit the problem sponsor profile.

##### **FNS Response**

In its written response to the draft report, dated February 3, 1999, FNS agreed with this recommendation.

##### **OIG Position**

To accept FNS' management decision on this recommendation, we will need to be advised of the date when the CDE expects to complete its identification of its high-risk sponsor universe and to direct its resources to those sponsors who fit the problem sponsor profile.

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## RECOMMENDATION NO. 1b

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Instruct the CDE to compile a database of all CACFP sponsors, including a classification of high-risk sponsors.

### FNS Response

In its written response to the draft report, dated February 3, 1999, FNS agreed with this recommendation.

### OIG Position

To accept FNS' management decision on this recommendation, we will need to be advised of the date when the CDE expects to complete its database of all CACFP sponsors, including a classification of high-risk sponsors.

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## FINDING NO. 2

### CDE WAS NEGLIGENT IN FULFILLING ITS CACFP OVERSIGHT RESPONSIBILITIES

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The CDE was negligent in fulfilling its oversight responsibilities for sponsors participating in the CACFP. The CDE fostered a lax environment in which day care sponsors could personally enrich themselves through various questionable or fraudulent schemes which they could perpetrate with little likelihood of detection by the CDE. In addition, we believe

that without a greater FNS presence in the State's conduct of the program, this lax environment may continue, and the integrity of the program may remain in doubt.

Regulations state "Each State agency shall provide sufficient consultative, technical and managerial personnel to administer the Program, provide sufficient training and technical assistance to institutions and monitor performance to facilitate expansion and effective operation of the Program."<sup>2</sup>

The CDE's oversight responsibilities for the CACFP included reviewing and approving the sponsor's budget, conducting administrative reviews, and conducting and/or reviewing audits. We determined that the CDE was deficient in its oversight responsibilities for all three areas.

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<sup>2</sup> 7 CFR 226.6 (a), dated January 1, 1995.



## BUDGET CONCERNS

Sponsors are required to submit a budget to their CDE program analyst by the end of September for the following fiscal year. Although not all of the problems could have been detected from a review of the budgets, our review of the budgets for the 10 sponsors identified "red flags" that indicated potential problems or concerns which should have been questioned:

### Claiming Administrative Costs for Day Care Centers

Reimbursement of administrative costs to sponsors of independent centers is not explicit in the regulations, as it is for sponsors of day care homes. On December 1, 1997, we issued a Management Alert recommending that FNS establish a rate that sponsors can retain for administering the program to the centers. However, FNS responded that "... State agencies are in the best position to evaluate the individual needs of their sponsoring organizations." California allowed sponsors of independent centers to retain up to a maximum of 30 percent of a center's meal reimbursement to cover their administrative expenses. (Because of our audit work, as of FY 1999, California is only allowing sponsors of independent centers to retain up to 15 percent.)

Six of the ten sponsors we reviewed were sponsors of independent centers, and five of the six also sponsored day care homes. Five of the six sponsors retained the maximum of 30 percent of food reimbursement from their centers for administrative expenditures. The other sponsor owned its own center, prepared the meals for its centers, and claimed food reimbursement directly from CDE.

Additionally, sponsors of day care homes receive an administrative payment according to the number of homes under their sponsorship. Therefore, for five of the six sponsors, the sponsor not only received administrative funds from the CDE for its day care home administration, but also retained 30 percent of center meal reimbursements for administrative expenditures.

We concluded that 30 percent was excessive and created an opportunity for sponsors to abuse the program. A math computation when the budgets were approved would have shown the reviewer that the 30-percent retention was questionable. For example, for FY 1997, Children's Spectrum received \$297,361 for administering an annual average of 493 homes and \$188,773 for administering 49 centers. Although oversight responsibilities for homes and centers are similar, the sponsor received about \$50 per month for each day care home provider and \$321 for each center.

For FY 1997, CBIA's budget was approved for the following: \$142,316 for its administration of 175 homes, \$147,585 for its administration of 180 homes, and \$301,321 for its administration of 38 centers. On average, the sponsor received about \$68 per month for each day care home provider and \$661 for each center. Based on our audit work, we could find no reason that sponsors should retain these large amounts of food reimbursement. In fact, we did not find that sponsors do any more administratively for centers than they do for home providers.

For FY 1996, PAAM's independent center budget was approved for \$840,628 for 63 centers. Thus, the sponsor's budget allowed \$1,112 per month for administrative expenses for each center.

For all three of these examples, we found that the sponsors were diverting funds made available in the 30 percent calculation to unauthorized uses.

#### **Created High Budgeted Amounts To Capture the 30 Percent from Centers**

As stated, sponsors of day care centers were permitted to retain up to a maximum of 30 percent of the food money intended for children attending day care centers, as long as the 30 percent did not exceed the "actual" or "budgeted" amounts. "Budgeted" amounts that equalled or exceeded this 30 percent should have been an automatic red flag and raised questions about the sponsors' budgets. This also applies to amounts that equal or exceed the new 15 percent maximum.

We found problems with all six of the sponsors that were justifying the retention of 30 percent reimbursement. These sponsors created high actual or budgeted amounts to capture the maximum 30 percent. Five of the six are being investigated for program fraud.

#### **Having More than One Day Care Home Agreement**

Sponsors of homes are reimbursed for their actual costs of administering the program, not to exceed the lesser of: (1) the budget amount approved annually by the State agency or (2) a maximum amount per home established by FNS (referred to as "homes times rates").<sup>3</sup> The maximum amount per home varies depending on the total number of homes participating (the more homes, the less per home). For the year ended June 30, 1997, the maximum ranged from \$38 to \$73 per home.

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<sup>3</sup> 7 CFR 226.10 (c) and 226.12 (a), dated January 1, 1995.

CBIA's budget showed that the sponsor had two agreements to sponsor day care homes. Sponsors are normally limited to only one home agreement to cover all homes sponsored. By having two home agreements the sponsor was paid a higher administrative reimbursement than if it had one agreement.

The sponsor in question budgeted 175 homes under one agreement and 180 homes under the second agreement. By not budgeting all 355 homes under one agreement, the sponsor was able to circumvent the maximum-amount-per-home rule. We believe that CDE should only allow one day care home agreement per sponsor.

**Effect of Budgeting 355 Homes Under 2 Agreements Instead of 1**

No. of Agreements	Number of Homes				Total Per Month	Total Annually
	Initial 50 \$73	Next 150 \$56	Next 800 \$44			
1	\$3,650	\$ 8,400	\$6,820		\$18,870	\$226,440
2	7,300	14,280			21,580	258,960
Difference					\$ 2,710	\$ 32,520

**Receiving Late Approval of Program Budget**

As stated, sponsors are required to have their budgets submitted to CDE by the end of September for the next fiscal year. CDE has 30 days from receipt of the completed budget in which to review and approve or disapprove the budget.<sup>4</sup>

Sponsor C's budget for Federal fiscal year 1998 was not approved until July of 1998, 10 months into the fiscal year. In this case, CDE questioned an item in the sponsor's budget--an out-of-State training seminar--but by July the sponsor had already incurred the expense of the trip. CDE was obliged to honor the sponsor's claim for the expense because the sponsor learned after the fact that CDE would not allow it. Under OMB Circular A-122 guidelines, the expense may have been allowable.

**Other Questionable Amounts on the Budgets**

We found other questionable amounts on CDE-approved CACFP budgets. Our audit work generally determined that if these amounts had been questioned, serious deficiencies would have been detected and abuses possibly prevented.

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<sup>4</sup> FNS Child and Adult Care Program Day Care Homes Handbook, page 13, dated October 1994.

1. Sponsor C's monthly employee benefits exceeded \$8,000, much greater than any other sponsor we reviewed. This sponsor also budgeted 11,000 miles per month for mileage expenses incurred by employees who use their personal vehicles for monitoring, training, and workshops. However, the sponsor also budgeted expenses for leased vehicles.
2. Sponsor D's approved budgets for Federal fiscal years 1995 and 1996 showed that their rent expense increased from \$16,200 to \$30,298. The sponsor cited the need for adequate working space as its justification for this increase. This large increase was just one example of a "red flag" which should have required further followup. OIG-Investigations is currently investigating this sponsor for program fraud.
3. Four of the ten sponsors we reviewed also engaged in less-than-arms-length transactions for office space rent. The budget requires sponsors to identify whether the office facilities are partially or fully owned by agency, agency official(s), employees, or relatives of either officials or employees.

Each of these sponsors incorrectly certified that they rented office space from unrelated parties. However, since some of the office space was located in a converted residential space (private residence), we believe that CDE should have asked additional questions to determine who actually owned the property.

4. The CDE program analyst for A Perfect Balance who reviews and approves the sponsor's budget, received information that the deputy director was employed full time at a California county agency. Although the budget analyst subsequently requested an explanation regarding this matter, the budget was still approved on September 18, 1997.

Since the deputy director was not available during normal business hours, we believe that this condition did not allow the sponsor time to properly administer the CACFP. We believe a sponsor must have trained staff members at the office at all times during normal business hours when providers are usually caring for children.

#### **ADMINISTRATIVE REVIEW AND AUDIT CONCERNS**

Administrative reviews and audits examine some of the same program compliance areas. An administrative review evaluates eligibility and meal requirement compliance. However, an audit is to be performed in accordance with Government

auditing standards (GAS) and is larger in scope than an administrative review.

Reviewers examine a sponsor's records, including participant eligibility, meal claim reimbursement, meal requirements, and license capacity. A limited review of the current year's budget and other fiscal information is also performed. The scope of the administrative review is always the most recent month for which the sponsor has submitted its final claim. In addition, followup is to be performed for issues identified in the previous administrative review. Administrative reviews are to be performed at least once every 4 years. For sponsors with over 200 sites, reviews are required once every 2 years.<sup>5</sup>

An audit examines the sponsor's program and accounting records and an opinion is issued based on the examination. In addition, an audit determines the extent and impact of noncompliance issues on meal reimbursement claims. Auditors follow an audit program which details procedures to perform. CDE audits generally consist of examining a sample of program and accounting records for 3 months of the scope year.

The audit reports issued for the 10 sponsors we reviewed had either unqualified or qualified opinions. Eight were unqualified and two were qualified. An unqualified opinion states that the financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of the entity in conformity with generally accepted accounting principles.

A qualified opinion states that, except for the effects of the matter(s) to which the qualification relates, the financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of the entity in conformity with generally accepted accounting principles.<sup>6</sup>

Only one of these audits was performed by CDE. The remainder were performed by CPA firms.

We believe CDE did not perform adequate followup actions when administrative reviews or audits detected that the sponsor may not be complying with all program requirements. The CDE also did not have formal procedures to ensure corrective action had been implemented, and it did not question "unqualified" audit reports when administrative reviews had noted potential problems. Consequently, there was no assurance sponsors

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<sup>5</sup> 7 CFR 226.6 (1), dated January 1, 1995.

<sup>6</sup> AICPA Professional Standards, U.S. Auditing Standards, Section 508, dated July 1, 1997.

implemented corrective action and complied with CACFP laws and regulations.

One primary cause of this lack of effectiveness by CDE to prevent and detect problems in the CACFP is the organizational structure of its oversight function. We found that the units within CDE responsible for the CACFP displayed a lack of coordination necessary to properly administer the program. The External Audit Unit did not always use the results of the administrative reviews conducted by the Field Services Unit during its audits, and the External Audit and Field Services Units did not issue their audit and administrative reports to the Programs Unit who would normally act on the audit findings and recommendations.

#### **Administrative Reviews**

The administrative reviews performed by the Field Services Unit disclosed material findings for 5 of the 10 sponsors we subsequently audited. If CDE had investigated these problem areas, they would have found additional evidence of serious program violations. However, the administrative review results were rarely shared with the Program or External Audit Units for followup. Because of our audits of these five sponsors, all five are being investigated for fraud in the CACFP.

For Children's Spectrum, the 1996-97 administrative review disclosed that the total administrative cost for the month reviewed was reported in the claim for reimbursement for centers and again in the claims for reimbursement for homes. The total administrative cost should have been prorated to the centers and homes. The sponsor was required to submit adjusted claims for October 1997 through January 1998. The adjusted claims were submitted to CDE in July 1997.

For Angela's Angels, the 1996-97 followup administrative review included a finding that administrative costs claimed could not be reconciled to the sponsor's records.

The 1995-96 administrative review for Aladdin concluded that the sponsor had an inadequate understanding of the CACFP requirements and the sponsor was negligent in its CACFP responsibilities.

The 1994-95 administrative review for CBIA included the finding that provider advances were issued as a payment for meals claimed rather than an advance.

And finally, for Sponsor D the 1993-94 administrative review disclosed many fiscal findings. The sponsor exceeded its budget for several line items; advance funds

were incorrectly used, only 7 out of 713 active providers were receiving advances that could be reconciled; funds were not disbursed within 5 days of receipt; and the sponsors record of advance funds did not agree with CDE's records.

Although material findings were discovered for 5 of the 10 sponsors during administrative reviews, the CDE did not adequately followup to ensure corrective action had been implemented.

### **Audits**

CDE or its contract CPA's gave an unqualified opinion to 8 of the 10 sponsors. As stated, administrative reviews noted potential material problems at five of these sponsors, and these five sponsors are being investigated for program fraud. Also, two of the CPA firms that conducted these audits were referred to the California Department of Consumer Affairs Division of Investigations for substandard audit work. We found that audit results were not communicated to the Program or Field Services Units for followup.

The External Audit Unit of the CDE performed a CACFP audit of 1 of the 10 sponsors that we audited. This audit was of Aladdin and covered the period October 1, 1993 through September 30, 1996. We concluded that CDE's work on this audit did not meet GAS and was substandard.

The CDE became aware of Aladdin's serious problems on April 24, 1996, when the CACFP Program Unit manager expressed her concern over the sponsor's accounting procedures for administrative costs.

On July 29, 1996, an administrative reviewer originated a request for an audit. The audit was requested because there appeared to be a gross lack of program management, eligibility applications were not collected annually, and the sponsor did not verify meal counts. The External Audit Unit began the audit in September 1996.

On January 28, 1997, the auditors notified the sponsor that the audit fieldwork would be completed in approximately 1 week. At this time the auditors knew the findings and should have informed the CACFP Program Unit so possible termination of this sponsor could begin.

However, in March 1997, the auditors were removed from the audit and reassigned to help review CPA audit reports. The auditors did not notify the CACFP Program Unit about the severe problems found with Aladdin until July 21, 1997, 6 months after the auditors completed work at the sponsor's

office. The audit report was finally issued in October 1997, 8 months after the auditors completed work at the sponsors office.

In its audit report, dated October 17, 1997, CDE reported that the sponsor had unallowable administrative expenses. CDE also reported that the sponsor incurred costs that were not reasonable and necessary to the overall operation of the sponsoring organization. Such costs included payments for its own center, employee bonuses, contributions and donations, security deposits, transferring funds between bank accounts, and refunds submitted to the CDE for the overpayment of meals claimed for reimbursement.

However, the CDE audit report did not quantify the amount of these payments, nor were these costs disallowed. The audit report merely stated that these costs were incurred and recommended that the sponsor review and observe OMB Circular A-122.

Additionally, CDE reported that this sponsor made payments to the IRS for fines and penalties pertaining to a prior year, and to a former landlord for office space the sponsor did not occupy. According to the audit report, these expenditures were disallowed. However, CDE also did not quantify these expenses in the audit report nor did it explain the result of the disallowed costs.

CDE only recommended the sponsor pay its obligations when due and observe program instructions or regulations pertaining to the allowability of costs. CDE did not include recommendations for the sponsor to either pay the amount of disallowed costs to its centers (since money was withheld from center reimbursements to cover administrative costs) or return the amount disallowed to CDE. Thus, even though the costs were disallowed, the sponsor was never required to repay the disallowed expenditures.

The CDE workpapers documented that this sponsor's administrative cost adjustments for the 3 years totaled \$111,857 and noted that this should be disallowed. However, the audit report only disallowed payments to the IRS and the sponsor's former landlord, the total of which was not quantified in the audit report.

The workpapers also documented that in fiscal years 1993 and 1994 the sponsor exceeded its budget by \$93,320 and noted this amount should be disallowed. However, this was never mentioned in the audit report, nor was there evidence CDE took any action in regards to this matter.

Although CDE reported in its audit report that this sponsor had unallowable administrative expenses, the report did not



quantify its administrative cost findings, and CDE did not act in a timely manner. This sponsor removed itself from the CACFP on September 30, 1997, 17 days before the final audit report was issued.

CDE was well aware of the serious problems associated with this sponsor in January 1997 as a result of its audit fieldwork. However, CDE audit staff were reassigned and fieldwork was suspended for higher priorities. These problems included the submission of false information, failure to maintain adequate records, failure to disburse payments to its facilities in accordance with its management plan, instances of account overdrafts, and a history of administrative or financial mismanagement. All of these are grounds for termination from the CACFP.<sup>7</sup> As a result of CDE's inaction in enforcing CACFP regulations, Aladdin was allowed to continue to spend thousands of dollars on unauthorized administrative expenses. In fact, approximately \$460,000 in program funds were paid to this sponsor after CDE became aware of these deficiencies.

Even though the CDE auditors documented these numerous problems, the CDE did not immediately act on these findings and allowed Aladdin to continue participating in the CACFP and continue to disregard regulations until the sponsor self-terminated on September 30, 1997. Had CDE acted within a reasonable time after discovering the problems, Aladdin could have been terminated earlier from the CACFP and saved taxpayers thousands of dollars.

#### **CDE STRUCTURE**

Program regulations state that, "Each State agency shall provide sufficient consultative, technical and managerial personnel to administer the Program, provide sufficient training and technical assistance to institutions and monitor performance to facilitate expansion and effective operation of the Program."<sup>8</sup> Regulations further state that the State agency shall establish procedures to annually review information submitted by institutions to ensure that all participating child care centers and day care homes are complying with program requirements.<sup>9</sup>

The CDE had the responsibility to monitor the CACFP on behalf of FNS. Within CDE, the External Audits Unit, Field Services Unit, and Program Unit were all involved in the monitoring

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<sup>7</sup> 7 CFR 226.6 (c), dated January 1, 1995.

<sup>8</sup> 7 CFR 226.6(a), dated January 1, 1995.

<sup>9</sup> 7 CFR 226.6(d), dated January 1, 1995.

process. The External Audit Unit conducted audits to determine sponsor's compliance with program requirements. The Field Services Unit performed administrative reviews to verify the sponsor's latest meal claim reimbursement and review the most current month of operations. In addition to approving sponsors' annual budgets, the Programs Unit interacted with sponsors on a daily basis, provided technical assistance, and had the authority to take administrative action against a sponsor.

Interviews with External Audit and Field Services Unit personnel disclosed that the units worked independently without consulting or sharing pertinent information with each other. Additionally, the Program Unit did not receive pertinent information from the External Audit Unit and from the Field Services Unit. Also, there was no documented communication (i.e. memos, meeting minutes, etc.) between the three units.

#### **COLLECTION OF OVERPAYMENTS**

The CDE collects overpayments due from sponsors by offsetting the amounts owed from future claims for reimbursements. The amounts owed are usually the result of ineligible administrative or meal claims identified through an audit or administrative review, or the result of outstanding program advances. In our Management Alert, dated July 24, 1998, we reported our concern over this practice. Our primary concern was that CDE took the food funds, which were owed to all providers and child care centers, to settle the debts owed by the sponsor, a particular provider, or a particular center. CDE did not determine who actually owed the funds (i.e., sponsor, provider, or center).

During our audit of Aladdin, we noted that CDE offset the August 1997 payment to the sponsor by \$34,383. This was to cover part of an \$208,160 overpayment of meal reimbursements that had been identified during an audit performed by CDE auditors covering FY's 1994, 1995, and 1996. During the period March 1996 through December 1997, CDE offset another \$83,889. The offsets against this sponsor totaled \$118,271.

In this case, CDE recovered overpayments identified as far back as FY 1994 with payments due to providers and centers in 1997. CDE made no effort to track the overpayments to the party that actually caused the problem--a provider, a center, or the sponsor itself. In fact, as we know in the case of this sponsor, the practice of offsetting future reimbursements penalizes all the sponsor's providers regardless of their involvement in the ineligible activities.

### CDE'S KEY ACTIONS

In response to our ongoing audits, CDE submitted an action plan dated April 17, 1998. We reviewed the list of 29 key actions which addressed some of the audit issues reported by OIG (see exhibit E). However, the plan did not specifically address the CACFP, and many of the actions were intended to improve oversight of all Child Nutrition Food Distribution Division (CNFDD) programs. While we agree with the action plan, additional steps must be taken to improve CDE's oversight of CACFP. Although some of the actions listed have been implemented, many have not.

We acknowledge that CDE addressed some key issues, such as improving the audit and review process. However, many of the actions intended to improve oversight have not yet been implemented. For example, the list of actions states that CDE "published a formal, comprehensive audit review procedures manual for ... audit staff." This manual was last updated in March 1997 and does not include the revised OMB Circular A-133, FASB 116, or FASB 117, all critical to the audit of sponsors. Additionally, the list also stated that CDE "developed draft procedures for review and referencing." Government auditing standards require an internal quality control system. Currently CDE does not have formal procedures for a quality control review of audit reports. Until CDE can establish formal audit procedures to incorporate OMB Circular A-133 and Government Auditing Standards, CDE audits will continue to be substandard and ineffective.

The list of actions also stated that CDE contracted with CPAs to conduct peer quality reviews of CPAs who audit sponsors. However, this has not occurred for any audits of sponsors who receive CACFP funds.

Also, CDE "... added six new audit positions effective 7/1/97 ..." to increase audits and peer quality reviews. However, there are currently eight audit positions open at the CNFDD, so we believe it is imperative these quality reviews of CPAs are performed to ensure the integrity of the CPA audits, a key element of monitoring CACFP.

Actions that have been implemented include installation of a "toll-free whistle blower hotline", assigning auditors to accompany administrative reviewers during sponsor reviews, and providing audit, program, and field staff with a list of "red flags" for fraud.

CDE has also "assigned additional audit staff to work with field staff to conduct field reviews of suspected fraudulent agencies." In addition, CDE instituted a policy of unannounced visits to child care centers and family day care

homes. We believe these actions will improve oversight of problem sponsors.

Coordination between CDE's External Audit and Field Services Units must improve significantly to ensure adequate monitoring of CACFP. Timely followup by CDE is crucial for **all** administrative review and audit findings to ensure corrective action has been implemented by the sponsor. We found that only monetary findings ever received followup action, and rarely was followup performed for administrative review findings. In some of the audits and reviews, the nonmonetary findings might have been indicative of more significant sponsor problems. We also believe that FNS needs to act aggressively in the State to ensure that CDE improves its oversight of the program.

Also, audits were not always performed timely, exceeding the requirement that the report be completed no later than 13 months after the end of the recipient's fiscal year<sup>10</sup>, and administrative reviews were only required at a minimum of every 2 years. We believe that this and the lack of followup also contributed to sponsor abuse. The External Audit Unit and the Field Services Unit must coordinate their efforts to ensure followup is completed on all findings.

If CDE is unable to reform its oversight function to any satisfactory measure, FNS should act unilaterally to restore integrity to the CACFP in California.

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## **RECOMMENDATION NO. 2a**

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Instruct the CDE to establish a management and accountability process which ensures coordination between the Child Nutrition and Food Distribution Division units and the Audits and Investigations Division.

### **FNS Response**

In its written response to the draft report, dated February 3, 1999, FNS agreed with this recommendation.

### **OIG Position**

To accept FNS' management decision on this recommendation, we will need to be advised of the estimated completion date of the CACFP Management Evaluation which will determine if the

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<sup>10</sup> OMB Circular A-133, Paragraph 15(h), dated March 1990.

CDE has established an acceptable management and accountability process.

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**RECOMMENDATION NO. 2b**

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Instruct the CDE to develop formal procedures to ensure corrective actions recommended in administrative reviews and audit reports are implemented by the sponsors.

**FNS Response**

In its written response to the draft report, dated February 3, 1999, FNS agreed with this recommendation.

**OIG Position**

To accept FNS' management decision on this recommendation, we will need to be advised of the date when the CDE expects to implement formal procedures to ensure corrective actions recommended in administrative reviews and audit reports are implemented by the sponsors.

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**RECOMMENDATION NO. 2c**

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Instruct the CDE to allow only one day care home agreement per sponsor and take action to ensure that all sponsors currently participating in the program have only one day care home agreement.

**FNS Response**

In its written response to the draft report, dated February 3, 1999, FNS agreed with this recommendation.

**OIG Position**

To accept FNS' management decision on this recommendation, we will need to be advised of the date when the CDE expects to implement its new methods to allow only one day care home agreement per sponsor.

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**RECOMMENDATION NO. 2d**

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Instruct the CDE to thoroughly review each sponsor's budget and obtain support for all questionable amounts listed on the budget.

**FNS Response**

This recommendation was added after the FNS response to the official draft audit report was received.

**OIG Position**

To accept FNS' management decision on this recommendation, we will need to be advised of the date when the CDE expects to implement its new methods to support questionable budget amounts.

**EXHIBIT A - SUMMARY OF AUDITS AND INVESTIGATIONS IN CALIFORNIA**

Summary of Audits and Investigations in California							
Sponsor Reviews	Sponsor Determined Seriously Deficient	Types of Program Deficiencies Identified				Results	
		Monitoring/ Training	Administrative Costs	Provider Payments	Fictitious Providers	Sponsor Terminated	Referred For Investigation
Angela's Angels Preschool, Inc.	X	X	X	X	X	X	X
Pacific Asian American Family Care, Inc.	X	X	X		X	X	X
Community Business Improvement Association, Inc.	X	X	X	X	X		X
Aladdin Child Care Services, Inc.	X	X	X	X		X	X
Children's Spectrum Child Care Services, Inc.	X	X	X				X
A Perfect Balance, Inc.	X	X	X	X			
Sponsor A	X	X	X				X
Sponsor B	X	X	X				
Sponsor C	X	X	X				X
Sponsor D	X	X	X			X	X
<b>TOTAL</b>	<b>10</b>	<b>10</b>	<b>10</b>	<b>4</b>	<b>3</b>	<b>4</b>	<b>8</b>

**EXHIBIT B - CHARACTERISTICS OF SPONSORS DETERMINED TO BE SERIOUSLY DEFICIENT**

Sponsor	CACFP Only	Family Run	Leased Vehicles	Outside Employment	Audit Opinion	Admin. Reviews- Material Findings Noted	Audit and Admin.- Review Follow up <sup>1</sup>	Centers	Personal Expenses (i.e., vacation, food, clothes, tuition)	False Claims	Non-disclosed Related Party Transact. for Rent
Angela's Angels	X	X			Qualified	X	No	X		X	
PAAM	X	X		X	Unqualified <sup>2</sup>		No	X	X	X	X
CBIA	X	X	X	X	Unqualified	X	No	X		X	X
Aladdin	X	X		X <sup>3</sup>	Qualified	X	No	X	X	X <sup>4</sup>	
Children's Spectrum	X		X	X	Unqualified	X	No	X			
A Perfect Balance	X			X	Unqualified		No	X			
Sponsor A	X	X			Unqualified		No		X		
Sponsor B					Unqualified		No				
Sponsor C	X	X	X	X	Unqualified		No		X		X
Sponsor D	X	X			Unqualified	X	No		X	X	X

<sup>1</sup>Only monetary follow-up was performed.

<sup>2</sup>CPA audit report not accepted by the CDE because the report did not meet minimum requirements.

<sup>3</sup>Sponsor also owns a day care center that it operates.

<sup>4</sup>To be determined by OIG.



## EXHIBIT C - CACFP MANAGEMENT ALERTS ISSUED

Name of Sponsor	Management Alerts
Angela's Angels Preschool, Inc.	None Issued
Pacific Asian American Family Care, Inc.	<p><b>November 18, 1996</b></p> <ul style="list-style-type: none"> <li>• Sponsor failed to provide records.</li> </ul> <p><b>December 4, 1996</b></p> <ul style="list-style-type: none"> <li>• Potential conflict of interest involving a CDE employee and the sponsor.</li> </ul>
Community Business Improvement Association, Inc.	<p><b>October 15, 1997</b></p> <ul style="list-style-type: none"> <li>• A key employee of the sponsor admitted participating in a scheme to misappropriate CACFP funds by submitting false claims for a nonexistent provider.</li> </ul> <p><b>October 29, 1997</b></p> <ul style="list-style-type: none"> <li>• CDE had taken funds which were owed to child care centers for their food expenses to settle the debt owed by the sponsor.</li> </ul> <p><b>February 24, 1998</b></p> <ul style="list-style-type: none"> <li>• The sponsor was consistently late in reimbursing its providers and centers for the cost of meals served to children.</li> </ul>
Children's Spectrum Child Care Services, Inc.	<p><b>March 5, 1998</b></p> <ul style="list-style-type: none"> <li>• The executive director of the sponsor, who received a salary from the California CACFP, actually resided, and was employed in the State of Wisconsin. In addition, the sponsor also claimed the cost of a leased vehicle used by the executive director, while he lived in Wisconsin.</li> </ul>
Aladdin Child Care Services, Inc.	<p><b>July 24, 1998</b></p> <ul style="list-style-type: none"> <li>• The CDE collected overpayments due from sponsors by offsetting the amounts owed from future claims for reimbursements, potentially harming the providers not responsible for the overpayments.</li> </ul>
A Perfect Balance, Inc.	None Issued
Sponsor A	None Issued
Sponsor B	None Issued
Sponsor C	None Issued
Sponsor D	None Issued
Review of State Agency Oversight	<p><b>April 29, 1998</b></p> <ul style="list-style-type: none"> <li>• CDE improperly claimed CACFP audit funds (2-percent funds) for administrative reviews, and did not have an adequate system in place to support claims for audit staff charged to this 2-percent audit funding source.</li> </ul>

## EXHIBIT D - RESULTS OF PROVIDER VISITS

Sponsor	Attempted Provider/ Center Visits	Review Completed	One or More Concerns Noted	Type of Concerns Noted <sup>1</sup>			
				Record-keeping	Possible Over-Claims	Health or Safety Issues	Meal Components
Angela's Angels	158	125	75	48	X	X	
Pacific Asian American Family Care, Inc.	108	86	49	40	X	X	
Community Business Improvement Association, Inc.	119	57	44	34	X		X
Aladdin Child Care Services, Inc.	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Children's Spectrum Child Care Services	270	187	122	110	X	X	X
A Perfect Balance, Inc.	43	40	24	19	X	X	X
Sponsor A	311	257	182	149	X	X	X
Sponsor B	No info yet						
Sponsor C	No info yet						
Sponsor D <sup>2</sup>	N/A	N/A	N/A	N/A	N/A	N/A	N/A
<b>TOTAL</b>	<b>1,009</b>	<b>752</b>	<b>496 (66%)</b>	<b>400 (53%)</b>			

<sup>1</sup>For recordkeeping concerns, we counted specific instances. For the other concerns, we noted the existence of deficiencies.

<sup>2</sup>OIG site visit was not performed because the sponsor was terminated from the program.

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**EXHIBIT E - CDE'S KEY ACTIONS**

<b>State Oversight Actions Child Nutrition and Food Distribution Division April 1998</b>
1. We added six new audit positions effective 7/1/97, and submitted Budget Change Proposals (in conjunction with CDD) for six more audit positions.
2. We established three investigative Auditor positions, and sent the fraud investigators through a 12-week intensive Peace Officer Standards and Training Academy. We have requested three more investigations for the 1999 state fiscal year.
3. We published a formal, comprehensive audit review procedures manual for our audit staff to ensure that our audit review processes and procedures are implemented in a consistent and thorough manner.
4. We established a procedure of assigning a staff administrator to close out the operations of agencies we terminated for fraud to ensure proper closeout, evidence collection, and timely and accurate payment to providers.
5. We contract with the State Department of Finance for auditors to assist in peak workload periods.
6. We established a professional working relationship with the USDA Investigative Unit of the Office of Inspector General to coordinate and collaborate on sensitive fraud cases.
7. We installed a toll-free whistle blower hot line to encourage identification and report of potential fraudulent activities.
8. We developed and are conducting training for our field, audit, program, and audit closure staff on early warning detection of fraud; proper procedures to follow when fraud is found or expected; how to handle calls or other information from individuals reporting fraud; and how to coordinate internally the information we receive to ensure timely referral, response, and corrective action.
9. We established clear work production standards for audit staff who perform desk reviews. We will also develop production standards for field audits.
10. We established program policy committees that meet regularly to ensure coordination and proper followup of reviews, complaints, and problem agencies.
11. We established procedures to increase the presence of auditors with our field and program staff on reviews needing strong fiscal scrutiny.
12. We hired private CPA's to conduct peer quality reviews of other private CPA work to ensure that the work is being done correctly and in accordance with proper auditing practices and procedures.
13. We conduct semi-annual (possibly annual in the future) training workshops for private CPA's to help ensure that annual independent audits are performed in accordance with proper program and auditing practices and procedures.
14. We are reevaluating our internal organizational structure and our compliance review procedures and responsibilities relating to field, program, audits, and audit closure functions.
15. We have established and implemented a policy of increasing the number and frequency of unannounced visits to child care centers and family day care homes.

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**EXHIBIT E - CDE'S KEY ACTIONS**

<b>State Oversight Actions Child Nutrition and Food Distribution Division April 1998</b>
16. We have instituted new monitoring procedures to ensure the proper implementation of corrective action plans.
17. With USDA approval, we have added more criteria to the minimum federal requirements for screening applications for the Child Care Food Program to help ensure the integrity and administrative viability of organizations applying to participate in the Child Care Food Program.
18. We have requested a peer review of our audit functions by the California State Auditor's Association. We expect that peer review possibly by September 1998 depending on availability of peer review team.
19. We have assigned additional audit staff to work with field staff to conduct field reviews of suspected fraudulent agencies, and will use the "sweep" approach to conduct such reviews.
20. We have expanded the number of field reviews conducted by our audit staff by redirecting staff who previously conducted only desk reviews of CPA audits.
21. We provide a regularly updated list of "red flags" for fraud to all of our audit, program, and field staff.
22. We reorganized our audit structure so all auditors are assigned to conduct audits of all child nutrition programs, rather than specialize in conducting audits of only one or a few child nutrition programs.
23. Reports and a sample of work papers are reviewed by the Administrator, Audits, and Administrative Services, before reports are issued.
24. We will spread review and referencing workload for field audits reports between other auditors instead of concentrating all reviews and referencing with primarily one auditor.
25. Reviewers will ensure all reports and findings are "referenced" in accord with normal audit procedure. OEA developed draft procedures for review and referencing.
26. We train field auditors to look for fraud indicators, "red flag" those as part of field work, then issue "management alerts" as necessary to program staff and the Division Administrator of program area involved.
27. Audit findings will be aged with 60-day, 180-day, and one-year followups to ensure corrective action taken.
28. Audit Programs will be reviewed annually and before the start of each audit, then approved by the Administrator, Audits, and Administrative Services.
29. Food Distribution staff have begun working with audit and investigation staff to identify and review certain commodity processors.

**EXHIBIT F - FNS' WRITTEN RESPONSE TO THE DRAFT REPORT**



United States Department of Agriculture  
Food and Nutrition Service

Western Region

Reply to  
Attn of: WFM-200

Subject: Child and Adult Care Food Program  
California State Agency Oversight  
Audit 27601-6-SF

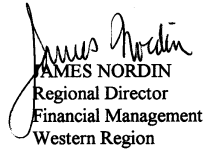
To: Sam W. Currie  
Regional Inspector General for Audit  
Office of Inspector General

We consider the results of the Child and Adult Care Food Program (CACFP) audits to be very serious matters. We are working with the California Department of Education (CDE) to ensure there are sufficient training and organizational controls in place for the CACFP. We have also increased our oversight of CACFP in conjunction with our Headquarters' CACFP integrity initiatives.

Attached are our responses to the specific findings and recommendations, along with suggested editorial changes and corrections.

We were also advised by Bob Gray of your staff that recommendation 2d has been deleted. We request OIG consider deleting the last sentence of the Executive Summary - Key Recommendations as this paraphrases recommendation 2d.

If you have any questions, please call Martin Tom at (415) 705-1341, extension 239.

  
JAMES NORDIN  
Regional Director  
Financial Management  
Western Region

Attachment

cc: Janet Allen, RD, SNP  
Stan Garnett, CND, Alexandria, VA

FORM FCS-606 (3-96)

550 Kearny St. ■ Room 400 ■ San Francisco, CA 94108-

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**EXHIBIT F - FNS' WRITTEN RESPONSE TO THE DRAFT REPORT**

Attachment

**FNS Comments on OIG Audit 27601-6-SF  
Child and Adult Care Food Program  
Review of State Agency Oversight  
State of California**

Following are our responses to OIG recommendations of this audit:

Executive Summary - Key Recommendations

We recommend that FNS work with CDE to identify its high-risk sponsor universe and prioritize its resources to those sponsors who fit the problem sponsor profile presented in this report. Also, instruct the CDE to reorganize its structure and establish a process which ensures coordination between the Child and Adult Care Food Program units. In addition, FNS should instruct CDE to develop formal procedures to ensure corrective action recommended in administrative reviews and audit reports is implemented by the sponsors, and allow only one day care home agreement per sponsor. *If CDE cannot improve its oversight of this program within a reasonable period of time, FNS should consider withholding administrative funding to CDE and/or removing CDE from administration of the CACFP.*

Note: We recommend the sentence we have shown above in *bold italics* be deleted from the key recommendations as it summarizes recommendation 2d which we understand has been deleted from the report.

Agency Position

We consider the results of the Child and Adult Care Food Program (CACFP) audits to be very serious matters. We have increased our oversight of CACFP in California and are working with CDE to ensure there are sufficient training and organizational controls in place for the CACFP.

Since the issuance of the first management alerts and subsequent individual audits of sponsors and the State agency, FNS has been working with the CDE to strengthen CACFP integrity. Since early 1998, FNS has been working with CDE to prioritize its resources to those sponsors which fit the problem sponsor profile and we will continue working with the CDE to identify high-risk sponsors. For example, in late January 1999, FNS participated with OIG and CDE in training CDE staff on sponsor fiscal management practices; this included training by OIG and CDE on identifying high-risk sponsors.

CDE has taken several actions to address concerns with its management of the CACFP. CDE has significantly reorganized its audit function which is now assigned to the CDE's Legal and Audits Branch and reports to CDE's General Counsel. CDE has also created an Integrity Committee composed of audit, review, administrative, and management staff to determine effective plans of action for individual problem sponsors, and coordinate and

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**EXHIBIT F - FNS' WRITTEN RESPONSE TO THE DRAFT REPORT**

Attachment

determine CDE actions needed to ensure sponsor integrity. In a January 8, 1999 meeting with OIG and the State, CDE indicated it has eliminated the double agreement with the sponsor and established procedures to prevent this from recurring. FNS' efforts with the CDE are ongoing and reflected in the region's Fiscal Year (FY) 1999 work plan. Additional resources for this initiative have been provided by specially appropriated funds to FNS.

FNS will further assess CDE's progress through a Management Evaluation scheduled for March 1999. We are confident in the State's commitment and efforts to improve its management of CACFP, and, should California fail to improve its management of the CACFP, we will consider sanction action.

Report Finding 1; Recommendation No. 1a – page 16

The Food and Nutrition Service should work with the California Department of Education to identify its high-risk sponsor universe and prioritize its resources to those sponsors who fit the problem sponsor profile.

FNS Response

We agree with the recommendation. FNS has been working with the CDE and will continue to do so in FY 1999 on a joint effort to identify high-risk sponsors. FNS recognizes the need to strengthen program integrity in the CACFP within CDE. We are committed to working with CDE towards this goal. Since the issuance of the first management alerts and subsequent individual audits of sponsors and the State agency, FNS has been working with the CDE to strengthen CACFP integrity. Since that time, the State agency has taken several steps to improve its management of CACFP; CDE has reorganized and reassigned the audit function to CDE's Legal and Audits Branch; created an Integrity Committee in CDE to determine effective plans of action for individual problem sponsors and address internal coordination; and increased efforts to improve program integrity, particularly through sponsor budget review and approval, and administrative reviews.

FNS' work with CDE is ongoing and is reflected in the region's Fiscal Year (FY) 1999 work plan. Additional resources for this initiative are provided by specially appropriated funds to FNS. Also, FNS participated in training the CDE on sponsor fiscal management practices on January 25, 1999, at which OIG and CDE staff presenting training on identifying high-risk sponsors. FNS has been working with the State agency since early 1998 to prioritize its resources to those sponsors which fit the problem sponsor profile and will continue to do so as part of our comprehensive efforts with CDE. We request your concurrence for management decision.

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**EXHIBIT F - FNS' WRITTEN RESPONSE TO THE DRAFT REPORT**

Attachment

Report Finding 1; Recommendation No. 1b – page 16

Instruct the California Department of Education to compile a database of all Child and Adult Care Food Program sponsors, including a classification of high-risk sponsors.

FNS Response

We agree with the recommendation. In our most recent Management Evaluation of CDE, we recommended CDE develop a comprehensive database accessible to the various CDE staff functions. We believe this database partially addresses the audit recommendation. Upon receipt of this audit, we will require the State agency include a method of identifying high-risk sponsors in this database. We will assure there is an acceptable time-frame for implementation, when we conduct our CACFP Management Evaluation in March 1999. We request your concurrence for management decision

Report Finding 2; Recommendation No. 2a – Page 30

Instruct the California Department of Education to establish a management and accountability process which ensure coordination between the Child Nutrition and Food Distribution Division units and the Audits and Investigations Division.

FNS Response

We agree with the recommendation. FNS' most recent Management Evaluation of CDE's CACFP made the same recommendation. Since that time, the State agency has significantly reorganized its audit function; this function is now under the CDE Legal and Audits Branch which reports to the CDE General Counsel and is separate and independent of education, program, and fiscal functions. The State has also created an Integrity Committee composed of audit, review, administrative, and management staff which meets bi-weekly to coordinate and determine State agency actions needed to ensure sponsor integrity. This committee is currently drafting a Letter of Understanding which defines unit responsibilities with inter-unit procedures and flow-charts to support effective coordination and communication; this is expected to be finalized by March 1999. We will follow up on this recommendation during the CACFP Management Evaluation in March 1999. We request your concurrence for management decision.

Report Finding 2; Recommendation 2b – page 30

Instruct the California Department of Education to develop formal procedures to ensure corrective action recommended in administrative reviews and audit reports is implemented by the sponsors.



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## **EXHIBIT F - FNS' WRITTEN RESPONSE TO THE DRAFT REPORT**

Attachment

FNS Response

We agree with the recommendation. In discussion of this audit, FNS suggested to OIG some corrective actions the State agency may undertake to address this finding; we will include these suggestions in our audit transmittal to the State agency. In addition, the CDE's Integrity Committee mentioned above will address this recommendation.

Report Finding 2, Recommendation 2c – page 30

Instruct the California Department of Education to allow only one day care home agreement per sponsor and take action to ensure that all sponsors currently participating in the program have only one day care home agreement.

FNS Response

We agree with the recommendation. In a January 8, 1999 meeting with OIG and the State, the State agency indicated it has eliminated the double agreement with the sponsor and established methods to prevent the recurrence of such errors. We request your concurrence for management decision.

**Additional comments and suggested changes:**

Report Finding 1, Page 6: We recommend that the heading be changed to "Fraudulent Sponsors Eluded CDE Detection" to more accurately reflect the problem behavior of some sponsors.

Report Finding 2, Page 19, Having More than One Day Care Home Agreement. We recommend that the order of the first two paragraphs be switched to provide continuity. The first paragraph provides the details of how sponsoring organizations are reimbursed and the second paragraph gives the specifics of CBIA's two agreements with the State agency to sponsor day care homes and the resulting fiscal implications.

Page 20, Receiving Late Approval of Program Budget. The footnote for last sentence of the first paragraph references regulatory citation 7 CFR 226.11(a) which allows a State agency to make payment for meals in the calendar month preceding the calendar month in which the agreement is executed. Under Federal regulations, this means a state has until the end of November each year to approve or disapprove sponsor budgets. The audit narrative reads: "...sponsors are required to have their budgets submitted to CDE by the end of September for the next fiscal year. CDE then has 30 days in which to review and approve or disapprove the budget." This narrative describes a CDE requirement rather than the Federal regulations at 7 CFR 226.11(a). We recommend that either the footnote referencing the Federal CFR or the narrative be corrected.

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**EXHIBIT F - FNS' WRITTEN RESPONSE TO THE DRAFT REPORT**

Attachment

Page 28, Collection of Overpayments, first paragraph, fifth line- change to: "In fact, as we know in the case of this sponsor, if a sponsor is forced to discontinue its participation in the CACFP as a result of CDE offsets, legitimate providers and centers will never receive their earned reimbursement."