CALIFORNIA STATE AUDITOR

Interim Reporting: Fiscal Year 2008–09 Single Audit

Employment Development
Health Care Services
Rehabilitation
Social Services
Transportation

December 2009 Report 2009-002.2

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December 21, 2009 2009-002.2

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

Dear Governor and Legislative Leaders:

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

This interim report summarizes audit results pertaining to eight federal programs administered by five departments. The State Auditor's Office has currently identified 24 findings regarding the departments' administration of these federal programs during fiscal year 2008–09. In many cases the findings are recurring issues we identified in past audits. In general, the findings focused on federal requirements regarding eligibility of individuals, whether costs were allowable, and monitoring subrecipients', such as cities and counties, use of funds. The specific federal programs, and their administering state departments, are listed in the table of contents. Where applicable, the State Auditor's Office performed a preliminary review of state departments' methodology for reporting the number of jobs created or retained with Recovery Act funds. Of the five departments, only two—the Department of Rehabilitation and the Department of Transportation—reported jobs created or retained. According to federal guidelines, the remaining three departments were not subject to these reporting requirements. The Department of Rehabilitation followed federal guidance and reported 13 jobs created or retained; however, the 1,590 jobs the Department of Transportation reported as created or retained is overstated by at least 390.

Respectfully submitted,

Elaine M. Howle

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State Auditor

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Results in Brief

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

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

This interim report summarizes audit results pertaining to eight federal programs administered by five departments. The State Auditor's Office has currently identified 24 findings regarding the departments' administration of these federal programs during fiscal year 2008–09. In many cases the findings are recurring issues we identified in past audits. In general, the findings focused on federal requirements regarding eligibility of individuals, whether costs were allowable, and monitoring subrecipients', such as cities and counties, use of funds. Where applicable the State Auditor's Office also performed a preliminary review of state departments' methodology for reporting the number of jobs created or retained with Recovery Act funds. Finally, we made numerous recommendations to the respective departments.

The Employment Development Department (EDD) administers the Unemployment Insurance program (Federal Catalog Number 17.225). The Unemployment Insurance program provides benefits to unemployed workers for periods of involuntary unemployment and helps stabilize the economy by maintaining spending power of workers while they are between jobs. During fiscal year 2008–09, EDD spent more than $14.5 billion in federal funds—of which at least $471.9 million were funds provided by the Recovery Act for this program. The State Auditor's Office identified one finding as of November 24, 2009, regarding EDD's administration of this program. This finding pertains to EDD's inability to identify all expenditures for two of three program components that were partially funded by the Recovery Act. Specifically, except for the component of its Unemployment Insurance program intended to add $25 a week to those receiving unemployment payments, EDD is unable to account for or track Recovery Act funds it spent in fiscal year 2008–09. Because this one component of the Unemployment Insurance program is funded exclusively by the Recovery Act, EDD was able to identify that it spent $471.9 million during fiscal year 2008–09. However, EDD could not tell us how much of the approximately $4 billion it spent on the two other components of the Unemployment Insurance program came from Recovery Act funds. These two program components were intended to provide unemployed California workers with additional weeks of benefits.

The Department of Health Care Services (Health Care Services) administers the Medical Assistance Program (Federal Catalog Number 93.778), commonly referred to as Medi-Cal in California. The objective of Medi-Cal is to provide payments for medical assistance to low-income persons who are age 65 or over, as well as others that meet certain criteria. In fiscal year 2008–09, Health Care Services received $24.9 billion for this program, including $2.8 billion in Recovery Act funds. The State Auditor's Office identified seven findings as of December 1, 2009, that pertain to Health Care Services' administration of Medi-Cal. Of these seven findings, five are repeat findings we have disclosed in previous annual audit reports. The audit findings generally focused on whether Health Care Services was making proper eligibility determinations and spending program funds only on allowable costs. For example, one of the tests we perform is to determine whether the State provided drug manufacturers with drug utilization information that is used to generate a rebate for the State. Federal law allows states to receive rebates for drug purchases the same as other payers receive. No later than 60 days after the end of a quarter, the State is required to provide drug utilization data to drug manufactures. These drug manufacturers then have 30 days to pay the State the required rebate or dispute the claim. We tested 40 rebate invoices amounting to $165.5 million from the third and fourth quarters of 2008, as well as the first and second quarters of 2009, and noted that Health Care Services provided drug manufacturers with utilization data after the 60-day deadline for each quarter tested. For instance, Health Care Services was 11 and 16 days late in providing the utilization data to drug manufacturers for the third and fourth quarters of 2008, respectively. As a result, the State did not obtain the $165.5 million it was due in a timely manner and potentially missed an opportunity to earn interest on these funds.

The Department of Rehabilitation (Rehabilitation) administers the Rehabilitation Services–Vocational Rehabilitation Grants to States Program (Federal Catalog Number 84.126). The objective of this program is to assist states in operating a comprehensive and effective state vocational rehabilitation program. Although during fiscal year 2008–09 Rehabilitation did not spend any of the $56.5 million the federal government awarded it under the Recovery Act for the vocational rehabilitation grant program, the State Auditor's Office identified five findings as of November 30, 2009, that could affect Rehabilitation's administration of these funds in fiscal year 2009–10 and beyond. In general, these findings focused on federal requirements pertaining to the activities allowed, eligibility, reporting, and matching compliance requirements. Further, the State Auditor's Office performed a preliminary review of Rehabilitation's reporting of job-related data under Section 1512 of the Recovery Act. Based on this preliminary review and Rehabilitation's description of its methodology, it appears that Rehabilitation followed applicable federal guidance when it reported 13 jobs created or retained.

The Department of Social Services (Social Services) administers a variety of programs that have been awarded Recovery Act funds during fiscal year 2008–09 including: the State Administrative Matching Grants for the Supplemental Nutrition Assistance Program (SNAP) (Federal Catalog Number 10.561), Temporary Assistance for Needy Families (TANF) program (Federal Catalog Number 93.558), Foster Care—Title IV-E (Foster Care) program (Federal Catalog Number 93.658), and the Adoption Assistance Program (Federal Catalog Number 93.659). All of these programs were collectively awarded $6.2 billion, including Recovery Act funds totaling $307.1 million during fiscal year 2008–09, and Social Services spent roughly $36.8 million in Recovery Act funds on two of these programs. The State Auditor's Office identified nine findings as of December 3, 2009, that pertain to Social Services' administration of these federal programs. The findings concerned a variety of different federal regulations including those governing allowable activities and subrecipient monitoring. For example, although in fiscal year 2008–09 Social Services reimbursed counties approximately $5.3 billion for the four programs previously mentioned, it did not conduct any on-site reviews to ensure that counties were spending federal funds only on allowable activities. This is a recurring finding we reported in last year's annual

audit. In fact, of these nine findings, eight are findings we have disclosed in previous annual audit reports. Our testing this year also revealed that Social Services corrected three other findings that we included in last year's annual report.

The Department of Transportation (Caltrans) administers the Highway Planning and Construction Program (Federal Catalog Number 20.205). Caltrans uses federal funds under this program for a variety of activities, such as making capital improvements to certain designated highways and providing subgrants to local agencies, such as cities and counties, for similar projects. During fiscal year 2008–09, Caltrans received more than $2.8 billion in federal funds, of which approximately $1.2 million—or less than 1 percent—is funding provided by the Recovery Act. The State Auditor's Office has identified two findings as of December 1, 2009, that pertain to Caltrans' administration of this federal program. These findings related to noncompliance with federal requirements concerning allowable costs and subrecipient monitoring. For instance, until it changed its policy in September 2009, Caltrans lacked effective controls to ensure that the progress payments it made to local agencies were reasonable and necessary in relation to the actual work being performed. Under its new policy, Caltrans requires engineers in its district offices to verify that work claimed on progress invoices was actually completed and eligible for reimbursement.

In addition to assessing Caltrans' administration of this federal program, the State Auditor's Office performed a preliminary review of Caltrans' October 2009 reporting of jobs data as required under Section 1512 of the Recovery Act. Based on this preliminary review, we believe that Caltrans followed the Federal Highway Administration's (FHWA) guidance for reporting jobs created or retained. However, the number of jobs it reported is overstated. Specifically, Caltrans reported that it spent $26.7 million in Recovery Act funds and created or retained nearly 1,590 jobs. Caltrans acknowledged that this jobs figure was overstated for a variety of reasons, including that it had counted jobs on some construction projects twice. Furthermore, Caltrans reported that one or more jobs were created or retained at 152 projects; but 94 of these projects representing 892 jobs created or retained had yet to spend any Recovery Act funds. Therefore, we question the accuracy of the 892 jobs reported for these 94 projects. In fact, the FHWA planned to review states' jobs data to check for errors and one of its validation rules states that if jobs were reported, then Recovery Act funds must have been expended. However, it appears that FHWA did not apply this validation rule.

Agency Comments

We summarized the departments' responses. In general, the state departments concurred with the audit findings discussed in this interim report and plan to take corrective action. However, the departments disagreed with our conclusions in a few cases. In those instances, we have summarized the departments' perspective on these issues, as well as our response, in this interim report.

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Employment Development Department

UNEMPLOYMENT INSURANCE
FEDERAL CATALOG NUMBER 17.225

Based on the U.S. Office of Management and Budget's (OMB) June 2009 guidance, the California State Auditor's Office (State Auditor's Office) presents its interim reporting on the Employment Development Department's (EDD) administration of the Unemployment Insurance program (Federal Catalog Number 17.225) during fiscal year 2008–09. The issue contained in this interim reporting represents the results of our internal control and compliance audit that require EDD's corrective action.

The State Auditor's Office identified one finding as of November 24, 2009, that pertains to EDD's administration of this federal program. This finding relates to requirements under the American Recovery and Reinvestment Act of 2009 (Recovery Act).

EDD Cannot Identify All of Its Recovery Act Expenditures

EDD's financial management systems do not allow it to separately identify and report on Recovery Act funds expended for certain benefits paid under the Unemployment Insurance program. OMB's June 2009 guidance requires separate accountability for Recovery Act funds. Additionally, federal regulations state that to maximize the transparency and accountability of funds authorized under the Recovery Act, recipients agree to maintain records that identify the source and application of Recovery Act funds and to separately identify the expenditures for federal awards under the Recovery Act on the Schedule of Expenditures of Federal Awards. Finally, according to a Program Letter provided by the U.S. Department of Labor, some unemployment benefit payments should be reported separately on required monthly financial reports as Recovery Act expenditures.

Unemployment Insurance Benefits Related to the Recovery Act

- Federal Additional Compensation (FAC): Increased all benefit payments (including regular unemployment insurance) by $25 a week, beginning February 22, 2009.
- Emergency Unemployment Compensation (EUC): Provides up to 33 additional weeks of unemployment benefits. The Recovery Act extended the time frame in which claimants could file for EUC and receive benefits.
- Federal-State Extended Benefits (Fed-Ed): Provides up to 20 additional weeks of unemployment benefits. The Recovery Act provided that such benefits are paid fully by the federal government except benefits paid to claimants whose eligibility for benefits was based on prior employment with state and local governments or federally recognized Indian Tribes.

Sources: Recovery Act, grant agreements, program letters, compliance supplement, and the Employment Development Department Web site.

The Unemployment Insurance program expended $14.5 billion during the fiscal year 2008–09, which included Recovery Act and non-Recovery Act funds. As detailed in the text box, of the several types of unemployment benefit program components, the Emergency Unemployment Compensation (EUC), Federal-State Extended Benefits (Fed-Ed), and Federal Additional Compensation (FAC) program components all expended Recovery Act funds. Of these three program components, FAC, which increased all benefit payments by $25 per week, is the only program component that is entirely funded through the Recovery Act. As a result, EDD is able to identify that it spent Recovery Act funds totaling $471.9 million for the FAC program component. However, for the other two program components, EDD cannot separately identify Recovery Act

funds from non-Recovery Act funds. Specifically, EDD spent a total of $3.7 billion in program benefits for the EUC program component in fiscal year 2008–09; however, it cannot identify the portion of those benefits paid with Recovery Act dollars. EUC existed before the enactment of the Recovery Act; however, the act extended the benefits paid under the program component. As described in the text box, the EUC program component provides up to 33 additional weeks of unemployment insurance benefits and the Recovery Act extended the time frame in which claimants could file for such benefits. Similarly, EDD spent a total of $255 million in benefits for the Fed-Ed in fiscal year 2008–09, a program component that provides up to 20 additional weeks of unemployment benefits. However, it cannot identify the portion of those benefits paid with Recovery Act dollars. Failure to identify the benefits provided to Californians with Recovery Act funds limits the State's ability to demonstrate how the funds have assisted those most affected by the recession.

The manager of the general ledger unit (manager) acknowledged that EDD cannot separately identify all Recovery Act expenditures for either the EUC or the Fed-Ed program components because its financial management systems do not allow it to identify the total dollar amount of benefit payments authorized by the Recovery Act and paid to claimants. However, the manager also noted that EDD is in the process of updating its systems so that it can identify this information.

To ensure that Recovery Act funds can be separately identified for the Fed-Ed and EUC program components, we recommend that EDD continue its efforts to update its financial management systems. EDD agreed with our recommendation and, according to the manager, hopes to complete the update by March 2010. The manager also noted that once EDD has completed the update of the financial management systems, it will amend the financial reports submitted to the U.S. Department of Labor that require separate identification of Recovery Act funds. However, until EDD has completed the necessary program changes, it cannot maintain records that identify the source and application of Recovery Act funds or separately identify the expenditures of federal awards under the Recovery Act on the Schedule of Expenditures of Federal Awards, as required by federal regulations.

Department of Health Care Services

MEDICAL ASSISTANCE PROGRAM
FEDERAL CATALOG NUMBER 93.778

Based on the U.S. Office of Management and Budget's (OMB) June 2009 guidance, the California State Auditor's Office (State Auditor's Office) presents its interim reporting on the Department of Health Care Services' (Health Care Services) administration of the Medical Assistance Program (Medi-Cal) (Federal Catalog Number 93.778) during fiscal year 2008–09. In fiscal year 2008–09 Health Care Services received $24.9 billion for this program, including $2.8 billion in Recovery Act funds. The issues contained in this interim reporting represent the results of our internal control and compliance audit that require Health Care Services' corrective action.

The State Auditor's Office identified seven findings as of December 1, 2009, that pertain to Health Care Services' administration of Medi-Cal. Of these seven findings, five are repeat findings we have disclosed in previous annual audit reports. Our testing this year also revealed that Health Care Services corrected four other findings that we included in last year's annual report.

Health Care Services Does Not Consistently Adhere to Requirements for Determining the Eligibility of Medi-Cal Beneficiaries

Federal regulations require Health Care Services to redetermine the eligibility of Medi-Cal beneficiaries, with respect to circumstances that may change, at least every 12 months.

Health Care Services does not have adequate internal controls in place to ensure that Medi-Cal benefits are discontinued when it does not receive redeterminations of beneficiaries' eligibility within the required time frame. States are required to operate a Medicaid Eligibility Quality Control (MEQC) system in accordance with requirements established by the Centers for Medicare and Medicaid Services (CMS). The MEQC system redetermines eligibility for a sample of beneficiaries whose eligibility was determined by state Medicaid agencies or their designees. The State of California has been granted a waiver from the traditional MEQC program described in federal regulations and differs from the traditional program by allowing for the performance of special studies, targeted reviews or other activities designed to ensure program integrity or improve program administration. Of the 3,506 cases Health Care Services reviewed as part of its MEQC process from July 2008 to June 2009, 215 were ineligible for Medi-Cal, resulting in a 6.13 percent error rate. This error rate affects Recovery Act expenditures, which amounted to $2.8 billion for fiscal year 2008–09, as it indicates there is risk of noncompliance related to eligibility. If the 6.13 percent error rate was applied to the population of total Recovery Act expenditures, a potential exposure of $169 million in erroneous payments may exist.

Additionally, we reviewed 60 case files from the general population of the State's Medi-Cal beneficiaries, in 10 different counties, to reperform the counties' eligibility determination. Of these 60 case files, one case had been deemed eligible by the county but was actually ineligible for Medi-Cal benefits. The county had failed to perform the annual redetermination of eligibility, which was due in June 2009, and the family remained active as Medi-Cal beneficiaries during the fiscal year ended June 30, 2009. There was no evidence in the family's case file to substantiate that a redetermination was performed and, as such, the beneficiaries were ineligible during the month of June 2009.

We recommend that Health Care Services strengthen its controls over its redetermination requirements for Medi-Cal beneficiaries to ensure that benefits are discontinued when redeterminations of beneficiaries' eligibility are not received within 12 months of the most recent redetermination date. In response to our recommendation, Health Care Services stated that it regularly screens its MEQC database for issues associated with redeterminations. Health Care Services indicated that counties demonstrating patterns of redetermination issues are contacted, consulted with, and are subject to focused reviews, as needed. However, without strengthening these controls, we believe Health Care Services may continue to provide Medi-Cal benefits to ineligible beneficiaries.

Health Care Services Does Not Adequately Track Information Related to Presumptive Eligibility

Federal law allows Health Care Services to provide immediate and temporary Medi-Cal coverage to a pregnant woman, during a presumptive eligibility period, who does not have health insurance or Medi-Cal coverage. Providers that determine a pregnant woman is presumptively eligible for medical assistance are required to promptly notify Health Care Services of the determination.

Health Care Services does not adequately track information related to presumptive eligibility for pregnant women. Health Care Services grants the right to enroll recipients under this program to qualified providers. Because the program provides immediate and temporary care prior to the approval of Medi-Cal eligibility, recipients enrolled through presumptive eligibility are not considered eligible for Medi-Cal and, therefore, are not entered into Health Care Services' eligibility systems. Recipients presumed to be eligible are assigned a prenumbered identification card that is obtained from Health Care Services by the provider. Providers are required by the state plan to submit to Health Care Services a weekly enrollment summary of all presumptive eligibility identification numbers issued, which Health Care Services is required to retain. Since this documentation is retained by Health Care Services, the State's fiscal intermediary, EDS does not perform any review procedures over the presumed eligible recipients.

Consistent with the finding we first reported in our annual audit report for fiscal year 2005–06, and have continued to report each fiscal year since that time, Health Care Services is unable to reconcile the presumptive eligibility identification numbers with weekly enrollment summary listings filed by providers at this time because of staffing limitations. However, Health Care Services is pursuing an automated process to post the presumptive eligibility identification numbers to the Medi-Cal eligibility system so records for these recipients can be accessed to authenticate, reconcile, and prevent duplicative issuances of the presumptive eligibility identification number during the claims review process. In the interim, there does not appear to be adequate tracking of presumptive eligibility identification numbers, and Health Care Services runs the risk that duplicate issuances of numbers or unauthorized use may occur because the existence of the recipient is not authenticated. Further, the lack of reconciliation of presumptive eligibility identification numbers to the summary enrollment listings may result in Recovery Act funds being paid to individuals who do not meet Medi-Cal eligibility requirements.

We recommend that Health Care Services strengthen its internal control process to obtain and track the enrollment presumptive eligibility identification numbers issued to prevent their unauthorized use. Further, we recommend that Health Care Services perform procedures to authenticate the existence of the recipient, prevent duplicative issuances, and reconcile the presumptive eligibility identification number against the summary recipient enrollment listings filed at Health Care Services during the claims review process. In its corrective action plan, Health Care Services stated that it

lacks the resources to initiate the system modifications recommended without funding appropriated by the Legislature. However, Health Care Services did indicate that it will continue to pursue the automated process described previously and will evaluate how presumptive eligibility for pregnant women will fit within the centralized eligibility program currently being planned under legislation signed by the governor. To the extent these proposed corrective actions do not occur, we will continue to recommend that Health Care Services strengthen its processes related to obtaining and tracking presumptive eligibility identification numbers to ensure it prevents their unauthorized use.

Health Care Services Does Not Provide Drug Rebate Information to Drug Manufacturers Within the Required Time Frame

Federal regulations require Health Care Services to report to each drug manufacturer, no later than 60 days after the end of each rebate period, information on outpatient drugs for which payments were made under the plan during the period.

Health Care Services was late in providing drug manufacturers with utilization data for outpatient drugs dispensed to Medi-Cal patients. Specifically, drug manufacturers provide a listing to the CMS of all covered outpatient drugs and, on a quarterly basis, are required to provide their average manufacturer's price and their best prices for each covered outpatient drug. Based upon this data, CMS calculates the rebate amount for each drug and provides this information to the states. Health Care Services is required to send the drug utilization data to manufacturers no later than 60 days after the end of the quarter. We tested 40 rebate invoices valued at approximately $165.5 million related to the third and fourth quarters of 2008, as well as the first and second quarters of 2009, and noted that Health Care Services provided drug manufacturers with drug utilization data after the 60-day deadline for each quarter tested. For instance, Health Care Services was 11 and 16 days late in providing the drug utilization data to manufacturers for the third and fourth quarters of 2008, respectively. As a result, the State did not obtain the $165.5 million it was due in a timely manner and potentially missed an opportunity to earn interest on these funds. This is a repeat finding first identified in our annual audit report for fiscal year 2006–07.

We recommend that Health Care Services ensure that drug utilization data are provided to manufacturers within the required time frame and to proactively monitor the receipt of payment from the manufacturers. In its corrective action plan, Health Care Services stated that it implemented changes to its processes on April 1, 2009, that substantially reduced the amount of manual review time needed for claims. Health Care Services asserted that the success of these changes were demonstrated in the second quarter of 2009 when rebate invoices were produced and mailed by September 1, 2009. Health Care Services stated that it will continue to review and modify its processes to ensure it provides manufacturers with timely utilization data.

Health Care Services Does Not Ensure That All Provider Claim Forms Contain the Required Signatures

Federal regulations require Health Care Services to ensure provider claim forms contain specific statements certifying as to the accuracy and completeness of the information they contain and include the claimant's signature.

Health Care Services and its contractor, the Department of Social Services (Social Services), lack controls to ensure claim forms submitted for reimbursement of the Personal Care Services Program (PCSP) of the Medi-Cal program contain the required signatures. The PCSP is part of the In-Home Supportive Services Program administered by Social Services. PCSP services are federally reimbursed in part through the Medi-Cal program. Health Care Services reviews all invoices submitted by Social Services for reimbursement and verifies the appropriateness of the costs incurred. The recipient and provider complete, sign, and submit semi-monthly claims in the form of timesheets to the county, which lists the number of hours worked by the provider in performing services for the care of the recipient. Although required by federal regulations, one of the 25 claims we reviewed did not have the provider's signature. As a result, Health Care Services lacks assurance as to whether the claim form contains accurate and complete information and, as a result, the costs associated with this claim form are questionable.

We recommend that both Health Care Services and Social Services enhance their controls related to the PCSP. Health Care Services agreed with our recommendation and stated that it will direct Social Services to remind counties that claim forms must be properly signed by the provider.

Health Care Services Does Not Always Inform Subrecipients of Information and Requirements Associated With the Federal Awards

Federal regulations require Health Care Services, as the recipient of federal awards, to provide certain information to subrecipients, including the program name, any identifying numbers, and the federal requirements that govern the use of such awards.

Health Care Services did not always disclose the required program information to its subrecipients. Specifically, of the sample of 40 agreements passing through Medi-Cal funds to subrecipients, we noted 21—all of which were in place prior to 2008—did not contain the identifying Catalog of Federal Domestic Assistance number for the federal program. As a result, Health Care Services disbursed more than $1.4 billion to subrecipients without communicating complete award information for the fiscal year ended June 30, 2009, which increased the risk that subrecipients may not follow federal requirements for the program, including having an audit performed under OMB Circular A-133. We reported a similar finding in our annual audit report for fiscal year 2007–08.

We recommend that Health Care Services ensure that the identifying number of the federal program is included in each of its agreements with subrecipients. Health Care Services agreed with our recommendation and stated that it revised contract documents in 2008 to include language containing the identifying number. Health Care Services explained that because contracts typically span three years and it is incorporating the new language into contracts as they come up for renewal, all contracts will contain the identifying number by December 31, 2010.

Health Care Services Does Not Ensure That Providers Retain Documentation That Would Show Compliance With Federal Requirements

Federal regulations require Health Care Services to enter into agreements with providers furnishing services under the state's plan, in which the provider agrees to maintain certain documentation. This documentation includes any records necessary to disclose the extent of services provided to recipients and any information regarding payments claimed by the provider for furnishing such services.

Health Care Services did not always ensure that its Provider Enrollment Division (PED) and the Department of Public Health's (Public Health) Licensing and Certification Division (L&C) retained required provider agreements. The determination of the eligibility for Medi-Cal providers in California is split between the PED and the L&C. The PED enrolls nonfacility providers, such as doctors and pharmacies, while the L&C determines the eligibility for facility providers, which includes hospitals and long-term care facilities. We noted that the L&C did not retain federally required provider agreements for 13 of the 35 facility providers we reviewed. Additionally, the PED did not retain the federally required disclosure statement for one of the 15 nonfacility providers we reviewed. Without such agreements, Health Care Services and Public Health lack assurance that providers are complying with federal requirements. These exceptions amount to approximately $99,000, including nearly $19,000 in Recovery Act funds, of the nearly $146,000 in expenditures sampled, a 68 percent error rate. This is a repeat finding first identified in our annual audit report for fiscal year 2007–08.

We recommend that Health Care Services and Public Health strengthen their controls to retain all provider agreements and continue efforts to ensure that they obtain the appropriate certifications and agreements. Health Care Services agreed with our recommendation and indicated that the PED has updated its provider enrollment process to require provider agreements and it continues its plan to reenroll all Medi-Cal providers as a continuous process as resources are available. Further, Health Care Services stated that in 2008 a new provider agreement was jointly developed for facility providers by Health Care Services and Public Health, and Public Health is currently in the process of collecting new provider agreements from facility providers.

Health Care Services Has Already Taken Steps to Correct a Finding Related to Federal Reporting Requirements

Federal regulations require Health Care Services to maintain statistical, fiscal, and other records necessary for reporting and accountability as required by the federal government.

Health Care Services did not ensure that amounts reported on its Quarterly Statement of Expenditures for the Medical Assistance Program reports are directly traceable to individual claims. Although these amounts are supported by summary reports, the lack of traceability down to an individual claim level precludes us from verifying the accuracy of the classification of expenditures by line item or category of service. This is a repeat finding first identified in our annual audit report for fiscal year 2007–08.

In June 2009 Health Care Services, in conjunction with its fiscal intermediary, EDS, implemented system changes that corrected the issue. However, the corrective action was only implemented on June 22, 2009. Further, Health Care Services spent $2.8 billion in Recovery Act funding during fiscal year 2008–09. The lack of claim traceability previously described prevented us from verifying the accuracy of expenditure classifications on an individual claim basis as they relate to Recovery Act funding.

We recommend that Health Care Services continue to ensure that the system changes it implemented allow it to classify expenditures that can be traced to individual claims. Health Care Services agreed with our recommendation and stated that the system changes include the requirement that all CMS summary reports produced by accounting are traceable to the original claims. Health Care Services indicated that the needed documentation will now be available whenever the summary reports are audited.

Health Care Services Took Steps to Correct Four Findings Reported in Fiscal Year 2007–08

During our current audit, we found that Health Care Services took steps to correct four findings we reported in our annual audit report for fiscal year 2007–08 for the Medi-Cal program. First, we reported in fiscal year 2007–08 that Health Care Services did not sufficiently monitor citizenship documentation and take appropriate corrective action on all eligibility cases for which individuals could not produce the appropriate citizenship documentation. Further, we reported that Health Care Services did not identify potential system interface issues between the county consortium system and the Medicaid Eligibility Database System (MEDS), and take appropriate corrective action to resolve potential problems. During our current audit work, we found that Health Care Services had taken appropriate corrective action on all eligibility cases that we identified as not having appropriate citizenship documentation. Further, Health Care Services has reviewed the citizenship status data on several cases and has not identified any interface issues between the county consortium systems and MEDS, as we had recommended in fiscal year 2007–08.

Second, during our testing of subrecipient monitoring for fiscal year 2007–08, we reported that Health Care Services did not ensure collection and completeness of subrecipients' OMB Circular A-133 audit reports for fiscal year 2006–07. In addition, we noted that Health Care Services did not issue management decisions within six months of the receipt of the OMB Circular A-133 audit reports by the State for all subrecipients we sampled. During our current year audit work, we found that Health Care Services designed and implemented internal controls that, if followed, will ensure that it collects and verifies the completeness of the subrecipient's OMB A-133 audit reports by delegating the responsibility to appropriate individuals. Health Care Services has also developed formal written procedures to ensure it issues management decisions within six months of the State's receipt of audit reports.

Third, we reported that for fiscal year 2007–08 Health Care Services did not ensure all agreements it entered into with providers contained the required signatures. Specifically, of the 50 Computer Media Claims' (CMC) agreements between Health Care Services and providers that we reviewed, one was missing the signature page. During our current audit work, we found that Health Care Services' PED had corrected this finding by developing and implementing new procedures and training staff to thoroughly review all CMC agreements and to ensure all the pages of these agreements are electronically scanned.

Finally, we reported that Health Care Services lacked adequate controls to verify that provider licenses are current and active. During our audit work for fiscal year 2007–08, we selected a sample of both facility and nonfacility providers and requested documentation to evidence whether each provider had an active license. However, we noted that the PED was unable to locate documentation in the provider file to support active licenses for six of the 50 providers sampled. In conducting our current work, we noted that the PED was able to provide documentation to support active licenses for all the providers sampled in fiscal year 2008–09.

Department of Rehabilitation

REHABILITATION SERVICES—VOCATIONAL REHABILITATION GRANTS TO STATES FEDERAL CATALOG NUMBER 84.126

Based on the U.S. Office of Management and Budget's (OMB) June 2009 guidance, the California State Auditor's Office (State Auditor's Office) presents its interim reporting on the Department of Rehabilitation's (Rehabilitation) administration of the Rehabilitation Services—Vocational Rehabilitation Grants to States (Federal Catalog Number 84.126), or the vocational rehabilitation grant, during fiscal year 2008–09. The issues contained in this interim reporting represent the results of our internal control and compliance audit that require Rehabilitation's corrective action. Under the risk-based approach for selecting grants to audit that OMB Circular A-133 describes, we had previously classified the vocational rehabilitation grant as low risk because we reported no findings for it from our audit covering fiscal year 2005–06. Accordingly, we opted to audit other grants we deemed to be more risky and did not audit this grant during fiscal years 2006–07 or 2007–08. As a result, there were no prior year findings that required follow up during our audit covering fiscal year 2008–09.

The State Auditor's Office identified five findings as of November 30, 2009, that pertain to Rehabilitation's administration of the vocational rehabilitation grant program. Although during fiscal year 2008–09 Rehabilitation did not spend any of the $56.5 million the federal government awarded it under the American Recovery and Reinvestment Act of 2009 (Recovery Act) for the vocational rehabilitation grant program, we identified internal control issues that could affect Rehabilitation's administration of these funds in fiscal year 2009–10 and beyond.

Further, in October 2009, Rehabilitation submitted its first quarterly report under Section 1512 of the Recovery Act. Section 1512 requires entities that receive Recovery Act funds[1] directly from the federal government to provide, not later than 10 days after the end of each calendar quarter, information concerning how it used the funds. For example, the Recovery Act requires recipients to provide data on the total amount of funds it received and expended, as well as provide information on the projects or activities supported with such funding. According to the federal government, for the quarter ending September 30, 2009, Rehabilitation reported that it had spent $7.3 million and that 13.33 jobs were created or retained. According to Rehabilitation, these jobs were new limited-term positions for vocational rehabilitation counselors, retired annuitants, and student assistants.

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

[1] OMB issued guidance dated June 22, 2009 (memo M-09-21) clarifying that recipients were not required to submit Section 1512 reports for certain entitlement programs, such as Medicaid.

Expenditures Are Not Always for Allowable Activities

Rehabilitation did not always ensure that expenditures of vocational rehabilitation grant funds were for allowable activities and costs. To be allowable, vocational rehabilitation services must be appropriately authorized prior to service delivery and must be described in a consumer's individual plan for employment (individual plan). Services to be provided after achieving a successful employment outcome must also be described in an individual plan and must be limited in scope and duration. Rehabilitation incorrectly made payments totaling $19,300 because it did not follow its processes to ensure that activities are allowable and appropriately authorized.

Of the 46 expenditure transactions reviewed, we found two instances where Rehabilitation paid for unallowable activities and costs. In the first instance, Rehabilitation paid a consumer's postemployment benefits that were not limited in scope and duration, as required by regulation. In this instance, more than five years after the consumer achieved her employment objective in March 2003, Rehabilitation paid for goods and services to support a different employment objective. These goods and services included training for a new job; airfare and hotel to attend the training; a new computer, software, and accessories; and a new cell phone with optical character recognition software. Because Rehabilitation paid for these postemployment expenditures from July 2008 through December 2008 without developing a new individual plan, it incorrectly provided $15,602 in goods and services to the consumer. In the second instance, Rehabilitation could not provide supporting documentation to verify that $3,700 in private educational costs were preauthorized by a rehabilitation supervisor, as required. When Rehabilitation incorrectly pays for unallowable activities and costs, it reduces resources available to serve the vocational rehabilitation needs of other eligible consumers.

We recommend that Rehabilitation ensure that staff understand and follow applicable processes, particularly relating to authorizations for postemployment services that are limited in scope and duration and obtaining preauthorizations for services received from private schools. Rehabilitation agreed and stated that it expects the implementation of a new electronic record system, estimated to be complete in October 2011, to improve functionality related to prior approval and the provision of postemployment services. To address issues in the interim, Rehabilitation stated that it has initiated meetings to provide training regarding staff performance gaps and that its rehabilitation supervisors will prioritize manual reviews of the record of services to ensure that all consumer expenditures reflect allowable activities and costs, and are adequately supported by appropriate documentation.

Time Distributions Are Not Always Supported

Rehabilitation lacks sufficient policies regarding staff time distribution. Depending on the circumstances, federal regulations require that staff time charged to the vocational rehabilitation grant be supported by either semiannual certifications signed by the employee or their supervisor or monthly personnel activity reports (timesheets) signed by the employee. Rehabilitation uses monthly timesheets to substantiate time distribution. Our review of six employees found one instance in which neither Rehabilitation's headquarters office nor its district office could locate an original, contemporaneous monthly timesheet signed by the employee. Rehabilitation personnel explained that the inability to locate the original timesheet most likely was caused by a combination of limited resources and staff inexperience. We also believe that Rehabilitation's lack of specific written guidance detailing how staff should process and maintain employee timesheets may have contributed to its inability to locate the original timesheet. For example, Rehabilitation has not updated the sections of its policy manual that relate to personnel issues, including timekeeping, since 1985. Without sufficient

updated policies regarding staff time distribution, Rehabilitation increases the risk that the staff time charged to the vocational rehabilitation grant will not be sufficiently supported. To minimize this risk, we recommend that Rehabilitation update and implement its policies regarding time distribution to ensure that appropriate support is maintained for personnel costs charged to the grant. Rehabilitation agreed and stated that it clarified roles and responsibilities regarding timesheets in a communication to all department employees in December 2009. Rehabilitation also stated that it plans to conduct training by March 2010 to reinforce the guidance provided in that communication. Finally, Rehabilitation stated that it will update its policy manual in 2010.

Eligibility Determinations Are Not Promptly Made and Extensions Lack Support

Rehabilitation did not always determine applicant eligibility under the vocational rehabilitation grant within the required time period or properly document eligibility extensions. Federal law requires Rehabilitation to determine applicant eligibility within 60 days of initial application status or by the expiration date of an extension that has been agreed upon with the applicant. For six of the 46 applications we reviewed (13 percent), Rehabilitation did not determine eligibility within 60 days or by the expiration of an extension. In three of these six cases, Rehabilitation was less than 31 days late in determining eligibility. For the other three cases, Rehabilitation was from 106 to 401 days late. Further, for two additional applicants Rehabilitation lacked documentation showing an agreed-upon extension date.

When Rehabilitation does not determine an applicant's eligibility within the required time period or does not document extensions in accordance with requirements, it reduces the assurance that applicants promptly receive the required vocational rehabilitation services. Rehabilitation has processes in place to monitor the timeliness of its eligibility decisions; however, such processes were not effective in identifying and correcting these eight exceptions. We recommend that Rehabilitation more closely monitor the timeliness of its eligibility decisions and ensure that it maintains sufficient documentation for time extensions. Rehabilitation agreed with the finding and stated that it expects its implementation of a new electronic record system, estimated to be complete by October 2011, will allow it to more effectively track and monitor eligibility determinations and extensions. Rehabilitation also stated that in the short term, it will emphasize the importance of manually tracking eligibility timelines and extensions using available reports, will reorient counselors and managers to the most effective tracking tools available, and will continue to review eligibility determinations and extensions.

Weak Internal Controls Resulted in Inaccurate Federal Reports

Rehabilitation submitted inaccurate program/cost and financial status reports to the federal government for the vocational rehabilitation grant program. Federal regulations require Rehabilitation to submit accurate reports regarding the status of its vocational rehabilitation grant. Specifically, Rehabilitation must submit an annual vocational rehabilitation program/cost report and quarterly and final financial status reports. Rehabilitation determines the amounts to include on its reports through a process of manual calculations in a series of support schedules that ultimately are based on accounting records and other appropriate supporting documentation (collectively, underlying documentation).

Our review of Rehabilitation's underlying documentation supporting its federal reports identified five errors. The five errors in the underlying documentation led to errors in Rehabilitation's program/cost report for the federal fiscal year ending in 2008, the final financial status report for

the 2007 grant, and quarterly financial status reports for the 2008 and 2009 grants. Specifically, in its program/cost report for the federal fiscal year ending in September 2008, Rehabilitation overstated services to individuals with disabilities by $1.4 million due to a calculation error in the underlying documentation. Additionally, in the remarks section of its final financial status report for the 2007 grant, Rehabilitation overstated costs for one of the reportable activities by $182 due to an apparent typographical error. Moreover, Rehabilitation made similar calculation errors in the underlying documentation used to support its quarterly financial status reports for other grant years. For example, in its quarterly financial status report for the 2008 grant (as of December 31, 2008), Rehabilitation understated its total expenditures by $24,105 because it inappropriately excluded this amount from its underlying documentation. Similarly, in its quarterly financial status report for the 2009 grant (as of December 31, 2008), Rehabilitation overstated total expenditures by $131,643 because a formula in its underlying documentation did not include all relevant amounts in the calculation. Finally, in its quarterly financial status report for the 2009 grant (as of June 30, 2009), Rehabilitation understated the amount of its cash match by $40,398 in the remarks section because the person responsible for preparing the report entered an amount from a wrong category in Rehabilitation's accounting records. However, Rehabilitation did not include this last error in other portions of the report. Because it relies on the same underlying documentation to ensure it complies with other federal requirements associated with the vocational rehabilitation grant, such as matching and level of effort, Rehabilitation increases its risk of not meeting these requirements when it fails to detect and correct such errors.

These errors occurred because Rehabilitation lacks internal controls to prevent them. Although an accounting chief's signature on the reports certifies that the reports are correct and complete, it appears that the level of the accounting chief's review was insufficient to detect the types of errors we noted. Also, Rehabilitation does not have formal, written policies and procedures in place to ensure consistent calculation of the underlying documentation used to prepare these reports. We recommend that Rehabilitation institute internal controls, including written procedures for preparing the underlying documentation supporting its reports along with supervisory review, sufficient to detect and correct errors in its reports to the federal government. Rehabilitation concurred with our finding and stated that it will ensure a more thorough review of the reports and underlying documentation before submission and will develop written procedures and conduct training to support the preparation of the federal financial reports. Rehabilitation also stated that three of the errors we identified—$1.4 million, $182, and $40,398—"did not affect the reporting financially." Notwithstanding its assertion, Rehabilitation submitted program/cost and financial status reports to the federal government that contained inaccurate amounts. As we stated earlier, regulations require Rehabilitation to submit accurate reports.

Poor Controls Caused Overstatement of Matching Obligation

Rehabilitation lacks adequate internal controls to ensure compliance with the federal matching requirement for the vocational rehabilitation grant. Specifically, a supervisor does not review the spreadsheets that staff prepare to document certified expenditure information submitted by its vendors. Federal regulations allow for the value of vocational rehabilitation services provided by state and local government vendors under contract with Rehabilitation to apply toward the requirement for states to match federal funds using nonfederal sources. Under its contract agreement, each vendor must submit a certified expenditure report. An accounting officer-specialist compiles the data from these certified expenditure reports into a summary spreadsheet that Rehabilitation uses to track and total the amounts it uses in helping to meet its nonfederal funds matching obligation. However,

we observed no evidence that the accounting officer-specialist's supervisor reviewed this summary spreadsheet. Without adequate review, the risk of Rehabilitation misreporting or miscalculating its matching share increases.

In fact, during our review of the summary spreadsheet Rehabilitation created to support amounts in the final financial status report (revised as of September 2009) for the 2007 grant, we noted six instances for one vendor where Rehabilitation erroneously included *year-to-date* amounts in the summary spreadsheet rather than *monthly* amounts. Because Rehabilitation uses the totals from this summary spreadsheet to calculate and report the certified expenditure portion of its nonfederal funding, it overreported the amount of its nonfederal matching share for the 2007 grant by $18,517. We recommend that Rehabilitation establish a supervisory review process of the amounts entered into its summary spreadsheet and used in support of its final financial status report. Rehabilitation concurred with our finding and stated that it will establish a review process for its certified time spreadsheet. It also stated that in more recent years it has been using a standardized template that eliminates the possibility of this type of error from occurring again.

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Department of Social Services

STATE ADMINISTRATIVE MATCHING GRANTS FOR THE SUPPLEMENTAL NUTRITION ASSISTANCE PROGRAM
FEDERAL CATALOG NUMBER 10.561

TEMPORARY ASSISTANCE FOR NEEDY FAMILIES
FEDERAL CATALOG NUMBER 93.558

FOSTER CARE—TITLE IV-E
FEDERAL CATALOG NUMBER 93.658

ADOPTION ASSISTANCE
FEDERAL CATALOG NUMBER 93.659

Based on the U.S. Office of Management and Budget's (OMB) June 2009 guidance, the California State Auditor's Office (State Auditor's Office) presents its interim reporting on the Department of Social Services' (Social Services) administration of the State Administrative Matching Grants for the Supplemental Nutrition Assistance Program (SNAP) (Federal Catalog Number 10.561), Temporary Assistance for Needy Families (TANF) program (Federal Catalog Number 93.558), Foster Care—Title IV-E (Foster Care) program (Federal Catalog Number 93.658), and Adoption Assistance program (Federal Catalog Number 93.659) during fiscal year 2008–09. All of these programs were collectively awarded $6.2 billion, including American Recovery and Reinvestment Act of 2009 (Recovery Act) funds totaling $307.1 million during fiscal year 2008–09, and Social Services spent roughly $36.8 million in Recovery Act funds on two of these programs. The issues contained in this interim reporting represent the results of our internal control and compliance audit that require Social Services' corrective action.

The State Auditor's Office identified nine findings as of December 3, 2009, that pertain to Social Services' administration of these federal programs. Of these nine findings, eight are findings we have disclosed in previous annual audit reports. Our testing this year also revealed that Social Services corrected three other findings that we included in last year's annual report.

Social Services Cannot Ensure That Payments to Counties Are Only for Allowable Activities

Social Services' processes for reviewing and authorizing the expense and assistance claims for the four programs awarded Recovery Act funds—SNAP, TANF, Foster Care, and Adoption Assistance—do not provide reasonable assurance that federal funds are expended only for allowable activities. Federal regulations require that a state's fiscal control and accounting procedures for its grant funds permit tracing of funds to a level of expenditure adequate to demonstrate that the funds were used only for allowable purposes. In fiscal year 2008–09, Social Services reimbursed counties approximately $5.3 billion for these four programs. Expense claims the counties submit to Social Services include administrative costs and their assistance claims include a summary total of county assistance payments to beneficiaries by program. However, Social Services does not require the counties to submit detailed supporting documentation for their expense and assistance claims. Counties submit their expense claims to Social Services quarterly and their assistance claims monthly. Social Services performs desk reviews on both types of claims. The steps in the desk review include making sure the counties' welfare directors and auditors have signed the certification page of the claims, attesting to their accuracy, and

that the amounts on the signed certification pages match the amounts in the claims. Other steps Social Services takes in reviewing claims include determining if program codes in counties' program cost summaries are allowable for expense claims and, according to the manager of the contracts and county assistance payment unit, identifying variances in assistance claims that are greater than 20 percent between months and following up with the counties for explanations.

However, since July 2005, Social Services has required counties to submit their claims in an electronic template provided by Social Services and has not required counties to submit detailed supporting documentation for specific line items with their claims. Moreover, according to Social Services' management, the department did not conduct any on-site visits to the counties to review their supporting documentation for their expense and assistance claims in fiscal year 2008–09. Without procedures such as reviewing the supporting documentation for the counties' expense and assistance claims prior to payment or conducting on-site visits to review the claims during the award period, Social Services has no way of assuring that counties are spending federal funds only on allowable activities. Thus, we are unable to conclude that Social Services is in compliance with this requirement for the programs previously listed. We reported a similar finding in our audit for fiscal year 2007–08.

Social Services believes it is complying with applicable federal requirements and cites several reasons for this belief. For example, it points out that all eligibility determinations are done through federally approved automated systems, which, according to Social Services, ensures all costs are allowable. Social Services also indicates that all expenses claimed by a county welfare department must be independently reviewed, verified, and approved by the county auditor's office. Social Services further pointed out that all counties must have an independent audit conducted annually in conformance with the single audit act and OMB Circular A-133 and these audits are submitted to the federal government. Nevertheless, none of these activities relieves Social Services of its responsibility to ensure that federal funds were expended only for allowable activities, which we believe requires Social Services to periodically review the underlying supporting documentation for counties' expense and assistance claims during the award period.

We recommend that if Social Services believes that its current processes comply with federal requirements concerning allowable activities, it seek concurrence in writing from the U.S. departments of Agriculture and Health and Human Services. However, if this does not occur, we will continue to recommend that Social Services strengthen its desk audits of counties' expense and assistance claims by requiring them to submit detailed supporting documentation for a sample of claims and reviewing the documentation or conduct site visits at the counties to review such documentation. In its corrective action plan, Social Services stated that it disagrees with the recommendation. It asserts that it is in frequent and open communication with the federal cognizant agencies and they have not expressed concern over Social Services' process for reviewing and authorizing counties' expense and assistance claims. If this is the case, we recommend that Social Services obtain its federal cognizant agencies' concurrence in writing.

Social Services Cannot Ensure That Counties Are Claiming Costs in Compliance With the Counties' Cost Allocation Plan

Federal regulations specify that when public assistance programs are administered by local government agencies (counties) under a state-supervised system, as in California, the State's overall cost allocation plan (CAP) shall include a CAP for the counties and the State may claim only those costs as approved in the plan.

Social Services does not have adequate internal controls in place to ensure that county welfare departments are claiming costs according to the CAP for three programs awarded federal Recovery Act funds—SNAP, Foster Care, and Adoption Assistance. Specifically, Social Services submits to the U.S. Department of Health and Human Services a CAP for the county welfare departments that describes the allocation basis and direct charge rationale for charging programs and projects supported by federal funds. The CAP indicates that the counties charge these program costs on the county expense claims (CEC) that they submit quarterly to Social Services. However, Social Services does not have a process in place to ensure that the costs reflected on the CECs are calculated in accordance with the CAP. Specifically, according to the chief of the Fiscal Systems Bureau, Social Services does not require counties to submit supporting documentation with their quarterly CECs, nor does Social Services conduct site visits during the award year to review the counties' processes related to capturing and allocating the costs reported in the CEC. We reported a similar finding for our audit in fiscal year 2007–08.

Similar to the previous finding, Social Services believes it is complying with applicable federal requirements and cites several reasons for this belief. For example, Social Services provides guidance in county fiscal letters it issues quarterly regarding completion of counties' CECs and of time studies used to allocate staff costs. According to the chief of the Fiscal Systems Bureau, the county fiscal letters reflect any changes in program code descriptions and the local agency CAP. In addition, each quarter Social Services provides the counties with a template for completing their CECs. According to the chief, the template is based on methodologies in the local agency CAP for claiming administrative expenses and, therefore, the counties use of the template ensures that they are complying with the CAP. However, although these procedures may be helpful to counties in completing their CECs, they neither validate that counties are claiming and being reimbursed only for allowable costs nor do they relieve Social Services of its responsibility to ensure that federal funds are expended only in accordance with its approved CAP, which we believe requires Social Services to periodically review the underlying supporting documentation for CECs during the award period.

Again, we recommend that Social Services seek written concurrence from the U.S. Department of Health and Human Services that its current processes comply with federal requirements. However, if the U.S. Department of Health and Human Services does not agree, we will continue to recommend that Social Services develop processes and procedures to ensure counties are adhering to the local agency CAP and claiming only allowable costs. In its corrective action plan, Social Services indicated that it disagrees with the recommendation. It stated that it is in frequent and open communication with the federal cognizant agency on the approval of the local agency CAP and it has not expressed any concern regarding Social Services' internal controls. If this is the case, we believe Social Services should follow our recommendation to obtain its federal cognizant agency's concurrence in writing.

Social Services Cannot Ensure Adjustments Claimed by Counties Are Within the Allowed Time Period

Social Services' processes for reviewing and authorizing the counties' administrative and assistance claims do not provide reasonable assurance that adjustments included on the claims are for expenditures made within the required time period for three programs awarded federal Recovery Act funds—SNAP, Foster Care, and Adoption Assistance. Federal regulations require counties to file claims within two years after the calendar quarter in which the expenditures were either initially paid or incurred, or two years after program funds were awarded. A county may adjust a claim when there is a need to increase or decrease an amount it had previously claimed. However, Social Services does not require the counties to provide documentation to support the adjustments on their claims.

Without supporting documentation, Social Services cannot be sure that counties' adjustments are for expenditures made within the two-year limits. We reported a similar finding for our audit in fiscal year 2007–08.

According to Social Services, it believes that the process outlined in an April 1, 2008 fiscal letter, to the counties notifying them of established due dates for submitting their adjusted claims, ensures that it is meeting the two-year limit for claiming payments. Social Services also cited several other reasons why it believes it is complying with applicable federal requirements, such as its use of a federally approved automated system and the requirement that the counties have an annual independent audit, which we describe in greater detail in the first finding. However, none of these activities relieves Social Services of its responsibility to ensure that adjustments were for transactions that occurred during the period of availability, which we believe requires Social Services to periodically review the underlying supporting documentation for adjustments included on the claims. If Social Services does not ensure that the expenditure of federal funds included in adjusted claims occurred within the proper period of time, it could result in fewer funds being available for current claims. Additionally, because Social Services does not require the counties to submit detailed supporting documentation for their administrative and assistance claims, we are unable to conclude that the counties' adjustments are for expenditures made within the two-year limit for claiming payment.

Again, we recommend that Social Services seek concurrence in writing from the U.S. departments of Agriculture and Health and Human Services that its current processes comply with federal requirements. However, if these federal agencies do not agree, we will continue to recommend that Social Services strengthen its desk audits of the adjustments included on the counties' expense and assistance claims by requiring them to submit detailed supporting documentation for a sample of claims and reviewing the support for the adjustments or by conducting site visits at the counties to review such documentation. As it did regarding other similar findings, Social Services disagrees with our recommendation and believes that its existing controls provide a reasonable level of accountability. Also, according to Social Services, federal cognizant agencies have not expressed concern over Social Services' process for reviewing and authorizing counties' expense and assistance claims. If this is the case, then Social Services should follow our recommendation and obtain its federal cognizant agencies' concurrence in writing.

Social Services Is Not Following Federal Requirements to Prevent Debarred or Suspended Parties From Receiving Federal Funds

Federal regulations and the grant agreements between the U.S. Department of Health and Human Services, Administration for Children and Families (ACF), and Social Services require that Social Services inform its subgrantees concerning the requirements that a debarred or suspended party may not participate in ACF programs. In addition, the grant agreements require that Social Services consult the Excluded Parties List System (EPLS) before it issues subawards or contracts to ensure that the entities it is considering for funding are eligible.

Social Services did not comply with the suspension and debarment requirements in the ACF grants' terms and conditions for three of the programs awarded federal Recovery Act funds—TANF, Adoption Assistance, and Foster Care. Specifically, Social Services did not adequately notify the counties of the suspension and debarment requirements articulated in the terms and conditions of the grant agreements. In addition, Social Services did not consult the EPLS to ensure that counties were eligible

for funding before disbursing funds to them. Until Social Services addresses these deficiencies in its internal controls, it risks losing federal funds for noncompliance with these requirements. We reported a similar finding in our audit for fiscal year 2007–08.

We recommend that Social Services amend its process for making ACF-funded subawards to the counties by using its annual county fiscal letters to notify counties of the suspension and debarment requirements they are to follow. In addition, for ACF programs, Social Services should establish and follow procedures to ensure that it consults the EPLS before issuing subawards to counties. In its corrective action plan, Social Services indicated that it will prepare and issue an annual county fiscal letter that will provide instructions to counties regarding the suspension and debarment requirements and the use of the EPLS. However, even though it provided counties with guidance concerning the EPLS, Social Services did not address its own responsibility to consult the EPLS before issuing subawards to the counties as required for ACF programs.

Social Services Does Not Always Inform Counties of Information and Requirements Associated With Federal Awards

OMB requires Social Services, as the recipient of federal awards, to provide certain information to subrecipients, including the Catalog of Federal Domestic Assistance (CFDA) program title and number, and the award name and number. The OMB also requires Social Services to advise subrecipients of all requirements they must meet, including applicable federal laws, regulations, and other requirements.

Social Services did not always inform the counties of certain federal award information, such as the CFDA program title and number, and relevant federal laws and regulations for the four programs for which the federal government awarded Recovery Act funds for fiscal year 2008–09—SNAP, TANF, Foster Care, and Adoption Assistance. Specifically, Social Services has periodic, ongoing correspondence with counties through fiscal letters that it uses to notify them of various issues including those related to administrative costs. Although Social Services issued several county fiscal letters that contained the CFDA number and program title, it did not consistently include this information in all fiscal letters it sent to the counties during fiscal year 2008–09. Moreover, Social Services did not include in any of the fiscal letters the federal laws, regulations, and grant provisions governing these programs, nor did it inform the counties of this required information using some other method. By not providing complete award information to its county subrecipients, Social Services cannot be sure that its county subrecipients are aware of and are following all program requirements imposed on them. We reported a similar finding in our audit for fiscal year 2007–08.

We recommend that Social Services ensure it consistently informs the counties of the federal award information and relevant federal laws and regulations governing the programs in its annual county fiscal letters, or use other media, such as a Web site, to provide counties with this information. Social Services agreed with our finding and indicated it will prepare and issue an annual county fiscal letter that will provide information for counties regarding the CFDA. Further, Social Services plans to post on its Web site the terms and conditions for all federal funds for which it is the responsible administering state agency.

Social Services Is Not Issuing Management Decisions on Counties' OMB Circular A-133 Audit Findings Within the Required Timeline

The Federal Single Audit Act, in conjunction with OMB Circular A-133, defines a pass-through entity as a nonfederal entity that provides a federal award to a subrecipient to carry out a federal program. In addition, each subrecipient expending $500,000 or more in federal awards must have an independent audit to demonstrate that it met audit requirements for the year in which the subrecipient expended the funds. Finally, OMB Circular A-133 requires that pass-through entities, such as Social Services, issue management decisions on findings in subrecipients' audit reports within six months of the State receiving the reports and ensure that the subrecipient takes appropriate and timely action to correct deficiencies. The State Controller's Office (SCO) is the state entity responsible for coordinating single audit compliance with local governments, which includes collecting the single audit reports and distributing them to the appropriate state agencies. State agencies are responsible for reviewing these reports and evaluating the corrective action plans submitted in response to findings included in the reports.

Social Services did not always ensure that it issued management decisions on audit findings within six months after the State received the counties' OMB Circular A-133 audit reports. Although Social Services told us it revised its policies and procedures in November 2008, they are still not sufficient to ensure it issues management decisions within the required six months. We reported a similar finding in our audit for fiscal year 2007–08.

According to Social Services, as of October 2009, the SCO had provided it with the fiscal year 2007–08 OMB Circular A-133 audit reports for 50 of the 58 counties. In addition, based on information the SCO provided Social Services, it was aware that the SCO had rejected as inadequate two audit reports and was in the process of reviewing another three audit reports from the counties that the SCO had not yet forwarded to Social Services. Although the SCO had provided Social Services with information indicating it had approved the audit reports from the remaining three counties, Social Services failed to follow up with the SCO to determine why it had not yet received the reports.

Additionally, our review of a sample of fiscal year 2007–08 OMB Circular A-133 audit reports for 10 counties that contained a total of 29 audit findings related to federal programs for which Social Services is the pass-through entity, found that Social Services had either not issued management decisions or issued the management decisions late for 13 of the 29 findings. Specifically, as of October 30, 2009, Social Services had not yet issued management decisions for eight of the 13 findings, even though the State had received the audit reports from the counties eight to 10 months earlier. Additionally, it issued management decisions for the remaining five findings from six to 49 days after the six-month time frame for issuing such decisions had already expired. The SCO contributed to Social Services issuing its management decisions late because it took between 55 and 92 days to process the audit reports before providing them to Social Services.

To assist it in tracking OMB Circular A-133 audit reports and ensuring it issues management decisions on time, Social Services has developed policies and procedures for processing findings contained in reports concerning programs for which it is the pass-through entity. However, its procedures incorrectly indicate that Social Services should use the date the SCO transmits the OMB Circular A-133 audit reports to it rather than the date the SCO received the audit reports from the counties when determining the date by which it must issue its management decisions.

By not issuing management decisions within the required six-month deadline and not following up on delinquent reports, Social Services has no assurance that the counties are promptly addressing the audit findings. Furthermore, by failing to ensure that counties correct audit findings, the risk of misuse of federal funds increases. Although the counties did not receive federal Recovery Act funds in fiscal year 2007–08, they will receive such funds in fiscal year 2008–09 and beyond, underscoring the importance of Social Services issuing management decisions within the required six months to help ensure county findings involving Recovery Act funds are resolved promptly.

We recommend that Social Services work with the SCO to obtain each county's OMB Circular A-133 audit report as soon as posible after the SCO receives the reports. In addition, Social Services needs to update its policies and procedures to reflect that it should use the date the SCO receives the counties' OMB Circular A-133 audit reports when determining the deadlines for it to issue its management decisions and then ensure it meets those deadlines. In its corrective action plan Social Services stated that it agreed with our finding and has implemented our recommendations to ensure it complies with the OMB Circular A-133 requirements.

Social Services Is Not Adequately Monitoring the Counties That Receive Adoption Assistance Program Funds

Federal regulations require Social Services, as the entity responsible for managing the day-to-day operations of any subgrants it provides others, such as the counties, to monitor the activities supported by its subgrants to ensure that the activities comply with applicable federal requirements and that any performance goals are achieved.

Social Services lacks formal processes to ensure it fulfills its pass-through responsibility to monitor the counties during the award period for its Adoption Assistance program, which was awarded Recovery Act funds for fiscal year 2008–09. For example, Social Services does not perform monitoring procedures such as on-site visits or desk reviews of the counties' activities to ensure they are administering the program in compliance with federal laws and regulations. Although Social Services provides technical assistance to the counties by answering questions regarding eligibility determinations, these efforts are not sufficient to ensure counties' compliance with all applicable federal laws and regulations during the award period. When it does not monitor the counties to the degree required, Social Services has no means of ensuring that counties are making correct eligibility determinations and complying with other requirements applicable to the program. Also, counties may be providing program funds to ineligible recipients. We reported a similar finding in our audit for fiscal year 2007–08.

We recommend that Social Services establish and implement policies and procedures for monitoring the counties during the award period to ensure they are complying with applicable laws, regulations, and the provisions of contracts or grant agreements. In its corrective action plan, Social Services indicated that it does not have sufficient resources to conduct desk reviews or on-site visits for the Adoption Assistance program, although it pointed out that it will continue to monitor and provide technical assistance to the counties. Social Services explained that it partners with the counties to implement and monitor the California Outcomes and Accountability System (COAS) as its way of monitoring county programs. Furthermore, Social Services indicated it also relies on the OMB Circular A-133 single audit reports as its primary tool for monitoring county activities relative to eligibility.

Although the COAS is critical for California's child welfare system and may allow Social Services to monitor program performance goals, it focuses primarily on measuring outcomes for safety, permanence, and child and family well-being. It does not address other important aspects of Social Services' responsibility for administering the day-to-day operations of the Adoption Assistance program in accordance with federal requirements, such as ensuring the counties are spending federal funds only on allowable activities or ensuring they make correct eligibility determinations. Furthermore, Social Services' reliance on the OMB Circular A-133 single audits for monitoring counties' activities related to the Adoption Assistance program does not relieve it of its responsibility for performing subrecipient monitoring procedures during the award period to ensure the counties are complying with federal laws and regulations.

Social Services Does Not Ensure That Its District Offices Retain Documentation That Would Show Compliance With Federal Requirements

Federal regulations require Social Services, as the state agency administering the Adoption Assistance program, and adopting parents to enter into an agreement specifying the nature and amount of the nonrecurring expenses of adoption that Social Services is to pay the parents. Nonrecurring expenses include any reasonable and necessary adoption fees and other expenses directly related to the legal adoption of a child with special needs, including payments for home study and health and psychological examinations. In addition, these regulations require that these agreements be signed prior to the final decree of adoption.

Social Services continues to need improvement in its controls over eligibility determinations for the Adoption Assistance program. Specifically, during our audit for fiscal year 2007–08, we found that Social Services did not always ensure that adoption case files at two of its seven district offices contained the appropriate supervisory approvals and documentation required by federal regulations. According to the chief of the Adoption Services Bureau (Adoptions Services), Social Services is in the process of correcting these deficiencies. For example, Social Services has developed a closing case summary checklist for use at all seven district offices. The checklist identifies the documents and information that should be in the case file before the adoption is finalized and requires a supervisor's approval. The chief also indicated that Social Services provided training in June 2009 to its managers and supervisors regarding the protocol for using this checklist and, as of October 28, 2009, it was making final revisions to the checklist.

Although Social Services is taking steps to correct its prior year finding, during our current audit we identified similar deficiencies at a third district office. Specifically, we found that all 18 adoption case files we reviewed at this district office were missing documents that demonstrate compliance with federal regulations or did not contain evidence of supervisory review. For example, we found that 12 of the 18 adoption case files did not contain a signed copy of the agreement. In addition, because the district office was using an outdated form, the agreements in the remaining six case files did not contain the date that the adoptive parent(s) signed the agreement. In addition, 16 of the 18 agreements did not include the amount of nonrecurring expenses to be paid. According to the chief of Adoption Services, although Social Services distributes standardized adoption forms to each of the seven district offices, it does not conduct periodic reviews or monitor to ensure that the district offices are using the appropriate forms. Because it did not review the forms that district offices are using, Adoption Services is not ensuring that they are complying with federal regulations. Consequently,

Social Services cannot demonstrate that adoptive families have been informed, before the final decree of adoption is issued, of their right to receive reimbursement for nonrecurring expenses and it runs the risk of the federal government disallowing reimbursement of these costs.

We also found that two of the 18 adoption case files we reviewed at this district office did not contain a copy of the adoption order, which provides the date on which the final decree of adoption was issued. Thus, for these two cases, we were unable to assess whether Social Services complied with the federal requirement that the agreement be signed prior to the final decree of adoption.

Finally, five of the 18 adoption case files we reviewed did not contain evidence of supervisor approvals. Adoption Services requires supervisors in its seven district offices to review case file documentation and verify the eligibility determinations made by the adoption specialists assigned to the cases to ensure Social Services is meeting federal requirements. Generally, the supervisors sign two standard forms to indicate their review and approval—the AAP Benefit Determination and Approval form and the Child Assessment and History form. However, for five of the case files we reviewed, neither form contained the supervisor's approval. The manager of this district office stated that she no longer requires supervisors to sign one of these forms because it duplicates other processes requiring supervisor approval. However, the forms with supervisory signatures for those other processes are not generally retained in the case files; thus, we did not find evidence that the district office supervisor reviewed and approved the five eligibility determinations. The district office manager did not offer an explanation as to why the second form was not signed.

We recommend that Social Services continue its efforts to implement a quality control process to ensure that staff in its seven district offices are using and retaining the appropriate documentation to demonstrate that Social Services is following established internal control procedures and complying with federal laws and regulations. In its corrective action plan, Social Services indicated that it will continue its efforts to implement controls over its documentation process. Social Services pointed out that because the revised checklist was approved after completion of this audit, its district offices will not show improvement until adoption cases finalized after December 1, 2009, are closed. Social Services also stated that it plans to provide training to managers and supervisors at a January 2010 meeting on the use of the new form and on monitoring the compliance requirements.

Social Services Cannot Substantiate the Payroll Expenditures It Charged to SNAP

Federal regulations require that when federally funded employees do not work exclusively on a single federal program, the distribution of their salaries or wages be supported by personnel activity reports or equivalent documentation, unless the federal government has approved a sampling system or other system to support these costs.

Social Services' Food Stamps Policy Bureau (policy bureau) cannot substantiate the payroll expenditures it charged to SNAP, a program awarded Recovery Act funds during fiscal year 2008–09. The policy bureau staff spend their time working on activities related to SNAP and the state-funded California Food Assistance Program. However, Social Services does not require its staff to complete personnel activity reports, such as timesheets, or equivalent documentation to support the actual amount of time they spend working on activities related to these two programs. Instead, according to the policy bureau chief, employees submit the hours they spend on the federal and state programs in monthly emails, which the policy bureau does not retain. Unless Social Services corrects this deficiency, it risks losing federal funds for the time state employees spent administering this program.

We recommend that Social Services require all staff who do not work exclusively on a single federal program to prepare personnel activity reports or equivalent documentation that meets federal requirements. In its corrective action plan, Social Services indicated that the policy bureau will use an individual timesheet for each of its staff that will indicate time spent on the federally funded program activities in lieu of the email account that it currently uses. According to Social Services, the timesheet will be filled out and signed by the employee and the manager, and maintained as documentation and substantiation for the appropriate period of time. These corrective actions will be implemented by January 2010.

Social Services Took Steps to Correct Three Findings Reported in Fiscal Year 2007–08

During our current audit, we found that Social Services took steps to correct one finding we reported in fiscal year 2007–08 for the Foster Care program and two findings for the Adoption Assistance program. Both of these programs were awarded Recovery Act funds during fiscal year 2008–09. First, we reported in fiscal year 2007–08 that Social Services did not adequately monitor the activities of its contractor—the Judicial Council of California (Judicial Council)—which evaluates the counties' juvenile court procedures and provides technical assistance to the counties' judges, commissioners, referees, and court staff for the Foster Care program. Specifically, Social Services did not follow up on the recommendations made by the Judicial Council to the counties. During our current audit work, we found that Social Services had developed written procedures that it was following to ensure it follows up with the counties on the recommendations made by the Judicial Council.

Second, while obtaining an understanding of internal controls over the Adoption Assistance program for fiscal year 2007–08, we noted that Social Services did not have controls in place to ensure that state laws, regulations, and policies and procedures were regularly updated to align with federal rules and regulations. During our current audit work, we confirmed that Social Services included this responsibility in the duty statement of one of the positions assigned to the Adoption Assistance program.

Finally, we also reported during fiscal year 2007–08 that Social Services' Adoption Assistance Bureau did not comply with its public assistance CAP. Specifically, the percentages for Adoption Services' Sacramento district office that were submitted for the first quarter of fiscal year 2007–08 contained an error in the Group Activity Percentage Time Reporting Summary. During our current audit, we verified that Social Services recalculated the report and submitted the corrected information.

Department of Transportation

HIGHWAY PLANNING AND CONSTRUCTION FEDERAL CATALOG NUMBER 20.205

Based on the U.S. Office of Management and Budget's (OMB) June 2009 guidance, the California State Auditor's (State Auditor's Office) presents its interim reporting on the Department of Transportation's (Caltrans) administration of the Highway Planning and Construction program (Federal Catalog Number 20.205) during fiscal year 2008–09. Over this period, Caltrans received more than $2.8 billion in federal funds for this program, of which approximately $1.2 million—or less than one percent—pertained to funding from the American Recovery and Reinvestment Act of 2009 (Recovery Act). The issues contained in this interim reporting represent the results of our internal control and compliance audit that require Caltrans' corrective action. The State Auditor's Office identified two findings as of December 1, 2009, that pertain to Caltrans' administration of this federal program.

Caltrans Has Recently Improved Its Procedures to Better Ensure That It Disburses Federal Funds to Local Agencies Only for Reasonable Costs

In 1992 the U.S. Department of Transportation—Federal Highway Administration (FHWA) delegated to Caltrans the responsibility for the authorization and oversight of certain federally funded projects, such as all highway projects not located on the National Highway System (NHS).[2] For state-authorized projects that are developed and administered by local agencies, Caltrans agreed to provide the necessary review and oversight to assure compliance with federal requirements. Working under this delegated authority, Caltrans provided more than $1 billion in federal funds to local agencies, such as cities and counties, during fiscal year 2008–09.

However, during this period, Caltrans lacked adequate internal controls to ensure that its progress payments—payments made while a project is ongoing—to local agencies were reasonable according to federal guidance. Specifically, Caltrans' procedures for approving progress payments did not consider or evaluate whether the costs that local agencies claimed for reimbursement were necessary or reasonable in relation to the work performed. Caltrans' *Local Assistance Procedures Manual* requires local agencies, such as cities and counties, to submit their progress invoices directly to Caltrans' Local Program Accounting Branch for processing and reimbursement. According to Caltrans' chief of the Division of Local Assistance, Caltrans' accounting staff do not review local agency progress invoice packages to determine whether the costs claimed meet federal eligibility requirements and do not verify that the work actually performed was consistent with the progress costs invoiced. Instead, according to Caltrans' procedures, accounting staff review other aspects of the progress invoices, such as reviewing them for mathematical accuracy and verifying that local agencies were not seeking reimbursement for costs incurred prior to the authorization of the work. Caltrans did not make a determination as to whether a project's costs were reasonable based on the work performed until a District Local Assistance Engineer—the Caltrans' engineer in each district responsible for providing services and assistance to the local agencies—reviewed the completed project and determined whether the local agency needed to return any funds that Caltrans had provided previously. Since some projects take multiple years to complete, Caltrans' lack of verification that the progress invoice

[2] NHS consists of approximately 160,000 miles of roadway important to the nation's economy, defense, and mobility. This system includes important interstate as well as rural and urban highways. The U.S. Department of Transportation—FHWA—is responsible for the oversight of NHS projects, but has delegated some of this oversight responsibility to Caltrans.

amounts were reasonable increased the risk that federal funds could be spent on unallowable costs and not be caught until much later at the project's conclusion. Such an approach did not seem, in our professional judgment, to be a timely and effective means to ensure that federal funds are spent properly.

In September 2008 FHWA concluded a review of Caltrans' local assistance program and recommended that Caltrans consider having its district staff copied on the progress invoices to review project status and the eligibility of pay items. In response to FHWA's concerns, Caltrans changed its policy effective September 1, 2009, requiring engineers at the district offices to ensure that the work claimed on progress invoices was actually performed and eligible for reimbursement. We recommend Caltrans continue with its implementation of this policy change. Caltrans agreed with our recommendation.

Caltrans and the State Controller's Office Need to Improve Oversight of Local Agencies That Receive Federal Funds

According to Caltrans' *Local Assistance Procedures Manual*, which has been approved by FHWA, Caltrans states that it will use *process reviews* as the main method for determining if local agencies are in compliance with all federal laws, regulations, and procedures. Process reviews are designed to be topic-oriented, such as focusing on whether a sample of local agencies have complied with the Americans with Disabilities Act or construction contractor payment requirements. The number of process reviews that Caltrans expects to perform is documented in an annual monitoring plan that is approved by Caltrans' Process Review Committee, which consists of various branch and division chiefs such as the chief of Caltrans' Division of Local Assistance. During fiscal year 2008–09, Caltrans' annual monitoring plan identified seven process reviews.

However, Caltrans did not complete any of the process reviews listed on its monitoring plan and only expects to issue a report on one of these seven reviews in January 2010. The chief of Caltrans' Division of Local Assistance acknowledged that Caltrans did not conduct all of the process reviews per its plan, explaining that the Caltrans' staff who were dedicated to performing the process reviews are now assisting other external agencies, such as FHWA and the U.S. Government Accountability Office, with their own performance reviews. Nevertheless, FHWA has an expectation that Caltrans is performing the process reviews according to its annual monitoring plan. In September 2008 FHWA completed a review of Caltrans' oversight activities for local agencies, concluding: "The gap in initiating and conducting reviews from 2004 on does not adequately provide verification that federal requirements are being met." FHWA recommended that Caltrans reassess its entire oversight process and methods for determining and verifying compliance and develop a comprehensive oversight action plan. Following FHWA's review, Caltrans began working with FHWA to develop a *Local Oversight Action Plan*, which is scheduled to be completed by September 2010. In the meantime, we recommend Caltrans take the necessary steps to complete the process reviews in accordance with its monitoring plan or work with FHWA to establish attainable expectations for the performance of these reviews. Caltrans agreed with this recommendation.

In addition to not completing its process reviews, Caltrans also did not ensure that it issued management decisions on audit findings at local agencies within six months in accordance with federal requirements. Local agencies that expend more than $500,000 in federal funds in a fiscal year are required to have their own independent audit in accordance with OMB Circular A-133, which prescribes the same standards the State Auditor's Office follows when performing its annual audit

of the State. A management decision is an evaluation by Caltrans of a local agency's audit findings and corrective action plan. The management decision culminates in Caltrans issuing a written decision to the local agency as to whether the local agency's corrective action plan will be effective in correcting the finding or what additional corrective action is necessary. The State has established a process whereby local governments submit copies of their audit reports to the State Controller's Office (SCO). The SCO receives the reports and distributes copies of each audit report to state entities affected by the audit findings. The state entities, such as Caltrans, are responsible for following up on the audit findings related to federal programs. In July 2009 the SCO provided Caltrans with a listing of 13 audit findings pertaining to 10 local agencies, instructing Caltrans to resolve the audit findings and provide an update on the status of each finding by July 28, 2009. The SCO's July 2009 letter did not specify when the State received these audit reports or when Caltrans' management decisions were due. In October 2009 the SCO provided an updated list of audit findings, identifying a total of 27 findings—which included the original 13 findings from July—pertaining to 21 local agencies. In its October 2009 letter, the SCO provided Caltrans with information on when the State received the audit reports and when Caltrans' six-month management decisions were due. However, we noted that the management decisions for 10 of the findings listed in the SCO's October letter were already overdue by the time the SCO provided the letter to Caltrans.

On November 3, 2009, Caltrans' chief of External Audits confirmed that Caltrans had not issued management decisions on any of the 27 findings, explaining that she expects such decisions to be issued in January 2010, six months after the SCO's initial July notification. As a result, Caltrans is late in issuing management decisions on 12 of the 27 findings—findings where the management decision due date preceded November 3, 2009. The chief of External Audits informed us that Caltrans will implement a new policy change by the end of 2009. This change will reflect the need for Caltrans to issue management decisions within six months of the date SCO receives audit reports from local agencies. Going forward, we recommend Caltrans coordinate with the SCO to ensure that audit findings are resolved within six months of the State's receipt of a local agency's audit report. Caltrans agreed with our recommendation.

Caltrans Appears to Have Followed Guidance From the FHWA for Reporting Jobs Created and Retained Under the Recovery Act, but the Jobs Data Still Seems Questionable

In October 2009 Caltrans submitted its first quarterly report under Section 1512 of the Recovery Act. Section 1512 requires certain entities that receive Recovery Act funds[3] directly from the federal government to provide, not later than 10 days after the end of each calendar quarter, information concerning how it used the funds. For example, the Recovery Act requires recipients to provide data on the total amount of funds it has received and expended, as well as provide information on the projects or activities supported with such funding. According to the federal government, for the quarter ending September 30, 2009, Caltrans reported activity on 680 projects. Caltrans also reported that it had spent $26.7 million and that nearly 1,590 jobs were created or retained.

Federal guidelines do not currently require us to, nor did we, audit the information recipients must report under Section 1512. Since Caltrans submitted its first Section 1512 report in October 2009, our subsequent audit of fiscal year 2009–10 expenditures of federal funds will likely examine these reports

[3] OMB issued guidance on June 22, 2009 (memo M-09-21) clarifying that recipients were not required to submit Section 1512 reports for certain entitlement programs, such as Medicaid.

in more detail. Nevertheless, in keeping with OMB's emphasis on early communication of issues to management, we conducted a high-level review of the methodology that Caltrans used to report the number of jobs created or retained with Recovery Act funds. Based on our preliminary review and Caltrans' explanation of its methodology, we believe that Caltrans followed the guidance provided by FHWA.

However, we noted that FHWA's guidance to Caltrans regarding how to report the number of jobs created or retained seems inconsistent with OMB's guidance concerning how to report this same information. Specifically, OMB's guidance states that a job created or retained is one that would not exist were it not for funding provided by the Recovery Act. One of the main goals of the Recovery Act is to preserve and create jobs and promote economic recovery, and OMB requires recipients to discuss the employment impact of the Recovery Act on their workforce. In contrast, FHWA has advised recipients, such as Caltrans, to report all jobs paid with Recovery Act funds and does not clarify that such reporting should be limited to those positions that would not have continued to exist without Recovery Act funding. According to Caltrans, their methodology for reporting the 1,590 jobs figure was based on taking the total number of hours charged to Recovery Act-funded projects—which would include the time of Caltrans employees, local agency staff, and construction workers—and then to divide this amount by the number of hours a full-time employee would work over that same three-month period. For example, if the total number of hours charged to a project over a three-month period was 3,000 hours, Caltrans would take this number and divide it by roughly 520 hours (173 hours per month times three months), which would result in 5.77 jobs created or retained. However, such a methodology only provides an estimate of how many full-time workers were paid with Recovery Act funds, regardless of whether these positions were truly at risk of being eliminated without federal funding.

Further, Caltrans' 1,590 figure appears to be overstated. Caltrans' manager in charge of Recovery Act programs acknowledged that the actual number that should have been reported is roughly 1,200 created or retained jobs. According to Caltrans, the overstatement occurred, in part, because some construction projects were accidentally counted twice. Further, FHWA's guidance to Caltrans that it report all hours charged to Recovery Act-funded projects may also have resulted in an overstatement of the Recovery Act's impact on creating and retaining jobs. In the previous example, Caltrans would report that 3,000 hours charged to a Recovery Act-funded project over a three-month period resulted in 5.77 created or retained jobs. However, providing all the credit to the Recovery Act for these jobs seems questionable if the project is only partially funded by the Recovery Act. One might argue that Caltrans' estimate of the jobs created or retained should reflect the Recovery Act's contribution on those projects. FHWA refers to these projects as split-funded projects and has instructed Caltrans to report all jobs on any split-funded project receiving Recovery Act funds. Caltrans indicated that it had sought clarification from FHWA regarding the proportioning of jobs to Recovery Act funds versus overall project cost, but had not received further guidance. However, guidance on FHWA's Web site explains that states should expend all of their Recovery Act funds on a project before initiating expenditures of other funds. FHWA also clarified that any adjustments to jobs required due to split-funding will be made at the national level to accurately and consistently report those jobs associated with Recovery Act funds. According to Caltrans, FHWA did not make such an adjustment to its data.

Caltrans' jobs data may also be overstated since many of the projects that claimed to create or retain jobs had yet to expend any Recovery Act funds. In its October 2009 report, Caltrans provided information on 680 projects, of which 152 projects claimed to have created or retained at least one job. However, 94 of these 152 projects had not expended any Recovery Act funds, raising

reasonable questions as to whether the Recovery Act's impact is being overstated. For perspective, these 94 projects accounted for 892 jobs created or retained, or roughly 56 percent of Caltrans' total jobs amount of 1,590. FHWA's Web site indicated that it was going to review the states' jobs data to check for errors. One of FHWA's validation rules is to ensure that if jobs data is present, then expenditure data must also be present. However, it appears that this validation rule was not applied. Going forward, it appears that Caltrans needs to continue to work with FHWA to ensure that its methodology for reporting jobs data is consistent with OMB's guidance and that clear expectations are established for validating the reasonableness of its jobs data.

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

Respectfully submitted,

ELAINE M. HOWLE, CPA
State Auditor

Date: December 21, 2009

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

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Office of the Lieutenant Governor
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