

REPORT BY THE  
AUDITOR GENERAL  
OF CALIFORNIA

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STATE DEPARTMENT OF EDUCATION  
SURPLUS PROPERTY - HARDWARE PROGRAM  
FINANCIAL AND COMPLIANCE AUDIT REPORT  
YEARS ENDED JUNE 30, 1983 AND 1984

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REPORT BY THE  
OFFICE OF THE AUDITOR GENERAL

F-481

STATE DEPARTMENT OF EDUCATION  
SURPLUS PROPERTY - HARDWARE PROGRAM  
FINANCIAL AND COMPLIANCE AUDIT REPORT  
YEARS ENDED JUNE 30, 1983 AND 1984

AUGUST 1985



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Thomas W. Hayes  
Auditor General

STATE OF CALIFORNIA  
**Office of the Auditor General**

660 J STREET, SUITE 300  
SACRAMENTO, CA 95814

August 13, 1985

F-481

Honorable Art Agnos, Chairman  
Members, Joint Legislative  
Audit Committee  
State Capitol, Room 3151  
Sacramento, California 95814

Dear Mr. Chairman and Members:

The Office of the Auditor General presents its financial and compliance audit report of the Surplus Property - Hardware Program for the fiscal years ended June 30, 1983, and 1984. During the audited years, the program was administered by the State Department of Education. The program showed substantial operating losses for the two fiscal years. The accumulated deficit was absorbed by the Commodities Program when the Hardware Program was transferred to the Department of General Services on July 1, 1984. The compliance audit revealed weaknesses in the control of participant eligibility and the inventory of federal surplus property, as well as other weaknesses. This report has a disclaimer of opinion on the financial statements due to various auditing problems that we encountered.

Respectfully submitted,

  
THOMAS W. HAYES  
Auditor General

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## INTRODUCTION

We have conducted a financial audit of the California State Department of Education's Surplus Property - Hardware Program. We conducted this audit under the authority vested in the Auditor General by Section 10500 et seq. of the California Government Code.

Education Code Section 12110 et seq. designated the State Department of Education as the state agency to administer the surplus hardware property that the federal government donates to California. Chapter 196, Statutes of 1984, amended those sections of the Education Code and added Article 5.5 to the Public Contract Code (commencing with Section 10383) to designate the Department of General Services as the administering state agency for the Surplus Property - Hardware Program starting July 1, 1984. The administration of the Surplus Property - Hardware Program is subject to the provisions of Section 203(j) of the Federal Property and Administrative Services Act of 1949, as amended.

The purpose of the Surplus Property - Hardware Program is to distribute federal surplus hardware property to public agencies and eligible private, nonprofit organizations. Title to the property passes directly from the federal government to the recipients. The administering state agency charges fees to recipients for providing services in distributing the property.



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We have examined the balance sheets of the California State Department of Education's Surplus Property - Hardware Program (Hardware Program) as of June 30, 1983, and 1984, and the related statements of revenues, expenses, and changes in retained earnings and changes in financial position for the years then ended. Except as set forth in the second through fourth paragraphs, we made our examination in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As discussed in Note 5 to the financial statements, the Hardware Program has incurred significant losses in the past but has been able to continue to operate through cash advanced by the Commodities Program. The amount of the cash advanced is shown as Due to Commodities Program. We could not determine the accuracy of the balance of the Cash account and the Due to Commodities Program account because it was not practicable to audit the cash activity of both the Hardware Program and the Commodities Program, since the two programs were separated into individual accounts within the Surplus Property Revolving Fund on July 1, 1981.

In addition, prior to December 1983, the State of California did not require retention of purchase documents beyond four years. Consequently, the State Department of Education does not maintain sufficient records to support the acquisition cost of equipment. The accounting records do not permit the application of alternative auditing procedures regarding the balance of the Equipment account in the amounts of \$372,400 at June 30, 1983, and \$382,327 at June 30, 1984, and the related Accumulated Depreciation balances of \$365,738 and \$368,508, respectively.

Furthermore, many of the expenses are allocated first at the fund level and frequently again at the program level. Because the State Department of Education's accounting system does not provide an adequate audit trail, we found it impracticable to test transactions at the program level. We could not apply alternative procedures regarding the expenses by category; therefore, we could not determine the accuracy of the balances in the various operating expense accounts.

As discussed in Note 6 to the financial statements, Chapter 196, Statutes of 1984, required the transfer of the Hardware Program's assets and liabilities, except for the amount due to the Commodities Program, from the State Department of Education to the Department of General Services on July 1, 1984. However, the State Department of Education transferred only the Hardware Program's equipment and continued to account for the remaining assets and liabilities. On February 11, 1985, the federal government agreed to allow the State Department of Education to transfer the remaining assets and liabilities of the Hardware Program to the Commodities Program and specifically approved the State Department of Education's request to forgive the loan from the Commodities Program to the Hardware Program.

Because we were unable to apply alternative auditing procedures to enable us to determine the accuracy of the balance of the Cash, Equipment, Due to Commodities Program, Retained Earnings, and various operating expense accounts, we are unable to express, and we do not express, an opinion on the financial statements referred to above.

OFFICE OF THE AUDITOR GENERAL



KARL W. DOLK, CPA  
Deputy Auditor General

Date: April 19, 1985

Staff: Ulrich Pelz, CPA, Audit Manager  
Christine M. Ford, CPA  
Jayne Hobbs

STATE OF CALIFORNIA  
STATE DEPARTMENT OF EDUCATION  
SURPLUS PROPERTY - HARDWARE PROGRAM  
BALANCE SHEET  
JUNE 30, 1983 AND 1984

	<u>1983</u>	<u>1984</u>
ASSETS		
Cash	\$ 249,827	\$ 18,083
Accounts receivable, less allowances for uncollectible accounts of \$44,075 at June 30, 1983, and \$46,304 at June 30, 1984	130,830	115,445
Due from other funds	428,426	739,338
Due from other governments	156,590	131,595
Equipment and leasehold improvement (Note 4)	<u>11,499</u>	<u>18,156</u>
Total Assets	<u>\$977,172</u>	<u>\$1,022,617</u>
LIABILITIES AND FUND EQUITY		
Liabilities		
Accounts payable	\$ 29,104	\$ 38,120
Accrued vacation pay	106,511	106,453
Due to Commodities Program (Note 5)	<u>3,397,721</u>	<u>4,593,816</u>
Total Liabilities	<u>\$3,533,336</u>	<u>\$4,738,389</u>
Fund Equity		
Retained earnings (deficit)	<u>(2,556,164)</u>	<u>(3,715,772)</u>
Total Liabilities and Fund Equity	<u>\$ 977,172</u>	<u>\$1,022,617</u>

See the notes accompanying the financial statements.



**STATE OF CALIFORNIA**  
**STATE DEPARTMENT OF EDUCATION**  
**SURPLUS PROPERTY - HARDWARE PROGRAM**  
**STATEMENT OF REVENUES, EXPENSES, AND**  
**CHANGES IN RETAINED EARNINGS**  
**FISCAL YEARS ENDED JUNE 30, 1983 AND 1984**

	<u>1983</u>	<u>1984</u>
Operating Revenues		
Service and handling fees	<u>\$ 1,375,993</u>	<u>\$ 1,235,396</u>
Operating Expenses		
Salaries and wages	1,421,460	1,391,333
Rent	222,558	260,894
Maintenance	86,879	133,346
Utilities	38,581	80,595
Travel	30,435	28,165
Depreciation	7,688	4,750
Departmental overhead	277,824	261,429
State overhead	89,338	97,510
Other	<u>130,046</u>	<u>136,982</u>
Total Operating Expenses	<u>2,304,809</u>	<u>2,395,004</u>
Net Loss	\$ (928,816)	\$(1,159,608)
Retained earnings, beginning of year	<u>(1,627,348)</u>	<u>(2,556,164)</u>
Retained earnings, end of year	<u><u>\$(2,556,164)</u></u>	<u><u>\$(3,715,772)</u></u>

See the notes accompanying the financial statements.

STATE OF CALIFORNIA  
STATE DEPARTMENT OF EDUCATION  
SURPLUS PROPERTY - HARDWARE PROGRAM  
STATEMENT OF CHANGES IN FINANCIAL POSITION  
FISCAL YEARS ENDED JUNE 30, 1983 AND 1984

	<u>1983</u>	<u>1984</u>
Resources Provided		
Net loss	\$ (928,816)	\$(1,159,608)
Add (deduct) items not affecting cash		
Depreciation expense	7,688	4,750
Loss on disposal of property	0	552
Increase in accounts payable	19,312	9,016
Decrease in accrued vacation pay	0	(58)
Increase in net receivables	<u>(239,836)</u>	<u>(270,532)</u>
Cash provided by operations	(1,141,652)	(1,415,880)
Increase in Due to Commodities Program	<u>1,182,539</u>	<u>1,196,095</u>
Total Resources Provided	<u>40,887</u>	<u>(219,785)</u>
Resources Applied		
Purchase of equipment	<u>2,378</u>	<u>11,959</u>
Total Resources Applied	<u>2,378</u>	<u>11,959</u>
Net Change in Cash	<u>\$ 38,509</u>	<u>\$ (231,744)</u>

See the notes accompanying the financial statements.

## NOTES TO THE FINANCIAL STATEMENTS

### 1. Definition of Reporting Entity

The Surplus Property - Hardware Program (Hardware Program) accounts for transactions related to the receiving of surplus hardware property from the federal government and its subsequent distribution to eligible state, local, and private nonprofit agencies.

### 2. Summary of Significant Accounting Policies

The accompanying financial statements reflect the financial position and results of operations of the Surplus Property Revolving Fund - Hardware Program for the years ended June 30, 1983, and 1984. The financial statements have been prepared in conformity with generally accepted accounting principles applicable to state and local governments. Below is a summary of the more significant accounting policies.

#### A. Fund Accounting

The Hardware Program is accounted for separately as a part of the Surplus Property Revolving Fund, which is classified as an Enterprise Fund. Enterprise Funds account for goods or services provided when management intends that all or most of the cost involved are to be financed by user charges or when periodic measurement of the results of operations is appropriate for management control, accountability, or other purposes.

#### B. Basis of Accounting

The Hardware Program is accounted for on the accrual basis of accounting, except for sick leave accruals. Under the accrual basis of accounting, revenues are recognized in the accounting period in which they are earned, and expenses are recognized in the accounting period in which they are incurred. The department does not accrue sick leave benefits because accumulated sick leave balances do not represent vested rights.

### 3. Inventory

The Hardware Program's financial statements do not reflect an inventory balance since title to the hardware inventory remains with the federal government until the property has been distributed to the recipients.

4. Equipment and Leasehold Improvement

Equipment is stated at acquisition cost less accumulated depreciation. Depreciation is computed on the straight-line basis over an estimated life of three to ten years. The following schedule presents a summary of the acquisition cost and accumulated depreciation of equipment as of June 30, 1983, and 1984:

<u>Equipment</u>	<u>June 30, 1983</u>	<u>June 30, 1984</u>
Acquisition cost	\$372,400	\$382,327
Accumulated depreciation	<u>(365,738)</u>	<u>(368,508)</u>
Equipment (net)	<u>\$ 6,662</u>	<u>\$ 13,819</u>

The leasehold improvement is stated at acquisition cost less accumulated depreciation. Depreciation is computed on the straight-line basis over 11 years, which was the remaining life of the lease when the improvement was made. The following schedule presents the acquisition cost and accumulated depreciation of the leasehold improvement as of June 30, 1983, and 1984:

<u>Leasehold Improvement</u>	<u>June 30, 1983</u>	<u>June 30, 1984</u>
Acquisition cost	\$5,506	\$5,506
Accumulated depreciation	<u>(668)</u>	<u>(1,169)</u>
Leasehold improvement (net)	<u>\$4,838</u>	<u>\$4,337</u>

5. Due to Commodities Program

Prior to July 1, 1981, the Surplus Property Revolving Fund did not maintain separate accounts for the Hardware Program and the Commodities Program. On that date, the programs were separated into individual accounts within the fund. Since then, the Hardware Program has not generated sufficient cash to support its operations. The Commodities Program has supported both operations by allowing the Hardware Program to operate through the Commodities Program's cash account. The amount of cash advanced by the Commodities Program is shown as Due to Commodities Program.

6. Subsequent Events

Chapter 196, Statutes of 1984, transferred the responsibility for distributing federal surplus hardware property from the State Department of Education to the Department of General Services beginning July 1, 1984. On that date, the State Department of Education transferred to the Department of General Services the federal surplus hardware property held for distribution and the equipment used in the operation of the Hardware Program. The State Department of Education also transferred the 55 employees in the Hardware Program to the Department of General Services. However, the State Department of Education remained responsible for collecting receivables and paying the liabilities reported at June 30, 1984.

On February 11, 1985, the United States Department of Agriculture, the administering federal agency for the Commodities Program, approved the transfer of all remaining assets and liabilities of the State Department of Education's Surplus Property - Hardware Program into the Commodities Program. Therefore, the Commodities Program has, in effect, forgiven the balance of the loan to the Hardware Program.

**REPORT ON COMPLIANCE WITH FEDERAL REGULATIONS**



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Members of the Joint Legislative Audit Committee  
State of California

We have examined the financial statements of the California State Department of Education's Surplus Property - Hardware Program (Hardware Program) for the years ended June 30, 1983, and 1984, and have issued our report dated April 19, 1985. We made our examination in accordance with generally accepted auditing standards, the standards for financial and compliance audits of the Comptroller General of the United States, the requirements of the Federal Property Management Regulations as contained in the Code of Federal Regulations, Title 41, and the State Plan of Operations. Accordingly, we included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The Hardware Program is administered by the Office of Surplus Property. Prior to July 1, 1984, the Office of Surplus Property was a unit within the State Department of Education, but it is now under the administrative control of the Department of General Services.

In connection with the examination of the financial statements of the Hardware Program, we tested the Office of Surplus Property's compliance with the State Plan of Operations and the applicable federal regulations. The results of our tests indicate that, for the items tested, the Office of Surplus Property complied with the material terms and conditions of the State Plan of Operations and the applicable federal regulations, except as described in the management letter findings disclosed on pages 25 to 31 of this report. Further, for the items not tested, nothing came to our attention to indicate that the Office of Surplus Property did not comply with the material terms and conditions of the State Plan of Operations and the applicable federal regulations beyond the findings referred to above.

This report is intended for the use of the management of the Hardware Program. This restriction is not intended to limit the distribution of this report, which, upon acceptance by the Joint Legislative Audit Committee, is a matter of public record.

OFFICE OF THE AUDITOR GENERAL

KARL W. DOLK, CPA  
Deputy Auditor General

Date: April 19, 1985

**REPORT ON THE STUDY AND  
EVALUATION OF INTERNAL CONTROLS**





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State of California

We have examined the financial statements of the California State Department of Education's Surplus Property - Hardware Program (Hardware Program) for the years ended June 30, 1983, and 1984, and have issued our report dated April 19, 1985. As part of our examination, we studied the State Department of Education's (department) system of internal controls to the extent we considered necessary to evaluate the system as required by generally accepted auditing standards and by the standards for financial and compliance audits of the Comptroller General of the United States. For the purpose of this audit, we classified the system of internal controls into four areas: revenues (including cash receipts), expenses (including cash disbursements), assets, and liabilities.

We studied and evaluated the internal controls over revenues and cash receipts. We did not study the internal controls over expenses because we had tested the department's internal control over personal services expenses in connection with our examination of the State of California's General Purpose Financial Statements. Additionally, most of the other expenses are allocated at the department level and sometimes again at the program level. This made it impracticable to test transactions at the program level.

The purpose of our study and evaluation was to determine the nature, timing, and extent of auditing procedures necessary for expressing an opinion on the Hardware Program's financial statements. Our study and evaluation was more limited than would be necessary to express an opinion on the system of internal controls taken as a whole.

The management of the department is responsible for establishing and maintaining a system of internal accounting controls at each department. In fulfilling this responsibility, they are expected to make estimates and judgments to assess the expected benefits and related costs of control procedures.

The objectives of a system of internal controls are to provide management with reasonable assurance that assets are safeguarded against loss from unauthorized use or disposition, that transactions are executed in accordance with the authorization of the Department of

Finance and other agencies, and that transactions are recorded properly. Proper recording of transactions permits the preparation of financial statements in accordance with generally accepted accounting principles.

Because of inherent limitations in any system of internal controls, errors or irregularities may nevertheless occur and not be detected. Also, projecting any evaluation of the system to future periods is subject to the risk that the degree of compliance with the procedures may deteriorate or that procedures may become inadequate because of changes in conditions.

Our study and evaluation, made for the limited purposes described in the third paragraph, would not necessarily disclose all material weaknesses in the department's system of internal controls. Accordingly, we do not express an opinion on the system of internal accounting controls of the Hardware Program as administered by the State Department of Education. However, our evaluation disclosed material weaknesses that could result in errors or irregularities that may not be detected and that involve amounts that could have a material effect on the financial statements.

#### Inadequate Accounting Procedures

The department does not maintain adequate support for the account balances of the Hardware Program. For example, the department does not maintain documentation to directly support the amount of Cash and Due to the Commodities Program shown in the Hardware Program's accounting records. Also, before December 1983, the State of California did not require retention of purchase documents beyond four years. Consequently, the department does not maintain sufficient records to support the acquisition of fixed assets. Furthermore, many of the department's expenses are allocated first at the fund level and again at the program level. Because the department's California Statewide Accounting and Reporting System (CALSTARS) does not provide document references for allocated costs, we could not trace many of the Hardware Program's expenses to the supporting documents. In addition, we found numerous errors in the recording of transactions that we could audit.

The weakness in accountability at the program level made it impracticable to determine the accuracy of the account balances. As a result, we were unable to express an opinion on the Hardware Program's financial statements for the years ended June 30, 1983, and 1984.

#### Recommendation

The State should maintain adequate support for account balances of the Hardware Program and should closely monitor the recording of the program's transactions.

While our study did not disclose any other material weaknesses in internal accounting controls, it did disclose weaknesses in the administration of the Hardware Program. These weaknesses are discussed in our management letter, beginning on page 25 of this report.

As disclosed in Note 6 to the financial statements, the Hardware Program was transferred from the State Department of Education to the Department of General Services. It is no longer accounted for in the Surplus Property Revolving Fund, except for the final closing of the current assets and liabilities.

This report is intended for the use of the management of the Hardware Program. This restriction is not intended to limit the distribution of this report, which, upon acceptance by the Joint Legislative Audit Committee, is a matter of public record.

OFFICE OF THE AUDITOR GENERAL



KARL W. DOLK, CPA  
Deputy Auditor General

Date: April 19, 1985

**MANAGEMENT LETTER FINDINGS**

## MATERIAL WEAKNESS IN INTERNAL ACCOUNTING CONTROLS

### Inadequate Accounting Procedures

The State Department of Education (department) does not maintain adequate support for the account balances of the Hardware Program. For example, the department does not maintain documentation to directly support the amount of Cash and Due to the Commodities Program shown in the Hardware Program's accounting records. Also, before December 1983, the State of California did not require retention of purchase documents beyond four years. Consequently, the department did not maintain sufficient records to support the acquisition cost of fixed assets. Furthermore, many of the department's expenses were allocated first at the fund level and again at the program level. Because the department's CALSTARS accounting system does not provide document references for allocated costs, we could not trace many of the Hardware Program's expenses to the supporting documents. In addition, we found numerous errors in the recording of transactions that we could audit.

The weakness in accountability at the program level made it impracticable to determine the accuracy of the account balances. As a result, we were unable to express an opinion on the Hardware Program's financial statements for the years ended June 30, 1983, and 1984.

### Recommendation

The State should maintain adequate support for account balances of the Hardware Program and should closely monitor the recording of the program's transactions.

## WEAKNESSES IN THE ADMINISTRATION OF THE SURPLUS PROPERTY - HARDWARE PROGRAM

Our study of the administration of the Hardware Program disclosed that the Office of Surplus Property (OSP) does not have a system to periodically review the eligibility of program participants, and it does not maintain an inventory control system that provides adequate protection of and accountability for federal surplus hardware property in its custody. In addition, the OSP's system of utilization surveys does not provide adequate assurance that donated property is used for the purpose for which it was acquired. Furthermore, the OSP prepared inaccurate quarterly federal reports. Finally, we could not determine whether the OSP is distributing federal surplus hardware property in accordance with the State Plan of Operations because the OSP does not maintain adequate documentation to support its allocation system.

### Inadequate Control Over Participant Eligibility

The OSP does not have a systematic method for regularly updating eligibility files. We found that the OSP did not update, within the past three years, 16 of the 30 eligibility files that we tested. Also, we found that in 5 of the 30 files sampled, the OSP did not include all of the evidence of eligibility that federal regulations require.

Part IX of the State Plan of Operations and Title 41 of the Code of Federal Regulations Section 101-44.207 require that agencies update eligibility files not less than once every three years and that the files include specific evidence that participants meet all of the eligibility criteria. Without a regular update of eligibility, the OSP is not assured that the property is distributed to eligible participants.

#### Recommendation

The OSP should ensure that all of the required evidence is included in the eligibility files and should develop a system to update the eligibility files of participants at least every three years.

### Inadequate Inventory Controls

As part of our examination, we conducted tests of inventory controls at both the Sacramento and Fullerton warehouses. We found that neither warehouse properly stores the hardware inventory. For example, we observed that machine tools, metal office equipment, and other items were stored outside and, therefore, were subject to deterioration from the elements.

We had difficulty locating most of the property that we tested in both warehouses, and we could not locate 3 of the 40 items we had selected for testing in Fullerton and 2 of the 31 items in Sacramento. In addition, although there is no federal criterion limiting the length of time that an agency can hold federal hardware property in inventory, in our opinion, the OSP is holding inventory too long. The average holding period of the property we tested was 16 months in Fullerton and 18 months in Sacramento.

We also observed that the Sacramento warehouse does not properly restrict its receiving area to authorized personnel to preclude the loss or theft of property. Finally, the quantity on hand in 3 of the 29 groups of items we sampled did not agree with the balance in the inventory records.

The Code of Federal Regulations Section 101-44.205(b)(2) requires that the state agency adequately protect property in its custody from theft and other hazards. Property that is improperly controlled and inadequately stored is susceptible to theft, damage, and weather hazards. In addition, when the State of California holds unneeded but

usable property for excessive periods of time, it deprives other states of the opportunity to make the property available to their participants.

#### Recommendation

The OSP should establish and maintain an inventory control system that provides adequate protection of and accountability for federal property in its custody. The system should include procedures that would enable the warehouse staff to readily identify slow-moving inventory items and periodically report any unneeded property to the federal government.

#### Infrequent Site Visits to Program Participants

Surplus Property officers conduct reviews of Hardware Program participants to determine that donated property is being used in accordance with federal program requirements. However, since the first priority of the officers is the screening of federal surplus property, they visit program participants only as time allows, unless a situation requires immediate attention. Therefore, the OSP relies primarily on mail surveys to determine whether participants are complying with program regulations.

During our site visits to program participants, we found that 2 of the 14 participants tested did not have the property in use within the time limits imposed by the federal government. In addition, 9 of the 14 participants we visited had the property in use on dates that differed from the dates they had given in the mail survey. Therefore, by primarily using mail surveys, the OSP is not assured that donated property is used in accordance with the terms specified by the federal government.

The Code of Federal Regulations Section 101-44.208(d) requires that the state agency make utilization surveys and reviews, as detailed in the State Plan of Operations, to ensure that during the period of restriction, donated property is being used for the purpose for which it was acquired. When participants do not comply with the terms and conditions of eligibility for donated property and the OSP is unaware of the violations, it cannot take the corrective action necessary during the period of restriction.

#### Recommendation

The OSP should make site visits to program participants systematically to ensure that the participants meet the conditions for continuing eligibility in the program and for the use of donated property.

### Inaccurate Federal Donation Reports

We found that the OSP did not submit accurate Quarterly Donation Reports (GSA 3040) to the federal government. For example, the Sacramento warehouse did not report its adjustments from the physical inventories performed in December 1983 and June 1984 until the quarter ending December 31, 1984.

Both the Fullerton and Sacramento warehouses contain inventory that was donated by the State and by private organizations, as well as by the federal government. We found that the Quarterly Donation Reports, which detail the combined activities of the two warehouses, erroneously included inventory adjustments on property donated by the State and private organizations. In addition, the two warehouses have interpreted differently the instructions for filling out the federal forms and, as a result, do not have uniform methods of reporting property that has been approved for return to the federal government.

The Code of Federal Regulations Section 101-44.4902-3040-1 provides instructions to state agencies in the proper completion of the Quarterly Donation Report. If these instructions are not clear, the state agency can contact the administering federal agency for clarification. As a result of delayed and erroneous inventory adjustments and of differences in the way the warehouses report inventories, the Quarterly Donation Reports do not accurately reflect the value of federal surplus hardware property on hand.

### Recommendation

The Chief of the OSP should instruct the warehouses in the correct procedures for reporting property that has been approved for return to the federal government and should monitor the Quarterly Donation Reports to ensure that the reports reflect accurate and consistent information to the federal government.

### Inadequate Documentation To Support Allocation System

In order to provide a wider and more equitable distribution of federal surplus hardware property, certain items of inventory that are in high demand or short supply are allocated by the OSP rather than distributed on a first-come, first-served basis. Part VIII of the State Plan of Operations specifies the factors that the agency should consider in providing for the equitable distribution of property. However, the OSP does not document its reasons for allocating property to one participant over another. Therefore, we cannot determine and report to the federal government whether or not the OSP allocates surplus property in accordance with the State Plan of Operations.



Recommendation

The OSP should establish a system that provides evidence that it allocates federal surplus hardware property in accordance with the State Plan of Operations.

**CONDITION REQUIRING  
MANAGEMENT'S ATTENTION**

Inadequate Follow-Up  
of Receivables

The State Department of Education has not assigned to specific personnel responsibility for taking action on the disposition of receivables after the usual collection efforts have been exhausted. For example, in October 1984, the staff who are responsible for the collection of Hardware Program receivables recommended that the department's accounting office submit nine vendors' accounts with receivable balances totaling over \$6,000 to the Board of Control for relief from accountability. However, as of February 1985, the department had neither submitted the accounts to the Board of Control nor taken any action to collect these balances through coordination with other programs or state agencies.

Section 8710.1 of the State Administrative Manual requires that the agency exhaust all avenues of collection before it submits the account to the Board of Control for relief from accountability. Inadequate follow-up of receivables often results in the department's not being able to collect any of the receivable balance when it could have secured at least partial collection through other avenues.

Recommendation

The department should assign responsibility for taking action on receivables after the usual collection efforts have failed.



July 24, 1985

Thomas W. Hayes, Auditor General  
Office of the Auditor General  
660 J Street, Suite 300  
Sacramento, CA 95814

Re: Management Letter F-481

Dear Mr. Hayes:

This is in response to the management letter reporting on your study of the Surplus Property--Hardware Program for the years ended June 30, 1983 and 1984. As agreed during the exit conference with Ulrich Pelz and Chris Ford, the Department of Education is commenting only on the fiscal findings. The Department of General Services is to respond separately on the administrative findings as the program is now housed in that department.

Inadequate Accounting Procedures

Response: The Department does maintain adequate support for account balances. The Department uses the California Statewide Accounting and Reporting System (CALSTARS) which the Department of Finance developed and currently maintains for use by State agencies. CALSTARS is the same system which the Auditor General has previously audited in its prior examinations of the State of California's General Purpose Financial Statements. While the Department recognizes that auditing CALSTARS may be cumbersome, the Department considers CALSTARS to be an auditable accounting system. The impracticability of auditing the Hardware Program is, therefore, not a systematic problem but rather an issue focused on audit workload versus lack of anticipated benefits.

It is our understanding that the errors detected in the recording of some transactions were a result of difficulty in distinguishing between Hardware and Commodities Program transactions when, in fact, the ultimate accountability resided in the Surplus Property Revolving Fund as a whole. This has been resolved because of the transfer of the Hardware Program to General Services and the creation of two new funds to account for the Hardware and Commodities Programs separately.\*

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\* The Auditor General's comments on this response is included on page 34.


Inadequate follow-up of Receivables

Response: The Department concurs with this recommendation. In this instance, the Office of Food Distribution (OFD) has the responsibility for initial collection efforts. As a service to the program office, the Accounting Office sent official reminder notices on delinquent accounts at 90/120/150 day intervals. After the 150 day notice, the staff of the OFD has made telephone calls and site visits in an effort to locate responsible parties from which to collect the receivables. When these efforts have been unsuccessful, the OFD has referred these accounts to the Accounting Office for submission to the Board of Control for relief from accountability.

The Department is in the process of updating the Management Memo concerning the responsibilities for clearance of receivables for reissuance to Department staff.

If you need further information, please contact Carolyn Pirillo, Audit Response Coordinator, at (916) 324-1164.

Sincerely,

  
William D. Dawson  
Executive Deputy Superintendent

WDD:dm

cc: Shirley Chilton, Secretary  
State and Consumer Services

W. J. Anthony, Director  
Department of General Services

Carolyn Pirillo, Audit Response Coordinator  
State Department of Education

Peggy Lowndes, Regional Donation Manager  
General Services Administration, Region 9

Auditor General's Comment: The State Department of Education's (department) response to our finding concerning inadequate accounting procedures erroneously compares our audit of the State of California's General Purpose Financial Statements with the audit of the Hardware Program, which represents only a part of the Surplus Property Revolving Fund. While the department's accounting system may be adequate for the statewide audit or for auditing a fund as a whole, it is inadequate for auditing a program that represents only a part of a fund. Because many transactions recorded at the program level could not be traced to the supporting documents, the financial statements were unauditible for all practical purposes. Although the department no longer accounts for the Hardware Program, our finding may still be relevant for the department if another individual program requires an audit of its financial statements.



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RESPONSE:

For the past one and one-half years, the OSP has conducted an extensive program of identifying non-donable and slow-moving property and has taken steps to remove this property from inventory by returning the property to the federal government for sale or, in the case of still usable property, reported the property to the General Services Administration (GSA) for offering to other states.

For many years, the OSP has identified slow-moving property through visual inspection by means of checking the date on the property identification card, using color-coded identification cards, reviewing stock record cards and by visual appearance of the condition of the property. This is another area which has been targeted for and would be greatly enhanced by the implementation of a computer automated system and utilization of a micro-fiche program.

The OSP acknowledges that, in some instances, it would be desirable to provide better storage for some items and attempts will be made to do so. It should be noted, however, that the OSP generally provides better storage conditions than were provided by the federal holding activity.

With regard to the statement that the OSP is holding items in inventory too long, keeping in mind only a minute test of the 6,000 to 8,000 line items of property in inventory was made, the following information is provided. On occasion, a large quantity of a single item becomes available. As long as that item is a steady mover, there is no reason to remove it from inventory. On other occasions, smaller quantities of an item become available, generally in the furniture line, which are nearly identical to a larger quantity of items in inventory. A consolidation of property takes place using the identification number and receiving date of the larger quantity. It is possible that by using the earlier receiving date, the actual time the newer property has been in inventory may be distorted. The OSP will examine its practice in this area.

As to the Sacramento warehouse not restricting its receiving area to authorized personnel, signs are posted in the warehouse to this effect and action will be taken to enforce this policy.

RECOMMENDATION 3:

The OSP should make site visits to program participants systematically to ensure that the participants meet the conditions for continuing eligibility in the program and for the use of the donated property.

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RESPONSE:

The OSP agrees that a routine site visitation program for review of eligibility and use of donated property would be beneficial. However, the current system of review by mail survey combined with site visitations on an as needed/exception basis is a more effective utilization of staff.

RECOMMENDATION 4:

The Chief of the OSP should instruct the warehouses in the correct procedures for reporting property that has been approved for return to the federal government and should monitor the Quarterly Donation Reports to ensure that the reports reflect accurate and consistent information to the federal government.

RESPONSE:

The OSP acknowledges that, in a few instances, the quarterly reports of donation activity were misrepresented; however, the causes for these errors have been corrected. The OSP no longer reports adjustments to inventory on non-federal property in its quarterly reports. The acquisition cost of property returned to the federal government for disposal is no longer reported on the line items marked "Returned to the Federal Government" but is now reported in the line item marked "Other Distribution," as instructed by the GSA. It should be noted that there was also a misinterpretation between the GSA Regional Office and its Central Office as to how this line item should be reported. This also is another area for inclusion in the implementation of a computer automated system.

RECOMMENDATION 5:

The OSP should establish a system that provides evidence that it allocates federal surplus hardware property in accordance with the State Plan of Operations.

RESPONSE:

The OSP is distributing property in a fair and equitable manner, as can be demonstrated by a review of donee distribution records. The OSP agrees that additional documentation of the allocation decision process could be beneficial. We intend to review present practices to determine what level of documentation is practical. It should be noted that these determinations are made by experienced professional staff using a variety of factors, which will be included in the review.

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The Department of General Services appreciates the opportunity to respond to your report. Your recommendations for improvement in the administration of the Surplus Personal Property Program were helpful. We have noted strong concurrence with most recommendations. We appreciate the thoughtful and comprehensive work by your staff and the opportunity to discuss these issues with you.

Sincerely,



SHIRLEY R. CHILTON  
Secretary of the Agency

cc: W. J. Anthony, Director  
Department of General Services

cc: Members of the Legislature  
Office of the Governor  
Office of the Lieutenant Governor  
State Controller  
Legislative Analyst  
Assembly Office of Research  
Senate Office of Research  
Assembly Majority/Minority Consultants  
Senate Majority/Minority Consultants  
Capitol Press Corps