REPORT BY THE

AUDITOR GENERAL

OF CALIFORNIA

AUDIT OF THE DEPARTMENT OF ECONOMIC OPPORTUNITY

F-511

JULY 1986

REPORT BY THE

OFFICE OF THE AUDITOR GENERAL

F-511

AUDIT OF THE DEPARTMENT OF ECONOMIC OPPORTUNITY

JULY 1986

Telephone:
(916) 445-0255

STATE OF CALIFORNIA

Office of the Auditor General

660 J STREET, SUITE 300
SACRAMENTO, CA 95814

Thomas W. Hayes
Auditor General

July 10, 1986 F-511

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 report concerning the need for the Department of Economic Opportunity to require and effectively review organization-wide audits of community agencies. Based on these audit reports, the department should direct the community agencies to develop and implement formal accounting policies and procedures and improve their systems of internal control.

Respectfully submitted,

Kurt Sjoberg

for THOMAS W. HAYES
Auditor General

TABLE OF CONTENTS

SUMMARY

RESULTS IN BRIEF

Since fiscal year 1980-81, federal law has preferred all community agencies contracting with the Department of Economic Opportunity (department) for block grant funds to have a single audit of all sources of funds received during an audit period. However, the department did not require organization-wide audits of all community agencies. Also, the independent auditors of those community agencies that did receive organization-wide audits and the Office of the Auditor General found a variety of internal control weaknesses. In addition, the reports written by the independent auditors did not contain all of the required disclosures, and the department did not adequately monitor these audit reports to ensure that they met federal requirements. As a result of those weaknesses, the department and the federal government could not assess whether or not public funds were spent in accordance with federal and state regulations.

BACKGROUND

The department, formerly known as the Office of Economic Opportunity, is responsible for developing, coordinating, and implementing the Low-Income Home Energy Assistance Program and the Community Services Block Grant. Services for these two block grants are provided either directly by the department or through a network of approximately 200 eligible community agencies.

For fiscal year 1984-85, the department received from the federal government approximately $93 million for the Low-Income Home Energy Assistance Program and approximately $34 million for the Community Services Block Grant.

PRINCIPAL FINDINGS

Weaknesses Identified by Independent Auditors at Community Agencies

During their single audits of the community agencies, the independent auditors for the Project Go, Inc., the Community Housing Improvement Systems and Planning Association, Inc. (CHISPA), and the Orange County Community Development Council, Inc. (OCCDC), each identified a variety of internal control weaknesses. For example, the independent auditor for the OCCDC found that the OCCDC failed to reconcile its bank accounts for an entire year, had overspent its resources for two publicly funded programs, and had not recorded its costs according to generally accepted accounting principles.

Weaknesses in the Department's Review of Independent Auditors' Reports

The department, as the state agency responsible for monitoring these community agencies, did not effectively review the independent auditors' reports to ensure that all the required reporting elements had been included.

The Office of the Auditor General examined the workpapers supporting the independent audit reports for the Project Go, Inc., the CHISPA, and the OCCDC, and while we concur with the independent auditors' findings and recommendations, we found that certain required reporting elements had been omitted from all three reports for the Project Go, Inc., the CHISPA, and the OCCDC. As a result, the department and the federal government could not properly assess the performance of these publicly funded agencies.

Weaknesses Identified by the Office of the Auditor General During an Organization-Wide Review of a Community Agency

The department did not request an organization-wide audit of the California Hispanic Commission on Alcohol and Drug Abuse, Inc. (commission), during 1984 as was federally preferred. Instead, the department requested only an audit of the department's grant with the commission. This audit failed to provide an overall examination of the commission's performance. The present department contracts do contain requirements for organization-wide audits. The Office of the Auditor General conducted an organization-wide audit of the commission for calendar year 1984. During that audit, we found that the commission did not have any written policies and procedures for its employees to follow. In addition, we found several weaknesses in controls over cash payments.

RECOMMENDATIONS

The department should take the following actions:

- Ensure that independent single audit reports of the community agencies reviewed contain all federally preferred reporting elements; and

- Include contract language requiring that future audits of nongovernmental community agencies be conducted on an organization-wide basis encompassing all funding sources.

In addition, the community agencies should implement the specific recommendations made by independent auditors during their organization-wide audits.

AGENCY COMMENTS

The department agrees with the Auditor General's recommendations. The department's audit guidelines now include specific contract language requiring audits to be performed in full accordance with OMB Circulars A-102-P and A-110-F. The department will include language in all future contracts with private agencies requiring organization-wide audits. The department concurs with the findings of the local agency audit conducted by the Office of the Auditor General and concurs with the recommended corrective actions. The department's audit staff will conduct a comprehensive review of the four audits discussed in the report to assure local agency implementation of audit recommendations.

INTRODUCTION

The Department of Economic Opportunity (department), formerly known as the Office of Economic Opportunity, is responsible for developing, coordinating, and implementing the Low-Income Home Energy Assistance Program and the Community Services Block Grant in California. These two federal programs are block grant programs intended to fight poverty. In these block grant programs, the federal government grants the State money to provide particular services. The State has some flexibility on how it can spend this grant money, but the State must use the grants to provide the services specified by the federal government.

Under the Low-Income Home Energy Assistance Program, the department funds the Home Energy Assistance Program, the Energy Crisis Intervention Program, and the Weatherization Program. These energy programs provide grants to low-income people to help them pay the high costs of energy and to help them use and conserve energy efficiently. Under the Community Services Block Grant, the department awards funds to eligible community agencies* to provide services and activities to help low-income individuals secure and retain employment and achieve

*In this report, the term "community agency" refers to a private nonprofit organization, a public agency, an American Indian tribe or organization, or a migrant and seasonal farmworker organization.

self-sufficiency. Services for these two programs are provided directly by the department or through 200 eligible community agencies.

For fiscal year 1984-85, the department received for both the Low-Income Home Energy Assistance Program and the Community Services Block Grant approximately $127 million from the federal government. Of this amount, the Low-Income Home Energy Assistance Program received approximately $93 million, while the Community Services Block Grant received approximately $34 million.

In a 1984 report entitled "The Office of Economic Opportunity Has Not Controlled Public Funds Properly," (P-412, June 1984), the Office of the Auditor General reviewed the Low-Income Home Energy Assistance Program and the Community Services Block Grant administered by the department. As part of that audit, the Office of the Auditor General conducted limited reviews of 12 community agencies that had received funds from the Community Services Block Grant, from the Low-Income Home Energy Assistance Program, or from both programs.

In our June 1984 review of these community agencies, we found some internal control problems. However, because we were not authorized by law to conduct a comprehensive audit of all the funds the community agencies received, we could not fully determine if the community agencies had properly used the funds they received from the department. Recently, we were given this authority by the appropriate federal inspectors general.

SCOPE AND METHODOLOGY

The purpose of this audit was to review certain community agencies that received federal funding from the department and public and private funding from other sources during 1984. To evaluate whether community agencies were using public funds properly during 1984, we selected four of the community agencies reviewed in the Office of the Auditor General's June 1984 report: Project Go, Inc.; Community Housing Improvement Systems and Planning Association, Inc. (CHISPA); the Orange County Community Development Council, Inc. (OCCDC); and the California Hispanic Commission on Alcohol and Drug Abuse, Inc., (commission). Since our June 1984 review of these four community agencies, Project Go, Inc., the CHISPA, and the OCCDC have been audited by an independent auditor using the organization-wide single audit approach. The audits of these agencies covered part or all of 1984. The commission was audited for only part of calendar year 1984, and the audit scope included only one of the commission's funding sources, a grant with the department.

Since fiscal year 1980-81, federal law has preferred all community agencies receiving block grant funds from the department to be independently audited. This audit must conform to the guidelines specified by the U.S. Office of Management and Budget Circular A-102, Attachment P, or Circular A-110, Attachment F. These guidelines require an audit of all sources of funds received by an agency during an audit period and an explanation of an agency's compliance or noncompliance with laws and regulations.

To evaluate the audits of Project Go, Inc., the CHISPA, and the OCCDC, we compared the audit reports with the reporting criteria found in the U.S. Office of Management and Budget Circular A-102, Attachment P, or Circular A-110, Attachment F, as well as the General Accounting Office publication, "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions."* We also examined the audit workpapers prepared by the independent auditors.

To evaluate the commission, which had not received a comprehensive single audit since our review in 1984, we conducted an organization-wide review covering all of the commission's funding sources for the 1984 calendar year.

*These federal criteria, which specify the auditing and reporting standards to be used in conducting an organization-wide single audit, were in effect in 1984, our audit period. These federal criteria have since been superseded by the Office of Management and Budget Circular A-128, which took effect on July 1, 1985.

CHAPTER 1

WEAKNESSES IDENTIFIED BY INDEPENDENT AUDITORS AT COMMUNITY AGENCIES

The independent auditors for the Project Go, Inc.; the Community Housing Improvement Systems and Planning Association, Inc. (CHISPA); and the Orange County Community Development Council, Inc. (OCCDC), all noted a variety of internal control weaknesses while conducting single audits of these three community agencies. The independent auditor for Project Go, Inc., found that its employees were not effectively cancelling invoices after payments were made and that Project Go, Inc., was losing potential interest earnings because it deposited large sums of money in an account that earned no interest. The CHISPA was cited by its independent auditor for failing to use subsidiary records for two of its accounts, for not properly separating transactions involving related parties, and for keeping unclear consulting and management services records, which prevented the proper billing for these services. Lastly, the independent auditor for the OCCDC cited that community agency for failing to reconcile its three bank accounts for the entire 1984 calendar year, for overspending its resources for two publicly funded programs, for failing to record its costs, and for having various internal control weaknesses.

Based on our review of these three single audit reports and our examination of the independent auditors' workpapers that support them, we concur with the independent auditors' findings and recommendations. However, we also noted during our review that all three of the independent auditors' single audit reports did not conform to the federal guidelines that the reports were to follow. The Department of Economic Opportunity (department) is responsible for administering and monitoring the federal funds it grants to community agencies. Because the department did not ensure that the audit reports of the community agencies followed federal guidelines, the department and the federal government could not properly assess the performance of these community agencies.

Independent Auditor Findings
at Project Go, Inc.

According to the independent auditors for Project Go, Inc., employees of that community agency did not effectively cancel invoices after their payment. Rather, a summary sheet was attached to the invoices that were paid. If an invoice becomes detached from the summary sheet, employees could make a second payment on the invoice. The independent auditor also noted that Project Go, Inc., was losing the opportunity to earn additional funds for its operation by depositing large sums of money in accounts that earned no interest.

Independent Auditor Findings at the
Community Housing Improvement Systems
and Planning Association, Inc.

The independent auditor for CHISPA found that the CHISPA did not separate transactions involving related parties. In addition, the independent auditor noted that the CHISPA did not maintain its records of management and consulting services provided to related parties. As a result, the CHISPA staff could not properly bill the parties that received these services. Finally, the independent auditor found that the CHISPA did not use subsidiary records to provide supporting information for its Land Cost and Work in Progress accounts.

Independent Auditor Findings at the Orange County Community Development Council, Inc.

According to the independent auditor at OCCDC, the accounting system of the OCCDC uses nine separate general ledgers. Each ledger accounts for the revenue and expenditure transactions of one or more of the OCCDC's programs. The computer system that records these transactions in the various general ledgers cannot simultaneously record transactions that affect more than one general ledger. As a result, when transactions between different programs occur, entries must be recorded in each program's general ledger separately. The independent auditor cited this computer system limitation as the underlying condition causing weaknesses in cash accountability, interfund transfers, and computer data entry.

The independent auditor found that, for all of 1984, the OCCDC had not balanced its three bank accounts with its general ledgers. Furthermore, the cash transactions recorded in the general ledger accounts could not be traced to specific activity in the individual bank accounts. Numerous adjustments had been posted to the general ledger accounts without any actual cash transactions taking place. Finally, the independent auditor noted that the OCCDC's list of outstanding checks contained some checks that were up to two years old and that had never been deleted from the cash account.

The independent auditor found weaknesses in the OCCDC's interfund transfers also. When the OCCDC makes interfund transfers, the OCCDC uses the Community Services Block Grant and unrestricted OCCDC funds to make loans to programs that have insufficient funds to pay their expenses. When such a loan is made, the independent auditor noted that the OCCDC has no procedures to ensure that the loan amount is recorded by the program receiving the loan. Additionally, when interfund loan repayments are made, no procedures exist to ensure that the OCCDC records these amounts in either its Community Services Block Grant or its Agency accounting records. As a result, the independent auditor found that many of the OCCDC's loans and repayments were not recorded in the accounting records of the program granting the loan or the program receiving the loan.

The independent auditor also found some weaknesses in the procedures for entering data into the computer. The independent auditor cited the OCCDC for deficiencies in the separation of duties and the absence of data review procedures. The independent auditor found that each accountant had access to the computer and authority to enter transactions that are recorded in the various general ledgers. Transactions entered into the computer this way are not reviewed for completeness or accuracy before being entered into the computer. In addition, the same accountant who initially prepares the transaction and enters it into the system is also responsible for checking the output for accuracy. The independent auditor cited these factors as the causes for faulty transactions being entered into the accounting records without management detecting the errors.

Other Weaknesses Found by the Independent Auditor

Several other weaknesses disclosed by the independent auditor at the OCCDC involved computer software changes, disaster contingency, revenue recognition, collectability of receivables, employee advances, equipment controls, and recording of costs.

The OCCDC does not have written procedures concerning the request and documentation of computer software changes. The independent auditor believed that, without written procedures, unauthorized program changes could be made and might not be promptly detected by the OCCDC's management.

According to the independent auditor, the OCCDC does not keep backup copies of critical data files and programs at an off-site location. In the event of a disaster, all information stored in the computer and the computer facility could be lost.

The independent auditor also noted that copies of program reports indicating the amounts of revenues earned under contracts with utility companies and the U.S. Department of Agriculture were not distributed to the OCCDC's accounting unit. The independent auditor concluded that, without copies of these program reports, the accounting unit could not reconcile the contract revenues earned with funds received from utility companies and the U.S. Department of Agriculture. The independent auditor further concluded that this weakness caused the OCCDC's accounting unit to record revenues from these two sources as the funds were received rather than when the revenues were actually earned.

In addition, the independent auditor found that the OCCDC overspent its funding for two programs. For its Community Services Block Grant, the OCCDC exceeded budgetary limits by $5,173. In addition, costs incurred under the OCCDC's Emergency Food Assistance Center program exceeded program revenue by $8,271. The auditor noted that although the balance sheets for both the Community Services Block Grant and the Emergency Food Assistance Center program showed that they owe funds to other programs, neither the Community Services Block Grant nor the Emergency Food Assistance Center program has any resources left to pay back these obligations. According to the independent auditor, unless additional funding is secured from the agency that grants the OCCDC funds, the OCCDC may not be able to collect $13,444 due to it.

The independent auditor found that the OCCDC has no formal procedures to collect travel advances or loans made to employees. By the end of 1984, the OCCDC had $5,455 in outstanding travel advances and loans that it had made to employees. Of this amount, $3,275 had been outstanding for up to one year, and $3,035 represented advances and loans made to employees who were no longer employed by the OCCDC.

In addition, the OCCDC does not update its property listing to reflect the most recent physical inventory counts. Consequently, the OCCDC's inventory account included obsolete equipment, equipment no longer held by the OCCDC, and expendable equipment, that is, equipment recorded as an expenditure in the year it was purchased rather than recorded as an expenditure over its useful life.

Finally, the independent auditor noted that the OCCDC did not record its expenditures by functional account classification. Functional account classification is the classifying of expenditures according to the principal purpose for which expenditures are made, such as public safety, public health, or public welfare. The American Institute of Certified Public Accountants' Statement of Position 78-10, related to certain nonprofit organizations, requires expenditures to be reported by functional account classification. According to the independent auditor, the OCCDC does not currently have procedures to determine the functional account classification of expenditures. As a result, the independent auditor concluded that the financial statements for the OCCDC had not been prepared in conformity with generally accepted accounting principles, and the independent auditor gave a qualified opinion on these statements.

<u>Reporting Omissions</u>

We concur with the findings of the independent auditors. However, the auditors' reports do not follow the federal guidelines for audit reports. For instance, the independent audit reports for Project Go, Inc., the CHISPA, and the OCCDC did not contain any statements indicating that the three agencies complied with federal requirements for the items tested. Additionally, the reports for Project Go, Inc., and the OCCDC did not include a statement of compliance regarding untested items. Further, the audit reports for Project Go, Inc., the CHISPA, and the OCCDC did not contain any comments on the accuracy or completeness of financial reports, of claims for advances, or of reimbursements submitted to agencies that grant the funds. Finally, although the audit reports prepared for the CHISPA and the OCCDC included comments to management regarding weaknesses discovered during the audits, neither report included responses by management on the corrective action taken or planned.

The department, as the state agency responsible for administering and monitoring the federal funds it grants to community agencies, did not ensure that these three audit reports complied with federally required guidelines for audit reports. Since our review, the

State Controller's office has assumed responsibility for monitoring independent audit reports of community agencies. The U.S. Office of Management and Budget Circular A-102, Attachment P, Section (10), and the General Accounting Office publication, "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions" specify the minimum reporting requirements to be included in comprehensive single audit reports. When these guidelines are not followed, the department and the federal government cannot accurately assess the performance of the community agencies.

Independent Auditors' Recommendations

The independent audit reports for Project Go, Inc., the CHISPA, and the OCCDC each included recommendations on how each community agency could correct its weaknesses. We concur with these recommendations.

The independent audit report for Project Go, Inc., recommended that employees stamp individual invoices "paid" and mark them with the check number. The report also recommended that Project Go, Inc., deposit its funds in an account that earns interest and invest any excess funds in a money market account.

The independent audit report for the CHISPA recommended that the CHISPA segregate all related party transactions for easy identification and that the CHISPA maintain schedules showing the monthly charges and the monthly payments received for consulting and management services provided by the CHISPA to related parties. The CHISPA should also maintain subsidiary records to provide management with information about the Land Cost and Work in Progress accounts.

In the independent audit report for the OCCDC, the independent auditor made numerous recommendations. These recommendations cover a wide range of internal control weaknesses. The independent auditors' recommendations included the following:

> Control Over Cash Accounts--All cash transactions posted to the OCCDC's cash accounts should be supported by activity in the various bank accounts. Furthermore, the OCCDC should reconcile each cash balance in its general ledger to the appropriate bank account each month, and these reconciliations should be reviewed for completeness and accuracy by someone other than the preparer. In addition, the fiscal manager for the OCCDC should review all adjustments to the accounts for propriety and accuracy prior to posting them. Finally, the OCCDC should develop a management policy to remove from its general ledger any checks that have been outstanding for a long time.

Processing of Interfund Loans--The accountant of the program making the loan should be responsible for preparing the entries to record the loan in the accounts of both the program making the loan and the program receiving the loan. Additionally, the accountant in the program receiving the loan should be responsible for reviewing the proposed entry and for noting the program that benefits from the loan. Finally, the fiscal manager for the OCCDC should review the loan transaction for propriety and should approve it before it is entered into the computer system.

Control Over Data Entering the Computer System--All proposed transactions having an effect on the general ledgers should first be reviewed and approved by the fiscal manager before being entered into the OCCDC's computer system. Once in the computer system, the updated general ledgers should be checked for accuracy by someone other than the OCCDC employees who are responsible for preparing the entries made to these ledgers.

Computer Programming Controls--All requests for software changes should be submitted in writing to and approved by management. The nature and effect of all program changes should be documented, and each program change should be documented to prove that the change is working as intended.

Disaster Contingency--The OCCDC should store backup copies of all critical files and programs in an off-site location and update them each month.

Procedures for the Recognition of Revenue--All program and financial reports should be processed through the accounting department where they would be reviewed for accuracy and propriety. The independent auditor further recommended that the accounting department then use these reports to recognize revenue as it is earned rather than when it is received and to reconcile the cash received from each funding agency with the respective program report requesting such funds.

Collecting Amounts Owed--To improve its ability to collect amounts owed to it, the OCCDC should implement procedures to ensure that none of its programs can exceed their budgets. The OCCDC exceeded the budget limits for two of its programs. The independent auditor recommended that the OCCDC overcome this problem by trying to negotiate contract modifications with its funding agencies to cover these deficits or to absorb these deficits through its unrestricted funds' assets.

Employee Advances and Loans--The OCCDC should develop formal procedures to collect employee travel advances and loans, and the OCCDC should impose time limits for the repayment of these travel advances and loans. The OCCDC should also take steps to collect any outstanding advances or loans before an employee's termination.

Equipment Control--The OCCDC should set a monetary limit under which equipment purchases would be expensed rather than capitalized. The independent auditor also recommended that the OCCDC take an annual inventory of equipment, remove any obsolete or unused equipment, and adjust the equipment account to reflect the results.

Recording Costs--The OCCDC should record its costs to conform with generally accepted accounting principles by developing written procedures on cost classification, which would provide for the identification of the functional account classification of costs.

CONCLUSION

During organization-wide audits of the community agencies that receive funds from the Department of Economic Opportunity, the independent auditors of those community agencies found a variety of internal control weaknesses. In addition, the reports written by the independent auditors did not contain all federally required disclosures. Also, during our review period, the department did not adequately monitor audit reports to ensure that they met federal requirements. Since our review, the State Controller's office has assumed responsibility for monitoring independent audit reports of community agencies.

RECOMMENDATIONS

The Department of Economic Opportunity should take the following actions:

- Ensure that independent single audit reports of the community agencies reviewed by the State Controller's office contain all federally required reporting elements.

- Include contract language requiring all future audits of nongovernmental community agencies be conducted on an organization-wide basis encompassing all funding sources.

In addition, the community agencies should implement the specific recommendations made by the independent auditors during their organization-wide audits.

CHAPTER 2

WEAKNESSES IDENTIFIED BY THE OFFICE OF THE AUDITOR GENERAL DURING AN ORGANIZATION-WIDE REVIEW AT A COMMUNITY AGENCY

The department did not request an organization-wide audit for the California Hispanic Commission on Alcohol and Drug Abuse, Inc. (commission), during 1984 as was federally required. Instead, the department requested an audit of only the department's grant with the commission. Therefore, this audit failed to provide an overall examination of the commission's performance. (The current department contracts do contain requirements for organization-wide audits.) The Office of the Auditor General has since conducted an organization-wide audit for 1984. Our review identified several weaknesses that were not found by the audit of the department's grant with the commission.

The commission lacks written policies and procedures to guide its employees in performing their duties. This deficiency has caused several weaknesses in the commission's controls over cash payments. The commission made one payment that violated the provisions of the commission's contract with the department. Three payments for travel reimbursements to employees were incorrectly computed, and numerous other payments lacked the proper supporting documentation. In addition, employees' duties involving cash payments were not properly segregated. Moreover, some of the commission's employees had inaccurate leave records, which could result in employees' being overpaid or underpaid. Furthermore, the commission had two other deficiencies not related to cash payments: the commission did not comply with the bonding requirements in a contract with one of its funding sources, and the commission did not follow its own bylaws when its board of directors failed to meet at least once each quarter.

Improper and Inaccurate Payments
Made by the Commission

According to the Office of Management and Budget Circular A-110, Attachment F, financial management systems of organizations that receive federal grants are required to provide for the "effective control over and accountability for all funds, property, and other assets. Grantees shall adequately safeguard all such assets and shall ensure that they are used solely for authorized purposes."

The commission failed to meet these requirements when it charged $76 for its coffee service to the Community Services Block Grant funded by the department. This cost was not allowed according to the contract with the department. Without written accounting procedures indicating the types of charges allowable under the commission's various publicly funded programs, improper payments can result.

The commission also made three inaccurate payments for reimbursements of employees' travel expenses. In three instances, payments to reimburse employees for travel expenses were computed incorrectly, causing one overpayment of $33.80 and two minor underpayments that totaled $1.40. Because there are no written procedures requiring the person approving the payments to verify the accuracy of the payments, inaccurate payments can be made and can remain undetected by management.

Payments Lacked Proper Supporting Documents

The Office of Management and Budget Circular A-110, Attachment F, also requires that accounting records be supported by source documents. We found some payments that lacked the proper supporting documents when we reviewed the cancelled checks and documentation supporting certain claimed expenses. Out of 45 operating expense claims examined, ten invoices were not cancelled and nine invoices showed no evidence that goods or services were received before payment was made. In addition, the amount of one paid check was $30 greater than the amount authorized on the supporting voucher. Further, although the commission's management requires that all checks be signed by two authorized signers, we found four cancelled checks that were signed by only one authorized signer. Finally, the commission made one payment which had no supporting documentation at all. Without developing and implementing written accounting policies and procedures that control payments, the commission has no safeguards against issuing duplicate payments or paying for goods and services it never received.

Cash Payment Duties Were Not Adequately Separated

The commission did not maintain a proper separation of its cash payment duties during the period we reviewed. During 1984, the commission's office manager prepared checks, recorded payments, reviewed supporting documentation, signed checks and then mailed them to vendors, and controlled the blank check stock. The potential existed in this situation for one person to both create and conceal an illegal payment.

Good internal control requires an organization to segregate duties so that no one person has total control over payments. This condition was also reported to management by the commission's independent auditors in their grant audit report dated October 8, 1984. Since that time, the commission's secretary has been assigned authority for signing checks.

Employee Leave Records Were Incorrect

The commission did not accurately record on accumulated leave records the leave taken or overtime worked by its employees. Of 20 payroll transactions reviewed, the information on three employees' time sheets was not recorded on their individual accumulated leave records. Two of these employees' time sheets indicated a total of 27.5 hours of overtime worked, while another employee's time sheet showed that one hour of vacation had been taken. However, the commission's staff recorded none of this information on the three employees' leave records. If the commission fails to reconcile the compensated leave recorded on its employees' timesheets with the compensated leave recorded on its employees' leave records, employees can be overpaid or underpaid. As a result, the commission could fail to meet the requirements of the Office of Management and Budget Circular A-110, Attachment F, which specifies that all funds be effectively controlled and accounted for so they can be available for authorized use.

The Commission Did Not Comply With Contract Bonding Requirements

The commission did not comply with the bond requirements specified in one of its contracts with the department during 1984. One of the provisions of this contract required that the commission obtain two fidelity bonds worth $45,000. The State's Standard Contract Agreement, used by the department during the 1983-84 fiscal year in its contract with the commission, required the contractor to maintain one fidelity bond equal to one-half of the total amount of the contract. The agreement further required that the contractor secure another fidelity bond equal to one-quarter of the contract amount or $25,000, whichever is greater, to cover those officials authorized to sign checks or pay large amounts of funds. However, the commission secured only one fidelity bond for $10,000. If the commission fails to adhere to bond requirements in its contracts with funding agencies, it may jeopardize continued funding from these sources.

The Commission's Board of Directors
Did Not Comply With Its Bylaws

Article V, Section 9, of the commission's Articles of Incorporation Bylaws requires that a regular meeting of the board of directors be held at least once each quarter. However, since 1978, the board has been meeting only once or twice a year. By not meeting regularly, the board cannot effectively monitor the operations of the commission. In addition, contracts and other decisions requiring the board's approval cannot be promptly dealt with.

CONCLUSION

The Department of Economic Opportunity did not require an organization-wide single audit of the California Hispanic Commission on Alcohol and Drug Abuse, Inc., during 1984 as was federally preferred. Instead, the department requested an audit of its grant with the commission. This audit failed to provide an overall examination of the commission's performance.

When we conducted an organization-wide review covering 1984, we identified several weaknesses which were not originally reported during the audit of department's grant with the commission because of that audit's narrower scope. Since the commission did not have written policies and procedures, it failed to provide proper assurance that a system of internal control was in place and operating. We identified weaknesses in the commission's control over cash payments. One payment was improperly charged according to the provisions of the grant contract, three payments were incorrectly computed, and other payments lacked supporting documentation. Additionally, the commission did not provide for an adequate separation of duties related to its cash payments and did not maintain accurate employee leave records, which could result in an improper payment being made. Further, the commission did not meet the bonding requirements specified by a contract with one of its funding sources. Finally, the commission's board of directors did not follow their own bylaws when they failed to meet at least once in each calendar quarter.

RECOMMENDATIONS

To ensure that the California Hispanic Commission on Alcohol and Drug Abuse, Inc., properly spends federal funds and all other funds, the Department of Economic Opportunity should take the following actions:

- Require that all future audits of the commission be conducted on an organization-wide basis so that all funding sources are included in the audit; and

- Direct the commission to develop and implement formal accounting policies and procedures that would improve the commission's control over payments.

To ensure that its payments are proper and accurate, the commission should take the following actions:

- Direct the employee who approves payments to verify the accuracy of the amounts being paid before approving payments;

- Reconcile the leave time on the employees' time sheets with the employees' leave records;

- Begin procedures that require employees to stamp all invoices "paid" after a payment has been made;

- Adopt procedures that require the employees who receive goods and services to initial and date the proper documents before any payments are made; and

- Require the employee who mails or distributes checks to verify that the checks are signed by two authorized employees and, if the payments are to be charged to publicly-funded programs, that the costs are allowable under the terms of the contracts.

The commission should take the following actions to protect its funding sources and to improve its operations:

- Draft procedures ensuring that it complies with the provisions of its contracts with agencies that fund it so that these sources of funding are not jeopardized; and

- Require the board of directors to meet at least once each calendar quarter in accordance with the commission's bylaws.

We conducted this review under the authority vested in the Auditor General by Section 10500 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,

Kurt R. Sjoberg

for THOMAS W. HAYES
Auditor General

Date: July 7, 1986

Staff: Philip Jelicich, CPA, Audit Manager
Doug Cordiner
Jim Rostron, CPA
Debbie Tang

STATE OF CALIFORNIA

GEORGE DEUKMEJIAN, *Governor*

DEPARTMENT OF ECONOMIC OPPORTUNITY
1600 NINTH STREET
SACRAMENTO, CA 95814

(916) 322-2490

June 26, 1986

Mr. Thomas W. Hayes, Auditor General
660 J Street, Suite 300
Sacramento, CA 95814

Dear Mr. Hayes:

We appreciate this opportunity to comment upon the Auditor General's Report F-511 of the State Department of Economic Opportunity.

The Department of Economic Opportunity (DEO) concurs with the findings of the local agency audit conducted by your staff and concurs with the recommended corrective actions.

This audit was a follow-up to some local agency issues discovered during your earlier audit, P-412. The issues in this report that are related to the absence of some federally mandated audit reporting elements were corrected by DEO on January 1, 1985. This was accomplished by the issuance of audit guidelines to contractors and the inclusion of specific contract language requiring audits to be performed in full accordance with OMB Circulars A-102-P and A-110-F.

DEO has been working with the State Controller's Office and the Department of Finance to implement the Single Audit Act of 1984 as specified in OMB Circular A-128. While this federal regulation applies to units of government only, DEO has been recommending to its private nonprofit contractors their utilization of the single, agency-wide audit under the provisions of OMB Circular A-110-F. This recommendation has been made to the agencies since we believe it provides for a more comprehensive financial and program audit and is also more cost effective than single contract audits.

As you recommend, DEO will include language in all future contracts with private nonprofit agencies requiring organization-wide audits.

Lastly, DEO audit staff will conduct a comprehensive review of the four audits discussed in your report to assure local agency implementation of audit recommendations.

Thank you again for the opportunity to comment on this report.

Sincerely,

ROBERT P. MARTINEZ
Director
066252

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