

California State Auditor

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

Department of Health Services:

*Safe Drinking Water State Revolving Fund
Financial and Federal Compliance Audit
Report for the Fiscal Year Ended June 30, 2001*



December 2001
2001-002.1

The first five copies of each California State Auditor report are free. Additional copies are \$3 each, payable by check or money order. You can obtain reports by contacting the Bureau of State Audits at the following address:

**California State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, California 95814
(916) 445-0255 or TDD (916) 445-0255 x 216**

OR

**This report may also be available
on the World Wide Web
<http://www.bsa.ca.gov/bsa/>**

The California State Auditor is pleased to announce the availability of an online subscription service. For information on how to subscribe, please visit our Web site at www.bsa.ca.gov/bsa. If you need additional information, please contact David Madrigal at (916) 445-0255, ext. 201.

Alternate format reports available upon request.

Permission is granted to reproduce reports.



CALIFORNIA STATE AUDITOR

ELAINE M. HOWLE
STATE AUDITOR

STEVEN M. HENDRICKSON
CHIEF DEPUTY STATE AUDITOR

December 4, 2001

2001-002.1

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

Dear Governor and Legislative Leaders:

As required by California Government Code, Section 8542, et. seq., the Bureau of State Audits (bureau) presents its audit report concerning our review of the Department of Health Services' (department) financial statements for the Safe Drinking Water State Revolving Fund and its compliance with federal laws and regulations applicable to the Capitalization Grants for Drinking Water State Revolving Fund program (program) for the year ended June 30, 2001. The department contracted with the bureau to perform this audit to satisfy a federal audit requirement.

This report concludes that the department was in compliance with federal laws and regulations governing the program. Additionally, the department's Safe Drinking Water State Revolving Fund (fund) financial statements are fairly presented. However, we did identify weaknesses in the department's accounting and administrative controls over the fund. Specifically, the department did not always record loan disbursements in contract files. Additionally, the department overstated its liabilities and understated its assets in the financial statements for the fund.

Respectfully submitted,

ELAINE M. HOWLE
State Auditor

BUREAU OF STATE AUDITS

555 Capitol Mall, Suite 300, Sacramento, California 95814 Telephone: (916) 445-0255 Fax: (916) 327-0019 www.bsa.ca.gov/bsa

CONTENTS

<i>Financial Section</i>	1
Independent Auditor's Report	3
Financial Statements	
Balance Sheet	5
Statement of Revenues, Expenses, and Changes in Retained Earnings	7
Statement of Cash Flows	9
Notes to the Financial Statements	11
<i>Auditor's Section</i>	15
Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With Government Auditing Standards	17
Independent Auditor's Report on Compliance With Requirements Applicable to the Federal Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133	19
Schedule of Findings and Questioned Costs	21
<i>Auditee's Section</i>	25
Schedule of Expenditures of Federal Awards	27
Notes to the Schedule of Expenditures of Federal Awards	29
Summary Schedule of Prior Audit Findings	31

FINANCIAL SECTION

Blank page inserted for reproduction purposes only.



CALIFORNIA STATE AUDITOR

ELAINE M. HOWLE
STATE AUDITOR

STEVEN M. HENDRICKSON
CHIEF DEPUTY STATE AUDITOR

Independent Auditor's Report

Department of Health Services
State of California

We have audited the accompanying financial statements of the Safe Drinking Water State Revolving Fund of the Department of Health Services, as of and for the year ended June 30, 2001. These financial statements are the responsibility of the Department of Health Services' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Safe Drinking Water State Revolving Fund and are not intended to present fairly the financial position of the Department of Health Services and the results of its operations and the cash flows of its proprietary fund types and nonexpendable trust funds in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Safe Drinking Water State Revolving Fund of the Department of Health Services, as of June 30, 2001, and the results of its operations and the cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 30, 2001, on our consideration of the Department of Health Services' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

BUREAU OF STATE AUDITS

The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

BUREAU OF STATE AUDITS

A handwritten signature in black ink that reads "Philip Jelicich". The signature is written in a cursive, flowing style.

PHILIP J. JELICICH, CPA
Deputy State Auditor

October 30, 2001

**DEPARTMENT OF HEALTH SERVICES
SAFE DRINKING WATER STATE REVOLVING FUND
BALANCE SHEET
June 30, 2001**

Assets	
Current Assets	
Cash and pooled investments	\$ 49,200
Accounts receivable—overpayment	191,000
Interest receivable	103,700
Due from Federal Trust Fund	21,526,500
<hr/>	
Total Current Assets	21,870,400
<hr/>	
Loans receivable	55,682,300
<hr/>	
Total Assets	\$77,552,700
<hr/>	
Equity	
Retained earnings	\$77,552,700
<hr/>	
Total Equity	77,552,700
<hr/>	
Total Liabilities and Equity	\$77,552,700

The accompanying notes are an integral part of the financial statements.

Blank page inserted for reproduction purposes only.

**DEPARTMENT OF HEALTH SERVICES
SAFE DRINKING WATER STATE REVOLVING FUND
STATEMENT OF REVENUES, EXPENSES, AND
CHANGES IN RETAINED EARNINGS
Year Ended June 30, 2001**

Operating Revenues	
Interest on loans	\$ 184,400
Total Operating Revenues	184,400
Nonoperating Revenues	
Federal grants	46,508,700
Total Nonoperating Revenues	46,508,700
Net Income	46,693,100
Retained Earnings, July 1, 2000	30,859,600
Retained Earnings, June 30, 2001	\$77,552,700

The accompanying notes are an integral part of the financial statements.

Blank page inserted for reproduction purposes only.

**DEPARTMENT OF HEALTH SERVICES
SAFE DRINKING WATER STATE REVOLVING FUND
STATEMENT OF CASH FLOWS
Year Ended June 30, 2001
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS**

Cash flows from noncapital financing activities:	
Federal grants received	\$24,982,200
<hr/>	
Net cash received from noncapital financing activities	24,982,200
<hr/>	
Cash flows from investing activities:	
Loan disbursements	(55,345,100)
Loan overpayment	(191,000)
Principal repayments received	34,000
Interest collected on loans receivable	81,900
<hr/>	
Net cash used for investing activities	(55,420,200)
<hr/>	
Net decrease in cash and cash equivalents	(30,438,000)
Cash and cash equivalents at beginning of year	30,487,200
<hr/>	
Cash and cash equivalents at end of year	\$ 49,200

<i>Reconciliation of operating income to net cash received (used) for operating activities:</i>	
<hr/>	
Operating Income	\$184,400
Adjustments to reconcile operating income to net cash received (used) for operating activities:	
Interest collected on loans	(81,900)
Change in assets and liabilities:	
Increase in interest receivable	(102,500)
<hr/>	
Total reconciling adjustments	(184,400)
<hr/>	
Net cash received (used) for operating activities	\$ 0

The accompanying notes are an integral part of the financial statements.

Blank page inserted for reproduction purposes only.

Notes to the Financial Statements

Note 1. Summary of Significant Accounting Policies

The accompanying financial statements present the financial position and the results of operations of the Safe Drinking Water State Revolving Fund for the year ended June 30, 2001. The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and applicable to government entities. The following is a summary of significant accounting policies that pertain to these financial statements.

Reporting Entity

The Department of Health Services (department) administers the Safe Drinking Water State Revolving Fund (revolving fund). Created pursuant to the Health and Safety Code, Section 116760.30, the revolving fund is continuously appropriated without regard to fiscal year and is financed by federal capitalization grants and state matching amounts. The department uses the revolving fund to make loans to public water systems to finance the cost of infrastructure needed to achieve or to maintain compliance with the Safe Drinking Water Act requirements and to protect public health.

The revolving fund does not include administrative costs. These costs are recorded in another fund. The establishment of a separate fund to account for the costs related to the administration of the revolving fund is consistent with federal guidelines.

Fund Accounting

The revolving fund is classified as an enterprise fund. Enterprise funds account for goods or services provided to the general public on a continuing basis when (1) the department intends that all or most of the cost involved is to be financed by user charges or (2) periodic measurement of the results of operations is appropriate for management control, accountability, capital maintenance, public policy, or other purposes. The revolving fund applies all applicable Governmental Accounting Standards Board (GASB) pronouncements, pursuant to GASB Statement No. 20, as well as all applicable Financial Accounting Standards Board (FASB) Statements and Interpretations issued on or before November 30, 1989, unless the FASB Statements and Interpretations conflict with or contradict GASB pronouncements. For purposes of the Statement of Cash Flows, all cash and pooled investments, as discussed in Note 2, are considered to be cash equivalents.

Measurement Focus and Basis of Accounting

The revolving fund is accounted for on the flow of economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned and become measurable, and expenses are recognized when incurred, if measurable.

Note 2. Cash and Pooled Investments

The cash account consists of \$43,700 in general cash to be remitted to the credit of the revolving fund in the state treasury and \$5,500 that is in the state treasury. The State Treasurer's Office administers a pooled investment program for the State. This program enables the State Treasurer's Office to combine available cash from all funds and to invest cash that exceeds current needs. The necessary disclosures for the State's pooled investment program are included in the general purpose financial statements of the State of California.

Note 3. Loans Receivable

The revolving fund makes loans to qualified local entities at interest rates ranging between 0 percent and 50 percent of the average rate paid by the State on general obligation bonds. Loans must be repaid within 20 years after completion of the project (30 years for financially disadvantaged communities). All repayments, including interest and principal, must be deposited in the revolving fund.

The department disburses the loan proceeds on a reimbursement basis. As entities spend money on projects financed by the revolving fund and request reimbursement, the department releases their loan proceeds. Interest accrues on all loan disbursements as of the date each disbursement is made. Even though \$55.7 million in loans have been disbursed since the inception of the fund, only two entities are currently required to make principal repayments. As a result, there is no provision for uncollectible accounts as of June 30, 2001.

Major Loan Commitments to Entities

As of June 30, 2001, the revolving fund had made loan commitments to 18 entities that, in the aggregate, totaled \$98.9 million. The remaining loan commitment balances of these loans are as follows:

Entity	Authorized Loan Amount	Cumulative Loan Disbursements	Remaining Loan Commitments
Asoleado Mutual Water Company	\$ 61,400	\$ 33,700	\$ 27,700
Bella Vista Water District	100,000	0	100,000
Calaveras County Water District— West Point	1,426,200	0	1,426,200
City of Anaheim	18,062,800	18,062,800	0
City of Brawley	16,050,000	16,050,000	0
City of Crescent	8,000,000	6,526,300	1,473,700
City of Los Angeles Department of Water and Power	17,751,400	0	17,751,400
City of Vallejo	6,675,000	6,675,000	0
City of Westmoreland	1,670,600	653,800	1,016,800
El Dorado Irrigation District	4,843,500	2,395,200	2,448,300
Faye Properties, Inc.	50,000	0	50,000
Hillview Water Company	25,000	23,700	1,300
Humboldt Bay Municipal Water District	11,677,000	2,781,200	8,895,800
Imperial County/Wiest Lake County Campground	83,700	0	83,700
Sereno Del Mar Water Company	250,000	46,800	203,200
Solano Irrigation District	2,127,300	1,831,200	296,100
Sonoma County Water Agency	9,952,400	562,400	9,390,000
Taylor Investment LLC dba Redwood MHP	92,800	74,200	4,300*
Totals	\$98,899,100	\$55,716,300	\$43,168,500*

*Totals do not cross foot because one entity did not need to use the full amount of the loan authorized.

The authorized loan amounts are for projects in progress. As of June 30, 2001, there was a principal repayment from the City of Vallejo totaling \$34,000 and the remaining amounts to be disbursed on projects in progress was \$43.2 million.

Note 4. Fund Financing

The revolving fund is financed by annual grants from the U.S. Environmental Protection Agency (EPA) and a state match equal to 20 percent of the federal award.

Of the amount awarded by EPA, the department has designated \$30.8 million for administrative expenses, program management, small systems technical assistance,

local assistance, and other state program expenses, together known as set-asides, and used \$46.8 million for loans. Set-asides are accounted for in other funds. The grants awarded, amounts drawn on each grant, and the balances available for future loans as of June 30, 2001, are presented below:

Year	Grant Award	Less Set-Asides	Award Available to Revolving Fund	Amount Drawn for Loans	Available for Loans as of June 30, 2001
1997	\$75,682,600	\$12,411,900	\$63,270,700	\$46,137,800	\$17,132,900
1998	77,108,200	4,934,900	72,173,300	675,400	71,497,900
1999	80,816,700	9,213,100	71,603,600	0	71,603,600
2000	83,993,100	4,199,700	79,793,400	0	79,793,400

In the past, the State's matching contributions were provided through appropriations from the General Fund. As of June 30, 2001, the State has not contributed its match for fiscal year 2000-01 because it has not drawn down any funds for the grant year. Under federal guidelines, the State is not required to provide the match until the date it receives federal funds for a particular grant year. Since the revolving fund's inception, the State has contributed \$30.6 million. The State's contributions for fiscal years 1998-1999 and 1999-2000 are presented below:

<i>Fiscal Year 1998-1999</i>	\$15,137,000
<i>Fiscal Year 1999-2000</i>	15,417,000
Total	\$30,554,000

Note 5. Subsequent Events

There were no events following the fiscal year-end requiring disclosure in these financial statements.

AUDITOR'S SECTION

Blank page inserted for reproduction purposes only.



CALIFORNIA STATE AUDITOR

ELAINE M. HOWLE
STATE AUDITOR

STEVEN M. HENDRICKSON
CHIEF DEPUTY STATE AUDITOR

Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With Government Auditing Standards

Department of Health Services
State of California

We have audited the financial statements of the Department of Health Services' Safe Drinking Water State Revolving Fund as of and for the year ended June 30, 2001, and have issued our report thereon dated October 30, 2001. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

COMPLIANCE

As part of obtaining reasonable assurance about whether the Department of Health Services' Safe Drinking Water State Revolving Fund financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of the financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit, we considered the Department of Health Services' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Department of Health Services' ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable condition is described in the accompanying schedule of findings and questioned costs.

BUREAU OF STATE AUDITS

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are considered to be material weaknesses. However, we believe that the reportable condition described above is not a material weakness.

This report is intended solely for the information and use of management, the State Legislature, and the federal awarding agency and is not intended to be and should not be used by anyone other than these specified parties.

BUREAU OF STATE AUDITS

A handwritten signature in black ink that reads "Philip Jelicich". The signature is written in a cursive style with a large initial "P".

PHILIP J. JELICICH, CPA
Deputy State Auditor

October 30, 2001



CALIFORNIA STATE AUDITOR

ELAINE M. HOWLE
STATE AUDITOR

STEVEN M. HENDRICKSON
CHIEF DEPUTY STATE AUDITOR

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

Department of Health Services
State of California

COMPLIANCE

We have audited the compliance of the Department of Health Services with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to the Capitalization Grants for Drinking Water State Revolving Fund program for the year ended June 30, 2001. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of the Department of Health Services' management. Our responsibility is to express an opinion on the Department of Health Services' compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on the Capitalization Grants for Drinking Water State Revolving Fund program occurred. An audit includes examining, on a test basis, evidence about the Department of Health Services' compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Department of Health Services' compliance with those requirements.

In our opinion, the Department of Health Services complied, in all material respects, with the requirements referred to above that are applicable to its Capitalization Grants for Drinking Water State Revolving Fund program for the year ended June 30, 2001.

INTERNAL CONTROL OVER COMPLIANCE

The management of the Department of Health Services is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and

BUREAU OF STATE AUDITS

performing our audit, we considered the Department of Health Services' internal control over compliance with requirements that could have a direct and material effect on its Capitalization Grants for Drinking Water State Revolving Fund program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

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

This report is intended solely for the information and use of management, the State Legislature, and the federal awarding agency and is not intended to be and should not be used by anyone other than these specified parties.

BUREAU OF STATE AUDITS

A handwritten signature in black ink that reads "Philip Jelicich". The signature is written in a cursive style with a large, prominent initial "P".

PHILIP J. JELICICH, CPA
Deputy State Auditor

October 30, 2001

**DEPARTMENT OF HEALTH SERVICES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year Ended June 30, 2001**

Summary of Auditor's Results

Financial Statements

Type of report the auditor issued?	Unqualified
Internal control over financial reporting:	
Material weaknesses identified?	No
Reportable conditions identified that are not considered to be material weaknesses?	Yes
Noncompliance material to the financial statements noted?	No

Federal Award

Internal control over the program:	
Material weaknesses identified?	No
Reportable conditions identified that are not considered to be material weaknesses?	None reported
Type of report the auditor issued on compliance for the program?	Unqualified
Any audit findings disclosed that are required to be reported in accordance with Section .510(a) of OMB Circular A-133?	No
Auditee qualified as low-risk auditee?	No

Identification of the program:

<u>CFDA Number</u>	<u>Name of Federal Program</u>
66.468	Capitalization Grants for Drinking Water State Revolving Fund

Financial Statement Findings

See page 22.

Federal Award Findings and Questioned Costs

No findings were reported.

DEPARTMENT OF HEALTH SERVICES

Reference Number: 2001-19-01

CRITERIA

Our review of the Safe Drinking Water State Revolving Fund (revolving fund) determined that the following compliance requirements relate to the Department of Health Services (department):

The California Government Code, sections 13401 and 13403, requires state agencies to effectively maintain internal accounting and administrative controls. Such controls include accurate record-keeping procedures.

Additionally, the Department of Finance's CALSTARS Procedure Manual, Volume 3, provides uniform procedures for departments that disburse loans to other governmental agencies. Specifically, departments are required to record the disbursements in the State's Loan Principal Disbursement and Loans Receivable accounts on a budgetary basis.

CONDITION

The department needs to strengthen its controls over the processing of loan payments. It also needs to strengthen controls on the preparation of its revolving fund financial statements. Specifically, the following concerns surfaced during our audit:

- The department did not always maintain accurate records for loan disbursements to local governments. For example, our review of loan contract files noted several instances in which the department did not record loan disbursements in the contract logs. We also noted that the department twice failed to record loan disbursements totaling \$883,000 in its federal reimbursement worksheet. At the time of these disbursements, the worksheet showed the department was eligible to request an additional \$73,000 in federal reimbursement; however, the amount should have been \$956,000.
- The department improperly reported a liability totaling \$539,000 twice in its financial statements. As a result, the amount of liabilities and expenditures reported to the State Controller's Office (SCO) was overstated by \$539,000.
- The department overpaid one loan recipient \$191,000. The overpayment occurred because the department erroneously paid the remaining contract funds still available even though the loan recipient had not submitted invoices for the additional amounts. The loan recipient returned the warrant shortly after it was issued. The department subsequently issued a revolving fund check for the appropriate amount.

- The department understated its interest receivable balance by \$25,000 because it did not properly accrue interest for all loan disbursements. The department bills loan recipients semiannually for interest charges for the six-month periods ending December 31 and June 30. However, because the department prepared the June billings in May and did not accrue interest for five loan disbursements made subsequent to the billing date, interest owed on these five loans was not recorded in its financial statements.
- The department does not properly account for loans made from the revolving fund. In fiscal year 2000-01, the department disbursed loans totaling over \$55 million. However, rather than record the disbursements as loans receivable or loans to other governments, the department expensed all payments to recipients. The department properly accounted for loan principal repayments by reducing the loans receivable balance. But because it had not previously established the loan balance, the department's financial statements reflected a negative balance in the loans receivable account.

RECOMMENDATION

The department should ensure that it records all transactions in its subsidiary records and reviews its financial statements for accuracy. Further, the department should account for loan transactions in accordance with the Department of Finance's CALSTARS Procedure Manual.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION

The department agrees with our finding and plans to take corrective action. The department stated that it will maintain a separate log for all loan disbursements and will cross-check the log against the federal reimbursement worksheet to ensure the proper accounting for all payments. The department will also remind staff to record payments in contract logs as soon as loans are disbursed.

The department will continue to review financial statements by utilizing the SCO checklist to assure accuracy, and will consider generally accepted accounting principles adjustments as they relate to this fund in the review process. Further, the department will identify loans disbursed after the May interest-billing date to make sure that interest is properly accrued for these loans. Finally, department staff will attend training to ensure that loan activity is accounted for in accordance with the CALSTARS Procedures Manual.

Blank page inserted for reproduction purposes only.

AUDITEE'S SECTION

This blank page inserted for reproduction purposes only.

**DEPARTMENT OF HEALTH SERVICES
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Year Ended June 30, 2001**

Federal Agency/Program Title	Federal Catalog Number	Federal Expenditures
U.S. Environmental Protection Agency: Capitalization Grants for Drinking Water State Revolving Fund	66.468	\$61,395,594

The accompanying notes are an integral part of this schedule.

This blank page inserted for reproduction purposes only.

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Year Ended June 30, 2001

1. *Basis of Presentation*

The accompanying schedule of federal expenditures of federal awards (schedule) includes the federal Capitalization Grants for Drinking Water State Revolving Fund grant activity of the Department of Health Services. The schedule is presented on the modified accrual basis of accounting. The information presented in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the financial statements.

2. *Loans to Subrecipients*

Of the federal expenditures presented in the schedule, the Department of Health Services disbursed \$55.3 million in loan proceeds to 13 subrecipients.

Blank page inserted for reproduction purposes only.

Summary Schedule of Prior Audit Findings

Reference Number:	00-B-1
Federal Catalog Number:	66.468
State Administering Department:	Department of Health Services
Fiscal Year Finding Initially Reported:	1998-99
Audit Finding:	Allowable Costs and Cost Principles. The Department of Health Services (department) did not always accurately allocate personnel costs to the program and did not require all program employees to complete and sign activity reports. As a result, the department overcharged the program at least \$44,612.
Status of Corrective Action:	The department requires all employees who work on multiple cost objectives or programs to complete and sign monthly activity reports and has established a system to allocate personnel costs using these activity reports.

This blank page inserted for reproduction purposes only.

Audit Staff: Nancy C. Woodward, CPA, Audit Principal
John F. Collins II, CPA
Steven Cummins, CPA
Robert Graham
Sheryl Liu-Philo
Nicole Ruszczycky
Dawn Tomita