Elaine M. Howle
State Auditor
Doug Cordiner
Chief Deputy

CALIFORNIA STATE AUDITOR
Bureau of State Audits

555 Capitol Mall, Suite 300 Sacramento, CA 95814 916.445.0255 916.327.0019 fax www.bsa.ca.gov

November 23, 2009

2009-002.1a
(Letter Report)

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

Dear Governor and Legislative Leaders:

On February 17, 2009, the federal government enacted the American Recovery and Reinvestment Act of 2009 (Recovery Act) to help fight the negative effects of the United States' economic recession. According to the Recovery Act, its purposes include preserving and creating jobs; promoting economic recovery; assisting those most affected by the recession; investing in transportation, environmental protection, and other infrastructure; and stabilizing state and local governmental budgets. California expects to receive $85 billion in Recovery Act funding for both new and existing federal programs. With this increased funding comes a strong emphasis on accountability and public transparency to ensure federal funds are spent properly. A key component of such accountability and transparency is the California State Auditor's Office (State Auditor's Office) annual report on internal control and compliance with federal laws and regulations. The State Auditor's Office conducts this audit in accordance with the U.S. Office of Management and Budget (OMB) Circular A-133.

With the federal government awarding Recovery Act funds beginning in 2009, OMB issued guidance dated June 2009 indicating the importance of, among other things, two tasks: recipients should establish effective internal control over these funds and auditors should communicate promptly any identified internal control deficiencies to management and those charged with governance. By encouraging prompt communication of internal control deficiencies, OMB intends for recipients, including states, to correct these findings as soon as possible to ensure proper accountability and transparency for expenditures of Recovery Act awards.

Based on OMB's June 2009 guidance, the State Auditor's Office presents its interim report concerning the Department of Developmental Services' (Developmental Services) administration of the Special Education—Grants for Infants and Families (Early Start) program (Federal Catalog Number 84.181) and Special Education—Grants for Infants and Families, Recovery Act program (Federal Catalog Number 84.393) during fiscal year 2008–09. The issues contained in this interim report represent the results of our internal control and compliance audit that require Developmental Services' corrective action.

The State Auditor's Office identified five findings as of November 2, 2009, that pertain to Developmental Services' administration of these federal programs. Of these five findings, one relates to requirements under the Recovery Act while the other four are repeat findings we have disclosed in previous annual audit reports. Our testing this year also revealed that Developmental Services corrected two other findings that we included in last year's annual report, thus we do not include them in this report.

Insufficient Internal Controls Over Maintenance of Effort

Developmental Services lacks a sufficient process to ensure it maintains a minimum level of non-federal spending for the Early Start program. Federal regulations require the State to ensure the total amount of state and local funds budgeted annually for the Early Start program be at least equal to the total amount of state and local funds actually spent for the Early Start program in the most recent preceding fiscal year for which information is available. However, Developmental Services could not adequately demonstrate that it had met this maintenance of effort (MOE) requirement. Although Developmental Services provided spreadsheets that contained calculations indicating that it had maintained a sufficient level of non-federal spending for fiscal year 2008–09, it did not provide sufficient documents to support the amounts on the spreadsheets. According to its chief, Developmental Services' accounting section cannot provide accounting records to show the total amount of state costs specific to the Early Start program because it is unable to separate these costs from others submitted within the same claim for reimbursement from subrecipients.

This is a repeat finding first identified in our annual audit report for fiscal year 2005–06. We have continued to report this finding in each fiscal year since that time. In response to the most recent prior-year finding on this issue, Developmental Services stated that it was in the process of revising its procedures related to the MOE requirement and that these procedures would become effective in fiscal year 2008–09. Further, in June 2009 the U.S. Department of Education (Education) notified Developmental Services that Education had concluded that, based on interviews and documentation, Developmental Services had taken steps to establish a system that would allow it to track and establish compliance with the MOE requirement and that Education considered the finding resolved. We examined the same information that Developmental Services stated it provided to Education and found it insufficient to demonstrate that it had implemented these revised procedures.

Because the assurance of being able to meet the MOE requirement is a condition to receive Early Start grant funds, Developmental Services' lack of sufficient documentation may jeopardize its ability to receive the full amount of funding that it might otherwise receive. To decrease the risk of losing federal grant funds, we recommended that Developmental Services maintain sufficient documentation showing its adherence to federal MOE requirements. In response to our finding, Developmental Services reiterated that Education approved the process it developed to track compliance with the MOE requirement. Developmental Services also stated that it implemented this process in March 2009. Because the process was not implemented until near the end of fiscal year 2008–09, Developmental Services could not have had the information to ensure that the total amount of state and local funds budgeted for that fiscal year was at least equal to the amount actually spent in the most recent preceding fiscal year for which the information is available.

Not Tracking Contractor Registrations

Developmental Services did not ensure that it disbursed Recovery Act funds only to subrecipients that met federal contractor registration requirements. Federal regulations for the Recovery Act require subrecipients to maintain current registration at all times in a federal database called the Central Contractor Registration and to have a Dun and Bradstreet Data Universal Numbering System (DUNS) number. The Central Contractor Registration is the federal government's primary contractor database; it can collect, store, and disseminate information regarding acquisitions. The DUNS number is a unique nine-digit number to identify a specific entity in Dun and Bradstreet's database of more than 100 million businesses worldwide. The federal government intends to use this information to help meet the Recovery Act's reporting requirements such as jobs created or retained and provide transparency in how Recovery Act funds are spent. However, Developmental Services did not ensure that the regional center subrecipients were registered in the Central Contractor Registration or had DUNS numbers before disbursing $16.6 million in Recovery Act funds. Not following applicable federal requirements increases the risk of losing Recovery Act funds because these requirements are a condition of receiving those funds. According to its coordinator for Recovery Act activities, Developmental Services had not verified whether its regional center subrecipients had registered with the Central Contractor Registration or received DUNS numbers because it is still determining whether these requirements are applicable. We recommended that Developmental Services ensure that applicable subrecipients maintain current registration and obtain DUNS numbers before it disburses Recovery Act funds. Developmental Services will consider our recommendation after it has made its determination.

Developmental Services Has Already Taken Steps to Correct Other Findings

Our audit work identified three findings from prior years for which Developmental Services took steps to correct during fiscal year 2008–09. First, Developmental Services did not have adequate internal controls in place throughout the fiscal year to ensure that the expenses incurred by regional centers were only for allowable activities and costs covered under the program. Federal regulations require a state's fiscal controls and accounting procedures to be sufficient to permit the tracing of funds to a level of expenditures adequate to establish that the funds have not been used in violation of applicable requirements. For 29 of the 46 reimbursements we examined amounting to $32.9 million, the reimbursements lacked the detail necessary to allow Developmental Services' staff to determine whether the claims included only allowable activities and costs. This is a repeat finding first identified in our annual audit report for fiscal year 2006–07. In response to our prior-year findings, Developmental Services implemented a new invoicing process in March 2009. We identified no concerns with the nine reimbursements we examined that were dated after it implemented the new process. Therefore, it appears that Developmental Services has corrected this finding. Developmental Services agreed with our recommendation that it continue to use the new invoicing process.

Second, certain active contracts that Developmental Services had during fiscal year 2008–09 did not contain all required information. The federal government requires grant recipients, such as Developmental Services, to include in documents, such as contracts, specific information related to the federal grant, including the amount and percentage of a project's total cost that will be financed with federal funds. The contracts that Developmental Services had with independent family resource centers (FRCs) during fiscal year 2008–09 did not explicitly identify the proportion of Early Start funds or the percentage they represent of the total funding. These FRC contracts expired on June 30, 2009. This is a repeat finding first identified in our annual audit report for fiscal year 2007–08. For the FRC contracts commencing July 1, 2009, Developmental Services has corrected this finding and now specifies the percentage and amount of funds received by the FRCs. Developmental Services agreed with our recommendation that it continue to identify the proportion of federal funds in its future contracts funded by this grant.

Finally, active contracts that Developmental Services had during fiscal year 2008–09 referenced an incorrect dollar threshold that triggers a requirement for contractors to have an independent audit performed. The federal government requires non-federal entities that spend $500,000 or more in federal funds during a year to have such an audit performed. Developmental Services' contracts with family resource centers incorrectly identified the threshold requiring an audit as $300,000, increasing the risk that the family resource centers would needlessly spend resources for audits that were not necessary. These contracts expired on June 30, 2009. This is a repeat finding first identified in our annual audit report for fiscal year 2007–08. For the contracts commencing July 1, 2009, Developmental Services corrected this finding and now identifies the appropriate threshold amount of $500,000. Developmental Services agreed with our recommendation that it continue to include in contracts funded by this grant the correct threshold amount for requiring that an audit be performed.

Respectfully submitted,

Elaine M. Howle

ELAINE M. HOWLE, CPA
State Auditor

cc: Members of the Legislature
Office of the Lieutenant Governor
Milton Marks Commission on California State
Government Organization and Economy
Department of Finance
Attorney General
State Controller
State Treasurer
Legislative Analyst
Senate Office of Research
California Research Bureau
Capitol Press