

## Interim Reporting: Fiscal Year 2010–11 Single Audit

Aging  
CaliforniaVolunteers  
Corrections and Rehabilitation  
Employment Development  
Housing and Community Development  
Mental Health  
Military  
Social Services  
Transportation  
Veterans Affairs

December 2011 Report 2011-002.1



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December 15, 2011

2011-002.1

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

Dear Governor and Legislative Leaders:

Pursuant to guidance issued by the U.S. Office of Management and Budget (OMB), the California State Auditor's Office (State Auditor's Office) presents its interim report concerning various state departments' administration of federal programs during fiscal year 2010–11. With the passage of the American Recovery and Reinvestment Act of 2009 (Recovery Act) comes a renewed emphasis on accountability and public transparency to ensure federal funds are spent properly. A key component of such accountability and transparency is the annual report from the State Auditor's Office on internal control and compliance with federal laws and regulations. OMB's March 2011 guidance stresses the importance of auditors communicating promptly any identified internal control deficiencies to management and those charged with governance. In addition, the guidance states that it is imperative that deficiencies in internal control be corrected by management as soon as possible to ensure proper accountability and transparency for expenditures of Recovery Act awards.

This interim report summarizes audit results pertaining to 31 federal programs administered by 10 departments. Seven of the 10 departments received Recovery Act funding through 15 programs during fiscal year 2010–11. The State Auditor's Office has currently identified 11 findings regarding the 10 departments' administration of these federal programs during fiscal year 2010–11. In many cases the findings are recurring issues we identified in past audits. The findings focused on various federal requirements including those regarding allowable costs, reporting, and monitoring subrecipients'—such as counties'—use of funds. We also reported that the departments fully corrected 18 findings that we included in last year's annual audit report. The specific federal programs, and their administering state departments, are listed in the table of contents.

Respectfully submitted,



ELAINE M. HOWLE, CPA  
State Auditor

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## Summary

### Results in Brief

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

The State Auditor's Office prepares its annual report in accordance with the requirements described in the U.S. Office of Management and Budget's (OMB) Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. In March 2011 OMB encouraged auditors to communicate promptly any identified internal control deficiencies to management and those charged with governance. By encouraging prompt communication, OMB intends for recipients, including states, to correct these findings as soon as possible to ensure proper accountability and transparency for expenditures of Recovery Act awards. Based on OMB's March 2011 guidance, the State Auditor's Office presents its interim report concerning the State's administration of selected federal programs. Although OMB's guidance regarding prompt communication focused on Recovery Act programs, we have also included audit results for certain departments that did not receive Recovery Act funding in the interests of maximizing the benefits of prompt communication.

This interim report summarizes audit results pertaining to 31 federal programs administered by 10 departments. Seven of the 10 departments received Recovery Act funding through 15 programs during fiscal year 2010–11. The State Auditor's Office has currently identified 11 findings regarding the 10 departments' administration of these federal programs during fiscal year 2010–11. In many cases the findings are recurring issues we identified in past audits. The findings focused on various federal requirements including those regarding allowable costs, reporting, and monitoring subrecipients'—such as counties—use of funds. We also reported that the departments fully corrected 18 findings that we included in last year's annual audit report. Finally, we made numerous recommendations to the respective departments.

**The Department of Aging (Aging)** administers the Aging Cluster of programs. The State reported receiving \$119 million in federal funds for these programs for fiscal year 2010–11, including Recovery Act funds totaling \$1.7 million. Aging distributes funds for these programs to 33 area agencies (subgrantees) that provide services and meals to seniors. The State Auditor's Office identified one finding that pertains to Aging's deficiencies in monitoring subgrantees within the Aging Cluster. Specifically, Aging did not issue monitoring reports and did not ensure that subgrantees submitted corrective action plans within the time required by Aging's policies and procedures, hindering its ability to ensure that subgrantees promptly correct problems detected during its on-site assessments. In addition, our testing this year confirmed that Aging corrected one of the findings that we included in last year's annual report.

**The CaliforniaVolunteers** administers the Americorps program. The State reported that this program received \$24.3 million during fiscal year 2010–11, including Recovery Act funds totaling \$1.9 million. The State Auditor's Office identified one finding that pertains to CaliforniaVolunteers' failure to verify that matching contributions are from allowable sources. Specifically, CaliforniaVolunteers is still in the process of requiring subgrantees to submit documentation to support the matching contributions they reported and it has not yet eliminated its backlog of desk reviews. Our testing this year also confirmed that CaliforniaVolunteers corrected another finding that we included in last year's annual report.

**The California Department of Corrections and Rehabilitation (Corrections)** administers the State Criminal Alien Assistance Program (SCAAP). The State reported that it received \$88.1 million in federal funds for SCAAP for fiscal year 2010–11, none of which were Recovery Act funds. The State Auditor’s Office identified one finding that pertains to deficiencies in Corrections’ claims for reimbursement for the incarceration of undocumented criminal aliens. Specifically, Corrections has not implemented procedures to ensure that it does not include ineligible inmate data in its application for SCAAP funding.

**The Employment Development Department (EDD)** administers several programs that have been awarded funds from the Recovery Act during fiscal year 2010–11, including the Unemployment Insurance program, the Employment Service Cluster, and the Workforce Investment Act Cluster. Additionally, EDD administers the Trade Adjustment Assistance program. The State reported that these programs collectively received \$22 billion for fiscal year 2010–11, including Recovery Act funds totaling \$843.1 million. However, as we reported in our last two annual audits and continue to report for our current audit, we cannot conclusively identify Recovery Act dollars because EDD has not been able to track all Recovery Act dollars separately from non-Recovery Act dollars. Our testing this year also confirmed that EDD corrected three findings that we included in last year’s annual audit report.

**The Department of Housing and Community Development (Housing)** administers the Community Development Block Grants/State’s Program (CDBG Program) and the ARRA CDBG Program. The State reported receiving \$85.7 million in federal funds for the program during fiscal year 2010–11, including Recovery Act funds totaling \$5.6 million. Our testing this year found that Housing still does not complete an adequate number of site visits of CDBG Program subrecipients. We also confirmed that Housing corrected two other CDBG Program findings that we included in last year’s annual audit report.

**The Department of Mental Health (Mental Health)** administers the Block Grants for Community Mental Health Services (block grant) program. The objectives of this program include providing financial assistance to states to carry out their plans for providing comprehensive community-based mental health services to adults with a serious mental illness and to children with a serious emotional disturbance. Almost all of the federal block grant funds Mental Health receives are passed down to county mental health agencies. During fiscal year 2010–11 the State reported receiving almost \$46.2 million in federal funds for the block grant program, none of which were Recovery Act funds. As of August 31, 2011, we found that Mental Health had not addressed three of the four findings we reported in our annual report for fiscal year 2009–10. Specifically, Mental Health had not yet implemented a process to verify that counties’ block grant program expenditures are for allowable activities and costs, had not ensured that it appropriately charges administrative costs to the block grant, and had not implemented a process to ensure it complies with maintenance of effort requirements. However, Mental Health corrected the one other finding that we included in last year’s annual report.

**The Military Department (Military)** administers the National Guard Military Operations and Maintenance Projects (O&M projects) program. The objectives of this program include providing funding for minor construction and maintenance of Army National Guard and Air National Guard facilities; installation of security surveillance remote monitoring equipment; and the maintenance, fabrication, and repair of aircraft and aircraft subassemblies. During fiscal year 2010–11, the State reported receiving \$59.8 million for this program, \$79,000 of which were Recovery Act funds. Our testing this year revealed that Military corrected the finding related to this program that we included in last year’s annual audit report.



**The Department of Social Services (Social Services)** administers a variety of federal programs that have been awarded Recovery Act funds during fiscal year 2010–11, including the State Administrative Matching Grants for the Supplemental Nutrition Assistance Program (SNAP), which is part of the SNAP Cluster; Foster Care—Title IV-E (Foster Care); Adoption Assistance; Temporary Assistance for Needy Families (TANF); and the ARRA—Emergency Contingency Fund for Temporary Assistance for Needy Families State Program. The last two programs listed are part of the TANF Cluster. Social Services also administers the Social Services Block Grant and the Social Security—Disability Insurance programs. The State reported that these seven programs collectively received \$7 billion for fiscal year 2010–11, including Recovery Act funds totaling \$695.4 million. We identified one finding that pertains to Social Services’ administration of these programs. Specifically, during fiscal year 2010–11 Social Services did not inform subrecipient counties of information and requirements associated with federal awards. Additionally, our testing this year confirmed that Social Services corrected all four findings that we included in last year’s annual audit report.

**The California Department of Transportation (Caltrans)** administers the Highway Planning and Construction Cluster, which includes the Highway Planning and Construction program. The objectives of this program are to assist states in the planning and development of an integrated, interconnected transportation system important to interstate commerce and travel by constructing and rehabilitating the National Highway System, including interstate highways and most other public roads. Caltrans uses federal funds under this program for a variety of activities, such as making capital improvements to certain designated highways and providing subgrants to local agencies, such as cities and counties, for similar projects. The State reported receiving approximately \$3.3 billion in federal funds for the program during fiscal year 2010–11, more than \$1 billion of which were Recovery Act funds. We identified one finding that pertains to Caltrans’ administration of the Highway Planning and Construction program. Specifically, we noted that Caltrans lacked adequate internal controls to ensure that local agencies had audits performed under the Single Audit Act as required by OMB Circular A-133. However, to its credit, our testing this year also confirmed that Caltrans corrected two findings that we included in last year’s annual audit report.

**The California Department of Veterans Affairs (Veterans Affairs)** administers the Grants to States for Construction of State Home Facilities (construction grant) and Veterans Housing—Guaranteed and Insured Loans (loan guaranty) programs. The objectives of the construction grant program include providing financial assistance to states to acquire or construct state veterans home facilities, while the loan guaranty program offers home loans to eligible veterans that are guaranteed in part by the U.S. Department of Veterans Affairs (VA). Through the loan guaranty program, as of June 30, 2011, the VA provided guarantees for loans held by Veterans Affairs totaling more than \$100 million. These guarantees are considered federal assistance to the State for fiscal year 2010–11. Additionally, the State reported receiving \$8.2 million in federal funds during that period for the construction grant program. Neither program received Recovery Act funds. We identified one finding related to the loan guaranty program that pertains to Veterans Affairs’ failure to report to the VA certain loan events by the required deadlines. As for the construction grant program, our testing this year confirmed that Veterans Affairs corrected the three findings that we included in last year’s annual report related to that program.

### Agency Comments

We summarized the departments’ responses. In general, the departments concurred with the audit findings discussed in this interim report and plan to take corrective action.

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## Department of Aging

Based on the U.S. Office of Management and Budget's (OMB) March 2011 guidance, the California State Auditor's Office (State Auditor's Office) presents its interim report concerning the Department of Aging's (Aging) administration of the Aging Cluster of federal programs during fiscal year 2010–11. The State reported receiving \$119 million in federal funds for these programs for fiscal year 2010–11, which included \$1.7 million in American Recovery and Reinvestment Act of 2009 funds. Aging distributes funds for these programs to 33 area agencies (subgrantees) that provide services and meals to seniors.

The issue discussed in this interim report resulted from our internal control and compliance audit completed as of September 21, 2011, and requires Aging's corrective action. Our audit procedures were limited to following up on findings we reported in our annual report for fiscal year 2009–10. Our testing this year found that Aging still is not ensuring that its subgrantees promptly address issues identified during its on-site assessments. However, we also confirmed that Aging corrected the one other finding that we included in last year's annual audit report.

### Name of Federal Programs Audited and Federal Catalog Number

#### Aging Cluster:

- Special Programs for the Aging—Title III, Part B—Grants for Supportive Services and Senior Centers (93.044)
- Special Programs for the Aging—Title III, Part C—Nutrition Services (93.045)
- Nutrition Services Incentive Program (93.053)
- ARRA—Aging Home-Delivered Nutrition Services for States (93.705)
- ARRA—Aging Congregate Nutrition Services for States (93.707)

### Aging Did Not Always Comply With Its Monitoring Procedures

Federal regulation makes award recipients, such as Aging, responsible for monitoring grant- and subgrant-supported activities to ensure compliance with applicable federal requirements and to ensure that performance goals are being achieved.

During our current review, we found that Aging still is not ensuring that its subgrantees promptly address issues identified during its on-site assessments. Aging's policy requires its program staff to conduct on-site comprehensive assessments of each subgrantee every four years, as resources permit. As part of this assessment process, Aging requires its staff to issue their final reports to the subgrantees 75 working days after the exit conference it holds at the conclusion of the on-site visit. The subgrantees then have 30 working days to respond to the final report. During fiscal year 2010–11, Aging completed seven comprehensive assessments and held the related exit conferences. Our review of these seven assessments found that Aging did not issue its final reports within 75 working days of the respective exit conference for six of them. Specifically, Aging issued four reports between four days and five months beyond the 75-working-day deadline and, as of September 21, 2011, it had not yet issued the remaining two reports, which at that time exceeded the deadline by roughly four months and six months, respectively. According to the deputy director of Aging's Long-Term Care and Aging Services Division, Aging did not complete these final reports by their due dates because of staffing shortages. Moreover, two of the five subgrantees that received Aging's final report did not submit their responses to Aging within the 30-working-day requirement—one submitted its response two working days late and the other had not yet submitted the response as of September 21, 2011, nearly a

month after it was due. When Aging does not issue its final reports on time and does not ensure that subgrantees submit their responses by the required deadlines, it cannot ensure that its subgrantees promptly address the issues identified during its on-site assessments.

We recommend that Aging ensure it complies with its 75-working-day requirement for issuing final reports for all of the on-site comprehensive assessments it performs annually and ensure that subgrantees respond to its final reports within the required 30 working days. In its corrective action plan, Aging stated that it would immediately ensure that staff are following its written procedures. In addition, Aging stated that by December 2011 it will add due dates and internal staff roles and responsibilities to its written procedures to ensure that it issues final reports for all on-site comprehensive assessments within 75 working days of the exit conference and take steps to ensure subgrantees respond to final on-site comprehensive assessment reports within 30 working days of their receipt.

### Aging Took Steps to Correct One Finding Reported for Fiscal Year 2009–10

During our current audit, we determined that Aging had fully corrected one of the two findings we reported for fiscal year 2009–10. Specifically, it refined its procedures to ensure that the financial status reports it submits to the federal government reflect accurate information. Table 1 presents a listing of the corrected finding and a reference to the finding description as it was reported in the State Auditor's Office annual report titled *State of California: Internal Control and State and Federal Compliance Audit Report for the Fiscal Year Ended June 30, 2010* (report number 2010-002, dated March 2011).

**Table 1**  
Findings Reported for Fiscal Year 2009–10 That the Department of Aging Has Corrected

FEDERAL PROGRAM TITLE	FEDERAL CATALOG NUMBER	CATEGORY OF FINDING	REPORT 2010-002, ISSUED MARCH 2011: REFERENCE NUMBER/ PAGE NUMBER	RECEIVED RECOVERY ACT FUNDS DURING FISCAL YEAR		
				2008-09	2009-10	2010-11
Special Programs for the Aging—Title III, Part B—Grants for Supportive Services and Senior Centers	93.044	Reporting	2010-12-1/page 56	No	No	No
Special Programs for the Aging—Title III, Part C—Nutrition Services	93.045			No	No	No

Source: California State Auditor's Office analysis of corrective action taken by the Department of Aging on prior-year findings.

# CaliforniaVolunteers

## AMERICORPS FEDERAL CATALOG NUMBER 94.006

Based on the U.S. Office of Management and Budget's (OMB) March 2011 guidance, the California State Auditor's Office (State Auditor's Office) presents its interim report concerning CaliforniaVolunteers' administration of the AmeriCorps program (Federal Catalog Number 94.006) during fiscal year 2010–11. The State reported that this program received \$24.3 million during fiscal year 2010–11, \$1.9 million of which were American Recovery and Reinvestment Act of 2009 funds. The issue contained in this interim report resulted from our internal control and compliance audit completed as of October 1, 2011, and requires CaliforniaVolunteers' corrective action. Our audit procedures were limited to following up on findings we reported in our annual report for fiscal year 2009–10. Our testing this year found that CaliforniaVolunteers is still in the process of requiring subgrantees to submit documentation that would demonstrate compliance with federal matching requirements. Further, CaliforniaVolunteers has not yet eliminated its backlog of desk reviews. However, we also confirmed that CaliforniaVolunteers corrected the one other finding that we included in last year's annual audit report.

### **CaliforniaVolunteers Still Does Not Verify That All Match Contributions Provided by Its Subgrantees Are From Allowable Sources**

Federal regulations state that subgrantees may satisfy a matching requirement by using cash, including other federal funds (as long as the other federal agency permits its funds to be used as match), or the value of third party in-kind contributions. Additionally, federal regulations require that contributions, including third party in-kind contributions, must be supported.

In our prior-year audit, we reported that CaliforniaVolunteers had not ensured its established policies and procedures for fiscal desk reviews were followed. Specifically, we found that it did not verify the allowability of grantee match contributions for the fiscal desk reviews we tested where requirements to verify match contributions existed. CaliforniaVolunteers' chief of staff indicated that the Department of Finance's Office of Statewide Audits and Evaluations (Finance) was performing the remaining desk reviews. However, the chief of staff also indicated that although Finance verified the supporting documentation for the match requirement when performing desk reviews, it did not verify the source of the match. As a result, we reported that CaliforniaVolunteers could not assure that its subgrantees were meeting the match requirement. In its corrective action plan, CaliforniaVolunteers indicated that during 2011, as part of its fiscal year 2009–10 desk reviews, it planned to require subgrantees to document the source of matching funds and it intended to review this documentation to verify that the matching funds were from allowable sources.

We also reported that CaliforniaVolunteers had yet to eliminate its backlog of fiscal desk reviews. The chief of staff indicated that as of January 2011, CaliforniaVolunteers had completed only three fiscal desk reviews initially scheduled for program year 2007–08, and that it intended to have Finance complete the remaining reviews. According to a log that CaliforniaVolunteers maintained to track pending fiscal desk reviews, although Finance had completed nine of 34 pending fiscal desk reviews for program years 2007–08 and 2008–09, CaliforniaVolunteers had not yet approved any of those desk reviews. In its corrective action plan, CaliforniaVolunteers indicated that during 2011, it intended to eliminate the backlog of 2007–08 and 2008–09 fiscal desk reviews and begin processing 2009–10 reviews.

During our follow-up procedures, we found that CaliforniaVolunteers has not fully implemented its corrective action plan to ensure that its established policies and procedures for fiscal desk reviews are followed by verifying the allowability of grantee match contributions. CaliforniaVolunteers is in the process of informing subgrantees that they are required to provide all documentation that supports any match that is reported for the fiscal year 2009–10 awards, including the source of the match, but it does not expect its subgrantees to begin submitting the documentation until the end of 2011. Finally, we also found that CaliforniaVolunteers has not yet eliminated its backlog of fiscal desk reviews. The fiscal desk review officer stated that she is nearly finished with the 2007–08 reviews and she expects to eliminate the backlog of 68 fiscal desk reviews by the end of the 2010–11 fiscal year.

We recommend that CaliforniaVolunteers follow its policies and procedures when performing fiscal desk reviews to ensure its subgrantees submit documentation to support their matching funds, including the source of the match. It should then verify that the contributions are from allowable sources. Finally, CaliforniaVolunteers should continue implementing its fiscal monitoring workplan to eliminate its backlog of fiscal desk reviews. CaliforniaVolunteers stated that for the 29 fiscal desk reviews scheduled for the 2009–10 program year, it has requested the supporting documentation and it has already collected documentation from nine of these programs. CaliforniaVolunteers indicated that it plans to complete the majority of 2009–10 program year reviews in-house, but anticipates contracting with Finance for the completion of fiscal desk reviews that appear to be especially time consuming or complex.

### CaliforniaVolunteers Took Steps to Correct One Finding Reported for Fiscal Year 2009–10

During our current audit, we determined that CaliforniaVolunteers had fully corrected one of the two findings we reported for fiscal year 2009–10. Specifically, it performed site visits for 12 of the 54 AmeriCorps grants and the remaining 42 received desk reviews. Table 2 presents a listing of the corrected finding and a reference to the finding description as it was reported in the State Auditor’s Office annual report titled *State of California: Internal Control and State and Federal Compliance Audit Report for the Fiscal Year Ended June 30, 2010* (report number 2010-002, dated March 2011).

**Table 2**  
Finding Reported for Fiscal Year 2009–10 That the CaliforniaVolunteers Has Corrected

FEDERAL PROGRAM TITLE	FEDERAL CATALOG NUMBER	CATEGORY OF FINDING	REPORT 2010-002, ISSUED MARCH 2011: REFERENCE NUMBER/ PAGE NUMBER	RECEIVED RECOVERY ACT FUNDS DURING FISCAL YEAR		
				2008–09	2009–10	2010–11
AmeriCorps	94.006	Subrecipient Monitoring	2010-13-8/page 31	No	Yes	Yes

Source: California State Auditor’s Office analysis of corrective action taken by the CaliforniaVolunteers on prior-year findings.

# California Department of Corrections and Rehabilitation

## STATE CRIMINAL ALIEN ASSISTANCE PROGRAM (SCAAP) FEDERAL CATALOG NUMBER 16.606

Based on the U.S. Office of Management and Budget's (OMB) March 2011 guidance, the California State Auditor's Office (State Auditor's Office) presents its interim report concerning California Department of Corrections and Rehabilitation's (Corrections) administration of the State Criminal Alien Assistance Program (SCAAP) (Federal Catalog Number 16.606) during fiscal year 2010–11. The State reported receiving \$88.1 million for this program during fiscal year 2010–11. Corrections did not receive any funds from the American Recovery and Reinvestment Act of 2009 for SCAAP during this period. The issue contained in this interim report resulted from our internal control and compliance audit completed as of October 17, 2011, and requires Corrections' corrective action. Our audit procedures were limited to following up on one finding we reported in our annual report for fiscal year 2009–10.

### **Corrections Has Not Revised Its Procedures to Ensure It Includes Only Eligible Inmate Data in Its Application for Funding**

Federal regulations allow states to receive compensation for the incarceration of undocumented criminal aliens who are defined as aliens that meet certain criteria.

In our prior-year audit, we reported that Corrections submitted ineligible inmate data in its federal fiscal year 2009 application for SCAAP funding. Specifically, Corrections' application included nearly 2,000 additional records in instances where an inmate had more than one alien registration number for the same incarceration period. We also reported that our review of 29 inmate records that Corrections submitted found that it had information in its files indicating 10 of these inmates were either U.S. citizens or permanent residents. In its corrective action plan for that fiscal year, Corrections stated that it will continue to partner with the U.S. Department of Justice—Bureau of Justice Assistance and the U.S. Immigration and Customs Enforcement to ensure that it is presenting its application in a manner that complies with federal standards.

During our follow-up procedures, Corrections confirmed that it has not revised its procedures for submitting the application for SCAAP funding. It indicated that the U.S. Department of Justice is revising the application process for SCAAP funding and that it is waiting for further directions before changing its application procedures. However, a policy advisor from the U.S. Department of Justice stated that the potential changes in the 2012 SCAAP application will not impact the application process or the grantee certifications, and that inmates should only be reported with a single, correct alien registration number. Because Corrections did not revise its procedures for submitting the federal fiscal year 2010 application for SCAAP funding, it cannot be sure that it did not include ineligible inmate data.

We recommend that Corrections work with U.S. Immigration and Customs Enforcement to ensure that it submits eligible inmate data in its application for SCAAP funding. In its most recent corrective action plan Corrections indicated that it has initiated contact with the Department of Homeland Security (Homeland Security) and has begun discussions to investigate the feasibility for establishing a process for verifying inmate alien numbers prior to the submission for the SCAAP grant application. In addition, Corrections stated that it hopes to establish a routine process with Homeland Security to obtain valid inmate alien numbers and citizenship status for all its inmates, which will allow it to collect the alien numbers for all inmates and incorporate the information into its databases.

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## Employment Development Department

Based on the U.S. Office of Management and Budget's (OMB) March 2011 guidance, the California State Auditor's Office (State Auditor's Office) presents its interim report on the Employment Development Department's (EDD) administration of the programs listed in the text box. The State reported that these 10 programs collectively received \$22 billion for fiscal year 2010–11, which included American Recovery and Reinvestment Act of 2009 (Recovery Act) funds totaling approximately \$843.1 million for five of these programs. The issue contained in this interim report represents the results of our internal control and compliance audit that requires EDD's corrective action. The State Auditor's Office identified one finding that pertains to EDD's administration of one of these federal programs. This finding is a repeat of an issue that we disclosed in previous annual audit reports. Our testing this year also confirmed that EDD corrected three other findings that we included in last year's annual audit report.

Name of Federal Programs Audited and Federal Catalog Number
Unemployment Insurance (17.225)
<b>Employment Service Cluster</b>
<ul style="list-style-type: none"> <li>• Employment Service/Wagner-Peyser Funded Activities (17.207)</li> <li>• Disabled Veterans' Outreach Program (17.801)</li> <li>• Local Veterans' Employment Representative Program (17.804)</li> </ul>
<b>Workforce Investment Act (WIA) Cluster</b>
<ul style="list-style-type: none"> <li>• WIA Adult Program (17.258)</li> <li>• WIA Youth Activities (17.259)</li> <li>• WIA Dislocated Workers (17.260)</li> <li>• WIA National Emergency Grants (17.277)</li> <li>• WIA Dislocated Worker Formula Grants (17.278)</li> </ul>
Trade Adjustment Assistance (17.245)

### EDD Cannot Identify All of Its Recovery Act Expenditures

EDD's financial management systems do not allow it to separately identify and report on Recovery Act funds expended for certain benefits paid under the Unemployment Insurance (UI) program. Federal regulations state that to maximize the transparency and accountability of funds authorized under the Recovery Act, recipients agree to maintain records that identify the source and application of Recovery Act funds and to separately identify the expenditures for federal awards under the Recovery Act on the Schedule of Expenditures of Federal Awards. Further, OMB's *Circular A-133 Compliance Supplement* dated March 2011 regarding special tests and provisions for awards with Recovery Act funding, indicates that the financial management system must permit the preparation of required reports and the tracing of funds adequate to establish that funds were used for authorized purposes and allowable costs. Additionally, according to a program letter provided by the U.S. Department of Labor, some unemployment benefit payments should be reported separately as Recovery Act expenditures.

EDD has not yet corrected a prior-year finding related to tracking Recovery Act funds. In our audit reports for fiscal years 2008–09 and 2009–10, we reported that EDD's financial management systems did not allow it to separately identify and report on Recovery Act funds expended for certain benefits paid under the UI program. Specifically, EDD could not separately identify Recovery Act expenditures for the Federal Additional Compensation (FAC) program, the Emergency Unemployment Compensation (EUC) program, and the Federal-State Extended Benefits (Fed-Ed) program. EDD stated that it agreed with our finding and intended to update its financial management systems by March 2010 but later revised this date to early 2012.

During fiscal year 2010–11, the UI program spent \$21 billion, which included both Recovery Act and non-Recovery Act funds. As detailed in the text box, of the several types of unemployment benefit program components, the FAC, EUC, and Fed-Ed program components expended Recovery Act funds. The FAC program provided an additional \$25 a week to claimants, the EUC program provided up to 53 additional weeks of UI benefits to claimants, and the Fed-Ed program provided up to 20 additional weeks of UI benefits to eligible claimants. In fiscal year 2010–11 EDD spent \$12.2 billion on these programs. However, because EDD is not able to separately identify Recovery Act and non-Recovery Act funds, it is unable to identify what portion of the total expenditures for these three program components were paid for with Recovery Act funds.

In our fiscal year 2009–10 audit report, we noted that EDD anticipated fully correcting this problem by early 2012. In July 2011 EDD provided a status report to the U.S. Department of Labor that explained the delays it has experienced as it attempts to reprogram its system to separately identify Recovery Act funds and reiterated its plans to fully correct the finding. In its response, the U.S. Department of Labor indicated that it considered the finding corrected. However, on August 31, 2011, an EDD division chief stated that EDD's plans to complete the programming changes necessary to separately account for Recovery Act funds by early 2012 have been delayed because of resource and scheduling conflicts and will not be fully implemented until mid-2013. Thus, EDD will not be able to account for its Recovery Act expenditures for the FAC, EUC, and Fed-Ed program components separately until that time.

To ensure the Recovery Act funds can be separately identified for the FAC, EUC, and Fed-Ed program components, we recommend that EDD continue its efforts to update its financial management systems. In its corrective action plan, EDD concurred with our recommendation and stated that it will continue working on information system changes to enable separate identification of Recovery Act funds.

### EDD Took Steps to Fully Correct Three Findings Reported for Fiscal Year 2009–10

During our current audit, we determined that EDD had fully corrected three of the four findings we reported for fiscal year 2009–10. Table 3 presents a listing of the corrected findings and a reference to the finding description as it was reported in the State Auditor's Office annual report titled *State of California: Internal Control and State and Federal Compliance Audit Report for the Fiscal Year Ended June 30, 2010* (report number 2010-002, dated March 2011).

#### Unemployment Insurance Benefits Related to the American Recovery and Reinvestment Act of 2009 (Recovery Act)

**Federal Additional Compensation (FAC):** Increased all benefit payments (including regular unemployment insurance) by \$25 a week, beginning February 22, 2009.

**Emergency Unemployment Compensation (EUC):** Provides up to 53 additional weeks of unemployment benefits. The Recovery Act extended the time frame in which claimants could file for EUC and receive benefits.

**Federal-State Extended Benefits (Fed-Ed):** Provides up to 20 additional weeks of unemployment benefits. The Recovery Act provided that such benefits are paid fully by the federal government except benefits paid to claimants whose eligibility for benefits was based on prior employment with state and local governments or federally recognized Indian Tribes.

Sources: Recovery Act, grant agreements, program letters, Compliance Supplement, and the Employment Development Department's Web site.

**Table 3**  
**Findings Reported for Fiscal Year 2009–10 That the Employment Development Department Has Fully Corrected**

FEDERAL PROGRAM TITLE	FEDERAL CATALOG NUMBER	CATEGORY OF FINDING	REPORT 2010-002, ISSUED MARCH 2011: REFERENCE NUMBER/PAGE NUMBER	RECEIVED RECOVERY ACT FUNDS DURING FISCAL YEAR		
				2008–09	2009–10	2010–11
Employment Service/Wagner-Peyser Funded Activities	17.207	Procurement, Suspension and Debarment	2010-9-2/page 94	Yes	Yes	Yes
Disabled Veterans' Outreach Program	17.801			No	No	Yes
Local Veterans' Employment Representative Program	17.804			No	No	Yes
Trade Adjustment Assistance	17.245	Activities Allowed/ Allowable Costs; Eligibility	2010-1-1/page 93	No	No	No
WIA Adult Program	17.258	Subrecipient Monitoring	2010-13-7/page 96	Yes	Yes	Yes
WIA Youth Activities	17.259			Yes	Yes	Yes
WIA Dislocated Workers	17.260			Yes	Yes	Yes

Source: California State Auditor's Office analysis of corrective action taken by the Employment Development Department on prior-year findings.

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# Department of Housing and Community Development

## COMMUNITY DEVELOPMENT BLOCK GRANTS/STATE'S PROGRAM FEDERAL CATALOG NUMBER 14.228

## ARRA—COMMUNITY DEVELOPMENT BLOCK GRANTS/STATE'S PROGRAM FEDERAL CATALOG NUMBER 14.255

Based on the U.S. Office of Management and Budget's (OMB) March 2011 guidance, the California State Auditor's Office (State Auditor's Office) presents its interim report concerning the Department of Housing and Community Development's (Housing) administration of the Community Development Block Grants/State's Program (CDBG Program) (Federal Catalog Number 14.228) and the ARRA CDBG Program (Federal Catalog Number 14.255) during fiscal year 2010–11. The State reported receiving \$85.7 million in federal funds for the CDBG Program, which included American Recovery and Reinvestment Act of 2009 funds totaling \$5.6 million.

The issue discussed in this report represents the interim results of our internal control and compliance audit that require Housing's corrective action. Our audit procedures were limited to following up on findings we reported in our annual report for fiscal year 2009–10. Our testing this year found that Housing still does not complete an adequate number of monitoring site visits of CDBG Program subrecipients. However, to its credit we also confirmed that Housing corrected two other CDBG Program findings that we included in last year's annual audit report.

### Housing Did Not Complete an Adequate Number of Monitoring Site Visits

Federal law requires Housing, as the pass-through entity for the CDBG Program, to monitor the activities of its subrecipients to ensure that federal awards are used for authorized purposes in compliance with applicable federal requirements and that performance goals are achieved.

During our audit for fiscal year 2009–10, we reported that Housing did not complete an adequate number of monitoring site visits to ensure that subrecipients were complying with program requirements. Specifically, we found that Housing completed only 16 of 40 scheduled site visits and that these site visits were not always focused on projects identified by Housing as having the highest risk. During our follow-up procedures for fiscal year 2010–11, we found that Housing has not yet addressed this finding. Specifically, Housing has since completed only one monitoring site visit and has not yet developed a monitoring schedule based on a risk assessment. As a result, Housing cannot ensure that its highest risk subrecipients are complying with federal laws, regulations, and provisions of grant agreements.

To ensure that it provides adequate monitoring over its subrecipients, we recommend that Housing complete and adhere to a site-visit monitoring schedule. In its corrective action plan, Housing stated that the CDBG Program section will continue to improve its monitoring process. Housing also stated that the CDBG Program section has completed a risk-based review of all active jurisdictions (those having active contracts) and identified the 15 highest risk jurisdictions. Further, the CDBG Program section has developed an annual monitoring schedule that includes all 15 identified jurisdictions, with an anticipated completion date of March 31, 2012.

## Housing Took Steps to Correct Two Findings Reported For Fiscal Year 2009–10

During our current audit, we determined that Housing had fully corrected two CDBG Program findings we reported for fiscal year 2009–10. Table 4 presents a listing of the corrected findings and a reference to the finding description as it was reported in the State Auditor’s Office annual report titled *State of California: Internal Control and State and Federal Compliance Audit Report for the Fiscal Year Ended June 30, 2010* (report number 2010-002, dated March 2011).

**Table 4**  
**Findings Reported for Fiscal Year 2009–10 That the Department of Housing and Community Development Has Corrected**

FEDERAL PROGRAM TITLE	FEDERAL CATALOG NUMBER	CATEGORY OF FINDING	REPORT 2010-002, ISSUED MARCH 2011: REFERENCE NUMBER/PAGE NUMBER	RECEIVED RECOVERY ACT FUNDS DURING FISCAL YEAR		
				2008-09	2009-10	2010-11
Community Development Block Grants/ State’s Program	14.228	Reporting	2010-12-9/page 80	No	Yes	Yes
Community Development Block Grants/ State’s Program	14.228	Subrecipient Monitoring	2010-13-17/page 84	No	Yes	Yes

Source: California State Auditor’s Office analysis of corrective action taken by the Department of Housing and Community Development on prior-year findings.

## Department of Mental Health

### **BLOCK GRANTS FOR COMMUNITY MENTAL HEALTH SERVICES FEDERAL CATALOG NUMBER 93.958**

Based on the U.S. Office of Management and Budget's (OMB) March 2011 guidance, the California State Auditor's Office (State Auditor's Office) presents its interim report concerning the Department of Mental Health's (Mental Health) administration of the Block Grants for Community Mental Health Services (block grant) program (Federal Catalog Number 93.958) during fiscal year 2010–11. The State reported receiving almost \$46.2 million in federal funds for the block grant program for fiscal year 2010–11. Mental Health did not receive any funds from the American Recovery and Reinvestment Act of 2009 for the block grant during this period.

The issues contained in this report represent the interim results of our internal control and compliance audit that require Mental Health's corrective action. Our audit procedures were limited to following up on four findings we reported in our annual report for fiscal year 2009–10. During our review, we confirmed that Mental Health had not corrected three of these findings as of August 31, 2011. However, Mental Health corrected the one other finding that we included in last year's annual report.

#### **Mental Health Does Not Ensure That Counties' Expenditures Were Only for Allowable Activities and Costs**

Although Mental Health receives some assurance from counties that they will expend block grant funds appropriately, it does not ensure that counties actually spend the federal funds only on allowable activities and costs. Federal law states that block grant funds are to be spent on activities related to a state's plan for providing comprehensive community mental health services, but places specific restrictions on the use of the funds, such as prohibiting their use for inpatient services.

In our audit reports for fiscal years 2006–07 through 2009–10, we reported that Mental Health did not ensure that its subgrantees' expenditures were only for allowable activities and costs. Mental Health relied on the counties' budget and program description components of their applications to determine if funds were used for allowable activities and costs. Specifically, the grant renewal application instructions for the block grant directs counties to include in their program narrative a description that specifies what is actually being paid for by the block grant funds. However, we reported that Mental Health did not require the counties to submit invoices, receipts, or payroll information to verify amounts they reported as expenditures. Additionally, Mental Health did not perform regular site visits to the counties to verify whether the block grant programs' activities and costs were allowable.

During our follow-up procedures for fiscal year 2010–11, we found that Mental Health has not yet implemented a process to verify that counties' actual expenditures of federal grant funds are for allowable activities and costs. According to Mental Health, in March 2011 it drafted a proposal identifying its options for reviewing counties' expenditures, which included conducting audits of the counties or reviewing invoices and other documentation from the counties to verify that activities and costs are allowable. As of July 2011 Mental Health had not determined which option it would implement.

We recommend that Mental Health complete its efforts to establish a process to ensure that only allowable activities and costs are paid for with block grant funds. According to Mental Health, it plans to finalize the proposal and adopt an option to verify that counties' actual expenditures of federal grant funds are for allowable activities and costs. Mental Health indicated that it plans to implement the process during fiscal year 2011–12.

## **Mental Health Continues to Lack Policies and Procedures to Adhere to the Earmarking Requirement**

Federal law requires that Mental Health expend no more than 5 percent of the block grant for administrative expenses. For fiscal year 2010–11, Mental Health allocated the entire 5 percent, or about \$2.7 million, for administrative costs.

In our audit reports for fiscal years 2006–07 through 2009–10, we reported that Mental Health did not have an official written policy or procedures in place to ensure that administrative costs were charged appropriately to the block grant. Mental Health charged all or a portion of salaries for certain key staff to the block grant, based on approved timesheets, but other expenditures, such as travel, were allocated to the block grant according to staff's discretion.

During our follow-up procedures for fiscal year 2010–11, we found that Mental Health still had not completed a written policy or procedures to ensure that it consistently and properly applied administrative costs to the block grant. Mental Health stated that it formed a workgroup in February 2010 to develop a written policy, processes, and procedures to ensure that only allowable costs are used to meet the earmarking requirement.

We recommend that Mental Health complete its efforts to establish a written policy, as well as processes and procedures, to ensure that only allowable costs are used to meet the earmarking requirement. In its corrective action plan, Mental Health stated that it plans to finalize the administrative cost policy and its Substance Abuse and Mental Health Service's Administration Desk Manual. Mental Health also indicated that it plans to implement the processes and procedures to ensure it consistently and properly applies administrative costs to the block grant during fiscal year 2011–12.

## **Mental Health's Calculation of Its Expenditures for Certain Activities Related to Its Maintenance of Effort Requirements Remain Problematic**

As a condition of receiving the block grant, federal law requires that a state spend at least as much on systems of integrated services for children with serious emotional disturbance (SED) as it did in fiscal year 1994–95. Similarly, federal law requires a state to spend at least as much on community mental health services for children with SED and adults with serious mental illness (SMI) as it averaged in the preceding two fiscal years. Laws and regulations that require the recipient of a federal grant to maintain a certain level of expenditures are referred to as maintenance of effort (MOE) requirements.

In our audit reports for fiscal years 2006–07 through 2009–10, we reported that Mental Health needs to refine its process for complying with the MOE requirements. Specifically, Mental Health did not provide documentation to support the percentages it applied against the total of managed care and realignment expenditures to arrive at the amount it reported as expenditures for children with SED. Additionally, for the MOE requirement related to the State's expenditures for community mental health services, Mental Health did not report all state expenditures for adults with SMI and children with SED. Specifically, it did not include any expenditures from the Mental Health Services Act, and it could not positively state whether other state agencies fund community mental health programs for adults with SMI or children with SED. Moreover, Mental Health was unable to provide documentation that showed the components and expenditures used to generate the fiscal year 1994–95 expenditure threshold of \$160 million.



During our follow-up procedures for fiscal year 2010–11, we found that Mental Health still has not implemented a process to comply with the MOE requirements. Specifically, all of the conditions that we reported for fiscal years 2006–07 through 2009–10 continued to exist during fiscal year 2010–11. However, although Mental Health did not implement corrective actions during fiscal year 2010–11, it did take steps to better ensure its compliance for future years. For example, Mental Health developed a methodology for determining the percentages to apply against managed care as part of determining the amount it reports as expenditures for children with SED. Mental Health also indicated that it is researching alternatives to determine the percentage it uses to support the realignment dollars used in its MOE calculation, and stated that it would implement these new methodologies in fiscal year 2011–12. Mental Health further stated that it requested guidance from its community services division on the reporting of all state expenditures for adults with SMI and children with SED. Specifically, it is determining the Mental Health Services Act expenditures that should be included in its MOE calculation. Finally, although Mental Health still has not located documentation to support its fiscal year 1994–95 expenditure threshold of \$160 million, beginning with the 2012 federal block grant award, program changes will allow Mental Health to use state fiscal year 2008–09 as the new expenditure threshold for its allocation to systems of integrated services for children. According to Mental Health, this should resolve the issue for future years.

We recommend that Mental Health finalize and implement its methods to determine the percentages used to support the realignment expenditure in its MOE calculation and retain the supporting documentation. Mental Health also should finalize a methodology for calculating the community mental health services MOE requirement to ensure that it accurately captures and reports all state expenditures for adults with SMI and children with SED. In its corrective action plan, Mental Health stated that it plans to continue its efforts to develop a methodology to determine the dollar amount expended on approved actual claims for realignment, and will retain the supporting documentation. After the methodology for realignment is finalized and implemented, Mental Health will update and implement its methodology for calculating the community mental health services MOE requirement to accurately capture and report all state expenditures for adults with SMI and children with SED only.

**Mental Health Took Steps to Correct One Finding Reported for Fiscal Year 2009–10**

During our current audit, we determined that Mental Health had fully corrected one of the four findings we reported for fiscal year 2009–10. Specifically, during fiscal year 2010–11, Mental Health ensured that three counties receiving block grant funds were reviewed as required by federal law. Table 5 presents the corrected finding and a reference to the finding description as it was reported in the State Auditor’s Office annual report titled *State of California: Internal Control and State and Federal Compliance Audit Report for the Fiscal Year Ended June 30, 2010* (report number 2010-002, dated March 2011).

**Table 5**  
**Finding Reported for Fiscal Year 2009–10 That the Department of Mental Health Has Corrected**

FEDERAL PROGRAM TITLE	FEDERAL CATALOG NUMBER	CATEGORY OF FINDING	REPORT 2010-002, ISSUED MARCH 2011: REFERENCE NUMBER/ PAGE NUMBER	RECEIVED RECOVERY ACT FUNDS DURING FISCAL YEAR		
				2008–09	2009–10	2010–11
Block Grants for Community Mental Health Services	93.958	Special Tests and Provisions	2010-14-1/page 71	No	No	No

Source: California State Auditor’s Office analysis of corrective action taken by the Department of Mental Health on prior-year findings.

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# Military Department

## NATIONAL GUARD MILITARY OPERATIONS AND MAINTENANCE PROJECTS FEDERAL CATALOG NUMBER 12.401

Based on the U.S. Office of Management and Budget’s March 2011 guidance, the California State Auditor’s Office (State Auditor’s Office) presents its interim report concerning the Military Department’s (Military) administration of the National Guard Military Operations and Maintenance Projects (O&M projects) program (Federal Catalog Number 12.401) during fiscal year 2010–11. The State reported receiving \$59.8 million for this program during fiscal year 2010–11, \$79,000 of which were American Recovery and Reinvestment Act of 2009 funds. Our audit procedures were limited to following up on the one finding that we included in our annual report for fiscal year 2009–10. As of August 31, 2011, our testing confirmed that Military corrected the finding.

### Military Took Steps to Correct the Finding Reported for Fiscal Year 2009–10

As we reported in our annual audit for fiscal year 2009–10, Military lacked internal controls that would allow it to prevent and/or detect instances when personnel costs are being inappropriately charged to the O&M projects program. Specifically, Military lacked a process to identify when personnel may no longer be working on allowable activities, and it did not have adequate documentation, such as certifications or personnel activity reports, to support personnel costs it charged to the O&M projects program. During our current audit we confirmed that Military corrected this finding. Military revised its procedures to ensure that it certifies every employee working exclusively on the O&M projects program, and it worked with the U.S. Department of Defense to resolve the issue concerning personnel activity reports. Table 6 presents the corrected finding and a reference to the finding description as it was reported in the State Auditor’s Office annual report titled *State of California: Internal Control and State and Federal Compliance Audit Report for the Fiscal Year Ended June 30, 2010* (report number 2010-002, dated March 2011).

**Table 6**  
**Finding Reported for Fiscal Year 2009–10 That the Military Department Has Corrected**

FEDERAL PROGRAM TITLE	FEDERAL CATALOG NUMBER	CATEGORY OF FINDING	REPORT 2010-002, ISSUED MARCH 2011: REFERENCE NUMBER/PAGE NUMBER	RECEIVED RECOVERY ACT FUNDS DURING FISCAL YEAR		
				2008–09	2009–10	2010–11
National Guard Military Operations and Maintenance Projects	12.401	Activities Allowed/ Allowable Costs	2010-1-2/page 33	No	No	Yes

Source: California State Auditor’s Office analysis of corrective action taken by the Military Department on prior-year findings.

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## Department of Social Services

Based on the U.S. Office of Management and Budget's (OMB) March 2011 guidance, the California State Auditor's Office (State Auditor's Office) presents its interim report concerning the Department of Social Services' (Social Services) administration of the programs listed in the text box. The State reported receiving \$7 billion for these programs for fiscal year 2010–11, which included American Recovery and Reinvestment Act of 2009 funds totaling \$695.4 million for four of these programs. The issue contained in this interim report represents the results of our internal control and compliance audit that require Social Services' corrective action.

The State Auditor's Office identified one finding that pertains to Social Services' administration of these federal programs. Our testing this year also confirmed that Social Services corrected all four findings that we included in last year's annual audit report.

### Name of Federal Programs Audited and Federal Catalog Numbers

#### SNAP Cluster

State Administrative Matching Grants for the Supplemental Nutrition Assistance Program (10.561)

#### TANF Cluster

- Temporary Assistance for Needy Families (93.558)
- ARRA—Emergency Contingency Fund for Temporary Assistance for Needy Families State Programs (93.714)

#### Other Programs

- Foster Care—Title IV-E (93.658)
- Adoption Assistance (93.659)
- Social Services Block Grant (93.667)
- Social Security—Disability Insurance (96.001)

### Social Services Did Not Inform Counties of Information and Requirements Associated With Federal Awards

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

Social Services did not inform its county subrecipients of certain federal award information, such as the CFDA program title and number, and relevant federal laws and regulations that govern each program we reviewed. Specifically, Social Services has periodic, ongoing correspondence with counties through fiscal letters that it uses to notify them of various issues. Although Social Services annually issues a fiscal letter that informs the counties of the required federal award information, it failed to issue this letter in fiscal year 2010–11. The chief of the fund accounting and reporting bureau indicated that Social Services did not issue the letter because of workload issues, but has since implemented a process to ensure the letters are released timely in the future. By not providing award information and requirements to its county subrecipients, Social Services cannot be sure that its subrecipients are aware of and are following all program requirements imposed on them.

We recommend that Social Services annually inform the counties of the required federal award information and relevant federal laws, regulations, and terms and conditions governing the programs in its annual county fiscal letters. Social Services agreed with our finding and indicated that the annual county letter for fiscal year 2011–12 was issued on August 12, 2011. Social Services stated that beginning in fiscal year 2012–13, this annual letter will be issued every October to coincide with the start of the new federal fiscal year.

## Social Services Took Steps to Fully Correct Four Findings Reported for Fiscal Year 2009–10

During our current audit, we determined that Social Services had fully corrected all four of the findings we reported for fiscal year 2009–10. Specifically, Social Services performed on-site reviews at county offices to verify that expenditures were allowable. Additionally, Social Services visited six county offices during fiscal year 2010–11 to verify that counties are making correct eligibility determinations and complying with other requirements applicable to the Adoption Assistance program. Further, Social Services' district offices now retain documentation showing compliance with federal eligibility requirements for the Adoption Assistance program. Finally, Social Services completed monthly time reports to substantiate the payroll expenditures it charged to the Disability Insurance program. Table 7 presents a listing of the corrected findings and a reference to the finding description as it was reported in the State Auditor's Office annual report titled *State of California: Internal Control and State and Federal Compliance Audit Report for the Fiscal Year Ended June 30, 2010* (report number 2010-002, dated March 2011).

**Table 7**  
**Findings Reported for Fiscal Year 2009–10 That the Department of Social Services Has Fully Corrected**

FEDERAL PROGRAM TITLE	FEDERAL CATALOG NUMBER	CATEGORY OF FINDING	REPORT 2010-002, ISSUED MARCH 2011: REFERENCE NUMBER/PAGE NUMBER	RECEIVED RECOVERY ACT FUNDS DURING FISCAL YEAR		
				2008–09	2009–10	2010–11
Adoption Assistance	93.659	Subrecipient Monitoring	2010-13-2/page 59	Yes	Yes	Yes
Adoption Assistance	93.659	Eligibility	2010-5-1/page 46	Yes	Yes	Yes
Social Security—Disability Insurance	96.001	Allowable Costs/Cost Principles	2010-2-1/page 101	No	No	No
State Administrative Matching Grants for the Supplemental Nutrition Assistance Program (SNAP)	10.561	Subrecipient Monitoring	2010-13-1/page 73	No	Yes	Yes
Temporary Assistance for Needy Families	93.558			No	Yes*	Yes*
Foster Care—Title IV-E	93.658			Yes	Yes	Yes
Adoption Assistance	93.659			Yes	Yes	Yes
Social Services Block Grant	93.667			No	No	No

Source: California State Auditor's Office analysis of corrective action taken by the Department of Social Services on prior-year findings.

\* American Recovery and Reinvestment Act of 2009 funds for the Temporary Assistance for Needy Families program were received under Federal Catalog Number 93.714.

# California Department of Transportation

## HIGHWAY PLANNING AND CONSTRUCTION CLUSTER

### HIGHWAY PLANNING AND CONSTRUCTION FEDERAL CATALOG NUMBER 20.205

Based on the U.S. Office of Management and Budget's (OMB) March 2011 guidance, the California State Auditor's Office (State Auditor's Office) presents its interim report concerning the California Department of Transportation's (Caltrans) administration of the Highway Planning and Construction Cluster, which includes the Highway Planning and Construction program (Federal Catalog Number 20.205). The State reported receiving \$3.3 billion in federal funds for the program for fiscal year 2010–11, which included American Recovery and Reinvestment Act of 2009 funds totaling more than \$1 billion.

The issue discussed in this interim report represents the results of our internal control and compliance audit that require Caltrans' corrective action. The State Auditor's Office identified one finding that pertains to Caltrans' administration of this federal program. This finding includes certain issues that we disclosed in our fiscal year 2009–10 audit report. Our testing this year also confirmed that Caltrans corrected two other findings that we had included in last year's annual audit report.

#### **Caltrans Did Not Ensure That Subrecipients Submitted Required Audit Reports**

As we reported in fiscal year 2009-10, Caltrans continues to lack internal controls to ensure subrecipients who spent \$500,000 or more during fiscal year 2009–10 submitted audit reports to the federal government as required under OMB Circular A-133. Based on Caltrans' records of the amounts it disbursed to subrecipients, it could have established reasonable expectations as to which subrecipients would need to submit audit reports. In response to the finding reported in our fiscal year 2009–10 audit report, Caltrans stated it developed written policies and procedures to determine whether subrecipients submit their single audit reports timely and impose sanctions on those that are delinquent.

Although we confirmed that Caltrans developed these policies and procedures, it did not fully implement them. For example, during the fiscal year 2010-11 audit we identified instances where subrecipients receiving \$500,000 or more—and, according to Caltrans' records, in some cases more than \$1 million—did not submit audit reports to the federal government. Specifically, we identified 12 subrecipients (including various cities, counties, and special districts) as having no record of an audit submission to the federal government for fiscal year 2009-10. Subrecipients with a fiscal year ending on June 30, 2010, were required to submit their audit reports to the federal government nine months after the end of the fiscal year, which would have been March 31, 2011. When subrecipients fail to submit audit reports to the federal government, federal agencies miss an opportunity to identify where federal funds might be misspent.

The failure of subrecipients to submit audit reports also limits Caltrans' ability to review and issue management decisions on potential findings and exercise effective oversight of the Highway Planning and Construction program. To facilitate the State's preparation of management decisions on its subrecipients' audit findings, the State has established a process whereby local governments submit copies of their OMB Circular A-133 audit reports to the State Controller's Office (SCO). According to the *State Administrative Manual*, Section 20070, the SCO distributes a copy of each audit report and

corrective action plan to state entities (such as Caltrans) that are affected by the findings, and such state entities follow up on audit findings pertaining to the federal programs they administer. To assist with its responsibilities, Caltrans provides the SCO with an annual listing of all of its subrecipients and the amounts of federal funds they received. Caltrans provided the SCO with the amounts it disbursed to its subrecipients on August 30, 2011. When the SCO receives audit reports from subrecipients, it updates its list to indicate which subrecipients have or have not submitted their audit reports. As of November 15, 2011, the SCO's Web site indicated the following information for certain Caltrans' subrecipients:

- Two subrecipients had either submitted incomplete audit reports, or had not submitted any audit reports, and the SCO was no longer going to follow up with those entities.
- Six subrecipients were classified by the SCO as "exempt" from the audit requirements because they spent less than \$500,000.
- Eight subrecipients were classified by the SCO as "no review" because SCO concluded after reviewing the audit reports that no funds had passed through state entities (such as Caltrans).

Based on our review, the SCO's data—identifying certain subrecipients as having an "exempt" or "no review" status—was in conflict with Caltrans' records that indicated it disbursed \$500,000 or more to these subrecipients. However, despite internal procedures that direct Caltrans staff to notify the SCO of any discrepancies, we determined that Caltrans did not follow up with the SCO to verify that the information was correct.

We recommend that Caltrans fully implement policies and procedures to ensure that subrecipients promptly submit required audit reports and impose sanctions on those that do not. In its corrective action plan, Caltrans indicated that it has further refined its policies and procedures to ensure its subrecipients submit their single audit reports timely. For example, Caltrans indicated it will reconcile the audit submissions on the federal and SCO Web sites to its own records of subrecipients that received \$500,000 or more, and will continue to follow up on and impose sanctions on noncompliant subrecipients.

### **Caltrans Took Steps to Correct Two Findings Reported for Fiscal Year 2009–10**

During the current audit, we determined that Caltrans had fully corrected two findings we reported for fiscal year 2009–10. Specifically, the department revised the Treasury-State Agreement to ensure it accurately reflected the funding techniques used for the program. Further, Caltrans implemented managerial oversight procedures to better ensure that it could prevent or detect noncompliance with matching requirements. Table 8 presents the two corrected findings and a reference to the finding description as it was reported in the State Auditor's Office annual report titled *State of California: Internal Control and State and Federal Compliance Audit Report for the Fiscal Year Ended June 30, 2010* (report number 2010-002, dated March 2011).



**Table 8**  
**Findings Reported for Fiscal Year 2009–10 That the California Department of Transportation Has Corrected**

FEDERAL PROGRAM TITLE	FEDERAL CATALOG NUMBER	CATEGORY OF FINDING	REPORT 2010-002, ISSUED MARCH 2011: REFERENCE NUMBER/PAGE NUMBER	RECEIVED RECOVERY ACT FUNDS DURING FISCAL YEAR		
				2008-09	2009-10	2010-11
Highway Planning and Construction	20.205	Cash Management	2010-3-4/page 103	Yes	Yes	Yes
Highway Planning and Construction	20.205	Matching	2010-7-10/page 106	Yes	Yes	Yes

Source: California State Auditor's Office analysis of corrective action taken by the California Department of Transportation on prior-year findings.

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## California Department of Veterans Affairs

### GRANTS TO STATES FOR CONSTRUCTION OF STATE HOME FACILITIES FEDERAL CATALOG NUMBER 64.005

### VETERANS HOUSING—GUARANTEED AND INSURED LOANS FEDERAL CATALOG NUMBER 64.114

Based on the U.S. Office of Management and Budget's (OMB) March 2011 guidance, the California State Auditor's Office (State Auditor's Office) presents its interim report concerning California Department of Veterans Affairs' (Veterans Affairs) administration of the Grants to States for Construction of State Home Facilities (construction grant) (Federal Catalog Number 64.005) and Veterans Housing—Guaranteed and Insured Loans (loan guaranty) (Federal Catalog Number 64.114) programs during fiscal year 2010–11. Through the loan guaranty program, as of June 30, 2011, the U.S. Department of Veterans Affairs (VA) guaranteed more than \$100 million of the nearly \$401 million in loans held by Veterans Affairs. These guarantees are considered federal assistance to the State for fiscal year 2010–11. Additionally, during fiscal year 2010–11, the State reported receiving \$8.2 million in federal funds for the construction grant program. Veterans Affairs did not receive American Recovery and Reinvestment Act of 2009 funds for either program.

The issues discussed in this interim report resulted from our internal control and compliance audit completed as of November 1, 2011, and requires Veterans Affairs' corrective action. Our audit procedures were limited to following up on findings we reported in our annual report for fiscal year 2009–10. Our testing this year found that Veterans Affairs still has not implemented adequate controls to ensure that it reports various events related to the loan guaranty program to the VA within the time required. Our current year testing also confirmed that Veterans Affairs corrected the three findings related to the construction grant program that we included in last year's annual audit report.

#### **Veterans Affairs Still Fails to Report Certain Loan Events to the VA by the Deadlines for the Loan Guaranty Program**

Veterans Affairs, as part of its administration of the loan guaranty program, is approved by the VA to offer VA-guaranteed home loans to eligible veterans. Since November 2008 the VA requires loan servicers, such as Veterans Affairs, to electronically report to the VA specific events related to loans that have been issued a VA guarantee. Federal regulations require that these events be reported to the VA within the first seven calendar days of the following month, or in certain instances, within seven days of the event itself. Late reporting may hinder the VA's ability to take appropriate oversight action on delinquent loans.

During our audit for fiscal year 2009–10, we reviewed a selection of 25 loans that were delinquent and found that Veterans Affairs did not always report bankruptcies, loss mitigation, foreclosure referrals, compromise sales, loan defaults, and the approval of a repayment plan to the VA within the applicable reporting deadlines. We also reported that in response to our audit report for fiscal year 2008–09, Veterans Affairs established a process in March 2010 to report to the VA as required when it notifies the credit bureaus of delinquent loans. However, we found that although it established this process, it still inconsistently reported this information to the VA. Finally, we also reported that Veterans Affairs lacked a process to use information in its system to determine which borrowers no longer have delinquent payments and therefore have cured their default. By not reporting cured defaults, the VA's reporting system continues to inaccurately show these loans as in default.

During our prior-year review, Veterans Affairs used a manual process to report most of the events for which we noted late reporting. In its corrective action plan for that year, Veterans Affairs indicated that the automation of the reporting requirement is a management priority and should resolve all noted issues. It stated that it has been working on this automation project and anticipated the system would be in place by March 31, 2011.

During our current audit, we determined that Veterans Affairs still has not fully addressed this finding. Specifically, Veterans Affairs indicated that the weekly reporting of information to the VA and the automation of most of the reporting requirements did not occur until July 2011. This included the automatic reporting to the VA of the repayment plan agreements, bankruptcies, and loss mitigation letters. Further, according to the property agent, Veterans Affairs is still testing the automatic reporting of compromise sales and it is manually reporting these events to the VA until the testing is completed. However, Veterans Affairs indicated that it was able to complete its project to automate its reporting of credit bureau notifications to the VA during fiscal year 2010–11. As such, we selected 24 delinquent loans it reported to the credit bureaus during fiscal year 2010–11 to determine whether Veterans Affairs appropriately notified the VA. Our review found that Veterans Affairs failed to report seven of these delinquent loans to the VA and reported another 11 of them between one and five days after the reporting deadline. According to Veterans Affairs, it failed to report the seven delinquent loans because of an undetected interruption in reporting during the automation of other processes, which it has now corrected.

We recommend that Veterans Affairs complete its automation project and, once the system is fully in place, ensure that the system allows it to report all required events to the VA by the applicable deadlines. In its most recent corrective action plan Veterans Affairs stated that it is continuing with the development of an automated system that should help it meet VA reporting requirements. It also indicated that the seven delinquent loans it did not report to the VA was a one-time event, which was subsequently corrected and normal reporting was resumed.

### **Veterans Affairs Took Steps to Correct Three Findings Reported for Fiscal Year 2009–10**

During our current audit, we determined that Veterans Affairs had fully corrected three findings related to the construction program that we reported for fiscal year 2009–10. Specifically, it updated and instituted new policies and procedures to address the prior year's findings. Table 9 presents the corrected findings and a reference to each finding description as it was reported in the State Auditor's Office annual report titled *State of California: Internal Control and State and Federal Compliance Audit Report for the Fiscal Year Ended June 30, 2010* (report number 2010-002, dated March 2011).

**Table 9**  
**Findings Reported for Fiscal Year 2009–10 That the California Department of Veterans Affairs Has Fully Corrected**

FEDERAL PROGRAM TITLE	FEDERAL CATALOG NUMBER	CATEGORY OF FINDING	REPORT 2010-002, ISSUED MARCH 2011: REFERENCE NUMBER/PAGE NUMBER	RECEIVED RECOVERY ACT FUNDS DURING FISCAL YEAR		
				2008-09	2009-10	2010-11
Grants to States for Construction of State Home Facilities	64.005	Activities Allowed/ Allowable Costs, Matching, Suspension and Debarment	2010-1-4/page 111	No	No	No
Grants to States for Construction of State Home Facilities	64.005	Davis-Bacon Act	2010-4-1/page 113	No	No	Yes
Grants to States for Construction of State Home Facilities	64.005	Reporting	2010-12-3/page 115	No	No	Yes

Source: California State Auditor’s Office analysis of corrective action taken by the California Department of Veterans Affairs on prior-year findings.

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

Respectfully submitted,



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 State Auditor

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

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