



May 13, 2009

Mark B. Horton, M.D., M.S.P.H., Director
California Department of Public Health
1615 Capitol Avenue, MS 0500
P.O. Box 997377
Sacramento, CA 95899-7377

Dear Dr. Horton:

Final Report—California Department of Public Health, Safe Drinking Water State Revolving Fund, Compliance Audit

The Department of Finance, Office of State Audits and Evaluations (Finance), has completed its federal compliance audit of the California Department of Public Health's (Department) Safe Drinking Water State Revolving Fund for the fiscal year ended June 30, 2008.

The enclosed report is for your information and use. The Department's response to the report findings are incorporated into this final report. The Department agreed with our observations and we appreciate its willingness to implement corrective actions. The observations in our report are intended to assist management in improving the effectiveness and efficiency of its operations.

In accordance with Finance's policy of increased transparency, both reports will be placed on our website.

A separate financial audit report dated January 30, 2009 was previously issued. The financial audit report and federal compliance report together will meet the Department's reporting requirements.

We appreciate the assistance and cooperation of the Department. If you have any questions regarding this report, please contact Richard R. Sierra, Assistant Chief, or James Kong, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

David Botelho, Chief
Office of State Audits and Evaluations

Enclosure

cc: On following page

cc: Dr. Bonita Sorensen, Chief Deputy Director of Policy and Programs, California Department of Public Health
Mr. Steve Kessler, Chief Deputy Director, Operations, California Department of Public Health
Mr. Jose Ortiz, Deputy Director – Administration, California Department of Public Health
Ms. Norma Tucker, Chief, Accounting Section, California Department of Public Health
Mr. Rufus Howell, Division Chief, Drinking Water & Environmental Management, California Department of Public Health
Mr. Gary Yamamoto, Division Chief, Center for Environmental Health, California Department of Public Health
Ms. Leah G. Walker, Chief, Drinking Water Technical Programs Branch, California Department of Public Health
Ms. Addie Aguirre, Chief, Infrastructure Funding Administration Section, California Department of Public Health
Mr. David Whitsell, Chief of Internal Audits, California Department of Public Health
Ms. Karen Petruzzi, Audit Coordinator, California Department of Public Health
Ms. Julianne Talbot, CPA, State Controller's Office, Division of Accounting and Reporting

ACOMPLIANCE AUDIT

California Department of Public Health
Safe Drinking Water State Revolving Fund
For the Fiscal Year Ended
June 30, 2008

Prepared By:
Office of State Audits and Evaluations
Department of Finance

MEMBERS OF THE TEAM

Richard R. Sierra, CPA, CGFM
Manager

James Kong, CPA
Supervisor

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This report is also available on our website at <http://www.dof.ca.gov>

You can contact our office at:

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AUDITOR'S REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO THE FEDERAL PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

Mark B. Horton, M.D., M.S.P.H., Director
California Department of Public Health
1615 Capitol Avenue, MS 0500
P.O. Box 997377
Sacramento, CA 95899-7377

Compliance

We have audited the compliance of the California Department of Public Health's (Department) Safe Drinking Water State Revolving Fund with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to the capitalization grants for the Safe Drinking Water State Revolving Fund program for the year ended June 30, 2008. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of the Department's management. Our responsibility is to express an opinion on the Safe Drinking Water State Revolving Fund's compliance based on our audit.

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

In connection with our audit, there are certain disclosures required by *Government Auditing Standards*. Finance is not independent of the audited entity, as both are part of the State of California's Executive Branch. As required by various statutes within the California Government Code, Finance performs certain management and accounting functions. These activities impair independence. However, sufficient safeguards exist for readers of this report to rely on the information contained herein.

As described in item 08-01 in the accompanying *Findings and Recommendations*, the Department did not comply with requirement regarding Cash Management applicable to the Safe Drinking Water State Revolving Fund. Compliance with such requirements is necessary, in our opinion, for the Department to comply with the requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, the Department complied, in all material respects, with the requirements referred to above that are applicable to its capitalization grants for the Safe Drinking Water State Revolving Fund program for the year ended June 30, 2008.

Internal Control Over Compliance

The management of the Department is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Department's internal control over compliance with requirements that could have a direct and material effect on its capitalization grants for the Safe Drinking Water State Revolving Fund program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the Department's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies.

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the Department's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the Department's internal control. We consider the deficiencies in internal control over compliance described in the accompanying *Findings and Recommendations* as item 08-02 to be a significant deficiency.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. We did not consider the deficiency described in item 08-02 in the accompanying schedule of findings and questioned costs to be a material weakness.

We did not audit the Department's response to the findings identified and, accordingly, we express no opinion on it.

We have audited the financial statements of the Department's Safe Drinking Water State Revolving Fund as of and for the year ended June 30, 2008, and have issued our report thereon dated January 30, 2009 under separate cover. Our audit was performed for the purpose of forming our opinion on the Safe Drinking Water State Revolving Fund financial statements.

They do not purport to, and do not present the financial position of the State of California as of June 30, 2008, or the changes in its financial position or its cash flows. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

This report is intended solely for the information and use of Department management, those charged with governance, federal awarding agencies, and pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Original signed by:

David Botelho, CPA
Chief, Office of State Audits and Evaluations

April 6, 2009

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Summary of Auditor's Results

Financial Statements (refer to the separately issued Safe Drinking Water State Revolving Fund financial audit report dated January 30, 2009)

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

Federal Award

Internal control over the program:	
Material weaknesses identified?	No
Significant deficiencies identified that are not considered to be material weaknesses?	Yes
Type of report the auditor issued on compliance for the program	Qualified
Any audit findings disclosed that are required to be reported in accordance with Section .510(a) of OMB Circular A-133?	Yes
Auditee qualified as low-risk auditee?	No

Identification of the program:

CFDA Number	Name of Federal Program
66.468	Capitalization Grants for Safe Drinking Water State Revolving Fund

Financial Statement Findings

One finding was noted. Refer to the *Finding and Recommendations* section of the Safe Drinking Water State Revolving Fund financial audit report dated January 30, 2009.

Federal Award Findings and Questioned Costs

There were two findings related to the Safe Drinking Water State Revolving Fund. There were no questioned costs.

FINDINGS AND RECOMMENDATIONS

REFERENCE NO.	08-01
FINDING CATEGORY:	Cash Management
CONDITION:	<p>The Department did not always minimize the time of the drawdown of federal funds and their disbursements. A federal loan disbursement of \$15,228,694 to the Los Angeles Department of Water was pending as of June 30, 2007. Subsequent to the state's fiscal year-end, the State Controller's Office denied payment on July 11, 2007 due to insufficient information to evaluate the allowability of the claim. The claim was eventually paid on August 27, 2007, which resulted in the federal funds being held in the state account for 55 days. As this disbursement was accrued in 2006-07, it does not affect the 2007-08 federal expenditures</p>
CRITERIA:	<p>Title 31—Money and Finance: Treasury, Part 205—Rules and Procedures for Efficient Federal-State Funds Transfers, Subpart B—Rules Applicable to Federal Assistance Programs Not Included in a Treasury-State Agreement, Section 205.33—How Are Fund Transfers Processed?</p> <ul style="list-style-type: none">• A state must minimize the time between the drawdown of Federal funds from the Federal government and their disbursement for Federal program purposes. A Federal Program Agency must limit a funds transfer to a state to the minimum amounts needed by the state and must time the disbursement to be in accord with the actual, immediate cash requirements of the state in carrying out a Federal assistance program or project. The timing and amount of funds transfers must be as close as is administratively feasible to a state's actual cash outlay for direct program costs and the proportionate share of any allowable indirect costs. States should exercise sound cash management in fund transfers to subgrantees in accordance with OMB Circular A-102 (For availability, see 5 CFR 1310.3.).
QUESTIONED COSTS:	Not applicable.
RECOMMENDATION:	<p>To minimize returned claims, the Department should reassess its claim scheduling policies and procedures to ensure all required documentation is properly authorized and provided to the State Controller's Office and, in the event claims are denied, to resolve the matter timely.</p>

REFERENCE NO.	08-02
FINDING CATEGORY:	Reporting
CONDITION:	<p>The Department does not have adequate processes and procedures in place to ensure that all Safe Drinking Water State Revolving Fund federal financial reports are accurate.</p> <ul style="list-style-type: none"> • There were eight federal capitalization grants that required a Federal Financial Status Report (SF-269) to be submitted as of June 30, 2008. Of the eight, three Financial Status Reports contained state match amounts based on estimations instead of the actual match provided. • The SF-272 and SF-272A Federal Cash Transactions Reports for the period January 1, 2007 to December 31, 2007 contained an incorrect net disbursements total due to a mathematical error. This error resulted in the underreporting of current period net disbursements by \$7,084,150.
CRITERIA:	<p>Title 40—Protection of Environment - Chapter I—Environmental Protection Agency - Part 31—Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments, Section 31.20, Standards for financial management systems</p> <ul style="list-style-type: none"> • A State must expend and account for grant funds in accordance with state laws and procedures for expending and accounting for its own funds. Fiscal controls and accounting procedures of the state, as well as its subgrantees and cost-type contractors, must be sufficient to: <ul style="list-style-type: none"> ○ Permit preparation of reports required by this part and the statutes authorizing the grant, and ○ Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes. <p>Sections 13401 and 13403 of the California Government Code, and Section 20050 of the State Administrative Manual require each state agency to maintain effective systems of internal accounting and administrative controls. Such controls include procedures that ensure the preparation of accurate and reliable financial reports.</p>
QUESTIONED COSTS:	Not applicable.
RECOMMENDATION:	The Department should enhance its policies and procedures to ensure the Federal Financial Status Reports and Cash Transactions Reports are accurately prepared and reviewed.

SCHEDULE OF EXPENDITURES OF
FEDERAL AWARDS

California Department of Public Health
Safe Drinking Water State Revolving Fund
Year Ended June 30, 2008

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Federal Expenditures</u>
U.S. Environmental Protection Agency:		
Capitalization Grants for Safe Drinking Water State Revolving Fund	66.468	\$37,712,612

The accompanying notes are an integral part of this schedule.

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

California Department of Public Health Safe Drinking Water State Revolving Fund Year Ended June 30, 2008

NOTE 1 Basis of Presentation

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

NOTE 2 Loans to Subrecipients

Of the federal expenditures presented in the schedule, the Department disbursed \$24 million in loan proceeds to subrecipients in the current year.

NOTE 3 Set Aside Expenses

The following schedule of set-aside expenses is included in total federal expenditures at June 30, 2008.

	Administration Account	Water System Reliability Account	Small System Technical Assistance Account	Public Water System, Safe Drinking Water Revolving Fund	Total
Salaries and Benefits	\$2,328,690	\$ 785,131	\$1,305,056	\$645,928	\$5,064,805
Other Expenses	2,145,492	2,339,232	627,582	255,874	5,368,180
Totals	<u>\$4,474,182</u>	<u>\$3,124,363</u>	<u>\$1,932,638</u>	<u>\$901,802</u>	<u>\$10,432,985</u>

DEPARTMENT'S RESPONSE



MARK B HORTON, MD, MSPH
Director

State of California—Health and Human Services Agency
California Department of Public Health



ARNOLD SCHWARZENEGGER
Governor

APR 27 2009

David Botelho, Chief
Department of Finance
Office of Audits and Evaluations
300 Capitol Mall, Suite 801
Sacramento, CA 95814

Dear Mr. Botelho:

The California Department of Public Health (CDPH) has prepared its response to the California Department of Finance draft report entitled, "Draft Audit Report: California Department of Public Health, Safe Drinking Water State Revolving Fund, Compliance Audit." The CDPH appreciates the opportunity to provide the Department of Finance with responses to the draft report.

Please contact Rufus Howell, Deputy Director, Center for Environmental Health, at (916) 445-0275, should you have any questions.

Sincerely,

Original signed by:

Mark B Horton, MD, MSPH
Director

Enclosure

cc: Rufus Howell
Deputy Director
Center for Environmental Health
MS 0511
P.O. Box 997377
Sacramento, CA 95899-7377

Reference No. 08-01

Department's Response:

We concur with this finding. The Accounting Section will meet with the SCO to discuss the time frames for receiving back claim cut invoices. If Accounting receives claim cut invoices back promptly from the SCO, we will be able to reschedule the claim cut invoices to minimize the time between the drawdown of federal funds and their disbursement. It takes approximately 30 days to get a denied payment (claim cut) invoice back from the SCO. This time frame could be longer at fiscal year-end each year due to the high volume of claims the SCO is processing. We reviewed our invoice processing procedures in November 2008 and worked with payables staff to ensure each person is aware of what a complete payment package is for the State Controller's Office (SCO). We provided each payable staff member with a Desk Manual with written procedures that stress the importance of providing the SCO with complete and properly authorized documentation for all claim schedules. Accounting will also reiterate to the payable staff the importance of assembling, approving and submitting claim schedules to SCO within a short time frame to minimize the time between the draw and disbursement of federal funds.

Reference No. 08-02

Department's Response:

We concur with this finding that the Department completed Financial Status Reports (FSR SF-269) with an estimation of state match instead of the actual state match. Accounting staff will undergo training on preparing the Financial Status Report (FSR) for the State Revolving Fund program to be submitted to United States Environmental Protection Agency (US EPA). Accounting staff will receive training from SRF Program staff on calculating the state match amounts accurately instead of using estimates. SRF Program staff will also be trained on reviewing the FSR for accurate reporting of expenditures and on reviewing the backup documentation used to prepare the FSR SF-269. SRF Program staff will also write procedures on properly preparing and reviewing the FSR and stress the importance of submitting accurate reports to the US EPA.

We concur that the Department had inaccurate SF-272 and SF272A Federal Cash Transaction Reports. Recognizing the importance of accurate Federal reporting, we implemented an enhanced review and approval process for Federal reporting in July 2008. We will continue to subject the SF-272 and SF-272A Federal Cash Transactions Reports to our enhanced review and approval process.