CALIFORNIA DEPARTMENT OF CORRECTIONS AND REHABILITATION

Audit Report

ADMINISTRATIVE AND INTERNAL ACCOUNTING CONTROLS OVER THE OFFICE REVOLVING FUND

July 1, 2009, through July 31, 2010

JOHN CHIANG
California State Controller

July 2011

JOHN CHIANG
California State Controller

July 20, 2011

Matthew Cate, Secretary
California Department of Corrections and Rehabilitation
1515 S Street
Sacramento, CA 95814

Dear Mr. Cate:

This report presents the results of the State Controller's Office (SCO) audit of the California Department of Corrections and Rehabilitation's (CDCR) administrative and accounting controls over its office revolving fund (ORF) for the period of July 1, 2009, through July 31, 2010.

We conducted our review pursuant to Government Code sections 12410 and 12418. Government Code section 12410 stipulates that the State Controller shall audit disbursements from the state treasury to ensure legality and propriety of payments. Government Code section 12418 stipulates that the State Controller shall direct and superintend the collection of money due the State.

Our audit found the CDCR effort to collect overpayments of salary and travel advances from employees to be grossly inadequate. In addition, as a result of severe internal control deficiencies, there is a high potential for fraud and misappropriation of public funds. Our audit also disclosed insufficient ORF policies and procedures, inadequate effort to discharge long-outstanding receivables from accountability, and inappropriate use of the ORF to pay for other program expenses.

We are encouraged by your department's response acknowledging the issues identified in our report and stating that you have already begun action to implement the audit recommendations. We are particularly pleased to note that you have fully implemented 22 of the 36 recommendations and have initiated a vigorous effort to collect outstanding debts.

Your response indicated that your department is preparing a six-month corrective action plan. We would appreciate receiving a copy of the plan upon completion. In addition, please be advised that we intend to conduct a follow-up review in approximately 12 months to assess the progress.

If you have any questions, please call Andrew Finlayson, Chief, State Agency Audits Bureau, at (916) 324-6310 or e-mail him at afinlayson@sco.ca.gov.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

JVB:wm

cc: Martin Hoshino, Undersecretary
Administration & Offender Services
California Department of Corrections and Rehabilitation
Scott Carney, Director, Administrative Services
California Department of Corrections and Rehabilitation
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California Department of Corrections and Rehabilitation

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Audit Report

Summary

The State Controller's Office (SCO) audited the California Department of Corrections and Rehabilitation's administrative and internal accounting controls over its office revolving fund (ORF) for the period of July 1, 2009, through July 31, 2010.

Our audit found serious internal control deficiencies over the department's system of internal controls and procedures for processing ORF transactions. These deficiencies could lead to waste, fraud, and misappropriation of funds. Specifically, we identified the following concerns:

- Inadequate collection efforts resulted in delayed collection of millions of dollars in receivables from employee salary and travel advances.
- The department has serious internal control deficiencies relate to ORF transactions that could lead to fraud, abuse, and misappropriation of funds.
- Invalid receivables related to salary advances and travel advances were not adjusted in a timely manner.
- The department does not have sufficient written policies and procedures for using the ORF.
- Discharges from accountability were not filed, and discharges were made internally without proper authority.
- The department used the ORF to pay for other program expenses.

The severity of internal control deficiencies identified in this audit raises concerns about the adequacy of administrative and internal accounting controls in other aspects of the department's fiscal operations.

Audit Authority

Under Government Code section 12418, the State Controller is to direct and superintend the collection of all money due the State. In addition, Government Code section 12410 stipulates that the State Controller shall audit all claims against the State, and may audit the disbursement of any State money for correctness and legality and for sufficient provision of law for payment.

Background

The mission of the California Department of Corrections and Rehabilitation is to enhance public safety through safe and secure incarceration of offenders, effective parole supervision, and rehabilitative strategies to successfully reintegrate offenders into California communities. The department currently operates 33 adult correctional institutions, 5 juvenile facilities, 47 juvenile and adult conservation/fire camps, and 13 adult community correction facilities in California, housing approximately 168,000 adult offenders and approximately 1,200 juvenile offenders. Furthermore, the department manages 187 parole offices and sub-offices located throughout the State, and oversees six out-of-state correctional facilities.

<u>Overview of the Department's Office Revolving Fund</u>

In accordance with Government Code section 16400, an agency may establish an office revolving fund (ORF) from any appropriation made to it subject to the following limitations:

- No approval is required if the revolving fund will not exceed 3% of the total appropriation.
- Approval of the Department of Finance budget analyst is required if the revolving fund will exceed 3% but not 10% of the total appropriation.
- Approval of the Department of Finance Program Budget Manager and the SCO is required if the ORF will exceed 10% of the appropriation.

In accordance with law, ORFs drawn under the provisions of Government Code section 16400 may be used only for payment of compensation earned, traveling expenses, traveling expense advances, or where immediate payment is otherwise necessary (Government Code section 16401).

The department's ORF had appropriations of $55,150,109 as of June 30, 2010.

The accounting function of the ORF is decentralized to eight locations of seven regional accounting offices (RAO) and a Sacramento accounting office as follows:

Sacramento Accounting Office
Bakersfield RAO
Central Coast RAO
Corcoran RAO
Central Valley RAO
El Centro RAO
Juvenile Justice North RAO
Southern California RAO

Personnel functions, including authorizations and collections of salary advances, are also decentralized to the locations of institutions/facilities/offices (collectively referred to in this report as "institutions"). Each RAO is designated with a number of institutions for which to perform fiscal and administrative functions.

In November 2008, the department implemented SAP (Systems, Applications, and Products in Data Processing), an enterprise application software. The recording of salary advances and vendor payments related to the ORF is in SAP, while travel advances are posted in the CalSTARS accounting system and subsequently transferred to SAP.

Objectives, Scope, and Methodology

The audit was performed in accordance with generally accepted government auditing standards. These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and recommendations. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The objectives of the audit were to determine whether the department has administrative and internal accounting controls in place to ensure that:

- Sufficient written policies and procedures exist for properly administering and controlling the ORF;
- ORF regulations, policies, and guidelines are properly followed;
- The amount advanced to the ORF does not exceed authorized amounts;
- The ORF is used for authorized purposes only;
- The ORF receivables are collected in a timely manner;
- Collection effort is adequate and supported by appropriate documentation;
- Claims for reimbursement of the ORF are processed in a timely manner and are supported by appropriate documentation;
- ORF receipts are deposited in a timely and economical manner;
- Monthly reconciliations are performed accurately and in a timely manner; and
- Discharge of accountability is performed in a timely manner on stale and uncollectable ORF items.

The scope of our audit included a review of government and departmental policies, processes, procedures, and practices relative to its general office revolving fund for the period of July 1, 2009, through July 31, 2010. We did not audit the financial statements of the California Department of Corrections and Rehabilitation. We did not review the department's practices and procedures relative to its petty cash accounts, permanent advances related to postage, or the inmate welfare fund, as the amounts involved do not appear to be material.

We performed the following procedures:

- Reviewed pertinent statutes, regulations, and written policies and procedures as they relate to the ORF.
- Reviewed and analyzed relevant audit reports issued by the department's Internal Audits Office, including a report on the ORF and a Financial Integrity and State Managers Accountability Act (FISMA) report.

- Documented a description of the internal controls over the ORF using an internal control questionnaire, walk-through, and flowcharting of the various ORF processes.
- Reviewed and analyzed aging reports of the department's outstanding ORF transactions.
- Interviewed responsible officials at all locations via in-person conversations or through written questionnaires.
- Performed tests of transactions for the period of July 1, 2009, through July 31, 2010, to ensure that advances to the ORF were properly administered, the fund was used for authorized purposes only, accountability was maintained, the fund was reimbursed in a timely manner, and reimbursement claims were properly supported.
- Selected a sample of outstanding travel receivables from each of eight accounting offices to determine if the travel advances were collected in accordance with the State Administrative Manual (SAM).
- Selected seven personnel offices and chose a sample from the ORF salary advance outstanding receivable report for each of the seven offices to determine compliance with relevant policies and procedures for salary advance receivables.
- Selected a sample of ORF disbursements from each of the eight accounting offices to determine if the ORF was used for permissible purposes, and if the ORF was replenished in a timely manner.
- Selected a sample from the outstanding vendor payment receivables to determine if the ORF was used for permissible purposes.
- Reviewed the deposits by several accounting offices to determine if deposits were made in a timely manner.
- Reviewed bank reconciliations and accountability reconciliations to determine if the reconciliations were performed accurately and in a timely manner.

Conclusion

Our audit disclosed that the California Department of Corrections and Rehabilitation does not ensure that outstanding office revolving fund amounts are recorded, collected, and processed accurately and in a timely manner. Additionally, the department lacks proper internal controls in the areas of coordination between offices, written policies and procedures, discharges from accountability, check approvals, maintenance of supporting documentation, permissible use, and monthly reconciliations.

Views of Responsible Officials

We issued a draft report on June 10, 2011. Martin Hoshino, Undersecretary, Administration & Offender Services, responded by letter dated July 5, 2011 (Attachment). Mr. Hoshino stated that the department agrees with the audit recommendations..

Restricted Use

This report is solely for the information and use of the California Department of Corrections and Rehabilitation and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record.

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

July 20, 2011

Findings and Recommendations

FINDING 1—
Inadequate collection efforts resulted in delayed collection of millions of dollars in receivables from employee salary and travel advances.

The department did not collect office revolving fund (ORF) receivables in a timely manner. As almost all ORF receivables consist of employee/former employee salary and travel advances, there should be a minimal amount of ORF receivables outstanding. According to a report generated by the department's accounting office, it had a total of $6,195,027 in outstanding receivables related to salary advances and travel advances as of June 30, 2010. Using this data, the SCO generated an aging report (Appendix) and found that $4,062,009 (65.6%) of the total $6,195,027 was outstanding for longer than 60 days. Of this amount, $465,029 (7.5%) had been outstanding for more than three years. Generally, the prospect of collection diminishes as an account ages. When an agency is unable to collect after three years, the possibility of collection is remote.

For salary advance receivables testing, we selected seven personnel offices and chose a sample from the ORF salary advance outstanding receivable report for each of the seven offices. For travel advance receivables testing, we selected one sample from the ORF travel advance outstanding receivables report for each of the seven regional accounting offices and the Sacramento Accounting Office. All 15 sites reported outstanding ORF transactions/receivables that have not been cleared or collected within 60 days. An ORF Receivable Aging Schedule prepared by the SCO (Appendix A) disclosed the age of receivables for each location in categories of 0 to 60 days, 61 days to three years, and more than three years. For salary advances, the Headquarters Office of Personnel Services (OPS), the California Institution for Men, and the California Correctional Center reported the largest amounts of ORF receivables more than 60 days old. For travel advances, the Sacramento Accounting Office, Bakersfield Regional Accounting Office (RAO), and Corcoran RAO disclosed the largest amount of ORF receivables more than 60 days old.

Our review found that the department did not adhere to collection guidelines prescribed in the State Administrative Manual (SAM). The detailed results of our audit are stated below:

- At 4 of the 15 sites, we found instances in which an SCO payroll warrant was not withheld to offset with the correlated salary advance. Therefore, an employee received both a salary advance and an SCO warrant, and site staff failed to initiate collection efforts promptly.

  In one instance, an employee served by the Headquarters OPS was terminated on May 22, 2010. The former employee received a lump-sum check in the amount of $14,950 from the ORF to meet the required timeline. The Headquarters OPS did not instruct the RAO to withhold the SCO warrant, and the former employee received both a salary advance and an SCO warrant, resulting in an overpayment of $14,950. The collection process to recover the overpayment had not been initiated as of November 1, 2010.

- Of the 15 sites, 11 did not consistently deduct the amount of outstanding travel advances and salary advances from an employee's next regular payroll warrant when the employee was still employed with the department. When an overpayment occurred, a payroll deduction should have been performed to recover the receivables in a timely manner.

  In one instance, an employee served by Headquarters OPS was issued a salary advance in the amount of $8,311 on January 1, 2008, and an SCO payroll warrant in the same period. Although the employee continued working for the department, the department failed to recover the overpayment through payroll deduction as of November 1, 2010.

- Staff at 9 of the 15 sites did not consistently send the overpayment notification or three collection letters for overdue receivables, or did not send the letters in a timely manner. For example, a retiring employee was issued an SCO payroll warrant on December 19, 2008, for a lump-sum payment of $25,953. The employee claimed that the warrant was not received and, thus, a salary advance check in the amount of $25,953 was issued via ORF on January 16, 2009, resulting in a duplicate payment. As of November 1, 2010, no collection letters were sent to the former employee to recover the overpayment, even though the receivable in the amount of $25,953 had been recorded on the books for almost two years.

- Personnel office staff at 5 of the 15 sites did not consistently verify departing employees' outstanding travel advances and salary advances with RAO staff during the exit clearance process to ensure that any outstanding receivables were offset with the final salary warrant. Many of the outstanding receivables could have been recovered if the personnel office staff had verified the employees' outstanding receivable and offsetting with the final warrant.

  For example, on October 31, 2008, an employee from California Correctional Center was issued an incorrect amount on an SCO payroll warrant and an ORF salary advance as replacement in the amount of $4,500. Both the warrant and salary advance were released to the employee in error. The employee subsequently separated. The outstanding advance was not verified with accounting during the exit clearance. The employee's last payroll warrant was not withheld to offset the outstanding amount. The outstanding amount of $4,500 had not been collected as of November 1, 2010.

- Staff from six of the eight RAOs in the sample did not consistently send, or did not send in a timely manner, a periodic statement to notify employees who have travel advances but have not submitted a travel expense claim (TEC) to substantiate the travel expenses, and/or to return any unspent travel advance amounts.

  For example, an employee served by the Bakersfield RAO was issued a travel advance in the amount of $1,131 on December 31, 2009. A periodic statement requesting that the employee submit the TEC and/or return any unspent travel advance amounts was not sent to the employee during his employment at the site. The employee was later transferred to another site within the department. The department did not perform any collection effort, including sending out the periodic statement, as of the audit date of November 1, 2010, even though the receivable of $1,131 had been recorded on the books for almost a year.

We believe the following factors contributed to the conditions described above:

- There is a lack of coordination between the personnel offices and the respective RAOs. The collection and clearance of outstanding advances requires close coordination by the personnel offices and their designated RAOs. We observed that, in general, the entities lack a cohesive process, significantly delaying their ability to collect and clear outstanding advances in a timely manner.

  In one instance, the Southern California RAO sent a notification letter of overpayment to an employee who owed a travel advance; the employee did not respond. The Southern California RAO then sent three memos to the designated institution personnel office to perform a payroll deduction. The institution's personnel office did not intercept the employee warrant and perform a payroll deduction until the fourth request. In addition, several RAO staff members stated that the institution's personnel office is lagging in providing requested information. A copy of the initial collection letter is often not provided to the RAO, and the RAO is not able to proceed with subsequent collection letters, tax-offsets, and discharges.

- The roles and responsibilities of the RAOs, the Sacramento Accounting Office, and the OPS are not specific and well-defined for the collection function.

  For example, Sacramento OPS staff members are not sure who is responsible for the salary collection function for separated employees. In another example, a personal check to clear a travel advance was not deposited for five months because staff did not know whether the RAO or Sacramento Accounting Office should perform the deposit. The personal check was sent back and forth between the RAO and Sacramento Accounting Office prior to being deposited in the bank. The lack of clear roles and responsibilities for the RAO, the Sacramento Accounting Office, and OPS has resulted in confusion for employees and delays in the collection and recording processes.

- The department lacks adequate procedures to ensure collection of advances when an employee transfers from one unit to another. A department staff member stated that it is not uncommon for the personnel office to not follow up on salary advances when an employee has changed institutions or goes to another state agency.

For example, in 2008, a San Quentin employee who owed a salary advance in the amount of $5,486 transferred to the Plata Support group within the department. The personnel office at the Plata Support group was supposed to collect the advance. Personnel at the Plata Support group failed to collect the advance, and it remains uncollected as of the audit date of November 1, 2010, even though the employee still works at the department.

- The ORF collection process is highly decentralized, with little oversight and monitoring by the department's headquarters. Even though all ORF checks related to the general fund are drawn from the same appropriation account, the travel advance receivable collection is decentralized in each of the eight accounting offices and salary advance receivables collection is decentralized to each personnel office. Therefore, it is the ultimate responsibility of each accounting office or each personnel office to collect receivables. When the accounting office or personnel office fails to collect, there is no further oversight function to monitor the collection task.

- The ORF receivable reports produced by SAP for outstanding salary advances and travel advances are not accurate or user-friendly. The ORF receivable reports do not include the balance due amount for each debtor. To obtain the amount owed by each debtor, the user must make separate calculations of the advance amount against the repayment amount. In addition, RAO staff members stated that the ORF receivables reports were not sent to them from September 2009 to August 2010.

- The personnel offices often do not verify the information on the SAP receivable reports and provide feedback to the accounting offices to correct incorrect information.

  For example, when an employee switches sites within the department, the receivables reports might not reflect the accurate code for the responsible personnel office. The responsible personnel office's receivable report does not include the employee's outstanding receivable if the non-responsible personnel office where the receivable is included does not correct the code.

Government Code section 19838 requires reimbursement to the State of overpayments made to employees.

SAM section 8116.2 (Substantiation of Travel Expense for Temporary Travel Advances) states, in part, "A periodic statement must be sent no less frequently than bi-monthly (e.g. on February 1, April 1, June 1, August 1, October 1, and December 1) to notify employees who have travel advances but have not submitted a TEC to substantiate the travel expenses and/or have not returned any excess travel advance amount. . . ."

SAM section 8776.7 (Employee Accounts Receivable) states that departments must notify employees (in writing) of overpayments and provide them an opportunity to respond.

SAM section 8776.6 (Nonemployee Accounts Receivable, Collection Letters) states, “Once the address of the debtor is known, the accounting office will send a sequence of three collection letters at 30 day intervals. If a reply or payment is not received within 30 days after sending the first letter, the accounting office will send a second letter. This follow-up letter will reference the original request for payment letter and will be stated in a stronger tone. If a response is still not received from the debtor, a third letter will be sent 30 days later. This last letter will include references to prior letters and will state what further actions may be taken in the collection process.”

SAM section 8776.6 (Nonemployee Accounts Receivable) states that if the three collection letters are unsuccessful, departments must prepare an analysis to determine what additional collection efforts should be made.

SAM section 8580.4 (Employee Separations) states, “Salary warrants will not be distributed to separating employees until the department had verified that all travel and salary advances have been paid (cleared). The verification must be provided by office revolving fund staff.”

SAM section 8116.3 (Recovery of Temporary Travel Advances) states, “If an employee does not submit TECs to substantiate the travel expenses within 30 calendar days of the periodic statement date, the total travel advance amount must be deducted from the next regular payroll warrant(s).”

SAM section 8776.7 (Employee Accounts Receivable) states that “if the employee does not agree to repay an overpayment or does not respond to the written overpayment notification by the afforded time, departments will collect overpayments by installment through payroll deduction. . . .”

SAM section 20050 (Internal Control) states, in part, “State entity heads, by reason of their appointments, are accountable for activities carried out in their agencies. This responsibility includes the establishment and maintenance of internal accounting and administrative controls. Each system an entity maintains to regulate and guide operations should be documented through flowcharts, narratives, desk procedures, and organizational charts. The ultimate responsibility for good internal control rests with management.”

Recommendation

The department should comply with SAM requirements and ensure that its RAOs and personnel offices:

- Review their ORF receivables reports on a monthly basis and ensure that outstanding amounts are collected and cleared in a timely manner. Personnel offices and RAOs should include a status update on each outstanding receivable transaction.
- Ensure that periodic statements are sent out in a timely manner to notify employees who have travel advances but who have not submitted a travel expense claim that they must substantiate expenses.
- Develop a process by which to ensure that collection letters and overpayment notification letters are sent out in accordance with SAM sections 8776.6 and 8776.7.
- Develop procedures by which to ensure that written analyses are performed to determine what collection efforts will be made after the three collection letters are unsuccessful in recovering the receivables.
- Develop a process by which to ensure that salary and travel advances are cleared within 30 days by a TEC and that advances not cleared within 30 days are deducted from an employee's next payroll warrant in accordance with applicable bargaining unit agreements.
- Direct staff members to ensure that any outstanding employee advances are cleared during the exit clearance process, and if the advance is not cleared, to deduct the amount due from the final payroll warrant.
- Provide sufficient training to staff members to ensure that a request is sent to withhold SCO warrants so that employees/separating employees do not receive both an SCO warrant and an ORF salary advance.
- Develop a training program for SAP and provide training to staff.
- Develop a cohesive process for the accounting office and personnel offices to use for the collection function.
- Define roles and responsibilities regarding ORF for the accounting offices and institutions.
- Develop a process by which to ensure that, when employees change positions within the department, a notification of outstanding advances is sent to the correct office.
- Develop more useful and easier-to-understand ORF receivables reports, including monthly aging reports.
- Develop an oversight function for both the accounting offices and institutions to ensure proper follow-up of outstanding advances.
- Review outstanding ORF reports for accuracy and ensure that reports reconcile.

FINDING 2—
Serious internal control deficiencies related to ORF transactions could lead to fraud, abuse, and misappropriation of funds.

We found the department's internal controls over ORF transactions to be critically weak. The combined effect of the following control deficiencies raises serious concerns about whether such a system could be relied upon to deter and prevent fraud, abuse, and misappropriation of public funds.

- The system could not provide departmental management with current, accurate, and reliable data to effectively monitor the ORF transactions or the progress of collection efforts. We found no evidence that the departmental management had requested or used reports to monitor the ORF transactions. Even if they had, it is doubtful that the system could produce meaningful data on a timely basis, as evidenced by the following examples:

  - We requested a report of the outstanding vendor payment receivables file on July 16, 2010, and did not receive the correct file until more than four months later, on November 30, 2010. Department staff lacked proper training in generating reports from SAP.

  - The balance of receivables related to salary and travel advances varied from report to report. For example, in August 2010, the accounting staff produced reports showing $6,195,027 in receivables from salary and travel advances as of June 30, 2010. On November 11, 2010, the department prepared an ORF appropriation accountability reconciliation showing $9,501,171 in such receivables. On February 7, 2011, the accounting staff provided documentation indicating the total amount to be $8,244,977. It is questionable whether any of the above amounts are accurate, as later the staff found $1,167,300 in receivables related to travel advances that was recorded twice in SAP.

- The department has not prepared a proper bank reconciliation for its two ORF accounts, one related to salary advances and vendor payments (Account #158) and the other related to travel advances (Account #057), since the inception of SAP in November 2008. Bank reconciliation is a critical element of the internal control system, as it provides an independent check on the accuracy and completeness of recorded transactions and validates the actual amount of cash available. We reviewed the two main bank reconciliations related to the ORF and found that they were not prepared properly or in a timely manner. Specifically, we noted the following issues:

  - Department staff apparently made little effort to resolve reconciliation items identified by the SAP's bank reconciliation process for Account #158. The process is automated within SAP; it identifies reconciling items, such as errors and unposted items, in the bank balances and the book balances. Departmental staff was to review and investigate each reconciling item on a monthly basis and, when necessary, make adjustments to the department's records or take other appropriate actions. We found that, since the inception of SAP in November 2008, departmental staff has not devoted adequate effort to resolving the reconciling items. As of June 30, 2010, the unresolved reconciling items for the bank balance and the book balance have accumulated to a total of $27,332,382 and $31,289,854, respectively. We found that figures in the reconciliation were unsupported.

For example, the June 30, 2010 reconciliation reported a net deposit in transit of $14,955,000 and a net outstanding check of $56,322,738. Departmental staff could not provide documentation to support these two balances. With unresolved reconciling items of this magnitude, anyone who had access to ORF check stocks could have fraudulently issued checks with little likelihood of being detected.

- We found numerous discrepancies in the bank reconciliations for Account #057. For example, in each of the six monthly reconciliations we reviewed, we found that departmental staff could not fully reconcile the balances and had resorted to using an arbitrary amount (a plug-in figure) to reconcile the bank balances to the book balances. Over the six-month period, the figure ranged between $461,147 to negative $583,561 without any support or explanation. Other discrepancies noted include:

  - The balances in the bank reconciliations did not agree with the amounts in the department's accounting records. Rather than using the general ledger balances, the preparer maintained a separate schedule to substitute for the general ledger. Therefore, the pre-adjusted balances of general cash and revolving fund cash on the bank reconciliation do not agree with balances in the department's accounting systems (CalSTARS). For example, the pre-adjusted balance of general cash was $7,090,640 as of June 30, 2010, on the bank reconciliation, but the general cash balance on CalSTARS G01 as of June 30, 2010, was $7,000,780, a variance of $89,860.

  - The supporting schedule for a reconciling item named "Deposit at Bank-Not on Books" did not agree with the amount on the bank reconciliation. The bank reconciliation reported $13,750,469, while the supporting schedule showed $14,966,355.

  - The department did not maintain supporting schedules or supporting documents for most of the reconciling items. Reconciling items were not resolved in a timely manner; some were dated 2009. Some items on the supporting schedule for the reconciling items contained no explanation as to why they were included.

  - Some transactions were not posted, while others were posted twice. In addition, there were considerable delays in the posting of certain transactions. For example, a transfer of $15,000,000 from Account #057 to Account #158 occurred on September 3, 2009, but the transaction was not recorded until July 2010. There is no written procedure to instruct users where to record the transaction prior to implementation of SAP.

- The required monthly reconciliations were not prepared in a timely manner and completed with preparer and reviewer signatures.
  - The bank reconciliation on Account #158 for the month ended June 30, 2010, was prepared on September 3, 2010, two months late.
  - The bank reconciliation on Account #057 for the month ended June 30, 2010, was not dated.
  - There was no evidence that reconciliations were reviewed and approved by a reviewer to ensure that they were properly and accurately prepared. In light of the discrepancies noted above, it would be difficult for any reviewer to conclude that these reconciliations were properly prepared.

The department is required by SAM section 8193 to reconcile its ORF appropriation on a monthly basis. The department had not prepared the appropriation accountability reconciliation of $55,150,109 to properly account for the ORF authorized appropriation since the implementation of SAP in November 2008. Finally, in November 2010, at our request, the department prepared a reconciliation for the month ended June 30, 2010. According to the department staff, the two-year delay in the reconciliation was caused by the transition from CalSTARS to the SAP system.

The following table is the appropriation accountability reconciliation prepared by the department for the month ended June 30, 2010:

Revolving Fund Cash	$ 21,387,129
Cash on Hand in Agency	417,197
Due From Other Funds/Appropriations (pending ORF replenishments)	22,171,284
Expense Advances (permanent advances)	1,673,329
Travel Advances	2,058,910
Salary Advances	7,442,261
Total Appropriations	$ 55,150,110

Our review of the above reconciliation found it to be inaccurate, unreliable, and unsupported by factual data. Specifically, we found the following discrepancies:

- The revolving fund cash of $21,387,129 did not include cash in Account #057 and in other old bank accounts.

- The Due From Other Funds/Appropriations in the amount of $22,171,284 was not supported by a detailed schedule. According to management, the department is working to clear some old pending ORF replenishments.

- The Travel Advances balance of $2,058,910 was overstated by $1,167,300. The overstatement was due to the old travel advances being recorded twice in SAP during the consolidation of organization codes.

- The Salary Advances Receivable of $7,442,261 on the reconciliation should be $7,445,261, according to the supporting schedule.

- In our testing of the disbursement file, we observed that two of five ORF checks that exceeded $15,000 and required two signatures did not have dual signatures. SAM section 8041 requires two signatures for additional approval on checks drawn in excess of $15,000.

- Documentation to substantiate ORF payments was inadequate. At 9 of the 15 sites, departmental staff could not provide all requested documents to support the ORF payments. Without adequate supporting documentation, we were not able to determine if such transactions were legitimately processed in accordance with ORF guidelines. Examples include:

    - From the outstanding vendor receivables file that contained vendor payments made through ORF that had not yet been reimbursed, we judgmentally selected and requested supporting documents for 25 payments that appeared to be unusual or had been outstanding for a prolonged period. In 13 of the 25 cases, representing $190,215 in payments, departmental staff could not produce the supporting documents such as the ORF requests and the vendors' invoices. Without these documents, we were unable to determine whether these payments constitute legitimate use of the ORF. Moreover, without the vendors' invoices, the department has no means by which to file a claim schedule with the SCO to seek reimbursement to the ORF for those payments.

    - From the disbursement files that contain vendor payments, we judgmentally selected 43 payments for review. Departmental staff could not provide supporting invoices for six of the payments totaling $23,992.

    - The department was not complying with its own internal procedures. The SCO paycheck calculator to compute the amount of salary advance amount was not retained as required by the department's Personnel Services Operations Manual for all personnel offices. In addition, contrary to department procedures, the signed "Authorization for Prepayment of Payroll Revolving Fund/Hardship Salary Advance" was not consistently retained. This form authorizes the department to withhold payroll to pre-pay overpayments.

SAM section 20050 specifies that the elements of a satisfactory system of internal accounting and administrative controls shall include, but are not limited to, a system of authorization to provide effective accounting control over assets, liabilities, revenues, and expenditures.

SAM section 20050 (Internal Control) states, in part, that "State entity heads, by reason of their appointments, are accountable for activities carried out in their agencies. This responsibility includes the establishment and maintenance of internal accounting and administrative controls. Each system an entity maintains to regulate and guide operations should be documented through flowcharts, narratives, desk procedures, and organizational charts. The ultimate responsibility for good internal control rests with management."

SAM section 8193 (Reconciliations) states, "Two monthly reconciliations are required for revolving fund transactions. (See SAM Section 7920 [Types of Reconciliations].) The Revolving Fund Cash Book balance plus the general ledger balance of Account No. 1110, General Cash, and Account No. 1120, Agency Trust Fund Cash, will be reconciled to the General Checking Account in the centralized State Treasury System. Also, the revolving fund resources will be reconciled with the amount of cash advanced as shown in Account No. 1130 of the funds concerned."

SAM section 7923 (Bank Reconciliation) states, "The person reconciling the bank statement will trace every reconciling item between the bank and the agency's records and include an explanation [of each item] on the reconciliation."

SAM section 7901 (Reconciliations–General) states, "The accuracy of an agency's accounting records may be proved partially by making certain reconciliations and verifications. . . . Corrections to errors should be made before financial reports are prepared to partially ensure the accuracy of an agency's financial reports. Properly prepared reconciliations also help to audit the agency's accounting records.

SAM section 7901 (Reconciliations–General) requires that "All reconciliations be prepared monthly within 30 days of the preceding month. . . ."

SAM section 7908 (Signatures Required on Reconciliation) states that all reconciliations must show the preparer's name, date prepared, and date reviewed.

SAM section 8041 (Checks) states that "Any check drawn in excess of $15,000 will require two authorized signatures. . . ."

The Department of General Services' General Records Retention Guidelines state that the receivable source documents (e.g., invoices) and documents of collection efforts should be retained for at least four years after the receivable has been paid.

The salary advance section of the department's Personnel Services Operations Manual states that any employee being issued a salary advance must sign the "Authorization for Repayment of Payroll Revolving Fund/Hardship Salary Advance." It further states that a copy of the paycheck calculator is printed and used to complete the salary advance request form 1004 once the paycheck calculator has been correctly completed.

Recommendation

The department should:

- Define roles and responsibilities regarding the ORF for the accounting offices and institutions.
- Review outstanding ORF reports for accuracy and ensure that reports reconcile.
- Develop an internal control to ensure that duplicate data cannot be posted in SAP.
- Develop a training program for SAP and provide training to staff.
- Develop an effective bank reconciliation method that reconciles the book balance to the bank balance in order to ensure the accuracy of the ORF cash book balance.
- Review and resolve the stale reconciling items and develop a new process by which to ensure that reconciling items are resolved in a timely manner.
- Ensure that reconciliations are prepared within 30 days and that the reconciliations are reviewed and signed off on by appropriate managers.
- Ensure that ORF request forms are properly authorized and that there are two authorized signatures for checks exceeding $15,000.
- Develop procedures to ensure that the accounting offices retain accounts receivable source documents and documentation of collection efforts for at least four years after the receivable has been paid.
- Ensure that the accounting offices retain the SCO paycheck calculator and that the “Authorization for Repayment of Payroll Revolving Fund/hardship Salary Advances” is signed by the employee and is retained.

FINDING 3—
Invalid receivables related to salary and travel advances were not adjusted in a timely manner.

The receivable balances included some items caused by procedural errors rather than actual overpayment. For example, an employee served by Headquarters OPS was issued a salary advance on April 21, 2010, in the amount of $4,506 due to incorrect pay on the warrant. Headquarters OPS had not sent Form 674 to the SCO to reissue a warrant and clear the outstanding amount of $4,506 as of November 1, 2010.

Another example concerns an employee at California State Prison, San Quentin who was issued a salary advance in the amount of $1,548 on January 28, 2009. The salary advance was collected on February 6, 2009; however, the collection was not posted by accounting as of November 1, 2010.

In short, the department's personnel and accounting staff failed to take timely action to correct the errors and adjust its records, which resulted in an overstatement of the receivables balances. The untimely clearing of receivables was a result of the departmental staff:

- Not requesting SCO warrants to be offset with salary advances;
- Not depositing warrant/personnel checks to clear overpayments;
- Not correcting PAR data;
- Not requesting stop payments on lost checks;
- Not clearing voided transactions by the accounting offices;
- Not correcting data in the ORF receivable aging report;
- Duplicate posting of the advance by the check writer or CalATERS conversion; and
- Not taking action in the garnishment stage.

SAM section 8776 states that the agencies must ensure that receivables are recorded promptly and accurately into the accounting system.

Recommendation

The department should perform the following functions in a timely manner to ensure the promptness and accuracy of its accounting records:

- Request SCO warrants to be offset with salary advances;
- Deposit warrant/personnel checks to clear overpayments;
- Correct PAR data;
- Request stop payments on lost checks;
- Clear voided transactions:
- Correct data in the ORF receivable aging report;
- Post the advance only once; and
- Take action in the garnishment stage.

FINDING 4—
The department does not have sufficient written policies and procedures for the ORF.

Formal SAP procedures have not been developed since the implementation of SAP in November 2008. The ORF unit developed its own written desk procedures at a low level specific to the processes of activities and transactions.

The department has department-wide salary advance procedures contained in sections 711 and 712 of the department's Personnel Services Operations Manual. However, the manual does not include the collection actions stated in SAM sections 8776.7 and 8776.6. More specifically, the manual does not state that the department will notify employees in writing of salary advance overpayments and provide them an opportunity to respond. In addition, the manual does not state the collection action for separated employees.

Sacramento OPS procedures state that an electronic log of salary advances is generated for management to monitor the outstanding salary advances. However, Sacramento OPS does not maintain the electronic log; therefore, Sacramento OPS is not following its own procedure. Maintaining the electronic log of salary advances would help management monitor the uncollected items and verify the accuracy of the aging report sent from the Sacramento Accounting Office.

SAM section 8776.6 (Nonemployee Accounts Receivable) states, "Each department will develop collection procedures that will assure prompt follow-up on receivables."

SAM section 8776.7 (Employee Accounts Receivable) states that departments will notify employees (in writing) of overpayments and provide them an opportunity to respond.

SAM section 8776.6 (Nonemployee Accounts Receivable, Collection Letters) states, "Once the address of the debtor is known, the accounting office will send a sequence of three collection letters at 30 day intervals."

SAM section 20050 (Internal Control) states, in part, that, "State entity heads, by reason of their appointments, are accountable for activities carried out in their agencies. This responsibility includes the establishment and maintenance of internal accounting and administrative controls. Each system an entity maintains to regulate and guide operations should be documented through flowcharts, narratives, desk procedures, and organizational charts. The ultimate responsibility for good internal control rests with management."

The Salary Advance Logs and Procedures provided by the Sacramento OPS states that a report for the most recent outstanding salary advances receivable and accounts receivable will be generated for management review.

Recommendation

The department should:

- Develop formal procedures for SAP to ensure that all SAM revolving fund and collection regulations are specified and enforced and provide appropriate training to staff on an ongoing basis.
- Update the Personnel Services Operations Manual to include the collection actions required by SAM sections 8776.6 and 8776.7.

FINDING 5—
Discharge from accountability was not filed and discharges were performed internally without proper authorization.

The department did not consistently file a request for discharge from accountability of uncollectable amounts due from private entities when all reasonable collection procedures did not result in payments. Failure to implement reasonable collection efforts precludes the department from discharging uncollectable receivables. The department is required by SAM to review the receivables no less than quarterly to identify receivables for discharge. The following table shows $465,030 in outstanding items older than three years that might have been discharged if reasonable collection efforts had been performed:

Accounting Office	Receivable More Than Three Years
Salary advances:	
HQ OPS (Acct. #065 and Acct. #061)	$ 70,592
California Institution for Men (Acct. #080)	114,868
California Correctional Center (Acct. #068)	16,797
California Medical Facility (Acct. #076)	7,338
Substance Abuse Treatment Facility (Acct. #587)	4,237
California State Prison, San Quentin (Acct. #095)	6,952
Deuel Vocational Institution (Acct. #106)	2,574
Others	192,151
Total salary advances	415,510
Travel advances:	
HQ Sacramento Accounting Office	836
Bakersfield Regional Accounting Office (RAO)	241
Corcoran RAO	36,037
El Centro RAO	496
Central Valley RAO	1,341
Central Coast RAO	6,825
Southern California RAO	—
JJ North RAO	3,744
Blank	—
Total travel advances	49,520
Combined salary advances and travel advances	$ 465,030

One departmental accounting office has a practice of discharging internally any ORF outstanding receivable that is less than $1,000 without filing the outstanding receivables with the SCO and the California Victim Compensation and Government Claims Board (VCGCB). The department provided the delegation from VCGCB; however, the delegation does not cover ORF travel advances and salary advances. Therefore, the department internally discharged ORF receivables without proper authority.

Government Code section 13940 states, "Any state agency or employee required to collect any state taxes, licenses, fees, or money owing to the state for any reason that is due and payable may be discharged by the board from accountability for the collection of taxes, licenses, fees, or money if the debt is uncollectible or the amount of the debt does not justify the cost of its collection."

Government Code section 13941 states, "The application for a discharge under this chapter shall be filed with the Controller. . . ."

SAM section 8776.6 states, in part, "If all reasonable collection procedures do not result in payment, departments may request discharge from accountability of uncollectable amounts due from private entities. Departments will review their accounts receivable no less than quarterly to identify receivables for discharge. If departments have identified receivables for discharge, departments will file an Application for Discharge from Accountability form, STD. 27, with the SCO, Division of Accounting and Reporting, no less than quarterly. . . ."

Recommendation

Departmental accounting offices should strictly follow SAM collection rules and submit uncollectible amounts to the SCO for discharge from accountability after all collection efforts have been performed.

FINDING 6—
The department used the ORF to make payment in excess of its appropriation.

After using the ORF to make payments, the department is to file a claim schedule with the SCO on at least a monthly basis to reimburse the ORF for the amount disbursed. We found that, as of November 30, 2010, the department still has not requested reimbursement for $3,502,788 in payments that were made prior to June 30, 2010. Further review disclosed that a majority of these payments were for Fiscal Year (FY) 2009-10 expenditures in which the department had already exhausted its appropriations. These payments—such as parolees' gate money—appear to be legitimate expenditures (the predetermined amount of money given to eligible inmates upon discharge from state prison). However, when its appropriation is exhausted, the department has no legal authority to make such payments. The department, in essence, circumvented appropriation control by using its ORF to make such payments.

The departmental accounting staff could not explain why it has not requested reimbursement for some payments for expenditures incurred prior to FY 2009-10. For example, according to its records, on October 13, 2008, the department issued a revolving fund check in the amount of $60,000 to the U.S. Postal Office. As of November 30, 2010, the department still has not filed a reimbursement claim and its staff could not provide explanation or documentation for not seeking reimbursement.

SAM section 8110 states that sufficient spending authority must exist for the related fiscal year of the revolving fund disbursement.

<u>Recommendation</u>

The department should monitor closely the budget in general fund and medical cost programs to ensure that sufficient funding is available prior to issuing disbursements from the ORF.

Appendix— Outstanding ORF Receivables Aging Report Salary Advances and Travel Advances

Accounting Office	Total Receivables	0 to 60 Days	61 Days to Three Years	More Than Three Years	0 to 60 Days	61 Days to Three Years	More Than Three Years
Salary advances:							
HQ OPS (Acct. #065 and Acct. #061	$ 1,022,077	$ 201,451	$ 750,033	$ 70,592	19.7%	73.4%	6.9%
California Institution for Men (Acct. #080)	323,511	41,466	167,178	114,868	12.8%	51.7%	35.5%
California Correctional Center (Acct. #068)	369,230	35,243	317,191	16,797	9.5%	85.9%	4.5%
California Medical Facility (Acct. #076)	251,135	135,780	108,017	7,338	54.1%	43.0%	2.9%
Substance Abuse Treatment Facility (Acct. #587)	219,216	101,707	113,273	4,237	46.4%	51.7%	1.9%
California State Prison, San Quentin (Acct. #095)	105,859	67,605	31,302	6,952	63.9%	29.6%	6.6%
Deuel Vocational Institution (Acct. #106)	118,855	16,082	100,198	2,574	13.5%	84.3%	2.2%
All others	2,993,781	1,148,476	1,653,154	192,151	38.4%	55.2%	6.4%
Total salary advances	5,403,664	1,747,809	3,240,346	415,509	32.3%	60.0%	7.7%
Travel advances:							
HQ Sacramento Accounting Office	474,073	273,083	200,154	836	57.6%	42.2%	0.2%
Bakersfield Regional Accounting Office (RAO)	78,346	15,580	62,526	241	19.9%	79.8%	0.3%
Corcoran RAO	69,147	12,058	21,052	36,037	17.4%	30.4%	52.1%
El Centro RAO	63,347	33,902	28,949	496	53.5%	45.7%	0.8%
Central Valley RAO	36,879	18,740	16,799	1,341	50.8%	45.6%	3.6%
Central Coast RAO	31,979	13,527	11,628	6,825	42.3%	36.4%	21.3%
Southern California RAO	27,230	16,546	10,684	—	60.8%	39.2%	0.0%
JJ North RAO	6,392	1,775	873	3,744	27.8%	13.7%	58.6%
Blank	3,970	—	3,970	—	0.0%	100.0%	0.0%
Total travel advances	791,363	385,210	356,634	49,520	48.7%	45.1%	6.3%
Combined salary advances and travel advances	$ 6,195,027	$ 2,133,019	$ 3,596,980	$ 465,029	34.4%	58.1%	7.5%

Source: Compiled from a report provided by the California Department of Corrections and Rehabilitation.

Attachment—
Department's Response to Draft Audit Report

STATE OF CALIFORNIA —DEPARTMENT OF CORRECTIONS AND REHABILITATION EDMUND G. BROWN JR., GOVERNOR

OFFICE OF THE SECRETARY
P.O. Box 942883
Sacramento, CA 94283-0001

July 5, 2011

Mr. Jeffrey V. Brownfield, Chief
California State Controller
Division of Audits
3301 C Street, Suite 700
Sacramento, CA 95816

Dear Mr. Brownfield:

The California Department of Corrections and Rehabilitation (CDCR) would like to thank the State Controller for his report entitled ***California Department of Corrections and Rehabilitation Audit Report Administrative and Internal Accounting Controls Over the Office Revolving Fund, July 1, 2009 through July 31, 2010.*** We agree with the recommendations set forth in this report. Indeed, our own internal audit of the revolving fund, launched late last year, identified many of the same issues and, together with these findings, has spurred us to take aggressive corrective action. The Department has already fully implemented 22 of the 36 recommendations set forth in this audit and is moving forward with implementing the remainder.

We have now prioritized the vigorous collection of outstanding debts by centralizing accountability and oversight. As a result of these efforts, the outstanding balance of advances has decreased by $2.2 million since November 1, 2010; nearly half of the samples cited in the audit where no collection had occurred have now been fully collected for a total of $199,275.93; and CDCR has decreased the number of advances distributed by over 300 each month. We will continue in our efforts until we have surmounted the issues identified in this audit.

Some examples of measures CDCR has already taken to establish and improve internal controls include, but are not limited to: regular conference calls among executive leadership on this issue; the reconciliation of all current revolving fund activity; the development of system and process changes to better account for revolving fund activities; technological upgrades that streamline the collection process; the development of a monitoring system to track benchmarks and progress; regular reviews of aging reports to track outstanding debts; and increased training and policy development to ensure timely collection. Through these efforts we have reached a point in our collection process where we are now collecting more advances then we are issuing each payroll period.

We would like to thank the State Controller for the guidance in improving our operations and will address the specific recommendations in the six-month corrective action plan. If you have further questions, please contact me at (916) 323-6001.

Sincerely,

MARTIN HOSHINO
Undersecretary, Administration & Offender Services

State Controller's Office
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