

ANNUAL REPORT TO THE FIRST 5 CALIFORNIA COMMISSION

RESULTS OF AUDIT OVERSIGHT OF LOCAL COMMISSIONS

For the Period of July 1, 2006, through June 30, 2007



JOHN CHIANG
California State Controller

October 2008



JOHN CHIANG
California State Controller

October 31, 2008

Kris Perry
Executive Director
First 5 California
2389 Gateway Oaks Drive, Suite 260
Sacramento, CA 95833

Dear Ms. Perry:

I am pleased to announce the completion of our annual report to the First 5 California Commission; the report summarizes the results of our oversight of the fiscal year 2006-07 audits for the local First 5 county commissions.

This report is the first submitted in accordance with the expanded audit statutes chaptered into law in 2005. Although we have no comparative statistics, we were able to establish benchmarks during our desk reviews of the 58 county commission audits. Our report summarizes the county commissions' compliance with the First 5 California requirements specified in Health and Safety Code section 130151(b) and the State Controller's Office's expanded audit guide. Our summary is based on our assessment of the audit reports' compliance with the expanded audit guide requirements and applicable auditing standards.

I hope our report will be useful to you in assessing the local First 5 county commissions' activities and compiling your annual report to the Legislature. Please direct any comments regarding the content of the report to Casandra Moore-Hudnall, Chief, Financial Audits Bureau, at (916) 322-4846.

Sincerely,

Original signed by

MICHAEL CARTER, Chief Operating Officer
State Controller's Office

cc: Terry Miller, Chief
Administrative Services Division
First 5 California Commission
Hector Ramirez, Chair
First 5 California Commission
David Kears, Vice Chair
First 5 California Commission
Donald Attore, Commissioner
First 5 California Commission
Carla Dartis, Commissioner
First 5 California Commission
Maria Minon, M.D., Commissioner
First 5 California Commission
Molly Munger, Commissioner
First 5 California Commission
Eleni Tsakopoulos-Kounalakis, Commissioner
First 5 California Commission
S. Kimberly Belshé, Ex Officio Member
Health and Human Services Agency
First 5 California Commission
David Long, Ex Officio Member
Office of the Secretary for Education
First 5 California Commission

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Executive Summary

The First 5 California (Children and Families) Program, established by an initiative measure in 1998, was amended in 2005 giving the State Controller's Office (SCO) oversight responsibility for audits of the local First 5 county commissions. The objective of the amendment was to provide the state commission with independently verified fiscal and state compliance information obtained from audits performed in accordance with applicable standards and requirements.

The State Controller's oversight responsibility includes providing audit guidelines, reviewing local commissions' annual audit reports, following up on findings contained in the audit reports, and ensuring that the audits were performed in accordance with applicable standards. As needed, the SCO approves and makes substantive changes to the audit guide after consultation with an audit guide committee which is comprised of representatives from the First 5 state commission, local First 5 county commissions, the Government Finance Officers Association, and independent certified public accounting firms.

This report is the first submitted in accordance with the State Controller's expanded audit guidelines which were issued in the spring of 2006. Our report on the results of our review of the 58 county commission reports for the fiscal year ended June 30, 2007, contains the following key observations:

- Of the 58 audit reports, 42 (72%) did not comply with audit guide requirements and/or audit standards. We notified the independent auditors and local commissions about the various reporting deficiencies and will follow-up in subsequent years using desk reviews and quality control reviews to ensure that the deficiencies are corrected.
- Of the 58 counties, 33 (57%) submitted the required audit reports on time. The remaining 25 reports were submitted late primarily due to miscommunications between the local commission and their auditors regarding the report deadline.
- Local commission auditors reported a total of 30 audit findings categorized as either internal control (17) or state compliance (13).

The information presented in this report will be our "base year" information. Subsequent reports will include comparative data and trend analyses.

Introduction

Overview

The State Controller's Office's (SCO), Division of Audits, is responsible for performing the audit oversight activities for the First 5 California (Children and Families) Program. Oversight activities consist of:

- Developing an audit guide based on the Health and Safety Code and audit standards;
- Verifying that the local First 5 commission audit reports are in compliance with the audit guide (via desk reviews); and
- Following up on reported audit findings.

Health and Safety Code section 130151 (added by Chapter 243, Statutes of 2005) requires that the SCO issue guidelines for annual expanded audits¹ that require a review of county commission compliance with policies and practices related to:

- Contracting and Procurement
- Administrative Costs
- Conflict of Interest
- County Ordinance
- Long-Range Financial Plans
- Financial Condition of Commission
- Program Evaluation
- Salaries and Benefit Policies

In addition, Health and Safety Code section 130151 also requires that the SCO:

- Determine, within six months of the state or county commission's response pursuant to subdivision 130151(d), whether the county commission has successfully implemented corrective action in response to the findings contained in its audit report, and;
- Annually by November 1st, submit a summary report of the final audits to the First 5 California state commission.

Currently, all 58 counties have a First 5 commission; the functional organization and reporting structure of the local commission is decided at the county level. Depending on its organizational structure, the county's annual audit is performed by either an independent CPA firm, or their county auditor-controller's office. The audits must conform to governmental audit standards issued by the United States Comptroller General.

¹ *Standards and Procedures for Audits of California Counties Participating in the First 5 California (Children and Families) Program*

Background

The First 5 California (Children and Families) Program was established by an initiative measure, the California Children and Families (CCF) Act of 1998 (the Act). The Act required that the program be funded by surtaxes imposed on the sale and distribution of cigarettes and tobacco products. The Act further required that the funds be deposited into the CCF Trust Fund, for the implementation of comprehensive early childhood development and smoking-prevention programs.

The SCO's oversight and reporting requirements (Health and Safety Code section 130151) were added by Senate Bill 35 (Chapter 243, Statutes of 2005). Because existing law included a fiscal/audit reporting component, the addition of SCO oversight was considered to be an expansion of those requirements. Consequently, the local and state First 5 programs refer to the SCO audit guidelines as "expanded" audit guidelines.

Health and Safety Code section 130151² also requires county commissions (or their auditors) to submit an audit report to both the SCO and the First 5 California commission each year by November 1st.

The fiscal year ended June 30, 2007, was the first year that the 58 local First 5 county commissions were subject to the SCO expanded audit guidelines; the resulting audit reports were due by November 1, 2007. The SCO is required to submit its first summary report of the final audits to the First 5 California state commission by November 1, 2008.

² Submission deadline is based on two codes, one requiring the submission and one specifying the deadline. Specifically:

- Health and Safety Code section 130151(c) requires that "the auditor for the state commission or the county commission shall submit each audit report, upon completion, simultaneously to both the Controller and to the state commission or applicable county commission."
- Health and Safety Code section 130150(a) requires that "... on or before November 1 of each year, each county commission shall submit its audit and report to the state commission. . . ."

Results of Oversight Activity

Audit Review Process

In accordance with Health and Safety Code section 130151, the SCO reviews and certifies the annual independent audit reports submitted by each local First 5 county commissions for compliance with audit guidelines set out in the *Standards and Procedures for Audits of California Counties Participating in the First 5 California (Children and Families) Program* (audit guide).

The SCO, along with a committee—comprised of representatives from the First 5 state commission, First 5 county commissions, the Government Finance Officers Association, county auditor-controllers, and independent auditors—developed the audit guide based on statutory requirements enumerated in Health and Safety Code section 130151(b), which states that the scope of the audits will address the counties’ policies and practices related to:

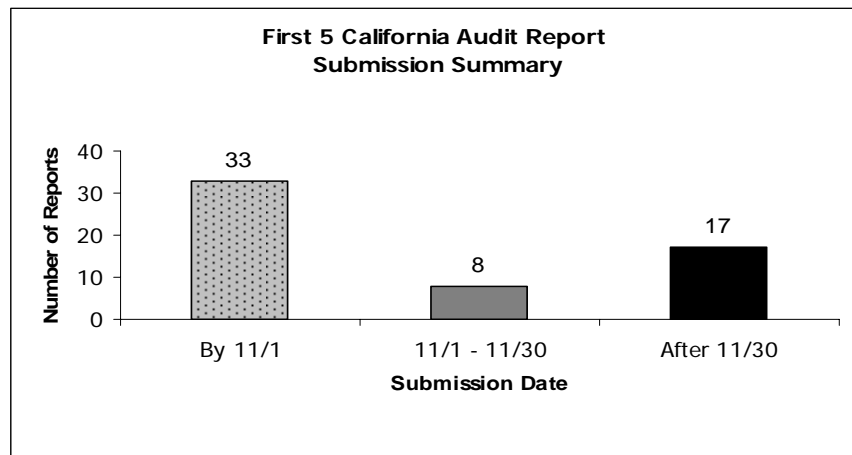
- Contracting and Procurement
- Administrative Costs
- Conflict of Interest
- County Ordinance
- Long-Range Financial Plans
- Financial Condition of Commission
- Program Evaluation
- Salaries and Benefit Policies

To facilitate the consistent review and certification of each audit, the SCO created a comprehensive desk review checklist that details and categorizes the program requirements specified in the audit guide requirements. The desk review checklist also includes the required components of an audit based on governmental auditing standards.

Audit Report Submissions

Audit reports for the preceding fiscal year must be filed with the SCO by November 1 of the current fiscal year. As noted in Figure 1, 33 of 58 (57%) county commission audits were submitted by the required deadline. Another eight (14%) were submitted within 30 days of the deadline.

Figure 1



On December 7, 2007, the SCO sent the remaining 17 local commissions letters notifying them that their reports were delinquent; all 17 reports were received by January 10, 2008. Most commissions promptly contacted us citing the following explanations for their non-compliance:

- Unaware of the deadline;
- Believed the state commission would forward the reports to the SCO; or
- Believed their auditor had handled the submission.

Health and Safety Code section 130151(c) states, in part, that

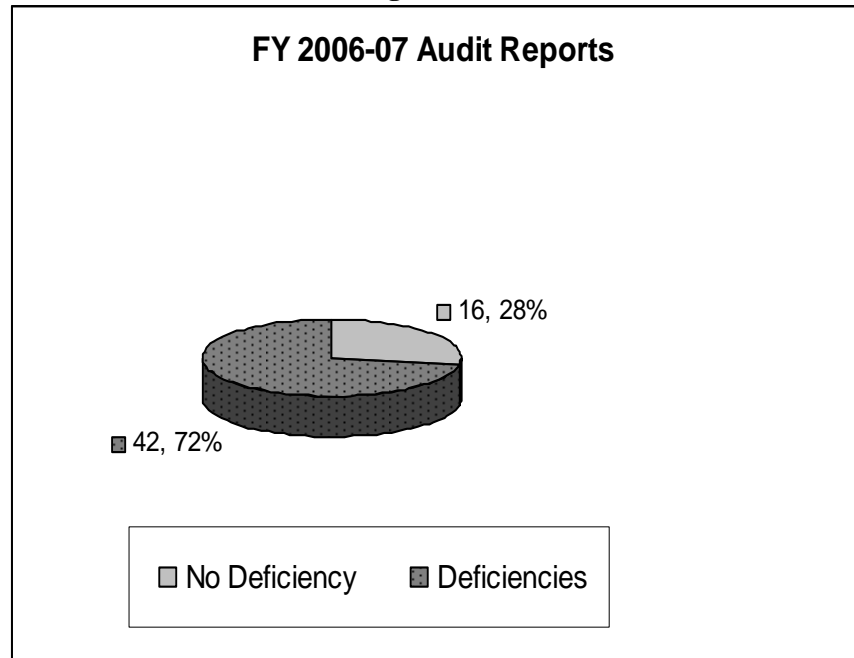
The auditor for . . . the county commission shall submit each audit report, upon completion, simultaneously to both the Controller and to the state commission or applicable county commission.

Audit Report Deficiencies

As part of its oversight responsibilities, the SCO determines whether audit reports conform to the reporting provisions of the *Standards and Procedures for Audits of California Counties Participating in the First 5 California (Children and Families) Program* (audit guide) and governmental auditing standards using a desk review checklist.

Based on our desk reviews of the county commission audits, we found that the 42 of the 58 audits (see Figure 2) contained 64 deficiencies. The Appendix to this report contains the detailed description and breakdown of the deficiencies noted.

Figure 2



As noted in Figure 3, the majority (39% or 25) of deficiencies noted related to the required state compliance report. Specifically, we observed state compliance reports that:

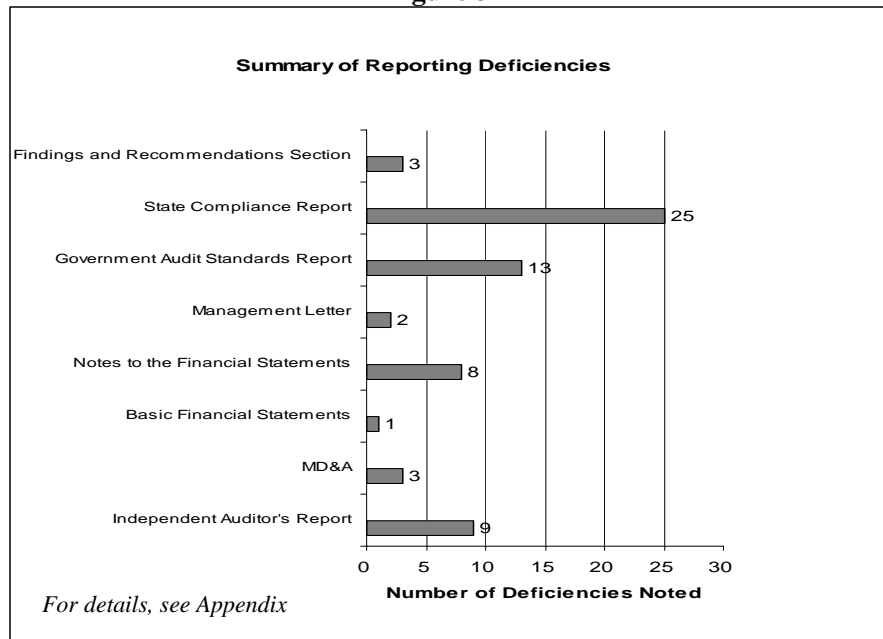
- Did not include the correct number of required procedures;
- Had required procedures that were changed to match procedures performed; and
- Did not explain why required procedures were not performed.

The required procedures in the state compliance report should match the audit guide; auditors are instructed to include an explanation in the State Compliance Report for any procedure that was not performed.

The remaining deficiencies related to non-compliance with governmental audit report standards for financial audits. The most notable issues were:

- The Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards* was deficient.
- The Independent Auditor’s Report, which expresses the auditor’s opinion on the local commission’s basic financial statements, was deficient.
- The Independent Auditor’s Report was omitted.
- The amounts the local commissions spent on program evaluation were not included in notes to the basic financial statements as required by the audit guide.

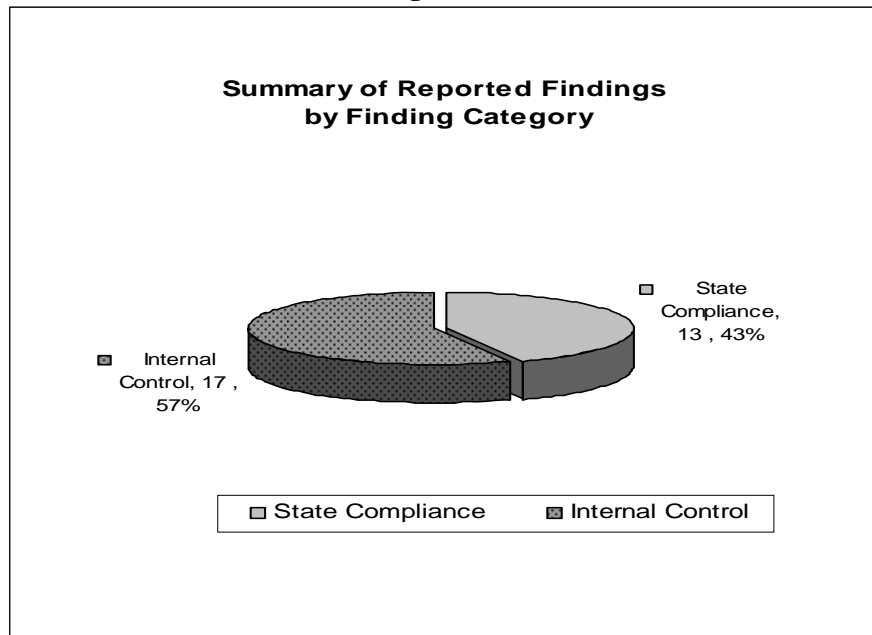
Figure 3



Audit Findings and Follow-up

Seventeen of the 58 audits contained a total of 30 audit findings (see Figure 4) categorized as either Internal Control or State Compliance.

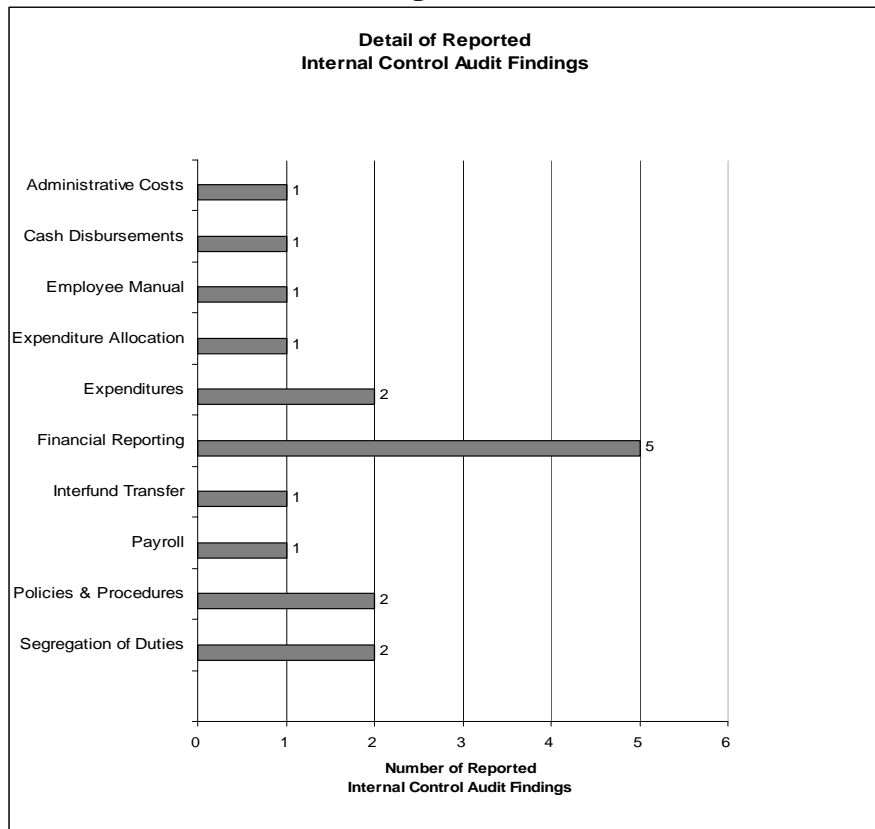
Figure 4



Breakdown of Reported Internal Control Findings

Ten functional areas are represented in the 17 internal control findings, as summarized in Figure 5.

Figure 5



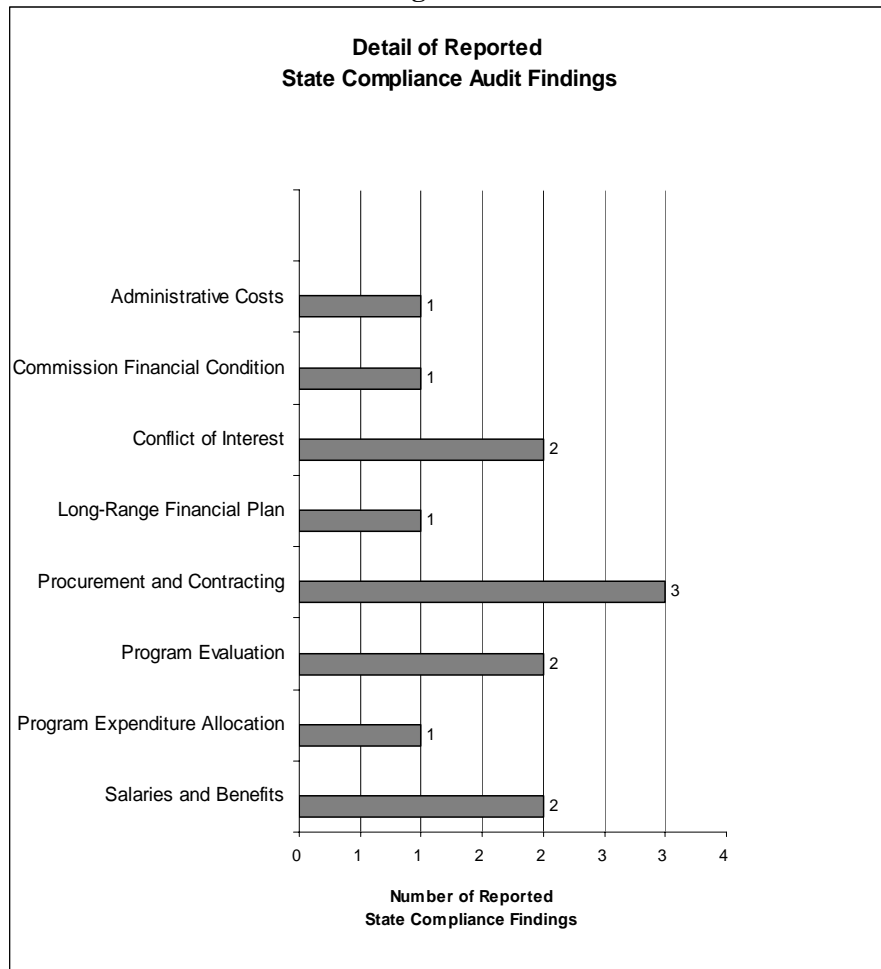
Examples of internal control findings in these functional areas include:

- Commission does not have a system to monitor administrative costs (Administrative Costs);
- Two adjusting entries did not meet generally accepted accounting principles (Financial Reporting);
- Commission relies on the auditor to prepare financial statements due to lack of skilled personnel (Financial Reporting);
- Commission did not hold a public hearing before adopting a limit of its operating budget (Policy and Procedures);
- Commission has inadequate separation of duties (Separation of Duties); and
- Commission was unable to locate supporting documentation for its cash disbursements (Cash Disbursement).

***Breakdown of
Reported State
Compliance Findings***

Eight functional areas are represented in the 13 state compliance findings, as summarized in Figure 6.

Figure 6



Examples of state compliance findings in these functional areas include:

- The calculation of the administrative costs was 0.2% above the upper limit of 15% for the current year ended. (Administrative Costs);
- Commission did not follow correct procurement policy with one of its vendors. (Procurement and Contracting);
- Commission was unable to obtain a representation letter from its legal representative indicating that the policies it follows (county office of education) are in accordance with state law (Procurement and Contracting);
- Two contracts during the fiscal year end were submitted more than 90 days after the end of the reporting period (Procurement and Contracting);
- Commission did not hold a public hearing before adopting policies and procedures for establishing salaries and benefits (Salaries and Benefits); and
- Long-Range Financial Plan was not adopted in a public hearing (Long-Range Planning).

We notified the auditors and local commissions of the deficiencies noted based on our desk reviews. We will follow-up in subsequent years using the desk reviews and quality control reviews to ensure that the deficiencies are corrected and that the auditors are adhering to the audit guide requirements and auditing standards.

In addition to our desk review of the county commission audits, we are required to follow up on findings reported in the local commission audits. Specifically, Health and Safety Code section 130151(e) requires:

Within six months of the state or county commission's response pursuant to subdivision (d), the Controller shall determine whether a county commission has successfully corrected its practices in response to the findings contained in the audit report.

The commissions, in accordance with Health and Safety Code section 130151(d) referenced above, are required to submit a response to findings in its audit report. The statute also requires that the commission discuss the findings in a public hearing.

Audit finding follow-up is accomplished in two ways.

1. Via the SCO follow-up with the local commissions to ensure that they have adopted a corrective action plan and/or resolved any findings.
2. Via the subsequent fiscal year financial and compliance audit. Audit standards require that the independent auditor or auditor-controller determine the status of prior audit findings.

To perform follow-up, the SCO obtained the local commission meeting minutes to confirm whether the commission discussed the audit report and findings, if applicable, in a public hearing. We found that 9 of the 17 commissions that had reported audit findings, adopted formal, written corrective action plans or resolutions to address their audit findings. Our follow-up with the remaining eight commission representatives disclosed that the findings and resolution or corrective action had been discussed during the public hearing even though this information was not clearly documented. We will determine if the local commission adequately resolved any reported audit findings based upon our review of the upcoming 2007-08 audit reports and field reviews.

Appendix— Summary of Audit Report Deficiencies

Description	Number of Findings
<u>Independent Auditor's Report</u>	
The audit report does not include an independent auditor's report on the financial statements.	1
The independent auditor's report does not reference the required supplementary information (RSI).	1
The independent auditor's report does not state that the auditor applied limited procedures to the RSI.	1
The independent auditor's report does not reference a separate report on compliance and on internal control over financial reporting.	1
The independent auditor's report does not identify the supplementary information accompanying the financial statements.	2
The independent auditor's report does not include an opinion on supplementary information in relation to the financial statements taken as a whole.	<u>3</u> 9
<u>Management's Discussion and Analysis</u>	
The Management's Discussion and Analysis is not included in the audit report.	3
<u>Basic Financial Statements</u>	
The audit report does not include basic financial statements prepared in accordance with accounting procedures generally accepted in the United States.	1
<u>Notes to the Financial Statements</u>	
The audit report does not include notes to the financial statements.	1
The Notes to the Financial Statements does not include a statement identifying the amount spent on program evaluation during the period being audited.	<u>7</u> 8
<u>Management Letter</u>	
Management letter not included in audit report.	2
<u>Government Auditing Standards (GAS) Report</u>	
The Report on Internal Control Over Financial Reporting and on Compliance and Other Matters (GAS) is not included.	1
The Report on Internal Control Over Financial Reporting and on Compliance and Other Matters (GAS) is not prepared in accordance American Institute of Certified Public Accountants (AICPA) Statement on Auditing Standards (SAS) No.112.	11
The Report on Internal Control Over Financial Reporting and on Compliance And Other Matters (GAS) does not include disclosure and references required by government auditing standards.	<u>1</u> 13
<u>State Compliance Report</u>	
The Auditor's Report on State Compliance was not included.	2
The Auditor's Report on State Compliance reference to the required audit guide procedures is either incorrect or incomplete.	<u>23</u> 25
<u>Findings and Recommendation Section</u>	
The Schedule of Findings and Questioned Costs is not included.	1
Auditee's corrective action plan to eliminate non-compliance is not included.	1
Finding does not conform with GAS.	<u>1</u> 3
Total	<u>64</u>

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