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DEPARTMENT OF AUDITOR-CONTROLLER

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June 23, 2006

TO: Mayor Michael D. Antonovich
Supervisor Gloria Molina
Supervisor Yvonne B. Burke
Supervisor Zev Yaroslavsky
Supervisor Don Knabe

FROM: J. Tyler McCauley
Auditor-Controller

SUBJECT: **FISCAL REVIEW OF SYDIA GROUP HOMES, INCORPORATED (AKA NEW HORIZON GROUP HOMES) – A GROUP HOME FOSTER CARE CONTRACTOR**

Attached is our audit report on Sydia Group Homes, Incorporated (Sydia or Agency), also known as New Horizon Group Homes, fiscal operations from January 1, 2003 through December 31, 2003. The Department of Children and Family Services (DCFS) contracted with Sydia to serve as a Group Home agency to provide the basic needs for foster care children placed in the Agency's care.

Sydia was licensed to operate two group homes, each with a resident capacity of six children between the ages of 13 and. For 2003, the Agency received a total of $502,346 in foster care funds DCFS. Both group homes were located in the Fifth Supervisorial District.

In December 2004, the County received a notice from the Agency's insurance company that the Agency's General Liability, Auto and Professional Liability insurance coverage would be terminated effective January 2005, due to non-payment of premiums. In response to Sydia's failure to maintain its required insurance coverage and other factors, such as the suspension of Sydia's non-profit status by the California Secretary of State, the County removed all its placed children from the Agency's group homes, completing this process by the end of December 2004. Currently, the Agency does not

have a contract with DCFS. DCFS subsequently advised us that the Agency has closed its group homes.

Scope

The purpose of our review was to determine whether Sydia had complied with its contract terms, and appropriately accounted for and spent foster care funds on allowable and reasonable expenditures. We also evaluated the adequacy of the Agency's accounting records, internal controls, and compliance with federal, State, and County fiscal guidelines governing the disbursement of group home foster care funds.

Summary of Findings

We identified a total of $36,512 in questioned costs, and $5,629 in unaccounted for revenue. More significantly, Sydia had liabilities of approximately $412,000 resulting from a California Department of Social Services (CDSS) rate audit, and delinquent payroll taxes, penalties and interest. We also noted issues with the Agency's internal controls over accounting and disbursement procedures, payroll/personnel records, bank reconciliations, reporting of independent contractors' income, and Workers' Compensation insurance. Details of our findings are discussed in the attached report.

We have recommended that DCFS resolve the questioned costs and unaccounted for revenue and, if appropriate, collect all disallowed amounts.

As previously discussed, DCFS removed all County placed children from Sydia by the end of December 2004. DCFS advised us that Sydia has closed. After DCFS removed all of the children placed with the Agency, Sydia expressed an interest in contracting with DCFS again. In the event Sydia resumes operations, and DCFS considers contracting with Sydia again, the Department must consider the significant liabilities of the Agency, and the effect the liabilities could have on the financial viability of the Agency, and on the quality of care that would be provided to foster children placed with the Agency. In addition, if DCFS does contract with Sydia again, DCFS needs to ensure that the Agency takes the appropriate corrective actions to address the recommendations in this report, and monitor to ensure that the corrective actions result in permanent changes.

Review of Report

Because Sydia has closed its group homes, we were unable to review our draft report with Agency management.

Please call if you have any questions, or your staff may contact Jim Schneiderman at (626) 293-1101.

JTM:MO:JLS:MM
Attachment

c: David E. Janssen, Chief Administrative Officer
David Sanders, Ph.D., Director, Department of Children and Family Services
Sydia Group Homes, Incorporated
Jeannette Gray, Executive Director
Board of Directors
California Department of Social Services
Cora Dixon, Chief, Foster Care Audit Bureau
Sheilah Dupuy, Chief, Foster Care Rates Bureau
Public Information Office
Audit Committee
Commission for Children and Families

SYDIA GROUP HOMES, INCORPORATED
FISCAL AUDIT OF GROUP HOME FOSTER CARE CONTRACT

BACKGROUND

The Department of Children and Family Services (DCFS) contracted with Sydia Group Homes, Incorporated (Sydia or Agency) to provide the basic needs and services for foster care children placed in the Agency's care. The Agency was licensed to operate two group homes, each with a resident capacity of six children between the ages of 13 and 18. Sydia was located in the Fifth Supervisorial District.

The County paid Sydia a monthly rate for each child based on the Group Home Annual Rate determined by the California Department of Social Services (CDSS). Between January 1, 2003 and December 31, 2003, Sydia received a monthly rate of $3,723 per child, for a total of $502,346 in foster care funds.

APPLICABLE REGULATIONS AND GUIDELINES

Sydia was required to operate its group homes in accordance with certain federal, State, and County regulations and guidelines. We referred to the following applicable regulations and guidelines during our review:

- Group Home Contract, including Exhibit I, Auditor-Controller Contract Accounting and Administration Handbook (A-C Handbook)
- Federal Office of Management and Budget Circular A-122 (Circular), Cost Principles for Non-Profit Organizations
- California Department of Social Services Manual of Policies and Procedures (CDSS-MPP)
- California Code of Regulations, Title 22 (Title 22)

REVIEW OF EXPENDITURES

Unsupported/Inadequately Supported Expenditures

We identified $17,195 in expenditures that were either unsupported or inadequately supported.

The A-C Handbook, Section A.3.2, states that all revenues and expenditures shall be supported by original vouchers, invoices, receipts, cancelled checks or other documentation. Unsupported expenditures will be disallowed upon audit. Specifically, we noted the following:

- $9,400 identified on Sydia's general ledger as "Uncategorized Expenses." The Agency was unable to provide any supporting documentation explaining these disbursements. As a result, we were unable to determine if these expenses were related to the group homes.

- $7,484 in expenses, including $6,195 in payments to the Agency's Executive Director (ED). While Sydia provided cancelled checks showing the payments to the ED, the receipts and invoices they provided to document the expenditures were either not original, or did not contain details of goods or services paid for by the Agency. Accordingly, we could not determine if these disbursements benefited the group home.

- $311 in petty cash expenditures. The Agency provided a petty cash log, but no receipts for $221 of the expenditures. The Agency had no documentation for the remaining $90 in questioned disbursements that was identified on the general ledger as petty cash expenses.

Unallowable Expenditures

We identified $19,317 in unallowable expenditures.

- $18,427 paid to the State Employment Development Department (EDD) for delinquent payroll taxes. These delinquent payroll taxes originated between the third quarter of 1999 and the fourth quarter of 2001. Sydia was unable to establish that these payments were made from unexpended foster care funds accumulated from the years in which the taxes originated. Accordingly, it appears the delinquent payroll tax payments were made from current period foster care funds.

  Foster care funds should only be used for expenses for the period in which they are received. Accordingly, the payments to the EDD for prior payroll taxes are unallowable. Section A.2.6 of the A-C Handbook states that the contractor will ensure compliance with all applicable federal and State requirements for withholding payroll taxes, reporting, filing, and all applicable tax deposits. If DCFS decides to contract with Sydia in the future, DCFS will need to ensure that the Agency makes all payroll tax payments in a timely manner.

- $890 in insufficient fund check charges to the Bank of America and late fees to Pacific Bell, Direct TV and Danone Water Bottling Company. According to Section 16 of Attachment B to the Circular, penalties are unallowable costs.

Unaccounted for GH Funds

Sydia received $5,629 in payments from DCFS which we could not verify were deposited into the Agency's bank accounts.

Recommendations

1. **DCFS management resolve the $36,512 in questioned costs and $5,629 in unaccounted for GH funds and, if appropriate, attempt to collect any disallowed amounts.**

As noted earlier, Sydia currently does not have a contract with the County, and Sydia is no longer in business. However, if the Agency were to resume operations and, if DCFS decides to consider contracting with Sydia again, Sydia will need to implement the following recommendations:

2. **Maintain adequate supporting documentation for all Agency expenditures, including original itemized invoices and receipts.**

3. **Ensure that foster care funds are used only for allowable expenditures to carry out the purpose and activities of the Agency.**

4. **Ensure that payroll taxes are paid to the appropriate taxing agencies timely.**

LIABILITIES AND FISCAL VIABILITY CONCERNS

Sydia owes approximately $412,000 to the California Department of Social Services (CDSS), the Internal Revenue Service (IRS) and the State's Employment Development Department (EDD) that may effect the financial viability of this Agency. The liabilities are as follows:

- $200,357 in overpayments owed to CDSS as of January 31, 2005, as a result of program rate audit covering July 1, 1998 through June 30, 1999. The Agency's repayment agreement with CDSS required monthly payments of $2,833 beginning on May 19, 2002. CDSS staff indicated that Section 11466.22 of the California Welfare and Institutions Code may allow Sydia to repay the liability created by the program rates audit with current period foster care funding.

- $145,554 in delinquent taxes, $28,648 in penalties and $28,129 in interest assessed by the IRS for tax years 1999 through 2003. Sydia is negotiating payment terms with the IRS.

- $9,356 for delinquent State payroll taxes for the 2004 tax period.

According to Sydia's internally prepared, unaudited December 31, 2003 balance sheet, the Agency had liquid assets (i.e., cash, investments, etc.) of approximately $11,000, along with fixed assets (e.g., equipment, furniture and vehicles, etc.) with an approximate book value of $8,500. Based on this information, it appears that Sydia did not have sufficient assets to meet its liabilities. As noted earlier, we understand that Sydia is no longer in business. However, if the Agency were to resume operations and if DCFS decides to consider contracting with Sydia, the Department must require Sydia to submit a plan which identifies how the Agency will meet its outstanding liabilities, without negatively effecting the delivery of services under a new contract.

Recommendation

5. **If DCFS decides to consider contracting with Sydia again, DCFS management require Sydia to submit a plan which identifies how the Agency will meet its outstanding liabilities, without negatively effecting the delivery of services under a new contract.**

CONTRACT COMPLIANCE AND INTERNAL CONTROLS

Our review disclosed several internal control weaknesses and contract non-compliance issues. Although the Agency no longer has a contract with DCFS, if DCFS decides to contract with this Agency again, it should ensure that Sydia's management takes appropriate corrective action(s) to address each of the following weaknesses:

Inadequate Accounting and Disbursement Procedures

We evaluated Sydia's compliance with the accounting and disbursement procedures from the Auditor-Controller Contract and Accounting Administration Handbook and noted the following:

- Seven (23%) of 30 expenditure items reviewed were not properly classified on the Agency's general ledger. Sydia's management should ensure that its accounting records accurately reflect the financial transactions of the Agency on a consistent basis.

- Supporting documentation for four (13%) of 30 expenditure items tested was not marked "paid" or otherwise cancelled, and the check number was not recorded on the supporting documentation. Section B.2.1 of the A-C Handbook states that all supporting documentation shall be marked "paid" or otherwise cancelled to prevent reuse or duplicate payments and referenced to the checks.

- We could not trace $203 petty cash transactions to the Agency's general ledger. This could result in an understatement of Sydia's expenses. Sydia's accountant was not able to provide us with an explanation of the omissions.

- The Agency could not locate ten outstanding checks that the Agency indicated were voided. Section B.2.1 of the A-C Handbook indicates that all voided checks must be marked void with the signature block cut out. The voided checks must be filed with the cancelled checks.

Recommendations

If Sydia resumes operations, Agency management:

6. **Ensure that expenditure items are properly classified on the Agency's general ledger on a consistent basis.**

7. **Ensure that all supporting documentation is marked "paid", or otherwise cancelled to prevent reuse or duplicate payments, and referenced to check numbers.**

8. **Ensure that all petty cash transactions are recorded in the Agency's general ledger.**

9. **Ensure that voided checks are consistently marked "void", with the signature block cut out, and filed the voided checks with the cancelled checks.**

Payroll/Personnel Controls

Sydia's payroll and personnel procedures were not in compliance with CDSS' MPP, Section 11-402, which requires supporting documentation to be maintained for all program expenditures, including employee salary rates. In addition, Attachment B of the Circular, Section 7(m), states that employee salaries and wages must be supported by records indicating the total number of hours worked each day. The Circular also states that payroll records must be signed by the employee and approved by a supervisor.

We sampled the personnel files and payroll records of 12 employees and noted the following:

- None of the employees' personnel files contained documentation to support the employees' current salary rates.

- Two (17%) of the 12 timecards reviewed were not signed by the employees.

Recommendations

If Sydia resumes operations, Agency management ensure:

10. **Employee personnel files contain authorized salary amounts or hourly rates of pay approved by management.**

11. **All employee timecards are consistently signed by the employees to certify the accuracy of the reported time.**

Bank Reconciliations

A-C Handbook Section B.1.4, states that bank reconciliations should be prepared within 30 days of the bank statement date, and reviewed by management for appropriateness and accuracy. Sydia's bank reconciliations were prepared by an accounting services contractor. None of the bank reconciliations we reviewed were signed or dated by the preparer, making it difficult to determine if the reconciliations were prepared timely. In addition, there was no evidence that the reconciliations were ever reviewed by Sydia management.

Recommendation

12. **If Sydia resumes operations, Agency management ensure that bank reconciliations are signed and dated by the preparer and reviewer.**

Failure to Report Independent Contractor Earnings

Section 18 of Sydia's contract with the County requires the Agency to comply with all applicable laws and regulations, including those related to the reporting of income to the appropriate federal and State taxing agencies. In addition, Section A.2.6 of the A-C Handbook states that the contractor will ensure compliance with all applicable federal and State requirements, including properly reporting and filing Form 1099s to the taxing agencies.

We noted the Agency did not report the income paid to one independent contractor to the federal and State taxing agencies. Specifically, the Agency paid a housekeeper $16,880 for calendar year 2003, but did not prepare a Form 1099.

Recommendation

13. **If Sydia resumes operations, Agency management ensure that all income paid to independent contractors is properly reported to the federal and State taxing agencies.**

Non-Compliance with Insurance Requirements

In December 2004, DCFS was notified by Sydia's insurance agent that the Agency's General and Professional Liability and Auto insurance policies were being cancelled in January 2005, due to the Agency's failure to pay the policy premiums. This ultimately resulted in DCFS removing all of its placed children from the Agency. We were also advised by DCFS that Sydia had not had Workers' Compensation insurance coverage since 2002. All of the above mentioned coverages were required under Section 30 of Sydia's contract with the County. As previously indicated, Sydia does not currently have a contract with DCFS. However, if DCFS decides to consider contract with the Agency in the future, DCFS should ensure that the Agency consistently maintains all required insurance coverage.

In addition, it appears that DCFS was not aware that Sydia had been without Workers' Compensation coverage since 2002. DCFS needs to evaluate the system it utilizes to monitor contractor compliance with insurance requirements, and determine why it failed to detect that Sydia did not have Workers' Compensation insurance and make appropriate changes to that system.

Recommendation

14. **DCFS management evaluate the system utilized to monitor contractor compliance with insurance requirements to determine why it failed to detect that Sydia did not have Workers' Compensation coverage and make the appropriate changes to the system.**