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April 24, 2008

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

FROM: Wendy L. Watanabe
Acting Auditor-Controller

SUBJECT: **FISCAL REVIEW OF M&R GROUP HOME - A GROUP HOME FOSTER CARE CONTRACTOR**

Attached is our report on M&R Group Home (M&R or Agency) fiscal operations from January 1, through December 31, 2005. The Department of Children and Family Services (DCFS) contracts with M&R to operate three group homes (GH) with a resident capacity of eighteen children. M&R is located in the First Supervisorial District.

During 2005, DCFS paid M&R $4,858 a month per child, based on a rate determined by the California Department of Social Services (CDSS), for a total of $751,847.

DCFS recently informed us that they have placed the Agency on a "Do Not Use" status and removed all County-placed children from the group home on February 29, 2008.

Scope

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

Summary of Findings

We identified a total of $193,024 in questioned costs. We also noted that M&R had negative net assets of $242,201 as of December 31, 2005, and has had to rely on large loans from its Executive Director to pay its operating expenses. As a result, it is unclear whether M&R can continue to provide an acceptable quality of care for placed children. In addition, M&R needs to develop a plan to allocate Agency expenditures among its group homes, establish written contracts and properly report income for independent contractors, establish proper separation of duties and strengthen its internal controls over accounting, disbursements, payroll and personnel records and bank reconciliations. Details of our findings are discussed in the attached report.

DCFS needs to resolve the questioned costs and collect any disallowed amounts. DCFS should also require M&R management to submit a plan indicating how the Agency will pay its current operating expenses and existing liabilities without additional loans and without negatively affecting the quality of care provided to children placed in their care. In addition, DCFS needs to ensure that M&R management takes appropriate action to address the recommendations in this report and monitor to ensure that the actions result in permanent changes.

Review of Report

We provided a draft of this report to M&R management for their review and comments. However, the Agency declined to have a formal exit conference to discuss the findings. The Agency will provide their response to this report directly to DCFS. DCFS will incorporate the Agency's response into a Fiscal Corrective Action Plan that will be submitted directly to the Board of Supervisors. We thank M&R management and staff for their cooperation during our review.

As indicated earlier, DCFS has placed the Agency on a "Do Not Use" status and removed all County-placed children from the Agency on February 29, 2008.

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

WLW:MMO:JLS

Attachment

c: William T Fujioka, Chief Executive Officer
Patricia S. Ploehn, Director, Department of Children and Family Services
Susan Kerr, Senior Deputy, Department of Children and Family Services
Mary Robinson, Executive Director, M&R Group Home
Board of Directors, M&R Group Home
Cora Dixon, Bureau Chief, Foster Care Audit Bureau, California Department of Social Services
Public Information Office
Audit Committee
Commission for Children and Families

M&R Group Home
Fiscal Review

REVIEW OF EXPENDITURES/REVENUES

We identified $6,987 in unallowable costs and $186,037 in expenditures that were unsupported or were inadequately supported.

Applicable Regulations and Guidelines

M&R is required to operate its group homes in accordance with the following federal, State and County regulations and guidelines:

- 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, Cost Principles for Non-Profit Organizations (Circular)
- California Department of Social Services Manual of Policies and Procedures (CDSS MPP)
- California Code of Regulations, Title 22 (Title 22)

Unallowable Costs

We identified $6,987 in unallowable expenses; $5,620 in payroll tax penalties to the Internal Revenue Service, $1,305 in Non Sufficient Fund (NSF) check fees, a $50 traffic fine and $12 in cell phone late fees. According to the Circular, fines, penalties and NSF fees are unallowable expenses.

Unsupported/Inadequately Supported Costs

A-C Handbook Section A.3.2 states that all expenditures shall be supported by original invoices, receipts, contracts and loan agreements, or other documents. Internally generated documents (e.g., vouchers, requisitions, petty cash logs, etc.) and account statements are not adequate supporting documentation. Unsupported and inadequately supported expenditures shall be disallowed upon audit.

We identified $186,037 in expenditures that were either unsupported or were inadequately supported.

- M&R's Executive Director (ED) received a $67,200 salary for working as the ED and $42,000 for working as an Administrator. However, the employee did not maintain time records documenting the time worked as the ED, she only accounted for time worked as the Administrator. The employee's time records as the Administrator accounted for 40-44 hours every two weeks, equating to a one-half time employee. A-C Handbook Section A.3.2 requires time distribution records be maintained for all employees for total work time on a daily basis. Since the ED did not account for time worked as the ED, we were unable to determine if her salary was reasonable, therefore we are questioning $88,200 (her entire ED salary and one-half of her Administrator's salary).

- The Assistant Executive Director (AED) received a $60,000 annual salary. This employee also did not complete timecards/timesheets as required by A-C Handbook Section 3.1. In addition, the employee indicated that he only worked approximately 20 hours a week, and was responsible for activities such as reviewing timesheets for accuracy, tracking and billing the County for placements, intervening with clients in special incidents and performing some maintenance at the homes. However, we found no evidence of the AED's review on employee timesheets that he would have been responsible for reviewing. Based on the lack of employee timesheets and our inability to establish that the employee was performing assigned duties, we were unable to establish how much of the AED's annual salary could be appropriately charged to the County's Group Home program and have questioned the $60,000 annual salary.

- $19,913 in petty cash expenditures, cash withdrawals and disbursements to employees. M&R was unable to provide support for these disbursements. While the Agency provided some receipts which they stated were for the disbursements in question, we were unable to tie the receipts provided to any specific disbursement. Section B.2.3 of the A-C Handbook states that petty cash disbursements must be supported by invoices, stores receipts or other external authenticating documents indicating the item purchased and the employee making the purchase.

- $15,000 in loan repayments to an employee. The Agency did not provide a written loan agreement, or any documentation showing that the funds were deposited into the Agency's bank account. A-C Handbook Section A.3.2 states that loans to the contractor shall be supported by a written loan agreement and records documenting that the funds were deposited into a contractor's bank account.

- $2,924 in unsupported or inadequately supported expenditures to Intuit, Wal-Mart, Office Max, Knott's Berry Farm, One Day Paint and Body, and several other payees. The Agency was unable to provide original receipts or other documentation to support these expenditures.

As discussed in the "Allocation of Costs" section of this report, M&R does not have a method to allocate costs among its funding sources. As a result, it is likely that some of the questioned costs discussed in this section were related to other counties/programs. Therefore, when the Agency develops a cost allocation plan, DCFS will need to determine the appropriate amount of unallowable and inadequately supported costs that should be recovered.

Recommendations

DCFS management:

1. **Resolve the $193,024 ($6,987 + $186,037) in questioned costs and collect any disallowed amounts.**

M&R management:

2. **Consistently maintain adequate supporting documentation for all foster care expenditures, including original itemized receipts/invoices, loan agreements and mileage logs.**

3. **Ensure that foster care funds are used only for necessary, allowable and reasonable expenditures to carry out the purpose and activities of the Group Home.**

AGENCY LIABILITIES

M&R has substantial liabilities that could affect the Agency's ability to provide quality services under the Agency's contract with the County. Specifically:

- The Agency had $305,682 in liabilities as of December 31, 2005, including $270,458 in long-term loans from the Executive Director, of which $157,000 was loaned during 2005. Management indicated the loans were used to pay Agency operating expenses, and there is no time frame for the repayment of these loans. M&R had a net deficit of $242,201 as of December 31, 2005.

- M&R's December 31 2006 bank statements for its payroll and operating accounts showed combined cash-in-bank balance of approximately $8,700.

- As of January 5, 2007 the Agency had $50,224 in outstanding DCFS overpayments dating to 2002. The Agency signed a repayment agreement to make monthly installment payments of $1,000, commencing August 10, 2006. According to DCFS, the Agency has made the required payments so far.

Based on M&R's financial position, and the fact that large loans have apparently been needed for the Agency to meet its ongoing obligations, we have concerns as to whether M&R will be able to continue to provide an acceptable quality of care for placed children.

DCFS should require M&R management to submit a plan indicating how the Agency will pay its current operating expenses and existing liabilities without additional loans and without negatively affecting the quality of care provided to children placed in their care.

Recommendation

4. **DCFS management require M&R management to submit a plan indicating how the Agency will pay its operating expenses and existing liabilities, without further loans and without negatively affecting the quality of care to placed children.**

Allocation of Costs

Section C.2.0 of the A-C Handbook requires contractors who operate multiple programs to allocate expenditures on an equitable basis.

M&R received group home funding from Los Angeles, San Bernardino and Riverside Counties and funding from a National School Lunch Program. While M&R did account for total group home revenues and expenditures at the program level, they did not separately account for revenues and expenditures by funding source (i.e., by county) as required by the contract.

Recommendation

5. **M&R management account for revenues and expenditures by funding source, and develop a plan to allocate expenditures to each county on an equitable basis.**

CONTRACT COMPLIANCE AND INTERNAL CONTROLS

We also noted a number of contract compliance issues and internal control weaknesses. DCFS should ensure that M&R management takes action to address the recommendations in this report and monitor to ensure that the actions result in permanent changes.

Interested Parties on Board of Directors

Section 5227 of the California Corporations Code (Code) states that not more than 49% of the persons serving on the board of any corporation may be "interested persons." "Interested persons" is defined by the Code as any person, or close relative, paid by the corporation within the prior 12 months.

M&R's Board has five members. Of the five, one is the Administrator's daughter, two are the Executive Director's brothers and another is an employee of the Agency.

Recommendation

6. **M&R management ensure that the Board of Directors complies with the California Corporations Code.**

Reporting Independent Contractor Income

The Agency is required to report income paid to independent contractors to the federal and State tax agencies.

We noted that the agency did not report to the IRS, $600 paid to an independent contractor for landscaping services.

Recommendation

7. **M&R management ensure all income paid to independent contractors is reported to the federal and State tax agencies.**

Independent Contractor Agreements

Section 3.2 of the A-C Handbook requires that the Agency maintain supporting documentation such as contracts, time and attendance records, billing rates and other supporting documentation for independent contractors and consultants.

M&R did not have contracts with two landscape providers. For another contractor providing psychotherapy services, the agreement did not specify the billing rate. The Agency should ensure they have written agreements with all independent contractors, including the fees to be paid.

Recommendation

8. **M&R management ensure they have written agreements with all independent contractors, including the fees to be paid.**

Separation of Duties

The Agency does not have adequate separation of duties in cash disbursements and bank reconciliations. Specifically, the Agency's Executive Director performs the following functions:

- Approves and records all cash disbursements, including petty cash.
- Signs most disbursement checks.

- Reconciles the bank statements.

Section B.1.4 of the A-C Handbook indicates that bank statements should be received and reconciled by someone with no cash handling, check writing, or bookkeeping functions. Without proper separation of duties, the Agency cannot properly safeguard assets from misappropriation, misstatement or misuse.

Recommendation

9. M&R management work with the Board of Directors to establish adequate separation of duties.

Accounting Procedures and Records

We noted the following internal control weaknesses in M&R accounting procedures and records.

- In 2005, M&R's Executive Director loaned the Agency $157,000. The loan was not supported by an agreement and we were unable to trace $2,000 to the Agency's bank deposits. A-C Handbook Section A.3.2 states that loans to an agency by employees shall be supported by a written loan agreement and records documenting that the loaned funds were deposited into the agency's bank account.

- M&R did not record DCFS overpayments as liabilities in their financial records.

- The Agency's fixed assets listing did not contain a serial number or source of funding for the fixed assets as required by section B.4.2 of the A-C Handbook.

Recommendations

M&R management:

10. Adjust the books to reflect the actual liability to the Executive Director as supported by deposits into the Agency's bank account.

11. Ensure future loans are deposited into an Agency bank account and agreement documents accurately reflect loaned amounts.

12. Record DCFS overpayments as liabilities in their financial records.

13. Maintain a fixed asset listing in compliance with the A-C Handbook.

Disbursement Procedures

We noted the following internal control weaknesses in the Agency's disbursement procedures:

- 150 of the 312 (48%) expenditures reviewed were not marked "Paid" or referenced to a check number. Section B.2.1 of the A-C Handbook indicates that all supporting documentation shall be marked "Paid" or referenced to check numbers.

- 105 of 312 (34%) checks totaling $22,681 were made payable to cash, four checks totaling $400 were cashed with the payee left blank; and nine transactions, totaling $2,099, were ATM cash withdrawals. The A-C Handbook section B.2.1 states that checks shall not be payable to "cash" and that all disbursements for expenditures, other than petty cash, shall be made by check.

- Two of 312 checks totaling $1,229 were made payable to the check signer. The Agency does not require a second signature on checks, regardless of amount.

Recommendations

M&R management:

14. Ensure all vendor invoices and receipts are marked "Paid" and referenced to cancelled checks.

15. Stop issuing checks payable to Cash, signing checks with the payee left blank or taking cash from the ATM. Ensure that all disbursements except for petty cash are made by check.

16. Establish a written policy requiring two signatures on checks regardless of amounts, and discontinue the practice of issuing checks signed only by the payee.

Payroll/Personnel Controls

We reviewed the personnel files and timesheets of 12 employees and noted the following internal control weaknesses:

- Nine of 12 personnel files (75%) did not contain the approved pay rate. Three of 12 personnel files (25%) contained a salary rate that did not agree with the salary rate paid. CDSS' MPP, Section 11-402 requires supporting documentation for all program expenditures, including salary rates. We confirmed that the actual rates of pay were reasonable based on the Child Welfare of League Salary Study and salaries at comparable agencies.

- Three of 12 (25%) employees did not prepare a timecard and two of 12 (17%) timecards did not have a supervisor's signature. Section B.1.2 of the A-C Handbook states that timecards, or time reports must be prepared for each pay period, and all timecards or time reports must be signed in ink by the employee and the employee's supervisor.

- The Agency did not properly calculate overtime pay resulting in a $56 overpayment to an employee. The California Department of Industrial Relations, Division of Labor Standards requires overtime be paid when the time worked exceeds 8 hours in a day, 40 hours in a work week or work performed on the 7th day of the work week.

Recommendations

M&R management:

17. **Ensure personnel files contain current authorized rates of pay.**

18. **Ensure employee timecards are prepared for each pay period and signed by the employee and supervisor.**

19. **Collect the $56 overpayment and ensure that salary calculations are in accordance with the California Department of Industrial Relations, Division of Labor Standards.**

Bank Reconciliations

Section B.1.4 of the A-C Handbook states that monthly bank reconciliations should be prepared within 30 days of the bank statement date and be reviewed by management. Both the preparer and the reviewer should sign and date the bank reconciliations.

The agency used two checking accounts to make payroll and non-payroll disbursements and completed reconciliations for both accounts. We reviewed the June 2005 reconciliations for each account and noted the following discrepancies:

- M&R was unable to reconcile the payroll account. The deposits and credits in the reconciliation did not agree with the bank statement. The reconciliation also listed numerous payroll checks as outstanding that had in fact cleared the bank in prior months.

- The Agency does not investigate outstanding checks. We identified two checks on the payroll account reconciliation from October 2003 and April 2005 that had not been resolved as of December 2006. Similarly, the reconciliation of the general checking account had two checks that were outstanding from February and April 2005 that the Agency had not resolved.

- Neither bank reconciliation was signed or dated by the preparer and reviewer.

Recommendation

20. M&R management ensure bank reconciliations are completed on all checking accounts within 30 days of the bank statement date, are signed and dated by both the preparer and the reviewer, and that reconciling items are resolved timely.