COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER

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ROBERT A. DAVIS
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JUDI E. THOMAS

July 28, 2011

TO: Supervisor Michael D. Antonovich, Mayor
Supervisor Gloria Molina
Supervisor Mark Ridley-Thomas
Supervisor Zev Yaroslavsky
Supervisor Don Knabe

FROM: Wendy L. Watanabe
Auditor-Controller

SUBJECT: **DOWNS AND MARTIN CHILDREN'S SERVICES – A GROUP HOME FOSTER CARE CONTRACT PROVIDER - FISCAL REVIEW**

At the request of the Department of Children and Family Services (DCFS), we reviewed the fiscal operations of Downs and Martin Children's Services (D&M or Agency) from January 1 to December 31, 2009. D&M was licensed to operate one group home (GH) with a resident capacity of six children. D&M is located in San Bernardino County.

DCFS and the Probation Department contracted with D&M to care for foster care children placed in the Agency's home. DCFS paid D&M $5,092 per child per month, based on a rate determined by the California Department of Social Services, for a total of $265,193 during 2009.

DCFS and Probation no longer contract with D&M for GH services. According to DCFS, D&M's GH contract was not renewed because of numerous contract violations and child safety issues. DCFS indicated that the last Los Angeles County clients were removed on April 23, 2010. D&M currently provides GH services to San Bernardino County.

The issuance of our report to your Board was delayed in part by changes in federal and State regulations regarding possible repayment of questioned costs from fiscal audits.

Summary of Findings

We identified $3,634 in unallowable costs and $9,862 in unsupported/inadequately supported costs. In addition, DCFS and D&M need to work together to resolve some potential overpayments. DCFS should recover any verified overpayments.

D&M's audited financial statements for calendar year 2007 contained a going concern qualification, because the Agency had an operating loss of $41,061 and negative net assets of $146,230. For calendar years 2008 and 2009, D&M reported negative net assets of $139,329 and $138,661, respectively. The Agency's unaudited 2009 financial statements indicated that D&M had no reserves to pay its liabilities, or offset any future operating losses that may occur. In our opinion, D&M's financial condition raises questions as to whether the Agency has the resources to provide an adequate level of care and services to placed children. If DCFS contracts with D&M for GH services in the future, DCFS should require the Agency to develop a plan demonstrating how it will address its financial issues, while still providing quality services to children.

We also recommend that DCFS resolve the questioned costs noted in this report, and collect any disallowed amounts. If DCFS contracts with D&M for GH services in the future, D&M needs to prepare a cost allocation plan, properly classify agency workers as employees, and strengthen its controls over cash disbursements, payroll/personnel records, independent contractors, fixed assets and bank reconciliations. D&M also needs to submit their 2008 and 2009 Semi-Annual Expenditure Reports to DCFS. Details of our findings are discussed in Attachment I.

Review of Report

We discussed our report with D&M's management and DCFS on January 25, 2011. D&M generally agreed with our findings and recommendations. As noted earlier, the County no longer contracts with D&M. However, D&M still provides GH services to San Bernardino County. Since D&M is still in operation, DCFS is working with the Treasurer and Tax Collector to establish a repayment agreement and recover the questioned costs (see Attachment II).

This audit is not intended to be, and does not constitute, the discovery or identification of an overpayment for purposes of the federal Improper Payments Act, related California State laws, including but not necessarily limited to Welfare and Institutions Code sections 11466.23, 11466.235, 11466.24, etc., nor State regulations intended to implement either the federal Improper Payments Act or related provisions in State law. This audit is intended solely to assist the County Department of Children and Family Services in managing its contractual relationships. Consequently, this report will be forwarded to the County Department of Children and Family Services in order that it might take further action, as it deems appropriate, based on its contents. Such further

action may, or may not, include the discovery or identification of an overpayment for purposes of federal or State law.

We thank D&M management and staff for their cooperation and assistance during our review. Please call me if you have any questions, or your staff may contact Robert Campbell at (213) 253-0101.

WLW:JLS:RGC:MWM

Attachments

c: William T Fujioka, Chief Executive Officer
Jackie Contreras, Ph.D., Acting Director, DCFS
Donald H. Blevins, Chief Probation Officer
Emmett Downs, Executive Director, Downs and Martin Children's Services
Board of Directors, Downs and Martin Children's Services
Cora Dixon, Bureau Chief, Foster Care Audit Bureau, CA Dept. of Social Services
Commission for Children and Families
Public Information Office
Audit Committee

Downs and Martin Children's Services
Group Home Contract Provider
Fiscal Review

REVIEW OF EXPENDITURES/REVENUES

We identified $3,634 in unallowable costs and $9,862 in unsupported/inadequately supported costs. In addition, DCFS and D&M need to work together to resolve some potential overpayments. Details of these costs/overpayments are discussed below.

Applicable Regulations and Guidelines

D&M was required to operate its GH in accordance with the following federal, State and County regulations and guidelines:

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

Unallowable Costs

We identified $3,634 in unallowable expenditures:

- $1,053 in bank overdraft and non-sufficient fund (NSF) fees.
- $876 in credit card late fees, over limit fees and finance charges.
- $1,705 in penalties and interest to a collection agency and late fees to a utility company.

Circular A-122 Sections 16 and 23 indicate that penalties and interest are unallowable costs.

Unsupported/Inadequately Supported Costs

A-C Handbook Section A.3.2 states that all expenditures shall be supported by original vouchers, invoices, receipts, or other supporting documents, and that unsupported expenditures will be disallowed upon audit.

We identified $9,862 in inadequately supported costs, including loan repayments, food, utility charges, auto repairs, supplies and travel expenses. The Agency provided cancelled checks and credit card statements, but no receipts, or the receipts provided were inadequate to substantiate that the expenditures were GH-related.

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

Recommendations

1. **DCFS management resolve $13,496 ($3,634 + $9,862) in questioned costs and collect any disallowed amounts.**

If DCFS considers contracting with D&M for GH services in the future, D&M management:

2. **Ensure that foster care funds are used only for allowable expenditures to carry out the GH programs of the Agency.**

3. **Consistently maintain adequate supporting documentation for all Agency expenditures, including original itemized receipts, invoices and vehicle mileage logs.**

D&M's FINANCIAL CONDITION

D&M's calendar year (CY) 2007 audited financial statements included a going concern qualification, questioning the Agency's ability to continue to operate, due to an operating loss of $41,061, and negative net assets of $146,230. While the Agency's CY 2008 audited financial statements reported net income of $15,444, the Agency still had negative net assets of $139,329. For CY 2009, the Agency's unaudited financial statements showed negative net assets of $138,661, and indicated that the Agency had no reserves from which it could pay its liabilities or offset any future operating losses that may occur. D&M's financial condition raises questions as to whether the Agency has the resources to provide an adequate level of care to placed children.

If DCFS considers contracting with D&M for GH services in the future, DCFS should require the Agency to develop a plan demonstrating how it will address its financial issues, while still providing quality services to children. If DCFS contracts with D&M, DCFS must carefully monitor the Agency to ensure that service quality is maintained at an acceptable level.

Recommendations

If DCFS considers contracting with D&M for GH services in the future, DCFS management:

4. **Require D&M management to develop a plan demonstrating how it will address its financial issues, while still providing quality services to children.**

5. **Carefully monitor D&M to ensure that service quality is maintained at an acceptable level.**

POTENTIAL DCFS OVERPAYMENTS

DCFS' records show some potential overpayments made to the Agency. DCFS and D&M should work together to resolve the potential overpayments, and DCFS should collect any verified overpayments. If DCFS considers contracting with D&M for GH services in the future, D&M management should ensure that any future payment discrepancies are reported to DCFS immediately, and any excess payments are repaid promptly.

Recommendations

6. **DCFS work with D&M to resolve the potential overpayments and collect any verified overpayments.**

7. **If DCFS considers contracting with D&M for GH services in the future, D&M management ensure that any future payment discrepancies are reported to DCFS immediately, and any excess amounts are repaid promptly.**

ALLOCATION OF COSTS

A-C Handbook Section C.2.0 states that an agency should allocate expenditures that benefit multiple programs or funding sources on an equitable basis. During our review period, D&M received funding from Los Angeles and San Bernardino Counties. The Agency records all administrative costs at the GH program level, but does not allocate those costs between the counties. If DCFS considers contracting with D&M for GH services in the future, D&M should develop a plan to allocate its administrative expenses to each county on an equitable basis.

Recommendation

8. **If DCFS considers contracting with D&M for GH services in the future, D&M management develop a plan to allocate administrative expenses to each county on an equitable basis.**

CONTRACT COMPLIANCE AND INTERNAL CONTROLS

We noted several contract compliance issues and internal control weaknesses. If DCFS considers contracting with D&M for GH services in the future, DCFS should ensure that D&M management takes action to address the recommendations in this report. DCFS should monitor to ensure the actions result in permanent changes.

Accounting and Disbursement Procedures

We noted the following issues with the Agency's accounting and disbursement procedures:

- A-C Handbook Section B.2.1 states that checks shall not be payable to "cash." We noted 32 checks, totaling $16,172, that were payable to "cash". Most of the checks were for petty cash purposes.

- A-C Handbook Section B.2.3 states that a contractor may have a petty cash fund of up to $500 for incidental expenses (e.g. postage, small purchases of office supplies, etc.). Petty cash funds over $500 must be approved by the County. D&M's petty cash fund was over the $500 limit. Some of the petty cash reimbursement checks were for as much as $2,000.

- A-C Handbook Section A.3.2 requires an agency to have vehicle mileage logs. D&M has two vans, but does not keep logs to track the business use of the vehicles.

Recommendations

If DCFS considers contracting with D&M for GH services in the future, D&M management:

9. **Ensure checks are not payable to "cash".**

10. **Ensure that the petty cash fund does not exceed $500, or request approval from DCFS for a higher amount.**

11. **Ensure a log is maintained for each Agency vehicle.**

Child Care Workers

A-C Handbook Section A.2.6 requires agencies to comply with Internal Revenue Service (IRS) guidelines for classifying employees and independent contractors. According to IRS guidelines, an employee is a person who is generally subject to business instructions as to when, where and how to work, and is generally guaranteed a regular wage for an hourly, weekly or other period of time.

D&M has outsourced its payroll function. According to a written agreement with the payroll contractor, between April and August 2009, some of D&M's Child Care Workers (CCWs) were treated as employees of the payroll contractor. However, based on discussions with the Executive Director, and a review of D&M payroll records, we noted that the CCWs were interviewed, hired, trained, and instructed on how, when and where to work by D&M. D&M also maintained personnel files for these workers.

Based on IRS guidelines, it appears the CCWs should have been classified as employees of D&M, and not of the payroll contractor. Misclassification of employees may subject D&M to penalties and interest by taxing authorities. D&M management should consult with legal counsel and/or the IRS to determine what actions are necessary to reclassify the CCWs as Agency employees, and ensure that appropriate payroll taxes were paid during this period. DCFS management also needs to ensure that no foster care funds are used by the Agency to pay any penalties or interest.

Recommendations

12. **D&M management consult with legal counsel and/or the IRS to determine if CCWs should be classified as employees of the Agency, and ensure that appropriate payroll taxes were paid during this period.**

13. **If DCFS considers contracting with D&M for GH services in the future, DCFS ensure that no foster care funds are used by the Agency to pay for any penalties or interest if the CCWs are reclassified as employees of D&M, or if it is determined that there are delinquent payroll taxes.**

Payroll / Personnel Controls

CDSS-MPP Section 11-402 requires that supporting documentation be maintained for all program expenditures, including salary rates. In addition, A-C Handbook Section B.3.1 states that timecards or time reports must be prepared for each pay period, and all timecards or time reports must be signed by the employee and supervisor to certify the accuracy of the reported time.

We reviewed 16 employee personnel files and payroll records and noted the following:

- Three employees' personnel files did not contain the employees' current salaries.
- One timecard was not signed by the employee.
- One timecard was not signed by the supervisor.

Recommendations

If DCFS considers contracting with D&M for GH services in the future, D&M management:

14. Ensure personnel files contain current salary rates approved by management.

15. Ensure the timecards are signed by the employees and supervisors to certify the accuracy of the reported time.

Reporting Payments to Contractors

A-C Handbook Section A.2.6 requires contractors to comply with federal and State requirements for filing 1099 (Miscellaneous Income) Forms for independent contractors. We reviewed payments to three independent contractors, and noted that one contractor was not issued a 1099.

Recommendation

16. If DCFS considers contracting with D&M for GH services in the future, D&M management ensure all payments to independent contractors are properly reported to the federal and State taxing agencies.

Bank Reconciliations

A-C Handbook Section B.1.4 requires bank reconciliations be prepared within 30 days of the bank statement date, and be reviewed by management for appropriateness and accuracy. The bank reconciliations should be signed and dated by both the preparer and the reviewer.

We reviewed the Agency's monthly bank statements and noted the following:

- No bank reconciliations were performed until after the end of the calendar year.
- None of the bank reconciliations were dated or signed by the preparer or reviewer.

Recommendation

17. **If DCFS considers contracting with D&M for GH services in the future, D&M management prepare monthly bank reconciliations within 30 days of the bank statement date, and ensure that the reconciliations are signed and dated by both the preparer and reviewer.**

Semi-Annual Expenditure Reports

The GH Contract Section 16.2 states that an agency must submit Semi-Annual Expenditure Reports to the DCFS Fiscal Monitoring and Special Payments Unit no later than September 1, for the semi-annual period ended June 30, and March 1, for the semi-annual period ended December 31.

D&M submitted its Semi-Annual Reports for the periods January 1 through June 30, 2007, and July 1 through December 31, 2007. However, the Agency did not submit its Semi-Annual Expenditure Reports for 2008 and 2009.

Recommendation

18. **If DCFS considers contracting with D&M for GH services in the future, D&M management prepare and submit Semi-Annual Expenditure Reports for 2008 and 2009 to DCFS Fiscal Monitoring and Special Payments Unit.**

Fixed Assets

A-C Handbook Section B.4.2 states that each contractor shall maintain a current listing of fixed assets, including the item description, serial number, date of purchase, acquisition cost and source(s) of funding. Contractors should also conduct a physical inventory of all assets at least once each year to ensure that all fixed assets are accounted for and maintained in proper working order.

The fixed asset listing provided by D&M grouped assets into categories such as "Equipment and Furniture", and did not include a description, serial number, date of purchase, acquisition cost or source(s) of funds, as required by the A-C Handbook. In addition, the Agency does not conduct an annual inventory of fixed assets.

Recommendations

If DCFS considers contracting with D&M for GH services in the future, D&M management:

19. **Prepare a fixed assets listing that includes item description, serial number, date of purchase, acquisition cost and source(s) of funds.**

20. **Conduct an inventory of fixed assets at least once a year to ensure that all assets are accounted for and maintained in proper working order.**

Insurance Coverage

GH Contract Section 6.2 states that auto insurance shall include coverage for all "owned," "hired" and "non-owned" vehicles, or coverage for "any auto." D&M did not maintain the proper auto insurance coverage. Specifically, the Agency's auto insurance did not cover all owned autos.

Recommendation

21. **If DCFS considers contracting with D&M for GH services in the future, D&M management maintain auto insurance coverage as required by the GH Contract.**

Attachment II

County of Los Angeles
DEPARTMENT OF CHILDREN AND FAMILY SERVICES

425 Shatto Place, Los Angeles, California 90020
(213) 351-5602

ANTONIA JIMÉNEZ
Acting Director

Board of Supervisors
GLORIA MOLINA
First District
MARK RIDLEY-THOMAS
Second District
ZEV YAROSLAVSKY
Third District
DON KNABE
Fourth District
MICHAEL D. ANTONOVICH
Fifth District

March 23, 2011

Emmett Downs, Executive Director
Downs and Martin Children's Services
P.O. BOX 1107
POMONA, CA 91769-1107

Dear Mr. Downs:

AUDITOR-CONTROLLER'S FISCAL AUDIT REPORT ON DOWNS AND MARTIN CHILDREN'S SERVICES – A GROUP HOME FOSTER CARE CONTRACTOR

We have reviewed your fiscal corrective action plan (FCAP) received on March 21, 2011 in response to the Auditor-Controller's final draft fiscal audit.

With regard to the $13,496 in questioned costs, Downs and Martin Children's Services and DCFS agreed that the total of $13,496 was disallowed and must be repaid to the Department.

Please contact the Los Angeles County Treasurer and Tax Collector Department, by March 28, 2011 to schedule a date and time to sign a repayment agreement for the amount of $13,496.

Kathy Gloster, Operations Chief
Los Angeles County Treasurer and Tax Collector Revenue and Enforcement
225 N. Hill Street Room 122, Los Angeles, CA 90012
(213) 893-7968
kgloster@ttc.lacounty.gov

If you have any questions, please contact Ali Gomaa-Mersal, Financial Specialist IV, at (213) 351-3209.

Sincerely,

Latisha Thompson, ASM III
Fiscal Monitoring and Special Payments

Attachments

c: Mike McWatters, Chief Audit Division (via electronic mail only)
Sandra Gomez, Principal Accountant-Auditor (via electronic mail only)

"To Enrich Lives Through Effective and Caring Service"

ATTACHMENT III

FISCAL REVIEW OF
DOWNS AND MARTIN CHILDREN'S SERVICES - A GROUP HOME FOSTER CARE CONTRACTOR

Note: Department of Children and Family Services (DCFS) will only review documentation not previously provided to the Auditor-Controller.

Summary of Recommendations

Based on the FCAP dated March 21, 2011, submitted by Downs and Martin Children's Services, status of each recommendation is summarized as follows:

- 1 Recommendation (1) was fully addressed.
- __ Recommendations (_) were partially addressed.
- 1 Recommendation (1) directed to the Department was addressed.

Recommendation Status

1. **DCFS management resolves $13,496 ($3,634 + $9,862) in questioned costs and collect any disallowed amounts.**

   Agency Proposed FCAP: Downs and Martin Children's Services understands it owes LA County DCFS $13,496.00 if DMCS cannot submit additional information regarding these costs, DMCS is willing to make arrangements with LA County DCFS to repay unsupported and unallowable costs. Please call Emmett Downs Exe. Director @ (909)910-9502 if there are any questions. March 18, 2011

   DCFS Response: DCFS accepts the agency's response. Please contact the Los Angeles County Treasurer and Tax Collector Department, as soon as possible to schedule a date and time to sign a repayment agreement for the amount of $13,496. Please contact

   Kathy Gloster, Operations Chief
   Los Angeles County Treasurer and Tax Collector Revenue and Enforcement
   225 N. Hill Street Room 122
   Los Angeles, CA 90012
   (213) 893-7968
   kgloster@ttc.lacounty.gov