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November 6, 2007

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

FROM: J. Tyler McCauley
Auditor-Controller

SUBJECT: **DEPARTMENT OF CHILDREN AND FAMILY SERVICES – PROCUREMENT REVIEW (PHASE II)**

In January 2007, Department of Children and Family Services (DCFS) management asked us to review the Department's procurement operations. Our Phase I report, dated August 3, 2007, identified a number of issues in the Department's central Procurement and Forms Management Section (Procurement and Forms Management), which has overall responsibility for DCFS procurement. DCFS management has taken action to address most of the issues in our Phase I report.

We have completed the second phase of our review of DCFS Procurement. The Phase II review included evaluating procurement practices and controls at DCFS regional/program offices (offices), the Bureau of Information Services (BIS) and the Governmental Relations – Legislation Office's Training Section (Training). We also reviewed the offices' controls over gift cards.

Results of Review

Our Phase II review indicates that the BIS and Training Sections generally did a better job complying with County procurement policies than DCFS' Procurement and Forms Management. However, we noted significant deficiencies in controls over equipment and supply inventories in the five regional offices we reviewed. For example, the offices do not always maintain inventory records, conduct required annual physical inventories, or adequately separate ordering, receiving and maintaining supply inventories. In addition, some procurement staff did not comply with County procurement rules by

structuring purchases to avoid Internal Services Department (ISD) requirements. As with the Phase I report, most of the problems noted were related to non-compliance with established process controls by Departmental staff.

DCFS offices use gift cards to provide emergency food and other essentials to the children served by the department. However, we noted a lack of controls over gift cards in five of the six program/regional offices we reviewed, and that some offices used the cards for inappropriate purposes. For example:

- DCFS staff purchased gift cards from non-program related businesses (e.g., Cheesecake Factory, P.F. Chang's, Glenn Ivy Hot Springs-Spa, Starbucks, etc.)

- Staff in one program office used gift cards to pay for staff luncheons.

- DCFS staff gave gift cards to volunteers at training classes and/or recruiting events. DCFS records indicated that gift cards were mailed even when volunteers signed up but did not attend. However, six of the seven volunteers we contacted, who were supposed to have received gift cards in the mail, stated they did not receive the cards.

- One staff person attempted to conceal extra gift cards they received from the vendors by requesting false invoices from the vendors.

- One program office spent $14,000 on 160 tickets to a musical play. However, only 53 of the tickets (33%) were used by the children. The remaining tickets were used by DCFS employees and their family members/guests, mentors, unidentified "potential mentors", and a number of not-for-profit organization employees. DCFS received program funds for the mentoring program. However, federal funding guidelines specifically disallow the cost of entertainment.

We referred the falsified invoices and the inappropriate use of gift cards/program funds to our Office of County Investigations (OCI) for further review. OCI reported its findings to the Department Head last month.

Details of our findings and recommendations are attached.

Review of Report

We have worked closely with DCFS management during our review. DCFS management immediately began taking corrective action, including collecting all gift cards from the regional offices and seeking refunds of unneeded gift cards. DCFS management has initiated disciplinary action against staff who misused gift cards and/or

program funds. Management is also proactively working to correct the remaining deficiencies noted in this report.

We discussed the report with DCFS representatives on October 31, 2007. The Department's initial response (attached) indicates general agreement with our findings and recommendations. The Department also indicated that they will provide a detailed response to your Board within 60 days.

We thank DCFS management and staff for their responsiveness, cooperation and assistance during the audit. Please call me if you have any questions, or your staff may contact Terri Kasman at (626) 293-1121.

JTM:MMO:JLS:TK:YK
Attachment

c: William T Fujioka, Chief Executive Officer
Patricia S. Ploehn, Director, Department of Children and Family Services
Susan Kerr, Chief Deputy Director, Department of Children and Family Services
Dave Lambertson, Director, Internal Services Department
Sachi A. Hamai, Executive Officer
Public Information Office
Audit Committee

DEPARTMENT OF CHILDREN AND FAMILY SERVICES
PROCUREMENT REVIEW (PHASE II)

Background

In January 2007, Department of Children and Family Services (DCFS) management asked us to review the Department's procurement operations. We issued Phase I of our review on August 3, 2007. Our Phase I review disclosed significant deficiencies in the Department's central Procurement and Forms Management Section (Procurement and Forms Management), including violations of County fiscal and purchasing policies and guidelines, and a lack of controls over purchasing, supply inventories and gift cards.

In Phase II, we reviewed the procurement practices at the Department's regional/program offices, the Bureau of Information Services (BIS), and the Governmental Relations – Legislation Office's Training Section (Training). The BIS Section handles information systems-related purchases (e.g., computers, software, servers, system-related training, etc.) and the Training Section purchases training-related materials and services.

Stockroom/Warehouse Inventory Controls

During Phase I, we noted that DCFS' Procurement and Forms Management did not have adequate controls over purchasing and equipment and supply inventories. In our Phase II review, we noted that the BIS and Training units generally did a better job complying with County procurement policies than the Procurement and Forms Management. However, we also noted that the five regional offices we reviewed have significant control problems similar to the issues noted at Procurement and Forms Management. For example, the offices did not always comply with the County Fiscal Manual in the areas of maintaining inventory records, conducting annual physical inventories as required, or adequately separating the functions of ordering, receiving and maintaining supplies.

We also visited three BIS warehouses and noted that the inventory logs were not always complete/accurate. For example, we counted 246 computer monitors in storage, but the inventory records showed 222 monitors.

During Phase I, we made a number of recommendations related to purchasing, warehousing and inventory controls, including the need to conduct annual physical inventories and maintain perpetual inventory records (see recommendations 24, 26, and 27 from our August 3, 2007 report). These recommendations are also applicable to the regional offices and the BIS warehouses. It should be noted that DCFS management is proactively working with our eCAPS team, with assistance from the Department of Public Works, to implement an automated inventory system (i.e., eCAPS Inventory Module). This system should be implemented in 2008. In the meantime, DCFS needs to ensure that regional office staff maintain manual perpetual inventory records that are updated timely as additions or deletions occur.

Purchases Structured to Avoid ISD Involvement

Departments are allowed to make purchases without soliciting bids (i.e., sole source purchases) up to $5,000, but only under special circumstances, such as an emergency purchase. Sole source purchases over $5,000 must be processed through ISD.

We noted a number of regional office sole source purchases that appeared to have been kept below $5,000 to avoid ISD involvement. For example, DCFS staff ordered $4,999.99 in gift cards, including 124 $40 gift cards and one $39.99 gift card. Regional office staff sometimes tell vendors that orders can be processed "quicker" if they are under $5,000, or that the Department can only purchase up to $4,999, because additional approvals would be required for higher amounts. We noted 57 transactions between $4,900 and $4,999 over the last two fiscal years, including 18 transactions that were either $4,999 or $4999.99.

Recommendation

1. **DCFS management ensure that purchases are not intentionally kept below $5,000 to avoid ISD involvement in the purchase.**

Gift Card Usage and Controls

Gift cards are supposed to be issued to children and foster parents to purchase necessities (e.g., food and clothing for children in the mentoring and emancipation programs, etc.). Most of DCFS program funds are subject to the federal Office of Management and Budget's (OMB) Circular A-87, Cost Principles for State, Local, and Indian Tribal Governments. The Circular specifically disallows the cost of entertainment (i.e., tickets to shows or sports events, meals, lodging, etc.) and requires costs to be reasonable and necessary for operating programs.

In Phase I, we noted DCFS' Procurement and Forms Management did not have adequate controls over gift cards. For example, Procurement and Forms Management did not maintain perpetual inventory records, proper security or segregation of duties, or controls to prevent gift card deliveries to unauthorized personnel. These deficiencies resulted in a lack of accountability and could have resulted in misuse of gift cards.

During Phase II, we reviewed regional/program offices controls over gift cards and noted similar control weaknesses in five of the six offices we reviewed. In addition, we noted the following misuses of gift cards:

- DCFS staff purchased gift cards from non-program related businesses (e.g., Cheesecake Factory, P.F. Chang's, Glenn Ivy Hot Springs-Spa, Starbucks and Red Lobster).

- DCFS staff in one program office used gift cards to pay for staff luncheons.

- The offices used gift cards to pay vendors and reimburse employees for job-related expenses, instead of following normal reimbursement procedures.

- DCFS staff gave gift cards to volunteers at training classes and/or recruiting events. DCFS records indicated that gift cards were mailed even when volunteers signed up but did not attend. However, six of the seven volunteers we contacted, who were supposed to have received gift cards in the mail, stated they did not receive the cards.

- DCFS staff attempted to conceal extra gift cards they received from the vendors by requesting false invoices from the vendors. In one program office, staff also told the auditors that they no longer had gift cards in inventory when, in fact, they had over $23,000 in gift cards/certificates. In total, this office purchased more than $50,000 in gift cards since March 2007.

Finally, we noted that one program office spent $14,000 of program funds on 160 tickets to a musical play. However, only 53 of the tickets (33%) were used by the children. The remaining tickets were used by DCFS employees and their family members/guests, mentors, unidentified "potential mentors", and a number of not-for-profit organization employees. The same office spent approximately $5,700 for 150 tickets to the Gospel Sunday Brunch at the House of Blues. Only 43 of the tickets were used by children. The remaining 107 tickets were used by DCFS employees, mentors, and a DCFS vendor. DCFS employees received at least 24 of the 107 tickets, including one employee who received seven tickets. In total, since March 2007, this office spent over $200,000 for entertainment.

During our review, at our suggestion, DCFS management immediately collected all gift cards from the offices and stopped using gift cards except for emergencies (e.g., a child removed from an unsafe environment at night that has to be clothed and fed) or to fulfill allowable program needs (e.g., gift cards for emancipated youth to purchase food and clothing). DCFS management also started asking for refunds from vendors for unneeded cards, and reinforced with regional/program office managers the allowable uses of program funds/gift cards.

DCFS does not have Department-wide written policies and procedures regarding gift card uses, controls and record-keeping. DCFS management needs to develop written policies and procedures delineating allowable gift card uses, required purchasing procedures and record-keeping requirements, as well as unallowed uses of gift cards. The policies should also specifically prohibit the use of gift cards for employee functions/entertainment, vendor payments, and employee reimbursements.

DCFS management should also require employees to sign a statement acknowledging that using gift cards for unauthorized purposes will result in disciplinary action up to and including discharge.

Recommendations

DCFS management:

2. **Develop Department-wide written procedures specifying allowable gift card uses, required purchasing procedures and record-keeping requirements, as well as unallowed uses of gift cards.**

3. **Require employees who handle gift cards to sign a statement acknowledging that using gift cards for unauthorized purposes will result in disciplinary action up to and including discharge.**

4. **Ensure that program funds are used for reasonable and necessary purposes to operate programs.**

5. **In conjunction with Human Resources management, take appropriate disciplinary actions for staff who misused and/or personally benefited from gift cards or program funds.**

Operational Efficiency

DCFS management requested that we evaluate whether the BIS and Training Sections' procurement activities should be combined with the Department's Procurement and Forms Management operation. Due to the specialized purchases (e.g., systems-related purchases, etc.) handled by the BIS and Training Sections, and the significance of the deficiencies we noted in the Department's Procurement and Forms management operations, merging the three Sections at this time does not appear advisable.

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DEPARTMENT OF CHILDREN AND FAMILY SERVICES

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November 2, 2007

To: J. Tyler McCauley
Auditor-Controller

From: Patricia S. Ploehn, LCSW
Director

RESPONSE TO PROCUREMENT REVIEW - PHASE II

Thank you for the opportunity to review the draft report of Phase II of the Auditor-Controller's review of the Department of Children and Family Services' (DCFS) procurement processes which specifically addresses regional and program operations.

We agree with all of the recommendations contained in the report and implemented a number of corrective actions throughout the review process as your staff brought issues to our attention.

I would like to thank you for the level of staff resources you devoted to helping DCFS to improve its operations. As always, it has been a pleasure working with your staff.

If you have any questions, please let me know, or your staff may contact Claudine Crank, Deputy Director, Bureau of Finance and Administration, at (213) 351-5847.

PSP:SK
CC:cc