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DEPARTMENT OF AUDITOR-CONTROLLER

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May 22, 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 MOORE'S COTTAGE GROUP HOME - A GROUP HOME FOSTER CARE CONTRACTOR**

Attached is our report on the fiscal operations of Moore's Cottage Group Home (Moore or Agency) from January 1, through December 31, 2006. Moore is licensed to operate two group homes (GH), each with a resident capacity of six children. Moore is located in the Fifth Supervisorial District.

The Department of Children and Family Services (DCFS) and the Probation Department (Probation) contract with Moore to care for foster care children placed in the Agency's homes. Under the Contract, the County pays Moore $4,479 a month per child based on a rate established by the California Department of Social Services. Moore received a total of $563,773 in group home foster care funds from the County during 2006.

Scope

The purpose of our review was to determine whether Moore complied with the contract terms and appropriately accounted for and spent foster care funds on allowable and reasonable expenditures. We also evaluated Moore's expenditure and revenue documentation, internal controls and compliance with applicable federal, State and County guidelines governing GH foster care funds.

Summary of Findings

We identified $12,985 in unallowable costs. In addition, DCFS and the Agency need to work together to resolve potential overpayments.

Moore has approximately $23,000 in delinquent federal and State payroll taxes, including interest and penalties. The Agency needs to submit a plan to DCFS describing how they will pay this payroll tax liability without using current period foster care funds, since Moore has no net assets from which this liability can be paid.

The Agency also needs to take steps to strengthen its controls over accounting, disbursements, payroll/personnel, loan agreements, bank reconciliations, and reporting of independent contractor payments. Finally, Moore's financial statements reflect significant loans payable which the Executive Director believes the Agency may not ultimately have to repay. The Agency should consult with their accountant to determine if this debt should be written-off. Details of our findings are discussed in the attached report.

DCFS needs to resolve the questioned costs and collect any disallowed amounts. In addition, DCFS needs to ensure that Moore's management takes action to address the recommendations in this report, and monitor to ensure that the actions result in permanent changes.

Review of Report

We discussed our report with Moore's management on February 12, 2008. They will provide their response to the report to DCFS who will prepare a Fiscal Corrective Action Plan and submit directly to your Board. We thank Moore's management and staff for their cooperation during our review.

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

WLW:MMO:JS:MM:RL

Attachment

c: William T Fujioka, Chief Executive Officer
Patricia S. Ploehn, Director, Department of Children and Family Services
Susan Kerr, Senior Deputy Director, Department of Children and Family Services
Robert B. Taylor, Chief Probation Officer
Steven Smith, Executive Director, Moore's Cottage Group Home
Board of Directors, Moore's Cottage Group Home
Cora Dixon, Bureau Chief, Foster Care Audits Bureau CA Dept. of Social Svcs.
Public Information Office
Commission for Children and Families
Audit Committee Members

Moore's Cottage Group Home
Fiscal Review

REVIEW OF EXPENDITURES

We identified $12,985 in unallowable costs. Details of these costs are discussed below.

Applicable Regulations and Guidelines

Moore is required to operate its GH in accordance with the following federal, State and County regulations and guidelines:

- GH Contract, including Exhibit C-2, 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)
- California Department of Social Services Manual of Policies and Procedures (CDSS-MPP)
- California Code of Regulations, Title 22 (Title 22)

Unallowable Costs

The Agency incurred $12,985 in unallowable expenditures consisting of:

- $7,172 in delinquent federal payroll taxes, interest and penalties for the quarterly tax periods ending December 31, 2003 and penalties for the tax period ending June 30, 2006.
- $4,246 in delinquent State payroll taxes, interest and penalties for the quarterly tax period ending December 31, 2005.
- $1,567 in other unallowable costs consisting of $268 in non-sufficient fund (NSF) fees, $1,050 in interest and late fees for auto payments, $91 in other late fees, $79 in line of credit finance charges and $79 for a parking violation.

Sections 16 and 23 of the Circular state that the costs incurred for interest and penalties are unallowable. In addition, section A.2.6 of the A-C Handbook states that the Agency will ensure compliance with all applicable federal and State requirements for withholding payroll taxes, reporting, filing and all applicable tax deposits. Using

current period foster care funds to pay prior year delinquent taxes is an unallowable use of funds.

Recommendations

1. **DCFS management collect the $12,985 in unallowable costs.**

2. **Moore's management ensure that foster care funds are only used for allowable expenditures to carry out the purpose and activities of the Agency.**

Potential DCFS Overpayments

DCFS records show some overpayments made to the Agency. DCFS and the Agency should work together to resolve the overpayments and DCFS should collect any verified overpayments. Moore's management should ensure that any future payment discrepancies are immediately reported to DCFS and any excess amounts are repaid promptly.

Recommendations

3. **DCFS management work with Moore to resolve the overpayments and DCFS should collect any verified overpayments.**

4. **Moore's management ensure that any future payment discrepancies are immediately reported to DCFS and any excess amounts are repaid promptly.**

Financial Viability

Moore's audited financial statements as of December 31, 2005 show negative net assets of $75,236 and minimal liquid assets. The negative net assets was due largely to the substantial liabilities for delinquent federal payroll taxes and loans from the Executive Director (ED), Facility Manager, and the ED's father (discussed below). However, an unaudited balance sheet and profit and loss statement for 2006 indicate that the Agency had a slight surplus and that the deficit in net assets was reduced to $63,705.

If the Agency incurs future operating losses, it is unclear how the Agency could cover the losses without further borrowing, which would further degrade its financial position. Further problems in Moore's financial condition could reduce its ability to provide an adequate level of care to placed children. (The two most recent program reviews of Moore's facilities disclosed no child safety issues.) DCFS needs to require that Moore, in consultation with its accountant, develop a plan to continue to provide an adequate

quality of care while addressing the Agency's financial issues. DCFS must carefully monitor Moore to ensure that its program is maintained at an acceptable level.

Recommendations

5. **Moore's management, in consultation with its accountant, develop a plan to continue an adequate quality of care while addressing the Agency's financial issues.**

6. **DCFS management carefully monitor Moore to ensure that program quality is maintained at an acceptable level.**

Payroll Tax Liability

Moore owes $21,888 in delinquent federal payroll taxes, interest and penalties for the 2003, 2005 and March 2006. The Agency paid $659 in penalties to the IRS in June 2006, which we have included in the unallowable costs above. The Agency entered into a repayment plan with the Internal Revenue Service (IRS) in November 2006. The Agency also owes the State $1,015 in delinquent payroll taxes, interest and penalties for the tax period ending December 31, 2005.

As previously discussed, Moore's audited December 31, 2005 financial statements showed negative net assets of $75,236 and the Agency's unaudited December 31, 2006 balance sheet shows negative net assets of $63,705. Because Moore has no net assets, it is unclear how the Agency will be able to pay its delinquent tax liability without using current period foster care contract funds. Current period foster care contract funds cannot be used to pay a liability that originated under a prior contract term. Further, foster care funds cannot be used to pay for penalties and interest related to delinquent taxes, since these costs are unallowable according to the Circular. In its plan to address the Agency's financial issues, Moore needs to address how they will pay their federal and State payroll tax liabilities without using current period foster care funds.

Recommendations

7. **DCFS management ensure that foster care funds are not used to pay penalties and interest related to delinquent payroll taxes.**

8. **Moore's management submit a plan to DCFS on how the Agency will pay its payroll tax liability without using current period funds.**

CONTRACT COMPLIANCE AND INTERNAL CONTROLS

We noted the following internal control weaknesses during our review.

Accounting and Disbursement Procedures

We noted weaknesses in the Agency's accounting and disbursement procedures:

- The payee was also the check signer on 162 checks totaling $56,584. The check signer should not be authorizing payments to themselves. Proper disbursement procedures require a second signature from someone independent of the transaction to verify the appropriateness of the expense.

- 3 of 30 expenditure items were not properly classified in the general ledger. For example, the Agency classified a payment of $400 for food, children's allowance, child transportation, supervised children activities and kitchen supplies as Building and Equipment Supplies on their general ledger. According to section A.2.5 of the A-C Handbook, the contractor must post transactions that are of a similar nature to the same account.

Recommendations

Moore's management:

9. **Require a second signature on all checks where the payee and the check signer are the same.**

10. **Properly classify all expenditures on the general ledger.**

Loan Agreements

The Executive Director (ED) and Facility Manager, who are husband and wife and the ED's father made significant loans to the Agency. As of December 31, 2006, the Agency's unaudited financial statements identified $56,160 in liabilities to these three individuals, of which $46,089 is owed to the ED's father, with the remaining $10,071 being owed to the ED and his wife. We verified that any loan proceeds received during our review period were deposited into Moore's bank accounts.

We noted that the Agency did not establish written loan agreements with the ED and his wife. The Agency did establish a written loan agreement with the ED's father for the initial loan amount of $32,760 in 1995. However, since that time, we were advised that the ED's father has made additional loans to the Agency that are not documented in a written loan agreement. According to the ED, it is doubtful that the loan from his father will ever be repaid.

As previously indicated, Moore's unaudited balance sheet as of December 31, 2006 reflects negative net assets of $63,705. This deficit is due in large part to the liabilities to the ED's father. If the Agency does not ultimately expect to repay these liabilities, they should consult with their accountant to determine if the debt should be removed from its financial statements.

To the extent the loans are valid, but are not supported by a written agreement, written agreements should be prepared. Section A.3.2 of the A-C Handbook indicates that loans to the Agency should be supported by a written loan agreement. We recommend that the Agency establish written agreements for all valid loans indicating the amounts borrowed and the repayment terms.

Recommendations

Moore's management:

11. **Consult with the Agency's accountant and ED's father to determine if the liabilities to the ED's father should be removed from its financial statements.**

12. **Establish written agreements for all loans indicating the amounts borrowed and the repayment terms.**

Bank Reconciliations

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

Moore's did not prepare the bank reconciliations within 30 days of the bank statement date and the reconciliations were not signed or dated by the reviewer. Also, the December 2006 reconciliation identified two checks totaling $6,630 from 2005 and thirteen checks totaling $5,873 that were over six months old and still outstanding.

Recommendations

Moore's management:

13. **Ensure the Agency's bank account reconciliations are prepared within 30 days of the bank statement date and are signed and dated by the reviewer.**

14. **Review and cancel any checks that have not been negotiated within six months and reissue, if appropriate.**

Payroll/Personnel Controls

CDSS MPP Section 11-402 requires that supporting documentation be maintained for all program expenditures, including employee salary rates. In addition, Section B.3.1 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 supervisor to certify the accuracy of the reported time.

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

- The Agency does not keep employee pay rate information in employee files.
- One employee's timecard did not have the supervisor's signature.

Recommendations

Moore's management:

15. **Ensure employees salary/pay rates are consistently documented and updated in the employees' personnel files.**

16. **Ensure the timecards are consistently signed by a supervisor to certify the accuracy of the reported time.**

Independent Contractors

Section A.2.6 of the A-C Handbook states that the Agency will ensure compliance with all applicable federal and State requirements for reporting and filing 1099 Forms. We reviewed five independent contractors hired by the Agency and noted:

- One independent contractor was not issued a 1099.
- For two independent contractors, the amount paid per the general ledger did not agree to the 1099s issued by the Agency. Specifically, the total on the general ledger for one contractor was more than the amount on the 1099 Form, and the other was less than the amount on the 1099 Form.

Recommendation

17. **Moore's management ensure that all income paid to independent contractors is properly reported to the federal and State taxing agencies.**