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DEPARTMENT OF AUDITOR-CONTROLLER

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November 3, 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 GAY AND LESBIAN ADOLESCENT SOCIAL SERVICES - A GROUP HOME FOSTER CARE CONTRACTOR**

Attached is our report on the fiscal operations of the Gay and Lesbian Adolescent Social Services (GLASS or Agency) from January 1, through December 31, 2006 for its Group Home (GH) program. GLASS is licensed to operate seven group homes, six with a capacity of six children each, and one with a capacity of 12 children. In addition to its GH program, GLASS operates a Foster Family Agency, Independent Living, Family Preservation and Mental Health programs. GLASS' headquarters is located in the Third Supervisorial District.

The Department of Children and Family Services (DCFS) and the Probation Department (Probation) contract with GLASS to care for foster children placed in the Agency's homes. Under the contract, DCFS pays GLASS $5,613 a month per child, based on a rate determined by the California Department of Social Services. During calendar year 2006, the Agency received $2,229,317 in GH foster care funds.

Scope

The purpose of our review was to determine whether GLASS complied with the contract terms and appropriately accounted for and spent foster care funds on allowable and reasonable expenditures. We also evaluated GLASS' 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 $166,279 in unallowable costs and $30,738 in unsupported/inadequately supported costs. In addition, DCFS and GLASS need to work together to resolve some potential overpayments.

We also noted that GLASS had operating losses of $175,058 in 2005 and $691,683 in 2006. As of December 31, 2006, the Agency had $2.9 million in Long-Term Debt and negative net assets of $1.26 million. It appears GLASS is operating some of its programs at a loss and is relying on borrowing to fund its operations. This could result in the Agency being unable to sustain its operations. It is unclear how GLASS will pay these liabilities, since the Agency cannot use current period foster care funds to pay prior period liabilities. GLASS will need to submit a plan to DCFS showing how the Agency will pay these liabilities without using current period foster care funds.

We also noted that GLASS needs to develop a plan to allocate its indirect costs, report independent contractor income accurately, and strengthen internal controls over its disbursements, personnel and payroll records, and bank reconciliations. Details of our findings are discussed in the attached report.

The findings noted in this report are significant and GLASS' corrective action plan needs to address the recommendations in this report. The corrective action plan needs to include how GLASS will provide an adequate level of care while addressing their continuing operating losses. DCFS needs to monitor to ensure that GLASS' corrective actions result in permanent changes.

Further, we have recommended that DCFS determine how much of the questioned costs should be disallowed collect any overpayments and disallowed amounts.

Review of Report

A draft report was provided to GLASS' management for their review and comments. However, the Agency declined a formal exit conference to discuss the findings and recommendations. They will provide their written response to DCFS who will prepare a Fiscal Corrective Action Plan that will be submitted directly to your Board. We thank GLASS 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:JLS:MM

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
Ted Myers, Chief Deputy Director, Department of Children and Family Services
Robert B. Taylor, Chief Probation Officer
Teresa Decrescenzo, Executive Director, GLASS Cottage, Inc.
Board of Directors, GLASS Cottage, Inc.
Cora Dixon, Bureau Chief, Foster Care Audits Bureau, CA Dept. of Social Services
Public Information Office
Audit Committee
Commission for Children and Families

GLASS, Inc.
Fiscal Review

REVIEW OF EXPENDITURES/REVENUES

We identified $166,279 in unallowable costs and $30,738 in unsupported/inadequately supported costs. In addition, DCFS and GLASS need to work together to resolve some potential overpayments. Details of these costs/overpayments are discussed below.

Applicable Regulations and Guidelines

GLASS 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 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 $166,279 in unallowable expenditures:

- $81,191 in interest and late payment fees for six loans with various banks and one loan from a prior GLASS Board member. OMB Circular A-122 Attachment B Sections 16 and 23 state that fines, penalties and interest are not allowable costs.
- $76,070 in penalties and interest payments; $38,741 in insufficient fund and overdraft fees and $37,741 for late federal payroll tax deposits.
- $6,535 in the Agency's Executive Director's vehicle allowance. OMB Circular A-122 Attachment B Section 8(h) states that the cost of personal use of organization-furnished automobiles is unallowable. The Executive Director did not maintain a log to document how the use of this vehicle benefited the group home program as required by the A-C Handbook.
- $2,483, consisting of $943 for credit card and insurance premium finance charges, a $601 traffic violation fine, $550 for expenses that should have been charged to the Agency's contract with the County Department of Mental Health, $367 in late fees

for a GH license and late vehicle payments, and $22 for a receipt that was crediting the Agency for the return of an item. As noted earlier, the OMB Circular states that fines, penalties and interest are unallowable. In addition, A-C Handbook Section C.1.5 states that only expenditures that are necessary, proper and reasonable for the purposes and activities of the program are allowable.

Unsupported/Inadequately Supported Costs

A-C Handbook Section A.3.2 states that all expenditures shall be supported by original vouchers, invoices, receipts, contracts or other documentation, and that unsupported expenditures shall be disallowed upon audit. Photocopied invoices or receipts, any internally generated documents (i.e., vouchers, request for check forms, requisitions, canceled checks, etc.), and account statements do not constitute supporting documentation for purchases.

We identified $30,738 in expenditures that were either unsupported or inadequately supported. These expenditures consisted of:

- $23,595 in payments to various vendors including Working Assets, Sallie Mae, City of West Hollywood, St. Monica's Church, Lexus, SC Fuels, American Express and employee reimbursements. The Agency did not provide invoices or receipts to support the disbursements.

- $5,757 in payments to five independent contractors. The Agency did not provide written agreements for the contractors. In addition, an invoice was not provided for one contractor payment and, in another instance, the payment did not agree with the amount on the invoice.

- $1,386 salary payment to an employee, which the Agency recorded as a vacation pay-out. However, an approved vacation pay-out request, or a benefit log showing the reduction to the employee's vacation time was not provided to support the payment.

As discussed later in this report in the "Allocation of Indirect Costs" section of this report, while GLASS captures indirect costs in their accounting records, the Agency does not have a written cost allocation plan and does not allocate those costs among its programs. As a result, it is likely that some of the questioned costs discussed in this section were related to other counties and 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 as part of the audit settlement.

Recommendations

DCFS management:

1. **Resolve the $197,017 ($166,279 + $30,738) in questioned costs and collect any disallowed amounts.**

GLASS management:

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

3. **Maintain adequate supporting documentation for all foster care expenditures, including original itemized receipts/invoices, contracts and vacation pay-out requests.**

FINANCIAL VIABILITY

GLASS had overall operating losses of $175,058 in 2005 and $691,683 in 2006. As of December 31, 2006, the Agency had $2.9 million in Long-Term Debt and negative net assets of $1.26 million. We also noted that GLASS had minimal cash and no investments as of December 31, 2006, which indicates the Agency is using loans to fund its operations. In addition, the Agency incurred approximately $625,000 in development and fund raising costs in 2006, and it is unclear whether the Agency receives any dedicated revenue to offset these costs.

It appears GLASS is operating some of its programs at a loss and is relying on borrowing to fund its operations. This could result in the Agency being unable to sustain its operations. It is unclear how the Agency will pay this liability, since the Agency cannot use current period foster care funds to pay prior period liabilities.

GLASS management needs to develop a plan describing how it will continue to provide adequate level of care while addressing its ongoing operating losses. Given the Agency's tenuous financial position, DCFS must carefully monitor GLASS to ensure that service quality is maintained at an acceptable level.

Recommendations

4. **GLASS management develop a plan demonstrating how it will provide an adequate level of care while addressing its ongoing operating losses.**

5. **DCFS management carefully monitor GLASS to ensure that service quality is maintained at an acceptable level.**

AGENCY LIABILITIES

As noted earlier, GLASS paid $37,741 in penalties to the IRS for late payment of payroll taxes. These penalties are an unallowable cost that we disallowed. We also noted that the Agency still owes an additional $7,745 in penalties and interest to the IRS. GLASS cannot use current period funds to pay the penalties and interest. In addition, as previously discussed, as of December 31, 2006, the Agency had approximately $2.9 million in Long-Term Debt. Similarly, foster care funds cannot be used to pay interest on this debt.

As part of GLASS' plan to DCFS, the Agency needs to indicate how they will repay the penalties and interest to the IRS and interest on its debt without using current period foster care funds.

Recommendations

6. **GLASS management address in their plan to DCFS how they will repay penalties and interest to the IRS and interest on its debt without using current period foster care funds.**

7. **DCFS management monitor to ensure that foster care funds are not used to pay penalties and interest to the IRS and interest on the Agency's debt.**

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. GLASS management should ensure that any future payment discrepancies are immediately reported to DCFS and any excess amounts are repaid promptly.

Recommendations

8. **DCFS management work with GLASS to resolve the overpayments and collect any verified overpayments.**

9. **GLASS management ensure that any future payment discrepancies are immediately reported to DCFS and excess amounts are repaid promptly.**

CONTRACT COMPLIANCE AND INTERNAL CONTROLS

We noted several contract compliance issues and internal control weaknesses. DCFS needs to ensure that GLASS management takes action to address the recommendations in this report. DCFS will also need to monitor to ensure the corrective actions result in permanent changes.

Allocation of Indirect Costs

A-C Handbook Section C.2.0 requires contractors who operate multiple programs to allocate expenditures that benefit multiple programs/funding sources on an equitable basis. The contractor should have documentation of how the expenses were allocated, such as timecards, time summaries, square footage measurements, number of employees, etc. County Contract Section 8.2 states that "By August 1 of each year, contractor shall submit to County a cost allocation plan, which provides for the reasonable allocation of contractor's expenditures for the then current fiscal year".

In addition to its GH program, GLASS operates a Foster Family Agency, Independent Living, Family Preservation, Mental Health programs and other grants. The Agency did not maintain a plan to allocate expenditures equitably among its programs. While general overhead expenses were captured, they were not allocated among the various programs/funding sources in their accounting records. GLASS indicated overhead is allocated annually by their Certified Public Accountant during their single audit.

The Agency needs to develop a plan to allocate overhead expenditures to each program and funding source on an equitable basis.

Recommendations

10. **GLASS management develop a plan to allocate overhead expenditures to each program and funding source on an equitable basis for the current fiscal year and submit it to DCFS.**

11. **DCFS management evaluate the Agency's cost allocation plan for appropriateness.**

Cost Centers

As previously indicated GLASS operates multiple programs and receives funding for each program from multiple funding sources. A-C Handbook Section A.2.4 requires that separate accounts be maintained for the program expenses and revenues of each county.

We noted that GLASS accounts for revenues and expenses only at the program level. The Agency's accounting records do not track activity at the funding source level. For example, GLASS receives funding for its GH from Los Angeles County and other counties. However, the Agency's records do not identify GH expenses related to Los Angeles County's contract with the Agency. GLASS' records only show total expenses of the GH program.

The Agency's lack of a cost allocation plan results in inaccurate information in their semi-annual revenue and expenditure report and L. A. County's portion of the Agency's GH program. GLASS' report shows the direct costs and revenue for the L. A. County GH contract, but did not include indirect/overhead costs, which results in an understatement of expenditures and an overstatement of Unexpended Funds.

Recommendations

12. **GLASS management maintain separate accounts for each county's program's expense and revenues.**

13. **GLASS management ensure their semi-annual revenue and expenditure report to DCFS includes all direct and overhead costs.**

Disbursement Procedures

A-C Handbook Section B.2.1 requires all supporting documentation be referenced to check numbers and marked "paid" or otherwise canceled to prevent reuse, or duplicate payments.

We reviewed 65 payments and noted 54 (83%) were not marked "paid" or referenced to the check number.

Recommendation

14. **GLASS Management ensure all vendor invoices and receipts marked "paid" and referenced to cancelled checks.**

Payroll Controls

A-C Handbook Section B.3.1 states that timecards and time reports must be signed in ink by the employee and the employee's supervisor to certify the accuracy of the reported time, and Section B.3.2 states that personnel and payroll records need to include the employee's authorized salary. A-C Handbook Section A.2.6 further states that the contractor must comply with federal and State requirements for filing W-2s.

We reviewed the personnel files and payroll information for 12 employees and noted the following:

- Two (17%) employees did not have a current pay rate in their personnel file. We verified the salaries were reasonable.

- Three (25%) timecards were not signed by a supervisor.

We also reviewed 42 timecards, salary payments and W-2s for three executive managers and noted the following:

- 36 (86%) timecards were not signed by a supervisor.
- The Agency did not provide four timecards (10%) for two employees.
- One timecard was not signed by the employee.
- Gross wages were underreported by $432 on one employee's W-2.

Recommendations

GLASS management:

15. **Ensure current salary rates are consistently recorded in the employees' personnel files.**

16. **Ensure time cards are prepared for all employees for each time period and signed by the employee and a supervisor.**

17. **Ensure employee wages are reported accurately on W-2s.**

Independent Contractors

Contract Section 18 requires the Agency to comply with State and federal rules for reporting income paid to independent contractors. We noted that GLASS did not report payments to seven independent contractors using a 1099 form.

Recommendation

18. **GLASS management ensure that all payments to independent contractors are properly reported to the federal and State taxing agencies.**

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 reconciling items should be resolved timely.

The October 2006 bank reconciliation listed 107 outstanding transactions, totaling $170,789. The November and December 2006 bank statements showed that 24 of those items, totaling $24,081, were still outstanding. Eight of the 24 outstanding checks

were written in April, May and June of 2006. GLASS Management needs to ensure it investigates and resolves outstanding checks in a timely manner.

Recommendation

19. GLASS management investigate and resolve outstanding checks timely.