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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 TOUCH A LIFE FOUNDATION - A GROUP HOME FOSTER CARE CONTRACTOR**

Attached is our report on the fiscal operations of Touch A Life Foundation (TALF or Agency) from January 1, through December 31, 2006. TALF is licensed to operate two group homes (GH), each with a resident capacity of six children. TALF's GHs are located in the First and Second Supervisorial Districts.

The Department of Children and Family Services (DCFS) and the Probation Department (Probation) contract with TALF to care for foster children placed in the Agency's homes. DCFS paid TALF $4,479 a month per child, based on a rate determined by the California Department of Social Services. During calendar year 2006, the Agency received $641,144 in GH foster care funds.

Scope

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

Summary of Findings

We identified $43,535 in unallowable costs and $198 in unsupported/inadequately supported costs. In addition, DCFS and the Agency need to work together to resolve some potential overpayments.

More significantly, TALF's audited financial statements for calendar years 2004 through 2006 contained a "going concern" qualification, which raises questions about the Agency's ability to continue its operations. The Agency has negative net assets of $418,875 as of December 31, 2006 and it appears to be relying on borrowing to fund 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. TALF will need to submit a plan to DCFS showing how the Agency will pay these liabilities without using current period foster care funds.

In addition, TALF should ensure its Board of Directors is independent, and strengthen its controls over accounting and disbursements, personnel/payroll records, and payments to independent contractors. Details of our findings are discussed in the attached report.

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

Further, we have recommended that DCFS resolve the questioned costs and, to the extent possible, collect any overpayments and disallowed amounts.

Review of Report

We discussed our report with TALF's management on June 10, 2008. The Agency will provide their response to DCFS who will prepare a Fiscal Corrective Action Plan and submit it directly to your Board. We thank TALF'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:JLS

c: William T Fujioka, Chief Executive Officer
Patricia S. Ploehn, Director, Department of Children and Family Services
Ted Myers, Chief Deputy Director, Department of Children and Family Services
Susan Kerr, Senior Deputy Director, Department of Children and Family Services
Robert B. Taylor, Chief Probation Officer
Charles Wade, Executive Director, Touch A Life Foundation
Board of Directors, Touch A Life Foundation
Cora Dixon, Bureau Chief, Foster Care Audits Bureau, CA Dept. of Social Services
Public Information Office
Audit Committee Members
Commission for Children and Families

Touch A Life Foundation
Fiscal Review

REVIEW OF EXPENDITURES/REVENUES

We identified $43,535 in unallowable costs and $198 in unsupported/inadequately supported costs. In addition, DCFS and TALF need to work together to resolve some potential overpayments. Details of these costs/overpayments are discussed below.

Applicable Regulations and Guidelines

TALF is 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)
- California Department of Social Services Manual of Policies and Procedures (CDSS-MPP)
- California Code of Regulations, Title 22 (Title 22)

Unallowable Costs

TALF incurred $43,535 in unallowable expenditures:

- $43,392 in late fees and finance charges from credit cards for calendar years 2003 through 2005. This issue was also identified in our 1999 fiscal audit report on TALF.
- $143 in late fees and finance charges from Toyota Financial Services, Union 76 and Best Buy.

Circular Sections 16 and 23 state that penalties and interest are unallowable.

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 $198 in inadequately supported expenditures related to donations, gas and clothing purchases. The Agency provided cancelled checks, but no receipts or the receipts were inadequate to substantiate that the expenditures were group home related.

Recommendations

DCFS management:

1. **Resolve the $43,733 ($43,535 + $198) in questioned costs and collect any disallowed amounts.**

TALF management:

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

3. **Maintain adequate supporting documentation for all Agency expenditures, including original itemized invoices and receipts.**

FINANCIAL VIABILITY

The Agency's audited financial statements for calendar 2004 through 2006 contained a "going concern" qualification, citing net losses of $110,643 during the period. In addition, the Agency had negative net assets of $418,875 as of December 31, 2006. The Agency appears to be financing its operations with loans from the Executive Director. From 2004 to 2006, the Agency's loans payable increased from $124,053 to $411,193.

TALF is operating its Group Home program at a loss and appears to be 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.

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

Recommendations

4. **TALF management develop a plan demonstrating how it will provide an adequate level of care while addressing its operating losses and repaying its debt.**

5. **DCFS management closely monitor TALF 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 the Agency should work together to resolve the overpayments, and DCFS should collect any verified overpayments. TALF's management should ensure that any future payment discrepancies are immediately reported to DCFS and any excess amounts are repaid promptly.

Recommendations

6. **DCFS management work with TALF to resolve the overpayments and collect any verified overpayments.**

7. **TALF 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 should ensure that TALF management takes action to address the recommendations in this report. DCFS should also monitor to ensure the actions result in permanent changes.

Board of Directors Independence

California Corporations Code Section 5227 states that not more than 49% of the persons serving on the Board of any corporation may be "interested persons." "Interested persons" include persons currently being paid by the corporation for services rendered within the previous 12 months. If a director is related to anyone who has received payment from the corporation, that director may be an "interested person."

Three of TALF's five board members are employees of the Agency. The Agency needs to comply with the California Corporations Code requirement for Board independence.

Recommendation

8. **TALF management ensure its Board of Directors complies with the California Corporations Code.**

Accounting and Disbursement Procedures

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

- The Agency issued 15 checks, totaling $25,135, in which the check signer (the Executive Director) was also the payee. On checks where the signer is also the payee, a second signature by someone independent of the payee (such as a Board member), should be required to verify the appropriateness of the expense.

- The Agency did not maintain an Accounts Receivable ledger. Without an Accounts Receivable ledger, the Agency cannot clearly identify over/under payments from DCFS. California Department of Social Services Manual Policies and Procedures (CDSS MPP) Section 11-402.84 states that accounting records shall be maintained in accordance with generally accepted accounting principles. Examples include, but are not limited to, accounting records and journals, ledgers and supporting documentation, invoices, receipts, checks and/or vouchers.

Recommendations

TALF management:

9. **Require a second signature by an independent party on all checks where the payee and the check signer are the same employee.**

10. **Maintain an Accounts Receivable ledger to identify over and under payments from DCFS.**

Payroll/Personnel Controls

CDSS MPP Section 11-402 requires that supporting documentation be maintained for all program expenditures, including employee 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 in ink by the employee and the employee's supervisor to certify the accuracy of the reported time.

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

- None of the employee personnel files contained a current salary or pay rate.

- Two timecards did not have the supervisor's signature.
- The hours worked on one timecard did not agree to the payroll register. The employee was not paid for 5 hours of overtime, an underpayment of $67.50.

Recommendations

TALF management:

11. **Ensure employee pay rates are consistently documented and updated in the personnel files**

12. **Ensure the timecards are signed by the employee and a supervisor to certify the accuracy of the reported time.**

13. **Ensure the timecards accurately reflect actual hours worked by employees and that employees are paid properly.**

Independent Contractors

A-C Handbook Section A.3.2 requires supporting documentation be maintained for independent contractors or consulting services. Supporting documentation includes contracts, time and attendance records, billing rates and invoices, or other supporting documentation detailing the nature of the services provided. In addition, A-C Handbook Section A.2.6 requires agencies to comply with federal and State requirements for filing 1099 (Miscellaneous Income) Forms.

We sampled all three of the Agency's independent contractors and noted

- Two contracts were not signed by the Agency.
- One contractor did not have a contract with the Agency.
- Two contractors did not provide invoices or other supporting documentation detailing the services provided.
- TALF did not report one contractor's payments to taxing agencies on a 1099.

Recommendations

TALF management:

14. **Ensure that the Agency maintain supporting documentation for all independent contractors, including contracts and invoices.**

15. **Ensure all payments to independent contractors are reported to the federal and State taxing agencies.**