



November 13, 2012

Ms. Jennifer Kent, Chair
First 5 California Commission
2389 Gateway Oaks Drive, Room 260
Sacramento, CA 95833

Dear Ms. Kent:

Management Letter—First 5 California, 2012 Financial Statement Audit of the Children and Families Trust Fund and Related Accounts

The Department of Finance, Office of State Audits and Evaluations (Finance), has completed its financial audit of the First 5 California's Children and Families Trust Fund (Fund) and related accounts for the fiscal year ended June 30, 2012. In planning and performing our audit of the financial statements of the Fund and related accounts for the fiscal year then ended, we considered the internal control in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on internal control. Additionally, we performed tests of compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. During our audit we became aware of an opportunity for strengthening internal control over the Fund and an instance where the First 5 Commission did not fully comply with a legislative requirement.

Observation 1: Undocumented Cost Allocation Plan Procedures

The Board of Equalization (BOE) does not have written cost allocation plan (CAP) procedures for program and administrative costs allocated to the various funds it administers. During fiscal year 2011-12, BOE allocated \$15.7 million of program and administrative costs to the Fund. BOE relies on the knowledge of a limited number of key staff in the Budget Operations Unit to perform the calculations and allocate the costs. However, the cost allocation calculation is a complex, manual process which consists of a series of multi-layered allocations employing various methodologies (i.e. allocation bases, and cost pools). Reliance on only the knowledge of key staff without documented CAP procedures creates a risk that costs may not be allocated consistently, appropriately, and in accordance with the benefits received by the Fund.

The Financial Integrity and State Manager's Accountability Act, Government Code section 13400, et. seq., requires state agencies to maintain effective systems of internal control as an integral part of its management practices to ensure the reliability of financial information. This responsibility includes documenting the system through flowcharts, narratives, and desk procedures as specified in the State Administrative Manual (SAM) section 20050. In addition, SAM section 9203 requires documentation of cost allocation procedures in the form of a CAP, with detailed information regarding the costs being allocated, allocation methodology, frequency of the allocation, and rationale for the allocation base. It further states that CAPs should be supported by appropriately cross-referenced working papers or system documentation, updated periodically, and retained for reference and audit purposes.

Recommendation: BOE should develop a CAP to document its cost allocation methodology. This will ensure the program and administrative costs are allocated consistently, appropriately, and in accordance with the benefits received by the Fund.

Response: BOE concurred with the observation and indicated the budget staff is in the process of developing comprehensive internal documentation of the cost allocation procedures and methodology, and is making adjustments to conform to statewide requirements.

Observation 2: Commission Transfer of Funds Authorization Requirements

The First 5 Children and Families Commission (Commission) did not fully comply with the technical requirements of Assembly Bill 1422, Chapter 157, statutes of 2009 (AB 1422), to authorize funding of \$50 million for the Department of Developmental Services' (DDS) Early Start Program. AB 1422 requires Commission approval to transfer funds not needed in various accounts to the Unallocated Account for any of the purposes of the California Children and Families Act of 1998 (Proposition 10).

On April 18, 2012, the Commission approved a motion authorizing \$50 million for DDS' Early Start Program. Although the Commission authorized the \$50 million funding for DDS, the motion did not specify the composition of the funding by the various contributing accounts, a determination that these funds were not needed in those accounts, nor authorize the specific transfer of the funds to the Unallocated account for subsequent disbursement to DDS. This impacts the presentation of the financial statements as the \$50 million is only authorized to be expended directly from the various accounts and not from the Unallocated account as required.

Recommendation: The Commission should ensure motions to transfer funds conform with all requirements of AB 1422. This will appropriately authorize the transfer of any funds and ensure the consistent presentation of these expenditures in the financial statements.

Response: The Commission indicated it has put in place stronger procedures to ensure all future motions will include, if appropriate, the authorization to transfer funds from specified accounts to the Unallocated account together with any required findings that the funds are not needed in the original account. Additionally, the Commission stated that for the above motion the Commissioners were presented with a financial plan, including proposed funding by account, and the subsequent transfer of funds adhered to the funding as presented during the meeting.

This letter is intended as an internal management tool to assist the Fund's management in improving internal control and compliance. We appreciate the assistance and cooperation of BOE and First 5 California's management and staff. If you have any questions regarding this letter, please contact Kimberly Tarvin, Manager, or Alma Ramirez, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

David Botelho, CPA
Chief, Office of State Audits and Evaluations

cc: On following page

cc: Ms. Renee Webster-Hawkins, Interim Executive Director, First 5 California
Ms. Sandra Beck, Chief, Administrative Services Division, First 5 California
Ms. Cynthia Bridges, Executive Director, State Board of Equalization
Mr. Larry Norris, Budget Officer, State Board of Equalization
Mr. Brock Wimberley, Acting Chief, Internal Audit Division, State Board of Equalization
State Controller's Office, Division of Audits, First 5 Oversight Unit