DEPARTMENT OF FINANCE

EDMUND G. BROWN JR. • GOVERNOR

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Transmitted via e-mail

December 12, 2013

Ms. Caroll Mortensen, Director
Department of Resources Recycling and Recovery
P.O. Box 4025
1001 I Street, MS 25A
Sacramento, CA 95814

Dear Ms. Mortensen:

Final Report—Department of Resources Recycling and Recovery, Internal Control Audit

The Department of Finance, Office of State Audits and Evaluations, has completed its internal control audit of the Department of Resources Recycling and Recovery's (CalRecycle) fiscal processes and procedures as of October 31, 2012.

The enclosed report is for your information and use. CalRecycle's response to the report observations and our evaluation of the response are incorporated into this final report. This report will be placed on our website.

We appreciate the assistance and cooperation of CalRecycle. If you have any questions regarding this report, please contact Kimberly Tarvin, Manager, or Jennifer Arbis, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

Richard R. Sierra, CPA
Acting Chief, Office of State Audits and Evaluations

Enclosure

cc: On following page

cc: Mr. Ken DaRosa, Chief Deputy Director, Department of Resources Recycling and Recovery
Mr. Tom Estes, Deputy Director, Administration, Finance, and Information Technology Services Division, Department of Resources Recycling and Recovery
Mr. Jose Ortiz, Deputy Director, Division of Recycling, Department of Resources Recycling and Recovery
Mr. Howard Levenson, Deputy Director, Materials Management and Local Assistance Division, Department of Resources Recycling and Recovery
Ms. Audrey Traina, Chief, Audits Office, Department of Resources Recycling and Recovery
Ms. Sarah Keck, Chief Financial Officer, Fiscal Services Branch, Department of Resources Recycling and Recovery
Ms. Kellie Schneider, Branch Chief, Administrative Services Branch, Department of Resources Recycling and Recovery
Mr. Andrew Felsenstein, Chief Accounting Officer, Accounting Section, Department of Resources Recycling and Recovery
Ms. Suzanne Blihovde, Budget Officer, Budget and Economic Forecasting Section, Department of Resources Recycling and Recovery
Mr. Kevin Campbell, Senior Management Auditor, Audits Office, Department of Resources Recycling and Recovery

Audit Report

Department of Resources Recycling and Recovery
Internal Control Over Fiscal Processes and Procedures

CalRecycle Website at www.CalRecycle.ca.gov

Prepared By:
Office of State Audits and Evaluations
Department of Finance

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September 2013

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Final reports are available on our website at http://www.dof.ca.gov

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Executive Summary

In accordance with an interagency agreement with the Department of Resources Recycling and Recovery (CalRecycle), the Department of Finance, Office of State Audits and Evaluations (Finance), conducted an internal control audit of CalRecycle's fiscal processes and procedures as of October 31, 2012.

CalRecycle has implemented many effective fiscal processes and procedures. However, several internal control weaknesses were identified in the areas of governance, information systems, receivables, revenues, purchasing, and asset management. As a result, some critical fiscal information is not timely or routinely available and other fiscal information may be unreliable and inaccurate. This increases the risk of a material misstatement in the financial statements. Further, assets are not adequately safeguarded from unauthorized use or disposition. The weaknesses identified include the following:

1. The Division of Recycling's (DOR) Fiscal Functions Are Not Fully Integrated Within CalRecycle's Fiscal Operations

    - The Accounting Section and DOR have adopted separate incompatible accounting methods to record the Beverage Container Recycling Program revenue and receivable transactions.
    - DOR has not developed critical DOR Integrated Information System (DOR*IIS*) receivables and revenue reports at month-end and year-end, with historical data maintained as of a certain point in time.
    - DOR has not researched and resolved approximately $784,100 in cash receipts classified as unapplied in DOR*IIS* for the period March 2007 through April 2012.
    - DOR wrote-off receivables without complying with all required collection letter procedures and obtaining the State Controller's Office approval.

2. Assets Are Not Safeguarded from Unauthorized Use or Disposition

    - Furniture items do not have state property decals.
    - The property ledger was incomplete.
    - Acquisition and disposition of capitalized assets are recorded once per year using an allocation method that may not record costs to the fund(s) that benefitted from the asset purchase.
    - The property ledger was missing detailed information for disposed or surveyed items.
    - Property Survey Report forms did not include make, model, serial number, and state decal number to identify the specific item surveyed.
    - Periodic reconciliations cannot be performed because capitalized assets are only recorded once a year and the properly ledger is incomplete.
    - A physical inventory was not performed.

3. Incompatible Information System Access and Duties

    - *CALSTARS*—Multiple staff are assigned conflicting CALSTARS functions, staff CALSTARS access does not always align with job duties, and some staff perform conflicting job duties.
    - *Oil Recycling and Claims Automation (ORCA) Claims Processing*—One accounting employee performs incompatible duties of reviewing, approving, and processing the ORCA incentive payment claims in both ORCA and CALSTARS without the review and approval of a used oil expert.
    - *ORCA Programming*—One employee performs incompatible duties of designing, programming, and record file maintenance for ORCA.

4. Information Systems at Risk

    - DOR*IIS* access was not removed for several employees that left CalRecycle between August 2012 and October 2012.
    - ORCA does not require a second electronic approval for claims transactions related to closed, pending or expired participant status.
    - ORCA and the Covered Electronic Waste Payment Information System (CEWIS) do not require routine password changes to ensure data integrity and security of automated files.

5. Policies and Procedures Are Inadequate or Absent for Certain Functions

    - CEWIS—Claim review/data input process
    - CEWIS, ORCA, and DOR*IIS*—Access controls
    - Forecasting procedures
    - Signature authority to approve some budget documents
    - Decentralized check distribution process
    - Application of property decals upon receipt of state property

For additional details, see the Results section of this report. The findings and recommendations in this report are intended to assist CalRecycle in strengthening its internal control. We met with CalRecycle management and staff during fieldwork to discuss the internal control weaknesses identified in this report.

BACKGROUND, SCOPE AND METHODOLOGY

BACKGROUND

The Department of Resources Recycling and Recovery (CalRecycle) protects public health and safety and the environment through the regulation of solid waste facilities, including landfills, and promotes recycling of a variety of materials including beverage containers, electronic waste, waste tires, used oil, and other materials. CalRecycle also promotes source reduction, recycling and composting, and reuse waste diversion practices. Additional departmental activities include research, permitting, inspection, enforcement, public awareness, market development to promote recycling industries, and technical assistance to local agencies.[1] To accomplish these objectives, CalRecycle administered approximately 14 funds with approximately $1.45 billion in expenditures during the fiscal year July 1, 2011 through June 30, 2012.[2]

The Financial Integrity and State Manager's Accountability Act (FISMA), Government Code section 13402, requires state managers to establish and maintain an internal control system that regulates and guides operations. Internal control is defined as a process designed to provide reasonable assurance regarding the achievement of objectives in the following categories: (a) reliability of financial and non-financial reporting; (b) effectiveness and efficiency of operations, including operational and financial performance goals, and safeguarding assets against loss; and (c) compliance with applicable laws and regulations. This definition of internal control includes the following five interrelated components:

- **Control Environment:** The set of standards, processes, and structures that provide the basis for carrying out internal control across the organization. It enables management to carry out its governance oversight responsibilities and impacts the overall system of internal control.

- **Risk Assessment:** A process that identifies and assesses risks related to the achievement of management's established objectives.

- **Control Activities:** Policies and procedures that ensure management's directives are carried out and help ensure that necessary actions are taken to minimize risks to achievement of management's objectives.

- **Information and Communication:** Information must be identified, captured, and communicated in a form and time frame that enable people to carry out their responsibilities.

- **Monitoring Activities:** Assessing the quality of the internal control system's performance over time. This is accomplished through ongoing monitoring activities, separate evaluations, or a combination of the two.

[1] Excerpts from www.calrecycle.ca.gov
[2] Excerpts from the fiscal year 2013-14 Governor's Budget

SCOPE

In accordance with an interagency agreement, the Department of Finance, Office of State Audits and Evaluations (Finance), performed an audit of CalRecycle's internal control over fiscal processes and procedures as of October 31, 2012.

METHODOLOGY

To evaluate CalRecycle's internal control over fiscal processes and procedures, we performed the following:

- Gained an overall understanding of CalRecycle's operations.
- Performed a risk assessment to identify the areas of greatest vulnerabilities.
- Interviewed key personnel to obtain an understanding of business processes.
- Identified critical fiscal functions.
- Evaluated fiscal accounting and administrative processes through observation of current practices, review of policies and procedures, and review of various documents.
- Observed physical assets on hand, reviewed related documents, and evaluated the maintenance of CalRecycle's property tracking system.
- Evaluated policies, procedures, and documentation of receipts and disbursements for the following systems: Oil Recycling and Claims Automation (ORCA); Division of Recycling Integrated Information System (DOR*IIS*); and Covered Electronic Waste Payment Information System (CEWIS).
- Compared subsidiary system balances to California State Accounting and Reporting System (CALSTARS), the department's official accounting system, to determine if the subsidiary databases agree to the accounting books of record.

Except as noted below, the audit was conducted in accordance with *Government Auditing Standards* (GAS), issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

In connection with this audit, there are certain disclosures required by *Government Auditing Standards*. Finance is not independent of CalRecycle, as both are part of the State of California's Executive Branch. As required by various statutes within the California Government Code, Finance performs certain management and accounting functions. These activities impair independence. However, sufficient safeguards exist for readers of this report to rely on the information contained herein.

The Department of Resources Recycling and Recovery (CalRecycle) implemented many effective fiscal processes and procedures. However, some significant controls are either not established or are not functioning in the areas of governance, information systems, receivables, revenue, purchasing, and asset management. As a result, critical fiscal information is not timely or routinely available and other fiscal information may be unreliable and inaccurate. This increases the risk of a material misstatement in the financial statements. Further, assets are not adequately safeguarded from unauthorized use or disposition.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider Findings 1 and 2 to be material weaknesses.

The following findings and recommendations are provided to assist CalRecycle in its efforts to improve fiscal processes and procedures. Appendix A identifies the criteria for each finding. The results of our audit are based on our review of documentation, other information made available to us, and interviews with staff.

FINDING 1: The Division of Recycling's (DOR) Fiscal Functions Are Not Fully Integrated Within CalRecycle's Fiscal Operations

Several fiscal weaknesses discussed below impact the Beverage Container Recycling Program. While DOR program staff expertise is essential in maintaining the subsidiary records, the Fiscal Services Branch (FSB) is responsible for fiscal accountability and financial reporting for the department. Coordination between FSB's Accounting Section and DOR is imperative to ensure the department meets fiscal requirements.

- The Accounting Section and DOR have adopted separate incompatible accounting methods to record the Beverage Container Recycling Program revenue and receivable transactions. Receipts are applied differently by each unit. As a result, the California State Accounting and Reporting System (CALSTARS) records cannot be supported by or reconciled to the subsidiary system records in DOR*IIS.*

- DOR has not developed critical DOR*IIS* receivables and revenue reports at month-end and year-end, with historical data maintained as of a certain point in time. As a result, the Accounting Section has not timely and accurately recorded, reconciled, and supported the receivables and revenue transactions within the Beverage Container Recycling special revenue funds monthly and at year-end.

- DOR has not researched and resolved approximately $784,100 in cash receipts classified as unapplied in DOR*IIS* for the period March 2007 through April 2012. The unapplied cash receipts represent either receivables not properly credited to participant manufacturer/distributor reports or participant overpayments. As a result, participant account balances may be incorrect or the financial statements may inaccurately report revenue instead of a liability.

- DOR wrote off receivables without complying with required procedures and approvals.

    - Only 2 of the 3 required collection letters (30 and 60 day letters) were sent to the debtors.
    - Authorization from the State Controller's Office (SCO) was not obtained prior to discharging receivables.

Recommendations:

A. Consult with the Department of Finance's Fiscal Systems and Consulting Unit to implement department-wide uniform accounting procedures that are consistent with state accounting practices and requirements.

B. Develop DOR*IIS* receivables and revenue reports, with point-in-time historical documentation maintained, that identify the receivables and revenue in accordance with state accounting practices.

C. Record and reconcile the receivables and revenue accounts in CALSTARS and DOR*IIS* monthly and at year-end.

D. Research and resolve DOR*IIS* unapplied receipts. Verify overpayments are accurately recorded in CALSTARS.

E. Transfer the DOR receivables write-off responsibility to the Accounting Section. The Accounting Section is responsible for fiscal accountability of write-offs for the department and its existing collections process complies with state requirements.

FINDING 2: Assets Are Not Safeguarded from Unauthorized Use or Disposition

Controls over property acquisitions, dispositions, record maintenance, reconciliations, and physical inventory are not sufficient to ensure assets are safeguarded and fiscal data is reliable. Collectively, these deficiencies create an opportunity for fraud or theft of state property without timely detection. Additionally, reliance cannot be placed on the accuracy of accounting records that support approximately $2.2 million of reported property as of June 30, 2012. Table 1 illustrates the asset acquisition and management processes and corresponding control weaknesses. The untimely recording, reconciliation, and inventory weaknesses are prior audit findings that have not been corrected.

Table 1: Asset Acquisition and Management Processes and Control Weaknesses

ASSET ACQUISITION AND MANAGEMENT PROCESSES	CONTROL WEAKNESSES
Apply property decals upon receipt of state property	**Not performed** • Furniture items do not have state property decals.
Record all acquisitions in property ledger	**Incomplete** • The property ledger was missing some of the following items: o Furniture o Equipment o Items from an old inventory database o Items acquired during the 2010 merger with DOR
Record acquisitions of capitalized assets in capital assets group of accounts	**Untimely and Inaccurate** • Acquisitions of capitalized assets are recorded once per year using an allocation method that may not record costs to the fund(s) that benefitted from the asset purchase.
Record all dispositions in property ledger	**Incomplete** • Property ledger was missing detailed information of items disposed or surveyed. These items could not be traced to the Property Survey Reports. • Property Survey Report forms did not include make, model, serial number, and state decal number.
Record disposition of capitalized assets in capital assets group of accounts	**Untimely and Inaccurate** • Dispositions of capitalized assets are recorded once per year using an allocation method that may not record costs to the fund(s) that benefitted from the asset purchase.
Perform periodic reconciliations of capitalized assets to the property ledger	**Not Performed** • Periodic reconciliations cannot be performed because capitalized assets are only recorded once per year and the property ledger is incomplete.
Inventory	**Not Performed** • A physical inventory including an inventory plan, count sheets, and reconciliations to the property ledger was not performed.

Recommendations:

A. Promptly apply property decals and record all state property in the property ledger.

B. Consolidate property lists into a centralized property accounting system.

C. Coordinate with the Department of Conservation to obtain all DOR property documentation to support acquired assets.

D. Ensure the following information is adequately documented:

   1. Property Ledger—Record the agency document number listed on the Property Survey Report in the Property Ledger.
   2. Property Survey Report—Document the make, model, serial number, and state decal number on the form.

E. Ensure that the allocation method used to capitalize and record disposal of assets accurately reflects costs charged to the fund(s) benefitting from the asset.

F. Reconcile capitalized assets in the Property Ledger to the Capital Asset Group of Accounts quarterly.

G. Perform physical inventories of all property at least once every three years and ensure that physical inventory counts are periodically reconciled with the accounting records.

FINDING 3: Incompatible Information System Access and Duties

Multiple staff have incompatible information systems access and perform incompatible duties as described below. This increases the risk of non-compliance with established policies, procedures, laws and regulations, and could result in errors or fraud without timely detection. Further, the CALSTARS and Oil Recycling and Claims Automation (ORCA) claims processing relate to prior audit findings that have not been corrected.

- *CALSTARS*— Multiple staff are assigned conflicting CALSTARS functions, staff access does not align with job duties, or staff perform incompatible duties as follows:

  - Multiple staff have CALSTARS access to all of the following incompatible functions: receipts, disbursements, receivables, vendor edit table, other tables, and/or check processing. This access does not align with assigned job duties.
  - One of the employees with conflicting access also has oversight authority for receivables, cashiering, and accounts payable.
  - Two accounting employees who authorize disbursements have access to enter disbursements into CALSTARS. These individuals also reconcile the monthly bank statement and have access to the safe containing CalRecycle’s blank check stock.

- *ORCA Claims Processing*—One accounting employee performs incompatible duties of reviewing, approving, and processing the ORCA incentive payment claims in both ORCA and CALSTARS without review and approval of a used oil expert.

- *ORCA Programming*—One employee performs incompatible duties of designing, programming, and record file maintenance for ORCA. This could result in manipulation of the system without detection through programming or file maintenance activities.

Recommendations:

A. Limit CALSTARS access to functions necessary to perform assigned job duties.

B. Segregate incompatible accounting duties in accordance with the State Administrative Manual.

C. Limit safe access to blank check stock to those who do not reconcile the monthly bank statement.

D. Require a used oil expert to review and approve ORCA expenditures prior to payment processing.

E. Segregate the ORCA system design, programming, and maintenance functions.

FINDING 4: Information Systems at Risk

Several subsidiary information systems are at risk due to unauthorized access rights, lack of security features, and weak access controls. Unauthorized access and inadequate system controls increase the risk that critical information could be compromised, such as payments made to unregistered participants or other unauthorized system transactions. Effective security controls would allow accurate and reliable financial reporting, and concurrently prevent unauthorized users from accessing critical information systems to manipulate, destroy, or acquire CalRecycle data. See Table 2 for examples of the security weaknesses identified.

Table 2: Information Technology Security Weaknesses

SECURITY WEAKNESSES	DESCRIPTION
Unauthorized Access Rights	**DOR*IIS*** access rights were not promptly removed upon staff separation from CalRecycle. Four of the six employees that left CalRecycle between August 2012 and October 2012 still had write access to DOR*IIS*.
Lack of Security Features	**ORCA** does not require a second electronic approval for claims transactions related to closed, pending, or expired participant status. The claims payment process is performed by one staff. Transactions related to closed, pending, or expired status have a higher risk of unauthorized or fraudulent transactions being processed without timely detection.
Weak Access Controls	**ORCA** and Covered Electronic Waste Payment Information System (**CEWIS**) do not require routine password changes to ensure data integrity and security of automated files.

Recommendations:

A. Develop and implement procedures for systems access removal at the time of employee separation or internal transfer.

B. Modify ORCA system controls to require a second approval for transactions related to participants with a closed, pending, or expired status.

C. Require system users to change passwords at specified intervals.

FINDING 5: Policies and Procedures Are Inadequate for Certain Functions

Written policies and procedures that govern several essential business functions either do not exist, are outdated, or do not comply with SAM. Adequate policies and procedures would allow staff to clearly understand their roles and responsibilities, ensure consistency and compliance with requirements, provide a training and succession tool, and allow management to guide operations without constant intervention. See Table 3 for the affected areas. Except in the area of Information Systems, these are prior audit findings that have not been corrected.

Table 3: Schedule of Inadequate Policies and Procedures

FUNCTIONAL AREA	POLICIES/PROCEDURES	NON-EXISTENT	OUTDATED	NONCOMPLIANCE WITH SAM
Information Systems	CEWIS – Claim review/data input process		X	
	CEWIS, ORCA, and DOR*IIS* – Access controls	X		
Budgeting	Forecasting procedures	X		
	Signature authority to approve some budget documents	X		
Revolving Fund	Decentralized check distribution process	X		
State Property	Application of property decals for state property			X

Recommendation:

Develop, revise, or update policies and procedures and ensure consistency with SAM. Communicate changes to staff and maintain the policies and procedures in a centralized location.

CRITERIA FOR REPORT FINDINGS

FINDING NUMBER	CRITERIA	SUMMARY
1	SAM[1] 7120	Uniformity of accounts and accounting procedure among the agencies is necessary. Confusion would result if each agency maintained its individual methods and accounts. Comparison among agencies would be impossible. Consolidation of detailed statements of agencies, each with dissimilar methods and classifications, into any such documents as an executive budget or Annual Report of the State Controller would be an overwhelming task.
1	GAFRS[2] 1300	Governmental accounting systems should be organized and operated on a fund basis. A fund is defined as a fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations.
1	SAM 7800	Subsidiary records will be reconciled to the General Ledger monthly.
1	SAM 8776	Departments must ensure receivables are recorded promptly and accurately into the accounting system. Further, departments are to review and reconcile receivable accounts in the accounting system to accounts maintained in departmental program records. This reconciliation is to be prepared monthly within 30 days of the preceding month.

[1] SAM = State Administrative Manual
[2] GAFRS = Governmental Accounting and Financial Reporting Standards

FINDING NUMBER	CRITERIA	SUMMARY
1	SAM 8776.6	Requires three collection letters at 30-day intervals. The last letter will include references to prior letters and will state what further actions may be taken in the collection process. If receivables have been identified for discharge, departments must file an Application for Discharge from Accountability with the State Controller's Office (SCO).
2	SAM 7924	Agencies should reconcile the acquisitions and dispositions of capitalized property with the amounts recorded in the property ledger at least quarterly.
2	SAM 8660	Requires departments which acquire property with governmental funds to include a listing of investments in general fixed assets by sources of governmental funds used to acquire each. These amounts and funding sources are reported on the Statement of General Fixed Assets year-end report.
2	SAM 8602	Lists specific requirements for capitalization of state property.
2	SAM 8671	Requires recording capitalized assets into the General Fixed Assets Account Group per accounting event and adjust whenever property is surveyed.
2	SAM 8652	Agencies will make a physical count of all property and reconcile the count with accounting records at least once every three years. In addition, agencies are responsible for developing and implementing an inventory plan which includes (1) inventory taking, (2) internal control, and (3) reporting of inventory adjustments.
2	SAM 8601, 8650, and 8651	Requires departments to track all state property, including furniture, whether capitalized or not, in an automated property accounting system. Additionally, all state property is required to be promptly tagged and adequately recorded in the property ledger after acquisition.
3	CALSTARS[3] Vol. 1, Ch. 19	Only authorized users should have access to CALSTARS and access should be limited to areas that are necessary for the user to perform his or her duties. Further, for management who do not perform accounting duties, but do review CALSTARS tables and data, access should be limited to view-only access.
3	SAM 8080	Lists the specific accounting duties that should be segregated.

[3] CALSTARS = California State Accounting and Reporting System Manual

FINDING NUMBER	CRITERIA	SUMMARY
3	SAM 8080.1	Lists incompatible duties for automated systems. This section further states that employees from units other than accounting or data processing should be used to provide separation of duties, when necessary.
3	SAM 5315.1	Agency information technology management is responsible for (1) implementing the necessary technical means to preserve the security, privacy, and integrity of the agency's information assets and manage the risks associated with those assets, and (2) acting as a custodian of information per SAM section 5320.3.
4	SAM 5340	Agency management is responsible for ensuring the appropriate physical, technical, and administrative controls are in place to support proper access to agency information assets. These controls must be based on both business and security requirements to prevent and detect unauthorized access.
5	SAM 20050	Lines of organizational authority and responsibility should exist and should be clearly articulated.
5	SAM 2050	Each system an entity maintains to regulate and guide operations should be documented through flowcharts, narratives, desk procedures, and organizational charts.
5	SAM 5320.2	An agency unit that is designated owner of electronic records, files, or databases is responsible for defining precautions for controlling access to and preserving the security and integrity of records, files, and databases.
5	GC[4] 13402	State agency head responsibility includes documenting the system of internal accounting and administrative controls, communicating system requirements to employees, and ensuring that the system is functioning as prescribed and is modified, as appropriate, for changes in conditions.

[4] GC = Government Code

RESPONSE

DEPARTMENT OF RESOURCES RECYCLING AND RECOVERY

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November 13, 2013

Mr. Richard R, Sierra, CPA
Acting Chief, Office of State Audits and Evaluations
915 L Street
Sacramento, CA 95814

Dear Mr. Sierra:

Thank you for the opportunity to review and comment on the October 14, 2013 Internal Control Draft Audit Report. Department of Resources Recycling And Recovery (CalRecycle) concurs with the results, and our efforts to implement each recommendation are detailed below.

Finding #1: The Division of Recycling's (DOR) Fiscal Functions are not fully integrated within CalRecycle's Fiscal Operations

Recommendation A: Consult with the Department of Finance's Fiscal Systems and Consulting Unit to implement department wide uniform accounting procedures that are consistent with state accounting practices and requirements.

> CalRecycle has already consulted with the Department of Finance's Fiscal Systems and Consulting Unit (FSCU). In order to achieve uniformity in our procedures, effective January 2014, all programs at CalRecycle will begin using the existing Accounting Office methodology to record revenue and receivable transactions. This will ensure consistency, as well as compliance with state requirements.

Recommendation B: Develop DORIIS receivables and revenue reports, with point-in-time historical documentation maintained, that identify the receivables and revenue in accordance with state accounting practices.

> The Accounting Office will work with CalRecycle's Information Technology Services to capture and report transactions/balances in fiscal periods reflective of the periodicity assumption in accrual basis of accounting.

Recommendation C: Record and reconcile the receivables accounts in CALSTARS and DORIIS monthly and at year-end.

> To ensure proper oversight and reconciliation for the Beverage Container program participant accounts (receivables, collections and write-offs) responsibility will be transferred to the Accounting Office effective January 1, 2014. Organizational structure and reporting relationships will be modified accordingly.

Recommendation D: Research and resolve DORIIS unapplied receipts. Verify overpayments are accurately recorded in CALSTARS.

> Upon relocation of these functions, DORiis "Unapplied" receipts will be reviewed for the time period in question and anything remaining will either be posted or refunded. In the interim, as part of managing participant accounts DOR's Account Management Unit (AMU) will continue to research and work towards resolving unapplied receipts.

Recommendation E: Transfer the DOR receivables write-off responsibility to the Accounting Section. The Accounting Section is responsible for fiscal accountability of write offs for the department and its existing collections process complies with state requirements.

> As stated in Recommendation A, the DOR receivables write-off responsibility will be transferred to the Accounting Office in January 2014. Meanwhile, an interim process has been in place since June 2012 where DOR refers write-offs to the Accounting Office. Once reviewed and approved, the Accounting Office sends the referrals to SCO for authorization to discharge. Accounts are not written off in DORiis until approved by SCO.

Finding #2: Assets are not safeguarded from unauthorized use or disposition

Recommendation A: Promptly apply decals and record all state property in the property ledger.

> The Business Services Office will follow policies and procedures that were revised in August 2013 to ensure that decals are added to state property upon acquisition and that the decal numbers are entered into the property ledger as appropriate.

Recommendation B: Consolidate property lists into a centralized property accounting system.

> CalRecycle will complete a comprehensive physical review of assets currently on-hand. State property, including that which was transferred from the Department of Conservation, will be tagged and entered into one centralized inventory system as appropriate.

Recommendation C: Coordinate with the Department of Conservation to obtain DOR property documentation to support acquired assets.

> CalRecycle will request records from the Department of Conservation to support property that was transferred over in 2010. Regardless of documentation received, CalRecycle will tag and enter state property into a centralized system during a physical review.

Recommendation D: Ensure the following information is adequately documented:

1. Property Ledger- Record the agency document number listed on the Property Survey Report in the Property Ledger.

   > The Business Services Office will follow established policies to comply with SAM requirements for capturing assets at the time of acquisition and ensure that the items are entered into the property ledger, with appropriately cited documentation.

2. Property Survey Report- Document the make, model, serial number, and state decal number on the form.

   > The Business Services Office will follow established policies to ensure that Property Survey forms are fully completed with identifying characteristics of property being surveyed.

Recommendation E: Ensure that the allocation method used to capitalize and record disposal of assets accurately reflects costs charged to the fund(s) benefitting for the asset.

> Beginning July 2013, the Accounting Office updated and implemented policies and procedures to ensure that capitalized assets are being recorded at the time of acquisition and disposition, and to the appropriate funds.

Recommendation F: Reconcile capitalized assets in the Property Ledger to Capital Asset Group of Accounts quarterly.

> In addition to what we implemented for Recommendation E, a monthly reconciliation process has been put in place to reconcile accounting records to the property ledgers.

Recommendation G: Perform physical inventories of all property at least once every three years and ensure that physical inventory counts are periodically reconciled with accounting records.

> The Business Services Office and Information Technology Branch, in concert with the Accounting Office, will engage in a physical inventory for all capitalized inventory annually and at least every three years for non-capitalized inventory.

Finding #3: Incompatible Information System Access and Duties

Recommendation A: Limit CalSTARS access to functions necessary to perform assigned job duties.

The CALSTARS security officer is currently reviewing access for all employees and changes will be made to align access with assigned job duties. This review and any necessary access changes will be completed by December 2013.

Recommendation B: Segregate incompatible accounting duties in accordance with the State Administrative Manual.

Effective October 2013, incompatible duties identified have been segregated to the extent possible. These duties will be continually reviewed and updated to reflect future changes to maintain compliance with this finding.

Recommendation C: Limit safe access to blank check stock to those who do not reconcile the monthly bank statement.

Access to the safe has been updated as recommended.

Recommendation D: Require a used oil expert to review and approve ORCA expenditures prior to payment processing.

The Accounting Office will begin working with Program staff in January 2014, to review and realign organizational structure and workflow of the ORCA claims process to the extent possible.

Recommendation E: Segregate the ORCA system design, programming, and maintenance functions.

While the design and initial development of ORCA was performed predominately by one Programmer Analyst (PA), nine other PAs, one Information System Analyst (ISA), and the Database Administrator (DBA) are on record in the IT Services Project Tracking System as having contributed to this project. IT Services will segregate duties associated with on-going system maintenance and enhancements of ORCA in the next 30 to 60 days by dividing duties between the primary PA, and at least one additional PA.

Finding # 4: Information Systems at Risk

Recommendation A: Develop and implement procedures for systems access removal at the time of employee separation or internal transfer.

In September 2012 an enhancement to the Position and Employee Tracking System (PETS) was implemented. This enhancement sends notification email messages in response to employee record updates in PETS such as employee departures and internal transfers. One notification email is sent to the CalRecycle IT Services Help Desk, which automatically generates a Help Desk work order, including a user network credentials update. A work order, specific to a request for a DORIIS user account update, was also added to the Help Desk work order generation process in early October 2013.

Recommendation B: Restrict adjustments to claims in ORCA system for participants that have a closed, pending, or expired status.

Not restricting adjustments to claims in the ORCA system for participants that have a closed, pending, or expired status is necessitated by statute and used oil regulation as participants are not prohibited from subsequently filing claims for a period they were actively certified. Therefore, accounting staff need the ability to make adjustments to claims for these participants. However, as stated in the response to Recommendation 3D, the Accounting Office will begin working with Program staff in January 2014, to review and realign organizational structure and workflow of the ORCA claims process to the extent possible.

Recommendation C: Require system users to change passwords at specified intervals

By June 30, 2014, policy and procedures related to the security weaknesses identified in Table 2 of the Audit Report will be established and documented whereby users of the identified systems will be required to change their passwords on a frequent basis (frequency to be determined by June 30, 2014).

FINDING # 5: Policies and Procedures Are Inadequate for Certain Functions

Recommendation: Develop, revise, or update policies and procedures and ensure consistency with SAM. Communicate changes to staff and maintain the policies and procedures in a centralized location.

CalRecycle will develop, revise, or update as applicable, the policies and procedures identified in Table 3 of the Audit Report to ensure consistency with SAM. Specifically, CEWIS claim review and data input process procedures are up to date. Also as mentioned in Finding #4, Recommendation A Forecasting procedures have been developed and implemented as they relate to the Fiscal Services Branch.

Policies and procedures, consistent with SAM, regarding access controls and user status changes, associated with the identified systems will be developed in the next 60 to 90 days. Those policies and procedures will be communicated to staff and maintained in a centralized location. Training will be provided on the new procedures on an as needed basis.

A delegation of authority has been drafted outlining the signature authority granted for key fiscal documents in both the Accounting and Budgeting offices.

Check distribution procedures and a process of reconciliation will be designed that is similar to the Head Quarters check distribution desk for delegated check distribution occurring in remote offices.

As stated in Finding #2 Recommendation A, policies and procedures were revised in August 2013.

As detailed above CalRecycle is committed to implementing recommendations noted in the Audit report and will ensure processes are periodically evaluated to ensure compliance with applicable requirements. Upon request we will make available any of the policies, procedures, reports or other documents that were mentioned above. Thank you for the opportunity to respond to the Draft Audit Report. Should you have any questions or concerns regarding our response, please contact Kevin Campbell at (916) 445-3356.

Sincerely,

“original signed by”

Caroll Mortensen
Director

Evaluation of Response

We reviewed the Department of Resources Recycling and Recovery's (CalRecycle) response, dated November 13, 2013, to our draft audit report. CalRecycle concurs with our findings, and we acknowledge CalRecycle's willingness to implement our recommendations. In evaluating CalRecycle's response, we further clarified a portion of Finding 4 and its related recommendation, and provide the following comments:

Finding 4: Information Systems at Risk—ORCA

CalRecycle agrees with our finding but indicated that closed, pending, or expired participants are allowed to submit claims for a period they were actively certified. Therefore, accounting staff need the ability to make adjustments to those claims.

We understand the occasional need for CalRecycle staff to process legitimate claims for participants with closed, pending, or expired status. However, the ORCA system currently allows one staff to process transactions with a closed, pending, or expired participant status, without additional approvals. Transactions related to participants with a closed, pending, or expired status have a higher risk of unauthorized or fraudulent transactions being processed without timely detection. To address this risk while recognizing the need to occasionally process these transactions, we revised the finding and recommendation in the final report.