

October 27, 2015

Jeffrey A. Beard, Ph.D., Secretary  
California Department of Corrections  
and Rehabilitation  
P.O. Box 942883  
Sacramento, CA 94283-0001

Dear Dr. Beard:

**Management Letter—California Department of Corrections and Rehabilitation, Combined Inmate Welfare Fund for the Fiscal Years Ended June 30, 2014 and June 30, 2013**

The Department of Finance, Office of State Audits and Evaluations (Finance), has completed its financial audit of the California Department of Corrections and Rehabilitation's (CDCR) Inmate Welfare Fund (Fund) for the fiscal years ended June 30, 2014 and June 30, 2013.

In planning and performing our audit of the statutory-basis financial statements of the Fund as of and for the years ended June 30, 2014 and 2013, in accordance with auditing standards generally accepted in the United States of America, we considered the Fund's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control.

During our audit, we noted certain matters involving the Fund's internal control and operations that are presented for your consideration. These comments and recommendations, which have been discussed with CDCR management, are intended to improve internal control and operational effectiveness, as discussed below.

**Observation 1: Improvement is Needed Over Reconciliation Activities**

We observed several instances where reconciliation processes need improvement. Specifically, during our review of the bank reconciliation process we noted the following:

- A. Fund cash receipts and disbursements reconciliations are performed only for the photo ducat revenues and sales tax disbursements accounts, and do not include any other significant accounts. Further, the reconciliations only include current month activities and do not consider Fund beginning and ending balances reported in the General Checking account (account number 158) bank reconciliation. Review procedures for General Cash and Office Revolving Fund accounts do not include the reconciliation of all transactions posted to the accounting records.
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- B. In fiscal year 2013-14, the second and third quarter reconciliation reports for the Surplus Money Investment Fund Interest (SMIFI) account were prepared and reviewed by the same employee, which are incompatible activities.
- C. The June 2013 bank reconciliation for account number 158 was re-performed after the financial statements were submitted to the State Controller's Office (SCO) because not all reconciling bank items were resolved prior to year-end. Reconciling items were cleared after the period was closed and the financial statements were finalized. Further, the June beginning bank balance did not agree to the prior month's ending balance.

Additionally, during our testing of controls over the Cal Card statement reconciliations, we noted several reconciliations were not signed by the central office accounting staff to indicate reviews were performed. This was identified in 2 of 25 (8 percent) of the fiscal year 2012-13 reconciliations sampled and in 8 of 25 (32 percent) of the fiscal year 2013-14 reconciliations sampled. Reconciliation procedures do not specifically direct the reviewer to document their review on the Cal Card reconciliation.

California State Administrative Manual (SAM) section 7901 requires reconciliations to be completed between the department accounts and the accounts maintained by the SCO to disclose errors as they occur. It also requires corrections to errors to be made before financial reports are prepared to ensure the accuracy of a department's financial reports.

SAM section 20050 and California Government Code section 13403 state the elements of a satisfactory system of internal accounting and administrative controls shall include (a) a plan of organization that provides segregation of duties appropriate for proper safeguarding of state agency assets, (b) a system of authorization and record keeping procedures adequate to provide effective accounting control over assets, liabilities, revenues, and expenditures, and (c) an effective system of internal review.

Inadequate reconciliation processes increase the risk accounts are not properly monitored and safeguarded, and increase the risk of misstatements due to error or fraud.

**Recommendations:**

- A. Perform reconciliations of all Fund cash accounts monthly and complete all reconciliations before finalizing the financial statements.
- B. Establish review procedures to ensure all reconciliations are properly performed and documented. These procedures should also include resolving reconciling bank items in a timely manner for all bank accounts, ensuring all transactions are reconciled and correctly posted in accounting records, ensuring adequate separation of duties over the reconciliation process, and ensuring reviewers indicate their review on reconciliation documents.

## **Observation 2: Year-End Financial Reporting Process Needs Improvement**

During our review of the year-end reporting process, we found the following areas where the closing process was not adequately performed:

- A. Year-end financial statement preparation and review processes were not properly documented. For fiscal year 2012-13, it was unclear who prepared and reviewed the certified financial statements, and for fiscal year 2013-14, the preparer and the reviewer of the certified financial statements was the same employee. The year-end financial statements review checklist tool was not developed until fiscal year 2013-14 and was not used correctly in the year it became available.
- B. Year-end accruals were not accurate. This was also an issue in the prior year audit report; however, because the dollar amounts and number of errors declined from the prior report period, we determined this was no longer a material weakness, but still remains an underlining deficiency in controls. For fiscal year 2012-13, the Due to Other Funds account was overstated by \$10,430, the Accounts Payable account was overstated by \$194,964, and an obligation for \$35,340 payable to the Department of Education was recorded in the Accounts Payable account instead of Due to Other Funds. For fiscal year 2013-14, the Due to Other Funds account was overstated by \$6,223, the Accounts Payable account was understated by \$30,758, and the Claims Filed account was understated by \$10,568.

As noted above, SAM section 20050 and California Government Code 13403 describe the elements of a satisfactory system of internal accounting and administrative control.

The lack of an effective system of internal review for year-end financial reporting processes increases the risk of material misstatements on the financial statements.

### **Recommendations:**

- A. Require the year-end financial reporting processes to include documentation of review activities and ensure all established policies and procedures are properly followed.
- B. Review obligations at year-end to ensure they are accurate and recorded in the appropriate liability accounts.

## **Observation 3: Insufficient Payroll Review and Monitoring**

Controls over the payroll processes at the central office and at several institutions were not functioning as designed. We also noted this issue in our prior letter to management dated July 8, 2014. Because management received the prior letter after our current audit period had closed, it was not able to implement our recommendations at that time. Therefore, we are providing the following information as an update.

At the central office level, we noted the following payroll issue:

- Of 49 timesheets reviewed (26 timesheets from fiscal year 2012-13 and 23 timesheets from fiscal year 2013-14), there were three instances where the position numbers were different on the staff timesheet, Fund Position Listings, and Payroll Distribution Reports. However, the amounts paid to the employees were correct.

At the institutional level, we noted the following payroll issues:

- Of 369 timesheets reviewed (174 timesheets from fiscal year 2012-13 for two months at 2 institutions; 195 timesheets from fiscal year 2013-14 for two months at 14 institutions), we identified the following:
  - Five timesheets were not signed by either the supervisor or the employee.
  - Five timesheets had incorrect position numbers; however, the position numbers on the Fund Position Listings and the Payroll Distribution reports were correct and the amounts paid to the employees were also correct.
  - Five instances where the employees were not listed on the Fund Position Listings for the periods paid.
  - Ten timesheets were missing and could not be provided.

Inadequate controls over the payroll process may result in material misstatements due to payments to employees for services not performed, or charging payroll costs to incorrect funding sources.

**Recommendations:**

- A. Ensure the timesheets are reviewed, approved, and retained.
- B. Review and update the Fund Position Listings thoroughly and timely to ensure they reflect the most current employment status for institution and central office employees. Ensure the position information agrees with the actual payroll disbursements.

In addition, we identified certain deficiencies in internal control that we considered a material weakness and a significant deficiency, and communicated them in our Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards, dated October 19, 2015.

This information is intended solely for the use of CDCR management and others within CDCR, and is not intended to be, and should not be, used by anyone other than these specified parties.

We appreciate the assistance and cooperation of CDCR management and staff. If you have any questions regarding this letter, please contact Jon Chapple, Manager, or Rebecca McAllister, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

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

cc: Mr. Scott Kernan, Undersecretary of Operations, California Department of Corrections and Rehabilitation  
Mr. Kenneth Pogue, Undersecretary, Administration and Offender Services, California Department of Corrections and Rehabilitation  
Mr. Kelly Harrington, Director, Division of Adult Institutions, California Department of Corrections and Rehabilitation  
Ms. Alene Shimazu, Director, Division of Administrative Services, California Department of Corrections and Rehabilitation  
Mr. Jason Lopez, Deputy Director, Fiscal Services, California Department of Corrections and Rehabilitation  
Mr. Bryan Beyer, Director, Internal Oversight and Research, California Department of Corrections and Rehabilitation  
Ms. Lori Zamora, Deputy Director, Office of Audits and Court Compliance, California Department of Corrections and Rehabilitation  
Mr. Jaime Corvera, Associate Director, Accounting Services, California Department of Corrections and Rehabilitation  
Ms. Linda Wong, External Audits Manager, Office of Audits and Court Compliance, California Department of Corrections and Rehabilitation  
Ms. Amy Casias, Accounting Administrator III, Accounting, Inmate Welfare Fund, California Department of Corrections and Rehabilitation  
Ms. Michele Gomez-Essex, Accounting Administrator II, Accounting, Inmate Welfare Fund, California Department of Corrections and Rehabilitation

**OFFICE OF THE SECRETARY**

P.O. Box 942883  
Sacramento, CA 94283-0001



November 18, 2015

Richard R. Sierra CPA  
Department of Finance  
Office of State Audits and Evaluations  
915 L Street, 6<sup>th</sup> Floor  
Sacramento, CA 95814

Dear Mr. Sierra:

We are providing this letter in connection with the Management Letter for the Inmate Welfare Fund for the fiscal years ended June 30, 2014 and June 30, 2013. We are responsible for assuring that our Department's/Agency's financial reports conform with legal and regulatory requirements and the State Administrative Manual. The State Controller's Office relies upon State Department/Agency financial reports as well as its own records to prepare the financial statements of the State. We are also responsible for adopting sound accounting policies, establishing and maintaining effective internal control over financial reporting, and designing and implementing programs and controls to prevent and detect fraud.

We are in agreement that there are certain processes and procedures that we can implement that will improve our internal control and operational effectiveness. The Department is constantly evaluating and improving its operations. The Management Letter has specific recommendations to assist us with this process. We have reviewed all of the Observations and our responses are as follows:

**Observation 1: Improvement is Needed Over Reconciliation Activities**

- A. Procedures and controls are currently in place to ensure all cash accounts are properly reconciled.
- B. We have expanded and improved our reconciliation process. We are resolving all current bank reconciliations items in a timely manner, ensuring all transactions are reconciled and recorded properly. Reviewers indicate their review on reconciliation documents.

**Observation 2: Year-End Financial Reporting Process Needs Improvement**

- A. We currently use the recommended State Controller's Office Year-End Financial Reporting Criteria Checklist requiring documentation of all reviewed activities. We are using and continue to improve and expand our own additional check list tool to ensure all reviews and reconciliations are documented and completed before finalizing the financial statements.
- B. We will continue to review obligations, review trends and provide training to staff to ensure all obligations are recorded accurately and to update our Year-End procedures and Year-End training.

**Observation 3: Insufficient Payroll Review and Monitoring**

- A.** Accounting is currently drafting a policy for distribution and also will be implementing spot audits to ensure procedures and policies are being followed.
- B.** A full reconciliation of the Fund position listing is now done on a monthly basis to ensure they reflect the most current employment status and that this agrees with the payroll disbursements.

We are confident that for the fiscal years ending June 30, 2015 and June 30, 2014 internal control and operational effectiveness will show even more improvements which continue to enable us to prepare accurate financial statements.

The Department appreciates the tremendous effort made to audit these years and make recommendations. If you have any questions, regarding this response, please contact Jaime Corvera, Associate Director at (916) 255-5730.

Original Signed by

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ALENE SHIMAZU  
Director  
Division of Administrative Services

cc: Jeffrey A. Beard, Ph.D., Secretary, CDCR  
Kenneth Pogue, Undersecretary, Administration and Offender Services, CDCR