

CALIFORNIA STATE BOARD OF EQUALIZATION

Review Report

INTERNAL ACCOUNTING AND ADMINISTRATIVE CONTROLS REVIEW

July 1, 2013, through April 30, 2015



BETTY T. YEE
California State Controller

November 2015



BETTY T. YEE
California State Controller

November 18, 2015

Cynthia Bridges, Executive Director
California State Board of Equalization
450 N Street
Sacramento, CA 95814

Dear Ms. Bridges,

We reviewed the internal accounting and administrative controls of the California State Board of Equalization's (BOE) financial management and reporting practices over the BOE's State Retail Sales Tax Fund (RSTF), Office Revolving Fund (ORF), accounts receivable cycle, and apportionment and allocation processes for the period of July 1, 2013, through April 30, 2015.

We identified material internal control weaknesses over the RSTF revenue allocation process that have led to improper distributions to the various fund allocations. We noted the following in regard to the RSTF (Findings 1 through 5):

- Inadequate internal accounting and administrative controls to appropriately allocate money in the RSTF;
- Inaccurate adjustments of fund allocations in quarterly true-ups;
- Improper allocations of sales tax on diesel fuel; (Note: After further review of the BOE's response, the SCO has determined that no further action is required on the recommendation associated with this portion of Finding 3);
- Improper allocations of the additional sales tax on diesel fuel;
- Improper allocations of Department of Motor Vehicles Use Tax; and
- Improper allocations of Franchise Tax Board Use Tax;

In addition, we noted that the BOE's RSTF accounts receivable balance is inaccurate (Finding 6)

Further, we identified control weaknesses over the BOE's ORF. We noted the following in regard to the ORF (Findings 7 through 11):

- Receivables were not collected in a timely manner;
- Claims were not scheduled for prompt reimbursement;

- Office revolving funds were improperly used, and there was a lack of supporting documentation for some payments;
- Controls over salary advances were inadequate; and
- Controls over travel advances and travel reimbursement claims were inadequate.

We issued a draft report with our conclusions, findings, and recommendations on October 23, 2015. You responded on behalf of the BOE to our findings and recommendations in a letter dated November 2, 2015. Your response, as a whole, is included as an attachment to this report. We have commented on your responses to our recommendations and have included those comments throughout the Findings and Recommendations section of this report.

In your letter, you stated that our findings associated with the allocation of funds in the RSTF were consistent with internal reviews you requested of the revenue and distribution processes, and as a part of these reviews, the BOE determined that a \$343 million adjustment was required to correct specific fund balances for the period of April 1, 2011, through December 13, 2013. Although the BOE determined an adjustment to correct fund balances, this did not solve or identify other weaknesses that contributed to inaccurate fund allocations in the RSTF during our review period of July 1, 2013, through April 30, 2015, as detailed in Findings 2 through 5.

We strongly recommend that the BOE develop a detailed corrective action plan within six months of this report to address the issues noted in Findings 1 through 11. We will review the action plan and determine whether a follow-up review will be necessary.

If you have any questions, please contact Andrew Finlayson, Chief, State Agency Audits Bureau, by telephone at (916) 324-6310 or by email at afinlayson@sco.ca.gov.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/ljs

Attachment

- cc. Betty T. Yee, California State Controller and Board Member
 - California State Board of Equalization
- Jerome Horton, Chair of the Board
 - California State Board of Equalization
- George Runner, Vice Chair of the Board
 - California State Board of Equalization
- Fiona Ma, Board Member
 - California State Board of Equalization
- Diane L. Harkey, Board Member
 - California State Board of Equalization
- David J. Gau, Chief Deputy Director
 - California State Board of Equalization
- Brock Wimberley, Chief, Internal Audit Division
 - California State Board of Equalization
- Edna B. Murphy, Deputy Director, Administration Department
 - California State Board of Equalization
- Julia Findley, Acting Chief, Financial Management Division
 - California State Board of Equalization
- Esther Cabrera-Diaz, Revenue Manager, Revenue Section
 - California State Board of Equalization
- Sandra Mayorga, Chief, Human Resources Division
 - California State Board of Equalization
- Mark Durham, Chief, Legislative and Research Division
 - California State Board of Equalization
- Lynn Bartolo, Acting Deputy Director, Sales and Use Tax Department
 - California State Board of Equalization
- Randy Ferris, Chief Counsel, Legal Department
 - California State Board of Equalization
- Liz Peralta, Chief, Accounting Branch
 - California State Board of Equalization
- Michelle Pielsticker, Chief, Legislative and Research Division
 - California State Board of Equalization

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Review Report

Summary

We reviewed the internal accounting and administrative controls of the California State Board of Equalization's (BOE) financial management and reporting practices over the BOE's State Retail Sales Tax Fund (RSTF), Office Revolving Fund (ORF), accounts receivable cycle, and apportionment and allocation processes for the period of July 1, 2013, through April 30, 2015.

We identified material internal control weaknesses over the RSTF revenue allocation process that have led to improper distributions to the various fund allocations. We noted the following in regard to the RSTF (Findings 1 through 5):

- Inadequate internal accounting and administrative controls to appropriately allocate money in the RSTF;
- Inaccurate adjustments of fund allocations in quarterly true-ups;
- Improper allocations of sales tax on diesel fuel; (Note: After further review of the BOE's response, the SCO has determined that no further action is required on the recommendation associated with this portion of Finding 3);
- Improper allocations of the additional sales tax on diesel fuel;
- Improper allocations of Department of Motor Vehicles (DMV) Use Tax; and
- Improper allocations of Franchise Tax Board (FTB) Use Tax;

In addition, we noted that the BOE's RSTF accounts receivable (A/R) balance is inaccurate (Finding 6).

Further, we identified control weaknesses over the BOE's ORF. We noted the following in regard to the ORF (Findings 7 through 11):

- Receivables were not collected in a timely manner;
- Claims were not scheduled for prompt reimbursement;
- Office revolving funds were improperly used, and there was a lack of supporting documentation for some payments;
- Controls over salary advances were inadequate; and
- Controls over travel advances and travel reimbursement claims were inadequate.

Review Authority

The State Controller's Office (SCO) conducted the review pursuant to California Government Code (GC) section 12410, which states, "The Controller shall superintend the fiscal concerns of the state. The Controller shall audit all claims against the state, and may audit the disbursement of any state money, for correctness, legality, and for sufficient provision of law for payment." In addition, GC section 12411 states that "The Controller shall suggest plans for the improvement and management of revenues."

Background

Established in 1879 by a California constitutional amendment, the BOE initially was charged with the responsibility for ensuring that county property tax assessment practices were equal and uniform throughout the state. Currently, the tax programs administered by the BOE are concentrated in four general areas: sales and use taxes, property taxes, special taxes, and the tax appellate program. In fiscal year (FY) 2013-14, BOE-administered taxes and fees generated \$60.4 billion to provide essential services for the people of California. BOE-administered programs accounted for more than 30% of all State revenue.

State Sales and Use Tax and Retail Sales Tax Fund

From the tax programs administered by the BOE, more than 80% of revenues are generated through the sales and use tax program. For FY 2013-14, sales and use tax revenue totaled \$48.5 billion. The sales and use tax rate in a specific California location is made up of three parts: the State tax rate, the local tax rate, and any district tax rates that may be in effect. State sales and use tax collected through the RSTF provides revenue to the State's General Fund to cities and counties through specific State fund allocations and to other local jurisdictions. A breakdown of the statewide sales and use tax of 7.5% is shown in the table below:

Components of the Statewide 7.5% Sales and Use Tax Rate¹

Rate	Jurisdiction	Purpose	Authority
3.6875%	State	Goes to State's General Fund	Revenue and Taxation Code sections 6051, 6201
0.25%	State	Goes to State's General Fund	Revenue and Taxation Code sections 6051.3, 6201.3 (Inoperative 1/1/01 – 12/31/01)
0.25%	State	Goes to State's Fiscal Recovery Fund, to pay off Economic Recovery Bonds (2004)	Revenue and Taxation Code sections 6051.5, 6201.5 (Operative 7/1/04)
0.50%	State	Goes to Local Public Safety Fund to support local criminal justice activities (1993)	State Constitution Section 35, Article XIII,
0.25%	State	Goes to State's Education Protection Account to support school districts, county offices of education, charter schools, and community college districts.	State Constitution Section 36, Article XIII, (Operative 1/1/13 to 12/31/16)

¹ Data obtained from the BOE website

Rate	Jurisdiction	Purpose	Authority
0.50%	State	Goes to Local Revenue Fund to support local health and social services programs (1991 Realignment)	Revenue and Taxation Code sections 6051.2, 6201.2
1.0625%	State	Goes to Local Revenue Fund 2011	Revenue and Taxation Code sections 6051.15 and 6201.15
1.00%	Local	0.25% Goes to county transportation funds; 0.75% Goes to city or county operations	Revenue and Taxation Code section 7203.1 (Operative 7/1/04)
Total:			
7.50%	State/Local	Total Statewide Base Sales and Use Tax Rate	

Office Revolving Fund

GC section 16400 established an agency's ability to draw from its appropriation an amount that may be used as a revolving fund. GC section 16401 states that any revolving fund drawn under the provisions of section 16400 may only be used in accordance with law for payment of compensation earned, traveling expenses, traveling expense advances, or where immediate payment is otherwise necessary. State Administrative Manual (SAM) section 8100 identifies the overall policies and procedures for revolving fund disbursements and accounting procedures.

Objectives, Scope, and Methodology

The review period was July 1, 2013, through April 30, 2015. The objectives of this review were to determine whether:

- The BOE has adequate internal accounting and administrative controls over certain financial operations and activities, specifically the RSTF, the ORF, the accounts receivable cycle, and the apportionment and allocation processes, to safeguard the State against theft, abuse, or losses; and
- The BOE is complying with applicable laws, rules, regulations, policies, and procedures.

To achieve our review objectives, we performed the following procedures:

- Reviewed State and BOE policies and procedures related to the RSTF to understand the practice of processing and allocating sales and use tax revenue;
- Performed analyses of RSTF allocations and adjustments;

- Interviewed Financial Management Division (FMD) staff to understand how they process and allocate sales and use tax revenue;
- Interviewed staff from the Local Revenue Allocation Unit (LRAU), the Research and Statistics Section (RSS), and the Technology Services Department (TSD) to gain an understanding of their involvement regarding the RSTF;
- Obtained an understanding of existing internal controls over the RSTF;
- Reviewed the SAM and BOE policies and procedures related to the ORF;
- Interviewed FMD Accounting Services staff and BOE Human Resources staff to understand how the BOE processes ORF payments, reimbursements, and advances, and to obtain or confirm our understanding of existing internal controls over the ORF; and
- Judgmentally selected and performed tests on samples of salary advances, travel advances, travel reimbursements, and immediate payments paid from the ORF to determine whether they were properly administered and recorded in accordance with state laws, regulations, policies, and procedures.

Conclusion

Our review identified material weaknesses in internal control over the RSTF allocation process that leaves the BOE at risk of additional improper allocations to the various funds if not mitigated. We believe that the control weaknesses, detailed in Findings 1 through 5, contribute to the increasing fund balance of the RSTF, inaccurate adjustments during the quarterly true-ups, improper allocations of DMV and FTB Use Taxes, and improper allocations of the additional sales tax on diesel fuel. In addition, the BOE's RSTF accounts receivable balance is inaccurate, as noted in Finding 6.

Furthermore, we noted that the BOE lacks proper internal controls to follow policies and procedures over its ORF in the areas of permissible use, claims submitted to the SCO for reimbursement, maintenance of supporting documentation, travel advance processes, and salary advance approvals. These weaknesses, detailed in Findings 7 through 11, could lead to waste, abuse, and the misappropriation of funds.

Based on our review, we determined that the BOE has a combination of weaknesses in internal control over the RSTF and ORF such that there is a reasonable possibility that a material misstatement in financial information, impairment of effectiveness or efficiency of operations, and/or noncompliance with provisions of laws, regulations, and policies will not be prevented, detected, and/or corrected in a timely manner.

**Views of
Responsible
Officials**

We discussed our results with Julia Findley, Chief, Financial Management Division, and other BOE staff at an exit conference held on October 22, 2015, at BOE Headquarters. At the exit conference, we stated that the final report will include the views of responsible officials.

On November 2, 2015, Cynthia Bridges, BOE Executive Director, responded on behalf of the BOE to the draft report issued on October 23, 2015. The BOE's response is included as an attachment to this report. The SCO has commented on the responses and has included those comments throughout the Findings and Recommendations section of this report.

Restricted Use

This report is intended for the information and use of the BOE and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record.

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

November 18, 2015

Findings and Recommendations

**FINDING 1—
Inadequate
internal
accounting and
administrative
controls to
appropriately
allocate money in
the RSTF**

The BOE lacks adequate internal accounting and administrative controls over the RSTF. Specifically, the BOE lacks controls to ensure that revenue is appropriately allocated to the various funds and complies with state laws, regulations, and policies.

GC sections 13402 and 13403 mandate that State agencies establish and maintain internal accounting and administrative controls, including ongoing monitoring and an effective system of internal review. With a lack of ongoing monitoring or review, the BOE is not able to timely detect any errors and ensure that the fund allocations are accurate. In addition, a lack of relevant and reliable information and communication contributes to the control weaknesses causing State tax revenues to be inappropriately allocated.

Our review found that the BOE's controls over the RSTF are inadequate in ensuring the accuracy of the fund allocations. No processes are in place to reconcile daily cash remittances to cash reported on tax returns. Therefore, the BOE cannot determine whether all daily cash that is statistically factored² has been captured and accurately adjusted during the quarterly true-up. The BOE has not implemented adequate controls to mitigate the risks associated with such a deficiency. For example, in 2010, legislation was passed to enact the Fuel Swap, which changed the sales tax on motor fuel. As the BOE did not timely identify an allocation problem caused by the Fuel Swap, the State's General Fund was overfunded by approximately \$352 million over a period of three fiscal years, while other funds were underfunded. Although the BOE has corrected this issue, we found no indication of ongoing monitoring activities to prevent future misallocations from reoccurring.

Furthermore, we noted a lack of communication among the various BOE units involved. This impairs staff members' ability to perform their duties and responsibilities efficiently and effectively. The RSTF revenue allocation process involves the FMD Revenue Section, the LRAU, the RSS, and the TSD. The BOE does not have effective communication channels among the units to ensure that staff involved in the revenue allocation process are aware of what the various information system reports contain, whether new laws and regulations that affect tax allocations are accurately applied, and/or how information flows from tax returns to data-generated reports.

In addition, relevant reports were not available for individuals in the FMD Revenue Section to carry out internal control responsibilities, such as reconciliations, while other reports that were not considered very useful were available. For example, a report was unavailable to determine the total money statistically factored to each allocation fund in a quarter. In addition, reports that clearly reflect changes in tax laws were not available.

² Every quarter, the BOE's Research and Statistics Section (RSS) establishes statistical factors, which are estimated rates used by the BOE to allocate taxes collected to the various fund allocations.

The lack of relevant and reliable information, as well as the lack of communication among the BOE units involved in the RSTF allocation process, have resulted in staff performing duties without fully understanding the impact on fund allocations. Furthermore, these control weaknesses have affected staff members' ability to detect allocation funding errors and issues, as noted in Findings 2 through 5.

Recommendation

We recommend that the BOE develop ongoing monitoring activities, such as monthly or quarterly reconciliations between cash remittances and data from information system reports, internal reviews, and separate evaluations, to strengthen controls and detect any weaknesses in a timely manner. In addition, the BOE should promote and establish open and effective communication channels among the units involved and develop reports that are useful, reliable, detailed, and up-to-date, in order to help prevent any miscommunication or inconsistent understandings of the revenue allocation process.

BOE's Response

BOE concurs with the above finding. In response to the above internal analyses, the external report, and SCO audit findings, a Financial Management Review Team (Team), has been established to simplify these processes, address the allocation methodologies and revenue reports, revise protocols, and create a clear and timely audit trail. Under the direction of the BOE Executive Director, this Team is led by the Financial Management Division Chief and includes staff from the following business units:

- Local Revenue Allocation Unit (LRAU)
- Research and Statistics (R&S)
- Technology Services Division (TSD)
- Revenue Accounting Section (FMD)

SCO's Comment

The BOE agreed with the SCO's finding and recommendations. However, before the SCO review findings were brought to the BOE's attention, we did not identify any action taking place to improve ongoing monitoring activities and to establish stronger controls. In addition, during our on-site fieldwork, we were not made aware of the BOE's improvement plans over its reports, protocols, and audit trails. We cannot attest to whether the Team has addressed the issues as no corrective action plan was provided.

FINDING 2— Quarterly true-up of RSTF inaccurately adjusts fund allocations

Based on our analysis of the quarterly true-up process, we noted that the BOE is:

- Improperly including suspense items and FTB Use Tax in the true-up adjustment; and
- Improperly adjusting prepaid sales tax on fuel sales.

Every quarter, the FMD Revenue Section performs a reconciliation, or true-up, to adjust the difference between what was allocated to funds (statistically factored) and what should have been allocated based on tax return totals on the quarterly IRIS (Internal Revenue Information System) allocation reports. The true-up process is complex, lengthy, and involves steps that do not correctly adjust the fund allocations.

When the FMD Revenue Section performs the quarterly true-up, staff uses tax return data generated from the IRIS and multiplies it by quarterly statistical factors. Those amounts are compared with what actually was allocated to the various funds earlier in the quarter based on tax return totals reported; the differences indicate the allocation adjustments needed. However, we noted that the BOE uses certain IRIS report data incorrectly, resulting in improper adjustments and funding allocations. The areas noted below affect the quarterly adjustments, contributing to the misallocation of funds.

Inclusion of Suspense Items

The FMD Revenue Section is erroneously including suspense items in the quarterly true-up. Suspense items are revenues already collected but not reported on the quarterly IRIS allocation reports for various reasons, such as errors on returns, amendments, or returns that have yet to be filed.

FMD Revenue Section staff did not understand why this step was included in the true-up process and did not know what the suspense amount comprised. Including a suspense adjustment in the true-up is inaccurate and will not adjust the various funds to the actual allocation. Therefore, the quarterly adjustment has been inaccurate and funds have been misallocated. We could not quantify the total misallocation for the review period, as the IRIS does not produce the relevant reports necessary for us to determine the amounts.

FTB Allocations are Improperly Adjusted

The FTB transfers the use tax it collects to the RSTF on a monthly basis. The use tax allocations do not need to be estimated at the time of allocation; therefore, the BOE should not include them in the quarterly true-up adjustment. The quarterly IRIS allocation reports do not separate FTB allocation amounts from return totals. Therefore, FTB amounts for the quarter cannot be identified. As a result of this issue, the staff performing the quarterly true-up are assuming that the FTB Use Tax was statistically factored and is adjusting accordingly. As a result, FTB allocations are improperly adjusted and misallocated to the various funds in the RSTF. As we could not obtain reports with the data necessary to quantify the errors, we could not determine the over/under-funding to the various fund allocations.

SG³ Fuel Swap Allocations are Improperly Adjusted

FMD Revenue Section staff obtain an SG report from IRIS which provides them with the SG amounts that were collected and allocated during the quarter. During the true-up process, staff assume that the SG amounts in the SG report are a part of the total reported in the quarterly IRIS allocation reports.

Prepaid sales tax on fuel sales is identified as SG revenue. SG revenue is collected by fuel suppliers and claimed as credits by retailers. However, the quarterly IRIS allocation reports do not identify the amount of SG revenue that was claimed as credits during the quarter. As the amount of SG revenue cannot be determined from the quarterly IRIS allocation reports, including all SG revenues in the true-up is inaccurate, and the various fund allocations are not being adjusted correctly.

Recommendations

To ensure that correct adjustments are being made to the various fund allocations, the BOE should:

- Exclude suspense items from the true-up process;
- Develop reports that identify FTB Use Tax separately from total returns to remove these amounts from the true-up process;
- Develop reports that identify SG revenue included in the total returns; and
- Perform reconciliations between daily cash statistically factored during the quarter and amounts on IRIS reports.

BOE's Response

In response to an internal BOE analysis, staff identified and began excluding suspense items and FTB use tax from the true-up process in Q4-2014.

SCO's Comment

During our on-site fieldwork, FMD staff could not provide a reason for including suspense items in the quarterly true-up. In addition, FMD staff performing the quarterly true-up did not mention that the suspense items were being removed in the Q4-2014 true-up process. As the Q4-2014 true-up process was being performed during our on-site fieldwork, Q4-2014 true-up spreadsheets were provided to us, which still contained suspense items. In addition, we brought to FMD staff members' attention that FTB use tax was improperly being included in the true-up process. FMD staff did not state that they were in the process of removing FTB tax and could not identify the amount of FTB Use Tax reported on the quarterly IRIS allocation reports. Therefore, we cannot attest to whether staff identified and began excluding suspense items and FTB Use Tax from the true-up process in Q4-2014. The finding and recommendations remain as stated.

³ "SG" is a prefix used by the BOE on a permit issued to wholesalers of fuel products.

**FINDING 3—
Sales tax on
diesel fuel is
being
improperly
allocated in the
RSTF**

The BOE is improperly allocating sales tax on diesel fuel. Diesel fuel sales are subject to the statewide tax rate of 7.5% and applicable district taxes. In addition, as of July 1, 2011, an additional sales and use tax rate for diesel fuel was added. The additional sales and use tax rate for diesel fuel was 1.87% from July 1, 2011; 2.17% from July 1, 2012; 1.94% from July 1, 2013; and 1.75% from July 1, 2014 forward. A portion of the diesel fuel sales tax funds the Public Transportation Account (PTA), a trust fund in the State Transportation Fund. However, due to improper allocations, the State's General Fund is being underfunded by sales tax on diesel fuel.

State's 4.75% Base Portion of Sales Tax on Diesel Fuel Misallocated

Regarding diesel fuel sales tax, Revenue Taxation Code (RTC) section 7102(a)(3) states, "All revenues, less refunds, derived under this part at the 4¾ percent rate... shall be transferred quarterly to the Public Transportation Account..."

The RTC requires the State's 4.75% base portion of sales tax on diesel fuel to be transferred quarterly to the PTA. The 4.75% is allocated and held in the State's General Fund, where a portion is returned to the RSTF for the quarterly transfers. As a result of the 2011 realignment, 1.0625% from the General Fund portion of the sales tax was allocated to the Local Revenue Fund 2011 (LRF 2011). The BOE also applied this allocation to the diesel fuel sales tax; the allocation should not have been applied in this way as the 2011 realignment did not apply to diesel fuel sales tax. Therefore, out of the 4.75%, only 3.6875% is being allocated to the State's General Fund, while the remaining 1.0625% is being allocated to the LRF 2011. As a result, the State's General Fund is being underfunded by diesel fuel sales taxes for the transfer, and partially funding the PTA. As IRIS reports could not identify sales tax on diesel fuel on the returns, we could not determine the amount by which the State's General Fund was underfunded.

Additional Sales Tax on Diesel Fuel Misallocated

RTC section 6051.8 states:

- (a) Except as provided by Section 6357.3, in addition to the taxes imposed by this part, for the privilege of selling tangible personal property at retail a tax is hereby imposed upon all retailers at the rate of 1.75 percent of the gross receipts of any retailer from the sale of all diesel fuel, as defined in Section 60022, sold at retail in this state on and after the operative date of this subdivision.
- (b) Notwithstanding subdivision (a), for the 2011-12 fiscal year only, the rate referenced in subdivision (a) shall be 1.87 percent.
- (c) Notwithstanding subdivision (a), for the 2012-13 fiscal year only, the rate referenced in subdivision (a) shall be 2.17 percent.
- (d) Notwithstanding subdivision (a), for the 2013-14 fiscal year only, the rate referenced in subdivision (a) shall be 1.94 percent.
- (e) Notwithstanding subdivision (b) of Section 7102, all of the revenues, less refunds, collected pursuant to this section shall be estimated by the State Board of Equalization, with the concurrence of the Department of Finance, and transferred quarterly to the Public Transportation Account in the State Transportation Fund for allocation pursuant to Section 99312.1 of the Public Utilities Code.

- (f) Subdivisions (a) to (e), inclusive, shall become operative on July 1, 2011.

The additional sales tax on diesel fuel also funds the PTA on a quarterly basis and should be allocated to the State's General Fund. The allocation and transfers are applied in the same manner as the State's 4.75% base portion of sales tax on diesel fuel. However, FMD Revenue Section staff members did not know how the funds should be allocated and, therefore, the additional sales tax on diesel fuel remains statistically factored. During the quarterly true-up, the additional diesel fuel sales tax has not been included in the adjustment. As additional diesel fuel sales tax remains statistically factored, the State's General Fund is being underfunded to provide the funds during the transfer. Essentially, the State's General Fund is partially funding the PTA. This has been occurring since the inception of the additional sales tax on diesel fuel in 2011.

We reviewed the 3rd Quarter 2013 through 4th Quarter 2014, which includes allocation periods from August 14, 2013, through February 12, 2015, to determine an approximate misallocation of the additional diesel fuel sales tax. The State's General Fund has been underfunded by approximately \$122,482,198 of the additional diesel fuel sales taxes. A total of approximately \$55,541,153 was overfunded to local, county, and special taxing jurisdictions (STJs)⁴; this amount will remain in the RSTF, as only Bradley-Burns Uniform Local Sales and Use Tax (Local and County) and district taxes are allocated to the local jurisdictions. This misallocation has contributed to the growth of the RSTF's fund balance. In addition, the LRF has been overfunded by \$14,473,740; the Local Public Safety Fund has been overfunded by \$14,473,740; the LRF 2011 has been overfunded by \$30,756,698; and the Fiscal Recovery Fund has been overfunded by \$7,236,866. The over- and under-allocations for the 3rd Quarter 2013 through 4th Quarter 2014 are summarized in the table below.

Third Quarter 2013 – Fourth Quarter 2014 Difference Summary

Fund Allocations	Est. \$ Over/ (Under) Allocation
Local (Bradley-Burns 75%) ^a	\$ 21,710,614
County (Bradley-Burns 25%) ^a	7,236,866
Special Taxing Jurisdictions (STJs) ^a	26,593,673
State General Fund	(122,482,198)
Local Revenue Fund	14,473,740
Local Public Safety Fund	14,473,740
Local Revenue Fund 2011 (LRF 2011)	30,756,698
Fiscal Recovery Fund (ERBA)	7,236,866

a The over/(under) allocations only apply to the funds held in the RSTF. This does not affect disbursements made to locals, counties, and STJs.

⁴ The overfunding only applies to the funding allocations which are held in the RSTF. This does not affect disbursements made to locals, counties, and STJs as payments are made based on actual tax returns.

Recommendation

The BOE should correct the allocation percentages for statewide sales tax on diesel fuel to ensure that the State's General Fund is receiving the correct allocation to fund the PTA. In addition, the BOE should calculate the misallocation of the additional sales tax on diesel fuel since inception and make adjustments accordingly. The BOE also should provide adequate training to ensure that staff involved understand the requirements under new legislation and existing State laws regarding sales tax on diesel fuel.

BOE's Response

BOE's Legal Department has provided the following analysis:

Revenue and Taxation Code section 7102(a)(3) provides that those tax revenues shall be transferred quarterly to the Public Transportation Account (PTA). BOE makes that quarterly transfer from funds allocated to the State General Fund.

RTC section 6051.15 was enacted after section 7102. RTC section 6051.15 provides that, notwithstanding any other law, revenues collected pursuant to section 6051 and attributable to a rate of 1.0625% shall be deposited with the Local Revenue Fund 2011 (LRF).

For sales of diesel fuel, BOE took the 4.75% in statewide sales tax imposed pursuant to section 6051, and allocated 3.6875% to the State General Fund and allocated 1.0625% to the LRF. At the end of the quarter, when it was time to fund the PTA, all 4.75% of the funding came from the State General Fund. In effect, the State General Fund subsidized the PTA.

The SCO auditor states that BOE staff erred in that, for sales of diesel fuel, all 4.75% imposed pursuant to section 6051 should have been allocated to the State General Fund because it is from that fund that amounts are transferred to the PTA, and section 7102(a)(3) requires that all 4.75% go to the PTA.

According to BOE's Legal Department staff, the SCO auditor's position ignores the plain language of RTC section 6051.15, says that "notwithstanding Section 7101 or any other law, the amount of revenues... collected pursuant to Section 6051 and attributable to a rate of 1.0625 percent shall" be deposited in the LRF. Section 6051.15 was not drafted to exclude revenues associated with sales of diesel fuel. Instead, it includes all amounts collected pursuant to section 6051, and this includes revenues associated with the sale of diesel fuel.

Based on the above analysis performed by the BOE Legal Department, the BOE is properly allocating the diesel fuel in accordance with the statutory mandate set forth in section 6051.15.

SCO's Comment

After further review of the BOE's response, the SCO has determined that no further action is required in regard to the 4.75% sales tax on diesel fuel.

The BOE did not address the finding and recommendation regarding the misallocation of the additional sales tax on diesel fuel. The finding and recommendation for this portion of Finding 3 remains as stated.

**FINDING 4—
DMV Use Tax is
being allocated
to the RSTF**

The BOE lacked adequate controls over the allocation of the DMV Use Tax. Consequently, for the review period, the State's General Fund was over-allocated, while the LRF 2011, the Fiscal Recovery Fund, and local jurisdictions were under-allocated.

The DMV transfers the Use Tax it collects to the various fund allocations in the RSTF. The fund allocations are based on a template provided by the LRAU. Based on discussions with LRAU staff, the IRIS includes the 1.0625% for LRF 2011 with the State's General Fund portion, and .25% for ERBA is included with the local jurisdictions' portion until the quarterly unload when IRIS reports are processed. As templates were based on the allocations noted above, of the 7.5% statewide tax rate, 5.25% was being allocated to the State's General Fund, and 1% was being allocated to the local jurisdictions. The LRF 2011 and the Fiscal Recovery Fund were not being funded.

FMD Revenue Section staff were aware of this misallocation but would perform monthly transfers to correct only the allocations for the LRF 2011. As this is done manually, we noted an error in the correction for December 2013 and observed that the correction for the LRF 2011 was not made for September 2014. As a result of this error, approximately \$6,683,942 was over-allocated to the State's General Fund and was under-allocated to the LRF 2011 by the same amount. In addition, from July 2013 through September 2014, the Fiscal Recovery Fund had been under-allocated by approximately \$20,525,165, and local jurisdictions had been over-allocated.⁵ The DMV Use Tax has not been allocated to the Fiscal Recovery Fund since 2004.

From October 2014 through April 2015, DMV Use Tax fund allocations were changed. During this period, the State's General Fund was over-allocated by approximately \$41,100,915, while the LRF 2011, local jurisdictions, and counties were under-allocated by approximately \$2,417,079; \$29,012,877; and \$9,670,959, respectively.⁶ The BOE stated that misallocations from October 2014 would be corrected at fiscal year-end 2015. The cumulative improper allocations for the entire review period are summarized below.

⁵ The overallocation does not affect disbursements made to local jurisdictions. It only applies to the funding amounts in the RSTF.

⁶ The underfunding does not affect disbursements made to local jurisdictions and counties. It only applies to funding amounts in the RSTF.

DMV Use Tax July 2013-April 2015 Improper Allocations

<u>Fund Allocation</u>	<u>Jul 2013-Sept. 2014 Over/(Under) Allocation</u>	<u>Oct 2014-Apr 2015 Over/(Under) Allocation</u>	<u>Total Est. \$ Over/(Under) Allocation</u>
State General Fund	\$ 6,683,942	\$ 41,100,915	\$ 47,784,857
Local Revenue Fund	—	—	—
Local Public Safety Fund	—	—	—
Local Revenue Fund 2011 (LRF 2011)	(6,683,942)	(2,417,079)	(9,101,021)
Fiscal Recovery Fund (ERBA)	(20,525,165)		(20,525,165)
Local ^a	20,525,165	(29,012,877)	(8,487,712)
County ^a		(9,670,959)	(9,670,959)
Special Taxing Jurisdictions (STJs) ^a	—	—	—

Note a: The over/(under) allocations only apply to the funds that are held in the RSTF. This does not affect disbursements made to locals, counties, and STJs.

Recommendation

The BOE should perform monthly reconciliations on DMV Use Tax allocations to ensure that they are accurate. Correct allocation templates should be provided to the DMV to avoid manual adjustments that can be prone to error. In addition, the BOE should determine the misallocation of the DMV Use Tax and make adjustments accordingly.

BOE's Response

BOE concurs with SCO, and has revised the DMV templates used to allocate LRF 2011 and the Fiscal Recovery Fund. The Team is evaluating the best methodologies for performing respective monthly reconciliations and making allocation adjustments.

SCO's Comment

The BOE agreed with the finding and recommendations.

**FINDING 5—
FTB Use Tax is
being
improperly
allocated to the
RSTF**

The BOE lacks adequate controls over the allocation of the FTB Use Tax. Consequently, the BOE is over-allocating the State's General Fund and local jurisdictions while under-allocating the LRF 2011 and the Fiscal Recovery Fund. The control weaknesses leave the BOE at risk of additional improper allocations if not corrected.

The FTB transfers the Use Tax it collects to the RSTF on a monthly basis. The Use Tax is allocated to the State's General Fund, and the FMD Revenue Section performs adjustments to correct the fund allocations monthly. However, since allocations are based on the same percentages noted for the DMV, the LRF 2011 and the Fiscal Recovery Fund are not being funded. FMD Revenue Section staff are aware of this misallocation. However, no adjustments have been made since the inception of the two funds.

During our review period, the State's General Fund and local jurisdictions have been over-allocated approximately \$3,688,911 and \$885,106, respectively.⁷ The LRF 2011 and the Fiscal Recovery Fund have been under-allocated accordingly. However, the misallocations have been occurring since 2004 for the Fiscal Recovery Fund, and since 2011 for the LRF 2011, so the impact is greater and has been a factor in the gradual growth of the RSTF's fund balance.

**FTB Use Tax
July 2013 – April 2015 Improper Allocations**

<u>Fund Allocations</u>	<u>Est. \$ Over/(Under) Allocated</u>
State General Fund	3,688,911
Local Revenue Fund	–
Local Public Safety Fund	–
Local Revenue Fund 2011 (LRF 2011)	(3,688,911)
Fiscal Recovery Fund (ERBA)	(885,106)
Local ^a	885,106
County ^a	–
Special Taxing Jurisdictions (STJs) ^a	–

a The over/(under) allocations only apply to the funds held in the RSTF. This does not affect disbursements made to locals, counties, and STJs.

Recommendation

The BOE should verify whether the FTB Use Tax allocations are correct by performing monthly reconciliations. Templates should be provided to the FTB to avoid manual adjustments that can be prone to error. In addition, the BOE should determine the misallocation of the FTB Use Tax and make adjustments accordingly.

BOE's Response

BOE concurs with SCO, and has revised the FTB templates used to allocate LRF 2011 and the Fiscal Recovery Fund. The Team is evaluating the best methodologies for performing respective monthly reconciliations and making allocation adjustments.

SCO's Comment

The BOE agreed with the finding and recommendations.

⁷ The over-allocation does not affect disbursements made to local jurisdictions. It only applies to the funding amounts in the RSTF.

**FINDING 6—
RSTF accounts
receivable
balance is
inaccurate**

The BOE lacks adequate controls to maintain consistent A/R records among the various BOE units involved and to ensure that A/Rs are accurately recorded. The FMD Revenue Section records a cumulative A/R amount that includes SCO-approved write-offs. This misrepresents the BOE's collectability of revenues.

SAM section 10509 states, "Accounts receivable are written off upon receipt of an approved Application for Discharge from Accountability Form, STD Form 27 from the State Controller's Office."

To record A/Rs, FMD Revenue Section staff use a FAC 506 report from the IRIS that shows monthly A/R billed activity. As of April 30, 2015, the closing A/R balance on the trial balance was approximately \$4.7 billion, which included approximately \$1.65 billion in SCO-approved write-offs. The FMD Revenue Section does not have policies or procedures in place regarding write-offs, and it relies solely on the FAC 506 report to record journal entries. The Data Analysis Section maintains separate A/R records that reflect a more accurate A/R balance; however, this information is not communicated to the FMD Revenue Section.

Recommendation

We recommend that BOE work with the Data Analysis Section to determine a more accurate amount of A/Rs that are collectible. The FMD Revenue Section also should have policies and procedures in place to ensure that A/R are properly recorded and that the A/R balance is reliable and accurate.

BOE's Response

BOE concurs with the SCO finding. FMD will develop and document procedures in conjunction with Special Operations Branch and Data Analysis Section to ensure that the A/R balance is accurately reflected and reliable. FMD will train its staff to implement these procedures, including approved write-offs as set forth in SAM section 10509.

SCO's Comment

The BOE agreed with the finding and recommendations.

**FINDING 7—
ORF receivables
not collected in a
timely manner**

Per our review of the BOE's Aging Report as of April 2015, we noted that the BOE did not collect ORF receivables in a timely manner. The ORF receivables consist of salary advances, travel advances, and payments to miscellaneous vendors. According to a report generated by the FMD Accounting Services Unit, the aging report had a total of \$1,594,476 in outstanding receivables that were more than 60 days old as of April 30, 2015. Of this amount, \$242,511 (15%) was outstanding for 61-90 days, \$936,168 (59%) was outstanding for 91 days to three years, and \$415,797 (26%) was outstanding for more than three years.

We found that the \$1,594,476 in outstanding receivables that were more than 60 days old are mainly attributable to a failure to follow proper collection guidelines as prescribed by the SAM. We reviewed 30 out of 415 ORF receivables that were more than 60 days old at April 30, 2015; the results of our testing are as follows:

- Two American Express payments from 2013, totaling \$16,538, have not been reimbursed to the ORF. Airline ticket charges and car rentals from traveling employees comprise the majority of this amount. Accounting Services Unit staff could not provide support for the outstanding amounts for these two items, the reasons for amounts outstanding, or the parties responsible for the outstanding items.
- One payment of \$11,250 that was more than 60 days old has not been scheduled for ORF reimbursement from the SCO.
- For five outstanding travel advances, totaling \$10,028, no periodic statements were sent to the employees;
- For three salary advances, totaling \$3,316, collection letters were sent 90 days from the issuance date of the ORF check.
- For two salary advances, totaling \$4,043, multiple collection letters were sent but no follow-up actions were taken.
- For one outstanding salary advance in the amount of \$1,157, no collection letter was sent. In addition, supporting documentation, such as the ORF check, salary advance request form, and the reason for the advance were not on file.

SAM section 8776.6 states:

For the collection letter process, the department will send a sequence of three collection letters at a minimum of 30 day intervals. If a reply or payment is not received within 30 days after sending the first letter, the department will send a second letter. This follow-up letter will reference the original request for payment letter and will be stated in a stronger tone. If a response is still not received from the debtor, a third letter will be sent 30 days later. This last letter will include references to prior letters and will state what further actions, including collection fees, may be taken in the collection process.

SAM Section 8776.6 further states that:

...if the three collection letters are unsuccessful, departments will prepare cost benefit analysis to determine what additional collection efforts should be made.

Recommendations

The BOE should comply with SAM requirements and ensure that:

- Collection letters and overpayment notification letters are sent out in accordance with SAM section 8776.6;

- Written analyses are performed to determine what collection efforts will be made if the three collection letters are unsuccessful in recovering the receivable; and
- A cohesive process is developed for both the Accounting Services Unit and Personnel Offices for the collection function.

BOE's Response

BOE's internal auditor found similar results in its recent review of the ORF process. In response to the internal report, FMD and Human Resources Division [HRD] convened a team to improve the salary advance and collection process, and transferred the responsibility for the collection of advances from HRD to FMD. To ensure compliance with SAM section 8776.6, HRD will continue to issue the first collection letter, and FMD will issue all subsequent collection notices through December 31, 2015. Effective January 1, 2016, FMD will be responsible for sending all three collection notices. FMD will develop procedures to address collection efforts which do not result in full repayment, including performing quarterly reviews to ensure that BOE is in compliance with SAM requirements.

SCO's Comment

While the BOE's internal auditors had conducted a review of the ORF process before the SCO conducted its review, during on-site fieldwork, we were not made aware of the BOE's plans to mitigate any of the weaknesses. Therefore, we cannot attest to whether BOE had already implemented the plans during on-site fieldwork. The finding and recommendations remain as stated.

FINDING 8— Claims not scheduled for prompt reimbursement to the ORF

The BOE did not schedule claims to replenish the ORF in a timely manner. Out of 90 claims reviewed, 12 claims, totaling \$197,546, were submitted to the SCO for reimbursement more than 90 days after the revolving fund checks were issued. In addition, four claims, totaling \$90,887, were more than 60 days old and had not been submitted for reimbursement from the SCO.

SAM section 8047 states that:

Scheduling claims for reimbursements of the ORF promptly is one of the principles to help prevent overdrafts.

Recommendation

The BOE should ensure that ORF claims are scheduled promptly to the SCO for reimbursement.

BOE's Response

The BOE will work to ensure timely and accurate submission of claims and documentation for reimbursement of salary and travel advances, and miscellaneous vendor expenses. The FMD will incorporate quarterly internal reviews to confirm compliance with SAM requirements.

SCO's Comment

The BOE agreed with the finding and recommendations.

**FINDING 9—
Improper use of
office revolving
funds and lack of
supporting
documentation**

Out of 3,755 payments, we selected 90 from the Check Register Report for testing. We noted the following:

- One vendor payment of \$25,563 was improperly paid by the ORF. This payment was paid to Advance Computer Service, Inc. for enhanced software support. The supporting documentation did not indicate the need for immediate payment through the ORF, such as an immediate payment for a discount, special terms, or to avoid a late fee. This payment should have been made through the normal claims process, and an SCO warrant should have been issued. Improper use of the ORF could result in the misuse of State funds.
- Six vendor payments, totaling \$81,475, did not have any supporting documentation. Accounting Services Unit staff could not locate supporting documents such as ORF requests, purchase orders, or invoices for these payments. Without these documents, we were unable to determine whether the payments were legal and proper and were processed in accordance with ORF payment requirements. A lack of supporting documentation could result in duplicate payments to vendors, unauthorized payments, and losses of state funds.

GC section 16401 states that:

Any revolving funds drawn under the provisions of Section 16400 may only be used in accordance with the law for payment of compensation earned, traveling expenses, traveling expense advances, or where immediate payment is otherwise necessary.

In addition, SAM section 8110 states that:

in determining whether immediate payment is necessary, the determining factor is whether payment could be made through the normal claim processing procedure and State Controller's warrant issued.

GC section 13403 states that:

Internal accounting and administrative controls are the methods through which state agencies can give reasonable assurance that measures are taken to safeguard assets, check the accuracy and reliability of accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policies.

The State Administrative Manual (SAM) Section 20050 states that the elements of a satisfactory system of internal accounting and administrative controls include, but are not limited to, a system of authorization and record keeping procedures adequate to provide effective accounting control over assets, liabilities, revenues, and expenditures.

Recommendation

The BOE should adhere to GC section 16401 and SAM section 8110 for ORF payments and ensure that BOE staff understand the permissible uses for office revolving funds. In addition, the BOE should uphold internal control guidelines per GC section 13403 and SAM section 20050 and maintain adequate supporting documentation for all ORF payments.

BOE's Response

The BOE will inform agency staff about the permissible uses of the ORF and required procedures. FMD management will update procedures and train its staff to ensure that the use of the ORF complies with the appropriate GC sections, including the maintenance and retention of appropriate supporting documentation, instituting monthly reviews and other internal controls.

SCO's Comment

The BOE agreed with the finding and recommendations.

FINDING 10— Inadequate controls over salary advances

We reviewed 32 of the 818 salary advances issued during the review period. Out of the 32 salary advances, we noted the following:

- For 12 salary advance payments, totaling \$201,451, there was no documentation to support calculations for salary advance amounts. In addition, the salary advance request forms were not signed by the separating employees, and there was no indication that the forms were approved by managers or supervisors. As a result, we were unable to verify whether these salary advances were calculated correctly and were legal and proper.
- For nine salary advance payments, totaling \$15,075, the reasons that the advances were needed were not indicated on supporting documents.

Per SAM section 8595:

Normally, departments will only issue office revolving fund checks to employees for salary earned when (1) there have been errors or delays in submitting or processing documents making it impossible for the State Controller's Office to prepare and deliver proper salary warrants within a reasonable time, or (2) separating employees are in immediate need of their final salary payments. However, department at their discretion may make payments of salaries earned when this is necessary to alleviate serious unforeseeable hardship. Departments will prepare criteria for advances including the procedures that must be followed before advances are given. The specific reason for the advance must be written on the request.

Salary advances shall be issued for amounts as close as possible to the actual net pay. Upon receipt of the SCO warrant for the full salary payment, departments shall pay the difference between the employee's warrant and the salary advance.

The Department of General Services' General Retention Schedule for Payroll/Personnel Records states that:

Revolving Fund forms should be retained for two years from end of pay period involved, and then retained two more years or until audited, whichever occurs first (maximum of four years).

The State Board of Equalization Administrative Manual (BEAM) section 2790 states that salary advances must be "initiated by the Unit Attendance Coordinator, signed by the employee, approved by the manager or supervisor, and forwarded to the Transaction Unit for processing."

SAM section 8580.4 states:

salary warrants will not be distributed to separating employees until the department has verified that all travel and salary advances have been paid (cleared). The verification must be provided by office revolving fund staff.

The BOE's noncompliance with the SAM and/or internal policies could result in a misuse of state resources, unauthorized payments, or overpayments.

Recommendation

The BOE should comply with SAM and BOE internal policies and ensure that sufficient and adequate supporting documentation for salary advances is maintained and retained for the appropriate amount of time. In addition, the BOE should establish a system of review to ensure that salary advances are calculated properly.

BOE's Response

The BOE will inform staff about the procedures, which must be followed to ensure compliance with SAM and internal policies regarding salary advances. FMD, in conjunction with HRD, will update procedures and train their staff regarding SAM requirements and internal controls.

SCO's Comment

The BOE agreed with the finding and recommendations.

FINDING 11— Inadequate controls over travel advances and reimbursement claims

We selected 186 travel advances for testing. We noted 99 instances of noncompliance:

- For 67 outstanding travel advances, the BOE did not send overpayment notifications or collection letters for receivables totaling \$133,045 that were older than 60 days.
- Thirty travel advance claims were submitted by the employee more than 10 days after travel ended;
- Two travel advances, totaling \$857, were issued in July and August of 2013, and had not been cleared as of April 30, 2015.

In addition, we selected 18 of the 22 months in the review period and reviewed each month's Daily CalATERS Global to Department Reconciliation Report. From each monthly report, we selected 148 travel reimbursement claims for testing. We noted 41 instances of noncompliance:

- Thirty-eight travel reimbursement claims were submitted by the employee more than 10 days after travel ended; and
- Three travel reimbursement claims did not provide Excess Lodging Rate Request/Approval (STD 255C) or justification for claiming excess lodging, totaling \$377 (not including lodging taxes and fees), in excess lodging expenses.

SAM section 8776.6 states:

For the collection letter process, the department will send a sequence of three collection letters at a minimum of 30-day intervals. If a reply or payment is not received within 30 days after sending the first letter, the department will send a second letter. This follow-up letter will reference the original request for payment letter and will be stated in a stronger tone. If a response is still not received from the debtor, a third letter will be sent 30 days later. This last letter will include references to prior letters and will state what further actions, including collection fees, may be taken in the collection process.

SAM section 8116 states, in part, that:

A properly prepared Travel Expense Claim (TEC) to substantiate the travel expenses must be submitted no later than 10 calendar days after the trip(s).

BOE Travel Guide (TG) Section 2110 states:

Represented and excluded employees traveling in-State must have prior approval from the Executive Director, the appropriate Deputy Director, or Director's designee to exceed the maximum lodging rates listed in TG 2100...Travelers are to submit the completed STD 255C to the Accounting Branch. The Accounting Branch will obtain the appropriate BOE and CalHR approvals. In order to provide the Accounting Branch sufficient time to process the STD 255C, please submit the form at least three weeks prior to the dates of travel. Employees are also required to make a "good faith effort" by contacting at least three moderately priced lodging establishments to obtain lodging at or below the State's maximum allowable rates and provide the rates, names, telephone numbers, and dates of contacts to demonstrate this effort and for verification if necessary.

BOE Travel Guide Section 2120 states:

The maximum allowable out-of-State lodging reimbursement rate is \$90.00 plus applicable taxes. Taking into consideration that some out-of-State cities are located in high cost areas, travelers may use the Federal per diem rate. However, employees must make every effort to obtain lodging within the allowable rate.

CalHR Rule 599.619 (e) specifies that exceptions to reimburse in excess of the maximum lodging rate may be granted by the Appointing Power only in an emergency, or when there is no lodging available at the State maximum rate or when it is cost effective.

CalHR PML Reference Code 2006-013 states that:

when requesting an exception, departments are to use the STD 225C, Excess Lodging Rate Request/Approval. All exception requests are to include three moderately priced establishments contacted, dates of the contacts, and the results of the contacts. The request must also be approved in advance and signed by the appointing authority.

Recommendation

The BOE should comply with SAM and CalHR requirements as well as its own internal travel policies to ensure that employees who were issued travel advances but who have not submitted travel expense claims, substantiate their expenses. In addition, the BOE should establish appropriate accounts receivable procedures to reimburse the State for unallowable expenditures.

BOE's Response

The BOE posted accounting bulletin FMD 15-008 on October 27, 2015, to remind staff of the travel advance policies and procedures.

FMD will develop procedures and train staff on monitoring outstanding travel advances, ensure timely collection from employees with outstanding balances, and the collection of reimbursements for unallowable expenditures.

SCO's Comment

The BOE agreed with the finding and recommendations.

**Attachment 1—
California Board of Equalization’s
Response to the Draft Review Report**



STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

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Third District, Los Angeles County

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Fourth District, Orange County

BETTY T. YEE
State Controller

CYNTHIA BRIDGES
Executive Director

November 2, 2015

Mr. Finlayson,
Chief, State Agency Audits Bureau
Office of State Controller's Office, Division of Audits
P.O. Box 942850
Sacramento, CA 94250-5874

Dear Mr. Finlayson,

We appreciate the opportunity to respond to the State Controller's Office (SCO) draft Review Report entitled "Internal Accounting and Administrative Controls Review" for the period of July 1, 2013 through April 30, 2015.

The internal accounting and administrative control findings associated with the allocation of funds in the State Retail Sales Tax Fund (RSTF) are consistent with internal reviews I requested of the revenue accounting and distribution processes of the Board of Equalization (BOE). As part of these reviews, the BOE determined that a \$343 million adjustment was required to correct specific fund balances for the period of April 1, 2011 through December 13, 2013.

Consistent with a comprehensive review of long-existing financial management practices in the RSTF, the BOE pursued an external evaluation of the RSTF revenue accounting, distribution and allocation cycles. The scope of this review was to identify opportunities for process improvement; to benchmark BOE's practices with other state agencies within and outside of California; and to determine if the BOE was in compliance with Generally Accepted Accounting Principles (GAAP), and Government Accounting Standards Board (GASB), and the State Administrative Manual (SAM) requirements. This review, "Revenue Cycle Management Analysis Report," was completed on June 30, 2015; and staff has developed an action plan, which is currently under review.

BOE commits to strengthening the control environment, risk assessment practices, control activities, communication and monitoring processes to reduce the recurrence of issues discussed in the SCO's Review Report, and that BOE's financial management protocols and procedures mirror the best practices of tax administration and the financial sector.

If you have any questions concerning the enclosed BOE response, please contact me at (916) 327-4975 or Edna Murphy, Deputy Director, Administration Department, at (916) 322-3320.

Sincerely,

Cynthia Bridges
Executive Director

Enclosure

CB:im

CC: Betty T. Yee, California State Controller and Board Member
California State Board of Equalization
George Runner, Vice Chair of the Board
California State Board of Equalization
Fiona Ma, Board Member
California State Board of Equalization
Jerome Horton, Chair
California State Board of Equalization
Diane Harkey, Board Member
California State Board of Equalization
David J. Gau, Chief Deputy Director
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Brock Wimberley, Internal Audit Division
California State Board of Equalization
Edna B. Murphy, Deputy Director, Administration Department
California State Board of Equalization
Julia Findley, Acting Chief, Financial Management Division
California State Board of Equalization
Ester Cabrera-Diaz, Revenue Manage, Revenue Section
California State Board of Equalization
Sandra Mayorga, Human Resources Division
California State Board of Equalization
Mark Durham, Chief, Legislative and Research Division
California State Board of Equalization
Lynn Bartolo, Acting Deputy Director, Sales and Use Tax Department
California State Board of Equalization
Randy Ferris, Chief Counsel, Legal Division
California State Board of Equalization
Liz Peralta, Chief, Accounting Branch
California State Board of Equalization
Michele Pielsticker, Chief, Legislative and Research Division
California State Board of Equalization

Finding 1 – Inadequate internal accounting and administrative controls to appropriately allocate money in the RSTF.

SCO Recommendation:

We recommend that the BOE develop ongoing monitoring activities, such as monthly or quarterly reconciliations between cash remittances and data from information system reports, internal reviews, and separate evaluations, to strengthen control and detect any weaknesses in a timely manner. In addition, the BOE should promote and establish open and effective communication channels among the units involved and develop reports that are useful, reliable, detailed, and up-to date, in order to help prevent any miscommunication or inconsistent understandings of the revenue allocation process.

BOE Response:

BOE concurs with the above finding. In response to the above internal analyses, the external report, and SCO audit findings, a Financial Management Review Team (Team), has been established to simplify these processes, address allocation methodologies and revenue reports, revise protocols, and create a clear and timely audit trail. Under the direction of the BOE Executive Director, this Team is led by the Financial Management Division Chief and includes staff from the following business units:

- Local Revenue Allocation Unit (LRAU)
- Research and Statistics (R&S)
- Technology Services Division (TSD)
- Revenue Accounting Section (FMD).

Finding 2 – Quarterly true-up of RSTF inaccurately adjusts fund allocations.

SCO Recommendation:

To assure that correct adjustments are being made to the various fund allocations, the BOE should do the following:

- *Exclude suspense items from the true-up process;*
- *Develop reports that identify FTB use tax separately from total returns to remove these amounts from the true-up process;*
- *Develop reports that identify SG revenue included in the total returns; and*
- *Perform reconciliations between daily cash statistically factored during the quarter and amounts on IRIS reports.*

BOE Response:

In response to an internal BOE analysis, staff identified and began excluding the suspense items and FTB use tax from the true-up process in Q4-2014.

The BOE concurs with the SCO, and FMD is in the process of developing the recommended reports for identifying SG revenue and evaluating the best methodology for reconciling daily cash to IRIS reports.

Finding 3 – Sales tax on diesel fuel is being improperly allocated in the RSTF.

SCO Recommendation

The BOE should correct the allocation percentages for statewide sales tax on diesel fuel to ensure that the State's General Fund is receiving the correct allocation to fund the PTA. In addition, the BOE should calculate the misallocation of the additional sales tax on diesel fuel since inception and make adjustments accordingly. The BOE also should provide adequate training to staff involved to ensure that they understand the requirements under new legislation and existing State laws regarding sales tax on diesel fuel.

BOE Response:

BOE's Legal Department has provided the following analysis:

Revenue and Taxation Code section 7102(a) (3) provides that those tax revenues shall be transferred quarterly to the Public Transportation Account (PTA). BOE makes that quarterly transfer from funds allocated to the State General Fund.

RTC section 6051.15 was enacted after section 7102. RTC section 6051.15 provides that, notwithstanding any other law, revenues collected pursuant to section 6051 and attributable to a rate of 1.0625% shall be deposited with the Local Revenue Fund 2011 (LRF).

For sales of diesel fuel, BOE took the 4.75% in statewide sales tax imposed pursuant to section 6051, and allocated 3.6875% to the State General Fund and allocated 1.0625% to the LRF. At the end of the quarter, when it was time to fund the PTA, all 4.75% of the funding came from the State General Fund. In effect, the State General Fund subsidized the PTA.

The SCO auditor states that BOE staff erred in that, for sales of diesel fuel, all 4.75% imposed pursuant to section 6051 should have been allocated to the State General Fund because it is from that fund that amounts are transferred to the PTA, and section 7102(a)(3) requires that all 4.75% go to the PTA.

According to BOE's Legal Department staff, the SCO auditor's position ignores the plain language of RTC section 6051.15. Again, section 7102 existed before section 6051.15 was enacted, and section 6051.15 says that "notwithstanding Section 7101 or any other law, the amount of revenues . . . collected pursuant to Section 6051 and attributable to a rate of 1.0625 percent shall" be deposited in the LRF. Section 6051.15 was not drafted to exclude revenues associated with sales of diesel fuel. Instead, it includes all amounts collected pursuant to section 6051, and this includes revenues associated with the sale of diesel fuel.

Based on the above analysis performed by the BOE Legal Department, the BOE is properly allocating the diesel fuel in accordance with the statutory mandate set forth in section 6051.15.

Finding 4 and Finding 5 – DMV and FTB use tax is being improperly allocated to the RSTF.

SCO Recommendation – Finding 4:

The BOE should perform monthly reconciliations on DMV use tax allocations to ensure that they are accurate. Correct allocation templates should be provided to the DMV to avoid manual adjustments that can be prone to error. In addition, the BOE should determine the misallocation of the DMV use tax and make adjustments accordingly.

SCO Recommendation – Finding 5:

The BOE should verify whether the FTB use tax allocations are correct by performing monthly reconciliations. Templates should be provided to the FTB to avoid manual adjustment that can be prone to error. In addition, the BOE should determine the misallocation of the FTB use tax and make adjustments accordingly.

BOE Response:

BOE concurs with SCO, and has revised the DMV and FTB templates used to allocate LRF 2011 and the Fiscal Recovery Fund. The Team is evaluating the best methodologies for performing respective monthly reconciliations and making allocation adjustments.

Finding 6 – RSTF accounts receivable balance is inaccurate.

SCO Recommendation:

We recommend that BOE work with Data Analysis Section to determine a more accurate amount of A/R that are collectable. The FMD Revenue Section also should have policies and procedures in place to ensure that A/R are properly recorded and that the A/R balance is reliable and accurate.

BOE Response:

BOE concurs with the SCO finding. FMD will develop and document procedures in conjunction with Special Operations Branch and Data Analysis Section to ensure that the accounts receivable (A/R) balance is accurately reflected and reliable. FMD will train its staff to implement these procedures, including approved write-offs as set forth in SAM section 10509.

Finding 7 – ORF receivables not collected in a timely manner.

SCO Recommendation:

The BOE should comply with SAM requirements and ensure that:

- *Collection letters and overpayment notification letters are sent out in accordance with SAM section 8776.6;*
- *Written analyses are performed to determine what collection efforts will be made if three collection letters are unsuccessful in recovering the receivable; and*
- *A cohesive process is developed for both the Accounting Services Unit and Personnel Office for the collection function.*

BOE Response:

BOE's internal auditor found similar results in its recent review of the office revolving fund (ORF) process. In response to the internal report, FMD and Human Resources Division (HRD) convened a team to improve the salary advance and collection process, and transferred the responsibility for the collection of advances from HRD to FMD. To ensure compliance with SAM section 8776.6, HRD will continue to issue the first collection letter and FMD will issue all subsequent collection notices through December 31, 2015. Effective January 1, 2016, FMD will be responsible for sending all three collection notices. FMD will develop procedures to address collection efforts which do not result in full repayment, including performing quarterly reviews to ensure that BOE is in compliance with SAM requirements.

Finding 8 – Claims not scheduled for prompt reimbursement to the ORF.

SCO Recommendation:

The BOE should ensure that ORF claims are scheduled promptly to the SCO for reimbursement.

BOE Response:

The BOE will work to ensure timely and accurate submission of claims and documentation for reimbursement of salary and travel advances, and miscellaneous vendor expenses. The FMD will incorporate quarterly internal reviews to confirm compliance with SAM requirements.

Finding 9 – Improper use of office revolving funds and lack of supporting documentation.

SCO Recommendation:

The BOE should adhere to GC section 16401 and SAM section 8110 for ORF payments and ensure that BOE staff understands the permissible uses for office revolving funds. In addition, the BOE should uphold internal control guidelines per GC section 13403 and SAM section 20050 and maintain adequate documentation for all ORF payments.

BOE Response:

The BOE will inform agency staff about the permissible uses of the ORF and required procedures. FMD management will update procedures and train its staff to ensure that the use of the ORF complies with the appropriate GC sections, including the maintenance and retention of appropriate supporting documentation, instituting monthly reviews and other internal controls.

Finding 10 – Inadequate controls over salary advances.

SCO Recommendation:

The BOE should comply with SAM and BOE internal policies and ensure that sufficient and adequate supporting documentation for salary advances is maintained and retained for the appropriate amount of time. In addition, the BOE should establish a system of review to ensure that salary advances are calculated properly.

BOE Response:

The BOE will inform staff about the procedures, which must be followed to ensure compliance with SAM and internal policies regarding salary advances. FMD, in conjunction with HRD, will update procedures and train their staff regarding SAM requirements and internal controls.

Finding 11 – Inadequate controls over travel advances and reimbursement claims.

SCO Recommendation:

The BOE should comply with SAM and CalHR requirements as well as its own internal travel policies to ensure that employees who were issued travel advances but who have not submitted travel claims, substantiate their expenses. In addition, the BOE should establish appropriate accounts receivable procedures to reimburse the State for unallowable expenditures.

BOE Response:

The BOE posted accounting bulletin FMD 15-008 on October 27, 2015, to remind staff of the travel advance policies and procedures.

FMD will develop procedures and train staff on monitoring outstanding travel advances, ensure timely collection from employees with outstanding balances, and the collection of reimbursements for unallowable expenditures.

Attachment 2—Glossary of Acronyms

A/R	Accounts receivable
BEAM	State Board of Equalization Administrative Manual
BOE	California Board of Equalization
DMV	California Department of Motor Vehicles
ERBA	Economic Recovery Bond Act
FMD	Financial Management Division of the Administration Department (Board of Equalization)
FTB	California Franchise Tax Board
GC	California Government Code
IRIS	Internal Revenue Information System
LRAU	Local Revenue Allocation Unit
LRF 2011	Local Revenue Fund 2011
ORF	Office Revolving Fund
PTA	Public Transportation Account
RSS	Research and Statistics Section of the Legislative and Research Division (Board of Equalization)
RSTF	State Retail Sales Tax Fund
RTC	California Revenue and Taxation Code
SAM	State Administrative Manual
SCO	California State Controller's Office
STJ	Special Taxing Jurisdictions
TSD	Technology Services Department (Board of Equalization)

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