



State of California

Internal Control and Compliance Audit Report
for the Fiscal Year Ended June 30, 2024

September 2025

REPORT 2024-001.1





CALIFORNIA STATE AUDITOR

621 Capitol Mall, Suite 1200 | Sacramento | CA | 95814



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September 13, 2025

2024-001.1

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As required by Government Code section 8543 et seq., the California State Auditor's Office presents its audit report pertaining to our review of the State of California's internal controls and compliance with state regulations for the fiscal year ended June 30, 2024.

This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the State's internal control and compliance based on our audit of the State's basic financial statements. We identified five deficiencies in internal control over financial reporting that we consider to be material weaknesses and six other deficiencies that we consider to be significant. Deficiencies in the State's internal control system could adversely affect its ability to provide accurate and timely financial information.

Respectfully submitted,

A handwritten signature in black ink that reads "Linus Li".

LINUS LI, CPA
Deputy State Auditor

Contents

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>	1
Schedule of Findings	4
Internal Control and Compliance Issues Applicable to the Financial Statements and State Requirements	5
Employment Development Department	6
Department of Financial Information System for California (FI\$Cal)	12
State Controller’s Office	16
Department of Health Care Services	19
Various Departments Preparing Year-End Financial Reports	24
California Department of Forestry and Fire Protection	27
California Energy Commission	29
Department of Parks and Recreation	31
Department of Parks and Recreation	33
California Department of Resources, Recycling and Recovery	35
State Water Resources Control Board	37



**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***

Independent Auditor's Report

The Governor and the Legislature of the State of California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of California as of and for the year ended June 30, 2024, and the related notes to the financial statements, and have issued our report thereon dated September 5, 2025. Our report disclaims an opinion on the Unemployment Programs Fund and qualifies an opinion on Business-Type Activities for the following reasons.

The Employment Development Department had inadequate internal control over its financial reporting for unemployment benefits. As a result, the department was unable to provide complete and accurate accounting information supporting the financial activity of the State's unemployment program. The condition of the department's records did not permit us, nor was it practicable to extend other auditing procedures, to obtain sufficient appropriate evidence to conclude that Cash and Pooled Investments, Amount on Deposit with U.S. Treasury, Due to Other Governments, Unemployment and Disability Insurance, and Distributions to Beneficiaries, within the Unemployment Programs Fund are free of material misstatement. In addition, the lack of sufficient appropriate evidence precluded us from determining whether the omission of a material amount of \$768 million should be reported as Non-Operating Revenues or as a Special Item. As a result of this matter, we were unable to determine whether further audit adjustments to these accounts were necessary. The issues described above also caused material misstatements of \$768 million in Distributions to Beneficiaries and \$580 million in Due to Other Governments.

These issues also affect the Business-Type Activities. Therefore, we were unable to obtain sufficient appropriate evidence about the Unemployment Programs Fund balances that represent 37 percent of Cash and Pooled Investments, 98 percent of Due to Other Governments, 100 percent of Unemployment Programs Expenses, and 100 percent of Unemployment Programs Revenues, within Business-Type Activities.

Our report includes a reference to other auditors who audited the financial statements of the following, as described in our report on the State of California's financial statements:

Government-wide Financial Statements

- Certain governmental funds that, in the aggregate, represent 1 percent of the assets and deferred outflows, and less than 1 percent of the revenues of the governmental activities.
- Certain enterprise funds that, in the aggregate, represent 86 percent of the assets and deferred outflows, and 58 percent of the revenues of the business-type activities.

- The University of California and the California Housing Finance Agency that represent 92 percent of the assets and deferred outflows, and 95 percent of the revenues of the discretely presented component units.

Fund Financial Statements

- The following major enterprise funds: Water Resources, State Lottery, and California State University.
- The Golden State Tobacco Securitization Corporation, the Public Buildings Construction, the Public Employees' Retirement, the State Teachers' Retirement, the State Water Pollution Control Revolving, the Safe Drinking Water State Revolving, and the 1943 Veterans Farm and Home Building funds, that represent 86 percent of the assets and deferred outflows, and 48 percent of the additions, revenues, and other financing sources of the aggregate remaining fund information.
- The discretely presented component units noted above.

This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors. The financial statements of the Golden State Tobacco Securitization Corporation, the Public Buildings Construction Fund, the State Lottery Fund, and the Campus Foundations of the University of California, which represent 14 percent of the university's total assets and deferred outflows of resources and 2 percent of its revenues, were not audited in accordance with *Government Auditing Standards*, and accordingly, this report does not include reporting on internal control over financial reporting or compliance and other matters associated with the Golden State Tobacco Securitization Corporation, the Public Buildings Construction Fund, the State Lottery Fund, or the Campus Foundations of the University of California.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the State of California'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 State of California's internal control. Accordingly, we do not express an opinion on the effectiveness of the State of California's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. However, as described in the accompanying section entitled Internal Control and Compliance Issues Applicable to the Financial Statements and State Requirements, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and

corrected on a timely basis. We consider the deficiencies described in the accompanying section entitled Internal Control and Compliance Issues Applicable to the Financial Statements and State Requirements as items 2024-1 through 2024-5 to be material weaknesses.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying section entitled Internal Control and Compliance Issues Applicable to the Financial Statements and State Requirements as items 2024-6 through 2024-11 to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of California's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. Additionally, if the scope of our work had been sufficient to enable us to express an opinion on the Unemployment Programs Fund, instances of noncompliance or other matters may have been identified and reported herein.

State of California's Response to Findings

Government Auditing Standards require the auditor to perform limited procedures on the State of California's response to the findings identified in our audit and described in the accompanying section entitled Internal Control and Compliance Issues Applicable to the Financial Statements and State Requirements. The State of California's responses were not subjected to the other auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the State of California's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the State of California's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

CALIFORNIA STATE AUDITOR



LINUS LI, CPA

Deputy State Auditor

Sacramento, California

September 5, 2025

STATE OF CALIFORNIA
SCHEDULE OF FINDINGS FOR THE FISCAL YEAR ENDED JUNE 30, 2024

Summary of Auditor’s Results

Financial Statements

Type of auditor’s report issued	Disclaimer of opinion for Unemployment Programs Fund, Qualified opinion for Business-Type Activities, and Unmodified opinions for all other opinion units
Internal control over financial reporting:	
Material weaknesses identified?	Yes
Significant deficiencies identified that are not considered to be material weaknesses?	Yes
Noncompliance material to financial statements noted?	No

Internal Control and Compliance Issues Applicable to the Financial Statements and State Requirements

EMPLOYMENT DEVELOPMENT DEPARTMENT

Reference Number: 2024-1

Condition:

The Employment Development Department (EDD) materially restated its Federal Fund and Governmental Activities financial statements in the State's Annual Comprehensive Financial Report (ACFR) for fiscal year 2023–24. This restatement occurred because EDD had incorrectly reported ineligible unemployment insurance (UI) benefit payments as a liability to the federal government in its fiscal year 2022–23 financial statements. After inquiring with the U.S. Department of Labor (Labor) and confirming that EDD was not required to repay those amounts, EDD removed this liability and restated the beginning fund balance and beginning net position in its Federal Fund and Governmental Activities financial statements. Our opinions for fiscal year 2023–24 were not modified with respect to this matter.

EDD also misstated liabilities, expenses, and beginning fund net position in its Unemployment Programs Fund financial statements for fiscal year 2023–24. Furthermore, EDD did not have adequate internal controls in place over its accounting and financial reporting, such as timely and thorough reconciliations of multiple material account balances. These conditions led to the modified opinions we express on the Unemployment Programs Fund and Business-Type Activities.

Material Restatements of Federal Fund and Governmental Activities Financial Statements

EDD restated its Federal Fund and Governmental Activities financial statements by \$46.2 billion. As reported in our internal control reports for the past four fiscal years, EDD's approach for preventing ineligible UI payments had significant weaknesses during fiscal years 2019–20 through 2022–23. As of June 30, 2023, EDD accrued \$46.2 billion in paid ineligible benefits as Other Liabilities in its Federal Fund and Governmental Activities financial statements. However, as reported in our fiscal year 2022–23 internal control report, EDD was unable to provide accurate and complete financial information supporting this estimate. Therefore, we modified the opinions we expressed on the Federal Fund and Governmental Activities within the State's ACFR for fiscal year 2022–23.

In September 2024, EDD asked Labor whether the State was required to repay the federal government for paid ineligible UI benefits that remain unrecovered. In January 2025, Labor responded to EDD stating that there is no requirement for the State to repay unrecovered overpayments to the federal government. Therefore, EDD made a material error when it reported its estimate of paid ineligible UI benefits as Other Liabilities due to the federal government in the fiscal year 2022–23 ACFR. To correct this error, EDD removed the previously reported \$46.2 billion balance in the Other Liabilities account and restated its Federal Fund beginning fund balance and Governmental Activities beginning net position by the same amount in the State's fiscal year 2023–24 ACFR. Our opinions on the State's fiscal year 2023–24 ACFR are not modified with respect to this matter.

Materially Misstated Account Balances and Lack of Adequate Internal Controls Over Financial Reporting in the Unemployment Programs Fund

Materially Understated Expenses and Inflows in the Unemployment Programs Fund

EDD materially understated its expenses and inflows by \$768 million in the Unemployment Programs Fund. The Federal Unemployment Tax Act (FUTA) authorizes the collection of a federal employer tax used to fund state workforce agencies. Employers who are required to pay this tax remit it directly to the federal government. The FUTA tax rate is 6 percent and applies to the first \$7,000 paid to each employee as wages during the tax year. Generally, employers who also pay into state unemployment funds receive a credit of up to 5.4 percent, which reduces the tax rate to 0.6 percent. However, when states have an outstanding loan balance for two or more consecutive years, Labor may reduce the credit by 0.3 percent for each subsequent tax year. The additional tax paid by employers is then used to reduce the state's loan balance.

The State's cash reserve for its unemployment compensation program was eliminated during the last quarter of fiscal year 2019–20, creating the need for it to borrow from the federal government to continue making unemployment benefit payments. Therefore, Labor began reducing the State's FUTA tax credit rate for tax year 2022. For fiscal year 2023–24, this credit reduction resulted in \$768 million in additional FUTA payments, which was material to EDD's financial statements. EDD appropriately reported the resulting reduction to the State's federal loan balance; however, EDD also reported this amount as a reduction to expenses, which does not comply with generally accepted accounting principles (GAAP). Rather, this amount should be reported as an inflow on EDD's Statement of Revenues, Expenses, and Changes in Fund Net Position. As a result of this error, EDD's expenses and inflows in its Unemployment Programs Fund are materially understated. This error occurred primarily because EDD did not develop a GAAP-compliant policy for reporting this transaction, and until EDD does so, the specific inflow affected by this issue remains unknown.

Misstated Liabilities, Expenses, and Beginning Fund Net Position in the Unemployment Programs Fund

EDD materially understated its liability to the federal government in the Unemployment Programs Fund. As described above, the State's cash reserve for its unemployment compensation program was eliminated during the last quarter of fiscal year 2019–20, creating the need for it to borrow from the federal government to continue making state program payments. As of June 30, 2024, the State reported a loan balance of \$19.1 billion, which agrees to the loan balance reported by the U.S. Treasury. However, EDD did not report additional amounts owed to the federal government totaling about \$580 million.

The largest of these liabilities is related to the reconciliation of certain Coronavirus Aid, Relief, and Economic Security Act funding, which was required to be completed by June 30, 2024. When we inquired with EDD about this reconciliation, EDD stated that it completed the reconciliation in Spring 2025 and determined that it owed \$440 million to the federal government, related to benefits paid in prior fiscal years. EDD returned this amount to the federal government shortly thereafter. However, EDD did not recognize a liability due to the federal government and a corresponding reduction to the beginning fund net position related to this amount in its Unemployment Programs Fund financial statements for fiscal year 2023–24.

Additionally, EDD did not report a liability for funds due to the federal government that were held in its cash account at fiscal year-end. During fiscal year 2023–24, Bank of America returned approximately \$3 billion to the State pertaining to previously suspended UI benefit accounts. EDD returned \$2.9 billion of this amount to the federal government during fiscal year 2023–24, nearly all of which was related to federal pandemic programs. Approximately \$140 million remained in EDD's cash account as of June 30, 2024, which EDD subsequently determined also pertained to federal pandemic programs, so it returned that balance to the federal government in June 2025. However, EDD did not report the amount as a liability due to the federal government and also did not correct the corresponding misstatement that understated expenses in its Unemployment Programs Fund resulting from this omission.

Lack of Adequate Reconciliations of EDD's Cash Account Balances in the Unemployment Programs Fund

EDD did not perform adequate reconciliations of its cash account balances reported in the Unemployment Programs Fund. In our internal control report for fiscal year 2022–23, we reported that EDD did not complete its bank reconciliations in a timely manner. Although EDD performed monthly reconciliations for its UI and disability insurance (DI) benefits cash accounts for fiscal year 2023–24, EDD did not complete these reconciliations within the required 30 days after the end of each month. Additionally, EDD did not perform the required monthly reconciliations for the cash account it uses to collect various employment-related taxes until we called that omission to its attention in January 2025. Nevertheless, EDD had already submitted its financial statements to the State Controller's Office (State Controller) at that time.

We also have concerns about the quality of EDD's bank reconciliations. For example, as of June 30, 2024, EDD reported a negative balance in the cash account that it uses to collect various employment-related taxes. When we inquired of EDD about the cause of this negative balance, EDD indicated that it had erroneously remitted the same receipts twice from this cash account to be reported as revenues in the Unemployment Programs Fund. Additionally, EDD asserted that it addressed this issue after the end of the fiscal year. However, EDD did not report this correction in its financial statements, meaning that the cash balance in this account is likely understated at fiscal year-end. It appears that EDD's bank reconciliation process was not sufficiently thorough to identify the over-remitted amounts when they occurred.

Additionally, we noted that EDD reported large reconciling items in its reconciliation of the cash account that issues UI benefit payments via paper checks. When we asked EDD about the nature of these reconciling items, we learned that EDD was still in the process of reconciling them. All departments are required to complete their reconciliations and resolve reconciling differences before preparing their financial statements.

Furthermore, EDD reported a large ending balance of \$676 million in the same cash account at fiscal year-end, despite having an outstanding loan from the federal government. Although EDD provided us with a listing of all cash transactions going into and out of this account during fiscal year 2023–24, it could not reconcile the ending balance in this account to identify the nature of the cash receipts reported at fiscal year-end. Consequently, we are unable to express an opinion on this account balance or determine the impact this balance may have on other accounts in the Unemployment Programs Fund.

Finally, we noted that EDD reported on its financial statements a balance of \$474 million as being on deposit with the federal government, which may not align with the fact that EDD has an outstanding federal loan. After we inquired as to the nature of this balance, EDD contacted Labor and learned that this balance may represent unspent federal grant funding. The largest amount pertains to the Emergency Unemployment Relief for Governmental Entities and Nonprofit Organizations, which provided state UI tax relief for government and non-profit employers. Nevertheless, EDD has not reconciled this balance and acknowledged that it would need to do so to determine the appropriate financial reporting for this amount. Therefore, until EDD completes its reconciliation of this account, we are unable to express an opinion on this balance, and we cannot determine the effect of this balance on other accounts in the Unemployment Programs Fund.

Lack of Adequate Reconciliations of EDD's Revenue Balances in the Unemployment Programs Fund

EDD did not thoroughly reconcile its accumulated uncollected collections balance, which it reported as part of its revenue account balance in the Unemployment Programs Fund. As of June 30, 2024, EDD accumulated a total balance of \$1.6 billion in its uncollected collections account. When we initially inquired in March 2025 about this material balance, EDD stated that it was in the process of reconciling it. Although EDD was subsequently able to reconcile \$784 million of this balance, the remaining unreconciled balance of approximately \$797 million is material to the financial statements, thereby precluding us from determining the impact of this amount on EDD's revenue account or on other accounts in the Unemployment Programs Fund, such as EDD's cash balances.

Issues With EDD's Reconciliations of Its Accounting Records to the Records Maintained by the State Controller

In our fiscal year 2022–23 internal control report, we reported that EDD did not reconcile its accounts to the State Controller's records in a timely manner. Although it made some progress in this area during fiscal year 2023–24, EDD did not complete these reconciliations within the required 30 days after the end of the month. We also found that some of these reconciliations included differences between EDD's records and the State Controller's records that EDD could not sufficiently explain.

Criteria:

Government Code section 12461 requires the State Controller to issue an ACFR that is prepared in accordance with GAAP.

Codification of Governmental Accounting and Financial Reporting Standards section 2250 states that an error correction should be reported retroactively by restating beginning net position, fund balance, and fund net position, as applicable, for the cumulative effect of the error correction on prior periods.

Codification of Governmental Accounting and Financial Reporting Standards section 1600 states that the financial statements for governmental funds should be presented using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues should be recognized in the accounting period in which they become available and measurable. Expenditures should be recognized in the accounting period in which the fund liability is incurred.

Codification of Governmental Accounting and Financial Reporting Standards section 1600 states that the financial statements for proprietary funds should be presented using the economic resources measurement focus and the accrual basis of accounting. Specifically, most transactions are recognized when they occur, regardless of when cash is received or disbursed.

State Administrative Manual (SAM) section 7901 requires that departments reconcile their accounts to those accounts maintained by the State Controller to disclose errors as they occur. Departments should analyze differences and make corrections to their accounts or request corrections to the State Controller's accounts so that information between both systems is complete and accurate. Corrections to errors must be made as soon as possible, and reconciling differences must be resolved before financial reports are prepared to ensure the accuracy of these reports. Reconciliations shall be prepared monthly within 30 days of the preceding month.

SAM section 7923 requires departments to reconcile their bank account balances with the like accounts maintained in the Centralized Treasury Trust System (CTS). Departments must reconcile their general cash, revolving fund cash, and agency trust fund cash accounts with their CTS Account Statement bank balance, and adjust for deposits in-transit, outstanding checks, and other reconciling items. The reconciliation must identify and describe each reconciling item.

Recommendations:

To prevent misstatements from recurring in its financial reports, EDD should take the following actions:

- Develop and document GAAP-compliant policies and procedures governing the financial reporting of the FUTA tax credit reduction and its impact on the State's outstanding federal loan balance.
- Develop a process for tracking and updating initial accrual estimates for material changes that occur after the submission of its financial statements to the State Controller but before the issuance of the ACFR.
- Redesign its internal business processes that are affecting the timeliness of performing monthly reconciliations and work with the Department of Finance and the State Controller to obtain any additional training for staff to ensure that they can properly perform monthly reconciliations and do so promptly.

- Perform its monthly bank reconciliations and reconciliations to the accounts maintained by the State Controller in a timely manner, and it should do so before submitting timely financial statements to the State Controller. In addition, reconcile its cash, including amounts reported as on deposit with the U.S. Treasury, and uncleared collections balances, and adjust its accounting records accordingly.
- Develop a process, such as the use of a checklist, to track completion of all required month-end and year-end business processes to ensure that they are completed promptly and prior to submitting its financial statements to the State Controller.
- Provide guidance and training to accounting staff on the requirements of GAAP.

Department's View and Corrective Actions:

EDD agreed with our recommendations and indicated that it would implement them. EDD stated that it has already started reconciling its uncleared collections balance and amounts reported as on deposit with the U.S. Treasury, and it plans to implement additional processes to ensure that balances across all accounts are checked at regular intervals. Additionally, EDD indicated that it has begun modifying its existing month-end and year-end processes to ensure completion of all required steps prior to the submission of financial statements to the State Controller. Moreover, EDD stated that it plans to establish a policy for reporting the impact of the additional FUTA tax collections on its loan balance after discussing the matter with the Governmental Accounting Standards Board.

DEPARTMENT OF FINANCIAL INFORMATION SYSTEM FOR CALIFORNIA (FI\$CAL)

Reference Number: 2024-2

Condition:

We identified pervasive findings in the overall information technology (IT) general controls and application controls environment of the Financial Information System for California (FI\$Cal). Details of these findings are being withheld pursuant to Government Code section 8592.45, which prohibits disclosure of certain information related to the FI\$Cal IT infrastructure. Accordingly, and consistent with applicable auditing standards, we decided not to publish these details. Fifteen (15) out of forty-six (46) control deficiencies have Plans of Action and Milestones (POAMs), which were not remediated as of the end of the audit period. Further, the Department of FISCAL (department) lacked sufficient compensating controls in place to reduce the impact of these findings on the IT general and application controls environment.

The primary cause of these issues was that the department's control processes lacked the necessary level of maturity to consistently achieve its objectives. This was due to inadequate documentation or documentation that was not retained, gaps in established processes or a lack of monitoring and feedback mechanisms to identify and implement process improvements in a timely manner.

The deficiencies result in pervasive risks at the entity and system-level to automated controls and configurations of the FI\$Cal system, which potentially impact the ability to rely on FI\$Cal data used for financial reporting. Lack of IT general controls could compromise the reliability and integrity of financial data and increases the risk of misstatements in the financial reports.

Criteria:

Financial Audit Manual (FAM) Volume 1, section 270 (June 2024) states in relevant part:

(.02) IS [Information System] controls consist of those internal controls that depend on information system processing and include general controls, application controls, and user controls. Information system general controls (implemented at the entity-wide, system, and application levels) are the structure, policies and procedures that apply to all or a large segment of an entity's information systems.

(.03) General controls help ensure the proper operation of information systems by creating the environment for effective operation of application controls. General controls include security management, access (logical and physical), configuration management, segregation of duties, and contingency planning controls. An effective information system general control environment:

- provides a framework and continuing cycle of activity for managing risk, developing security policies, assigning responsibilities, and monitoring the adequacy of the entity's computer-related controls (security management);

- limits or detects access to computer resources, such as data, programs, equipment, and facilities, thereby protecting them against unauthorized modification, loss, or disclosure (logical and physical access);
- prevents unauthorized changes to information system resources, such as software programs and hardware configurations, and provides reasonable assurance that systems are configured and operating securely and as intended (configuration management);
- includes policies, procedures, and an organizational structure to manage who can control key aspects of computer-related operations (segregation of duties); and
- protects critical and sensitive data, and provides for critical operations to continue without disruption or be promptly resumed when unexpected events occur (contingency planning).

(.04) Application controls, sometimes referred to as business process controls, are those controls incorporated directly into information systems to help ensure the validity, completeness, accuracy, and confidentiality of transactions and data during information system processing. An effective application control environment includes:

- general controls implemented at the application level (i.e., security management, access controls, configuration management, segregation of duties, and contingency planning);
- controls over transaction data input, processing, and output as well as master data maintenance;
- interface controls over the timely, accurate, and complete processing of information between information systems; and
- controls over the data management systems.

State Administrative Manual (SAM) section 5300.5, states:

California has adopted the National Institute of Standards and Technology (NIST) Special Publication (SP) 800-53 as minimum information security control requirements to support implementation and compliance with the Federal Information Processing Standards (FIPS). Each state entity shall use the FIPS and NIST SP 800-53 in the planning, development, implementation, and maintenance of their information security programs.

SAM section 5305, states:

Each state entity is responsible for establishing an information security program. The program shall include planning, oversight, and coordination of its information security program activities to effectively manage risk, provide for the protection of information assets, and prevent illegal activity, fraud, waste, and abuse in the use of information assets.

Each state entity shall:

1. Align the information security program, its activities, and staff with the requirements of this Chapter;

2. Establish a governance body to direct the development of state entity specific information security plans, policies, standards, and other authoritative documents;
3. Oversee the creation, maintenance, and enforcement of established information security policies, standards, procedures, and guidelines;
4. Ensure the state entity's security policies and procedures are fully documented and state entity staff is aware of, has agreed to comply with, and understands the consequences of failure to comply with policies and procedures;
5. Identify and integrate or align information security goals and objectives to the state entity's strategic and tactical plans;
6. Develop and track information security and privacy risk key performance indicators;
7. Develop and disseminate security and privacy metrics and risk information to state entity executives and other managers for decision making purposes; and
8. Coordinate state entity security efforts with local government entities and other branches of government as applicable.

Recommendations:

The department should perform a comprehensive risk assessment to re-evaluate the department's governance in accordance with SAM, NIST SP 800-53, FIPS, financial reporting, and other State and Federal requirements. Results should include, but are not limited to the following actions:

- Update the System Security Plan (SSP) to include all security controls associated with a system categorized as moderate risk.
- Continue to update policies and procedures, which demonstrate management's controls in place to monitor and prevent risk as designed within the SSP.
- Generate a project plan for remediation and establish a control environment, which reflects the strategic goals identified as part of the comprehensive risk assessment.
- Incorporate a process to make consistent progress against open POAMs and to actively pursue remediation of findings, which incorporates post-implementation monitoring.
- Coordinate and establish validation and verification of controls identified in the SSP.
- Conduct information, communication, and monitoring activities to promote awareness of updated processes.

Lastly, the department should retain audit evidence until our office's annual internal control review is completed for that corresponding fiscal year.

Department's View and Corrective Actions:

The department agrees with the California State Auditor's (State Auditor) comments and is committed to addressing any remaining findings in a timely manner. The security of the system is our highest priority and we greatly value the State Auditor's feedback and take the concerns stated in the report seriously.

To safeguard the system and data, the department is vigilant against external threats, including emerging threats and operational security, and has made consistent progress in closing the POAMs and improving our security posture. The independent security assessments performed by the California Department of Technology and the California Military Department have demonstrated continuous advances in our security posture.

The department's emphasis on both external threats and internal control process improvements continued during the State Auditor's audit for fiscal year 2023–24, which concluded in May 2025. We are happy to report the department has made several improvements to governance processes, internal controls, policies, procedures, and documentation review/update processes to address the findings and further improve our maturity in internal controls and compliance. The department will continue to advance the maturity of our internal controls to fully meet the compliance requirements.

We look forward to continuing our collaboration with the State Auditor to continue to ensure the security and highest standards of the FI\$Cal system and the financial data for which we are entrusted.

STATE CONTROLLER'S OFFICE

Reference Number: 2024-3

Condition:

Each year, the State Controller's Office (State Controller) is responsible for reconciling amounts from various departments related to the State's minimum funding guarantee to schools and colleges, known as Proposition 98, and recording any necessary entries into its reporting system for the State's Annual Comprehensive Financial Report (ACFR). This reconciliation is necessary for ensuring that the amounts reported by the multiple departments involved in the spending for schools and colleges reconcile to the most current information made available by the Department of Finance. The minimum funding guarantee for fiscal year 2023–24 is \$67.1 billion.

In the prior fiscal year, we issued a finding regarding misstatements in the Proposition 98 reconciliation, and the State Controller has since addressed some aspects of this finding. For example, the State Controller developed reconciliation procedures that include a review of variances between the current fiscal year and the prior fiscal year. Furthermore, the State Controller created a workbook to ensure that it tracks and accrues prior year appropriations as necessary. However, it has not developed plans to improve coordination with departments, such as conducting regular meetings to facilitate the inclusion of timely and accurate information in the reconciliation, including the preparation of necessary documentation.

Despite these efforts, the State Controller once again made material errors totaling \$6.1 billion during its reconciliation process for fiscal year 2023–24 by omitting or inappropriately including certain amounts. The material nature of these errors in the State Controller's reconciliation indicates that it still does not have sufficient controls in place to ensure the complete and accurate reporting of the minimum funding guarantee within the ACFR.

Moreover, the State Controller stated that conducting independent validation and verification of departmental support is inconsistent with its authority and responsibility in preparing the ACFR. This practice resulted in material items in the reconciliation that the State Controller could not support. For example, the State Controller could not provide support for a \$5.5 billion reconciling item it made pertaining to the Department of Education. The State Controller stated that its role with Proposition 98 is to collect sufficient available information to reconcile amounts for accounting purposes and that it is not the custodian of budgetary information and has no enforcement authority to produce unavailable departmental or Department of Finance support for the budget. However, the State Controller did not collect sufficient information in this case and is ultimately responsible for the preparation and posting of amounts pertaining to the minimum funding guarantee in the State's ACFR in accordance with generally accepted accounting principles.

Criteria:

The State Controller is responsible for maintaining a system of controls over financial reporting. The design and operation of these controls should permit management and staff, in the normal course of performing their duties, to prevent, or detect and correct, misstatements to the financial reports, in a timely manner.

Recommendation:

To ensure that the Proposition 98 reconciliation is accurate and complete, the State Controller should validate information that affects the reconciliation that it receives from departments, such as obtaining and reviewing documentation that supports the items in the reconciliation. The State Controller should also establish a memorandum of understanding with the relevant departments that are involved in the preparation of the Proposition 98 reconciliation to establish roles and responsibilities for the submission of data, validation of that data, and completion of the Proposition 98 reconciliation.

Department's View and Corrective Actions:

For the year ended June 30, 2024, the State Controller strengthened internal controls over Proposition 98 by developing a tracking worksheet for multi-year appropriations, increasing staffing resources, and documenting process reviews to reconcile to the minimum funding guarantee. However, \$5.2 billion of the \$6.2 billion in errors identified during the audit stemmed from a single journal entry recorded twice—an oversight that should have been caught by internal controls that were already in place. All errors were corrected in the financial statements.

To improve data and document collection, the State Controller established MOUs with two of the three key education departments and coordinated working sessions with the Department of Finance for the fiscal year 2024–25 ACFR.

The \$5.5 billion reconciling item cited by the State Auditor was a routine Department of Finance calculation related to the minimum funding guarantee, not an error by the State Controller. While documentation was lacking, explanatory support was deemed sufficient, and no financial statement adjustments were needed.

The State Controller remains dedicated to strengthening internal controls to prevent errors, continuing staff training, and ensuring timely and accurate financial reporting to uphold the State's fiscal integrity.

Comment:

To provide clarity and perspective, we are commenting on the State Controller's response to our finding.

The State Controller's response understates the importance of obtaining sufficient evidence for the work it performs to ensure proper presentation of amounts related to the minimum funding guarantee in the State's financial statements. The State Controller provided its reconciliation without any support for a material \$5.5 billion adjusting item. When we asked for evidence supporting this item, such as budget documentation, the State Controller stated that it did not have documentation and indicated that the item has typically been included in the minimum funding guarantee reconciliation. However, because the amount varies each year, we believe that it is important for the State Controller to verify the amount. Although we subsequently performed additional procedures to verify the accuracy of the amount in the reconciliation, the State Controller was unable to demonstrate how it ensured that the amount was accurate to begin with. By not obtaining support for material amounts identified in its reconciliation, the State Controller increases its risk of material misstatements in its financial reporting.

DEPARTMENT OF HEALTH CARE SERVICES

Reference Number: 2024-4

Condition:

The Department of Health Care Services (DHCS) overstated Medi-Cal expenditures for fiscal year 2023–24 in the General Fund by \$3.6 billion. Additionally, DHCS understated Medi-Cal expenditures and revenues in the Federal Fund by \$1 billion. For budgetary purposes, DHCS reports Medi-Cal expenditures on a cash-basis. Generally accepted accounting principles (GAAP), however, require governmental funds to be accounted for on a modified accrual basis. Specifically, expenditures must be recognized in the accounting period in which they are incurred. Additionally, the related federal funding should be recognized when all applicable eligibility requirements, including time requirements, are met. As a result, DHCS must prepare GAAP adjustments to convert its budgetary reports to the modified accrual basis for proper presentation in the State's Annual Comprehensive Financial Report (ACFR). The following sections provide more detail about DHCS's misstatements by program.

Errors Pertaining to the Managed Care Enrollment Fee

DHCS overstated its Medi-Cal Managed Care (Managed Care) expenditures in the General Fund by \$3.9 billion and understated its Health Care Related Programs Fund, a nonmajor governmental fund, expenditures by \$1.7 billion pertaining to transfers to the general fund. Additionally, DHCS overstated the General Fund's expenditure accruals by \$2.2 billion. The Managed Care Enrollment Tax is assessed on health plans providing services to Medi-Cal beneficiaries. The General Fund initially paid for Managed Care payments to Medi-Cal providers and was then reimbursed by Managed Care Organization Enrollment Tax revenue. However, DHCS initially recorded the reimbursement to the wrong account in the General Fund and it also did not initially identify the complete amount of reimbursements owed to the General Fund. After we brought these issues to DHCS's attention, accounting staff subsequently revised the General Fund and Managed Care Enrollment Fund accruals to correct these errors.

Understated Accruals for Mental Health Short Doyle Program

DHCS understated expenditures and related revenues in the Federal Fund by \$736 million for the Specialty Mental Health Services program, which is part of Medi-Cal. This program provides specialty mental health services for Medi-Cal beneficiaries who meet certain medical necessity criteria. DHCS develops an accrual for the estimated service costs incurred in prior periods that have not been paid as of the close of the fiscal year. However, DHCS's original accrual estimate of the unpaid prior period service costs was too low. When actual payment data became available, DHCS did not ensure that the accrual amounts were reasonably estimated or determine whether an accrual adjustment was necessary. After we brought this issue to the DHCS's attention, accounting staff subsequently revised the accrual to correct the misstatement.

Errors Pertaining to Proposition 56 Revenues and Expenditures

DHCS understated Healthcare Treatment Fund expenditures by \$223 million and understated Federal Fund expenditures and revenues by \$471 million. Additionally, DHCS misclassified amounts within its Healthcare Treatment Fund accrual, resulting in a \$723 million understatement to the Accounts Receivable account, a \$311 million understatement to the Due to Other Funds account, and a \$412 million overstatement to the Due From Other Governments account. DHCS also misclassified amounts within its Federal Fund accrual, resulting in a \$782 million overstatement to the Due From Other Governments account, a \$311 million understatement to the Due From Other Funds account, and \$471 million understatements to the accounts for both Due to Other Governments and Accounts Receivable. Finally, DHCS understated the beginning fund balance of the Healthcare Treatment Fund by \$223 million.

Proposition 56 passed in November 2016, resulting in an excise tax increase on cigarettes and other tobacco products. A specific portion of the Proposition 56 revenues raised through this tax increase is deposited into the Healthcare Treatment Fund to increase funding for the existing health programs and services, including those intended for tobacco-related conditions and diseases. DHCS regularly reviews the Healthcare Treatment Fund expenditures of Medi-Cal managed care plans (plans). Plans that did not fully expend their share of Proposition 56 revenues on qualifying services must return the unexpended amounts to DHCS. DHCS determined that many plans did not fully expend Proposition 56 revenues for calendar years 2022 and 2023 and distributed letters to the plans informing them of the amounts owed to DHCS.

In Fall 2024, DHCS sent letters to most plans, informing them of the Proposition 56 revenue amounts owed pertaining to calendar year 2022. However, DHCS did not accrue the amounts to be recovered (recoveries) in its fiscal year 2022–23 financial statements. Instead, DHCS incorrectly recorded the recoveries related to calendar year 2022 as reductions to its fiscal year 2023–24 expenditures. Because DHCS calculated the majority of these recovery amounts prior to the issuance of the ACFR for fiscal year 2022–23 but did not accrue them, the recoveries related to those amounts should be reported as a restatement of the beginning fund balance in the Healthcare Treatment Fund.

Additionally, DHCS incorrectly recorded the amounts due from the plans to the Due From Other Governments account in both the Healthcare Trust Fund and the Federal Fund. Because these amounts were owed by the plans, rather than by governmental entities, DHCS should have recorded the entries to the Accounts Receivable account. DHCS also incorrectly recorded an amount owed by the Healthcare Treatment Fund to the Federal Fund within the Due From Other Governments account. This amount should have been recorded in the Healthcare Treatment Fund in the Due to the Federal Fund account and in the Federal Fund within the Due From the Healthcare Treatment Fund account.

These errors occurred primarily because of insufficient communication between program and accounting staff, and the lack of a detailed, GAAP-compliant accrual methodology. After we brought these issues to DHCS's attention, accounting staff subsequently revised the accrual to correct most of these errors. However, DHCS did not fully correct its Federal Fund accrual for this program, resulting in \$471 million understatements in both its Accounts Receivable and Due to Other Governments accounts.

Errors Pertaining to the Managed Care Program

DHCS understated current year General Fund expenditures and beginning fund balance by \$246 million for the Managed Care Program. Additionally, DHCS understated General Fund's accounts receivable and accounts payable by \$558 million.

DHCS contracts with plans to provide health care coverage for Medi-Cal beneficiaries. The plans provide enrollees with most Medi-Cal covered health care services, including hospital, physician, and pharmacy services. These services include state-funded full scope Medi-Cal services to certain populations who meet all eligibility requirements except for their citizenship status, and who therefore are generally not eligible for federal funding (state-only beneficiaries). DHCS pays these plans monthly, predetermined rates—referred to as capitation rates—for each individual enrolled with them. DHCS uses its Capitation Payment Management System (CAPMAN), which contains the capitation rates, to generate monthly invoices for each plan.

For fiscal year 2023–24, the CAPMAN data also included recoveries of previous payments to plans. DHCS stated that these recoveries became necessary because of retroactive rate reductions related to services provided to state-only beneficiaries during calendar year 2023, which includes services provided in the prior and current fiscal years. DHCS had information about the retroactive rate reduction during the preparation of the State's fiscal year 2022–23 financial statements but did not include those recoveries in that year's financial statements. Therefore, the recovery amounts related to fiscal year 2022–23 services are reported in the current year as a restatement of beginning fund balance. According to DHCS, the contracts with plans for state-only services expired on December 31, 2023; therefore, DHCS was unable to offset these recoveries against future payments to the plans. However, when preparing its Managed Care accrual, DHCS reported these recoveries as an offset to amounts owed to plans rather than as receivables. DHCS also reported the entire recovery amount within fiscal year 2023–24 expenditures, resulting in an understatement of DHCS's expenditures and beginning General Fund balance of \$246 million. These errors occurred mainly because of insufficient communication between program and accounting staff. After we raised these issues, DHCS corrected its General Fund accrual.

Issues Pertaining to the Behavioral Health Continuum Infrastructure Program

We identified multiple issues with DHCS's methodology for estimating accruals related to its Behavioral Health Continuum Infrastructure Program (BHCIP). Welfare and Institutions Code sections 5960 and 5960.05 authorized DHCS to establish the BHCIP, as part of which DHCS may award competitive grants to qualified entities (grant recipients) to construct, acquire, and rehabilitate real estate assets or to invest in needed mobile crisis infrastructure to expand the community continuum of behavioral health treatment resources. Grant recipients incur eligible expenditures and then submit invoices for reimbursement of those expenditures. According to DHCS, it authorizes reimbursements to the grant recipients from their awarded grant amounts upon its review and approval of the invoices.

DHCS's accrual methodology for this program did not comply with generally accepted accounting principles (GAAP). DHCS needed to estimate the eligible expenditures incurred by grant recipients during fiscal year 2023–24 that remained unpaid at fiscal year-end, regardless of when grant recipients submitted invoices for reimbursement. However, DHCS based its accrual

solely on invoices received from grant recipients from July through September 2024. Although the grant agreements do not specifically require grant recipients to report expenditures incurred or submit expenditures for reimbursement within a specified time frame, they state that grantees are required to submit to DHCS periodic reports, updates, and information deemed necessary for monitoring compliance and evaluating the program. However, according to DHCS, not all grant recipients submitted expenditure information that it requested, resulting in incomplete data. Consequently, DHCS did not use this information when preparing its accrual for this program.

Because DHCS did not use a GAAP-compliant methodology to develop its accruals related to the BHCIP, DHCS's General Fund expenditures and liabilities could be understated. Given the amount of funding appropriated for the BHCIP, these issues do not pose a risk of material misstatement to the State's fiscal year 2023–24 ACFR. Nevertheless, it is important for DHCS to implement our recommendations to ensure accurate financial reporting related to this program.

When we brought these issues to DHCS's attention, DHCS asserted that it is taking steps to improve its collection of expenditure information from grant recipients and to improve its accrual methodology. Specifically, DHCS stated that to facilitate more consistent reporting by grant recipients, it implemented the use of an online form for grantees to report their monthly projected expenditures. Additionally, DHCS stated that it updated its accrual methodology to accrue projected expenditures that remain unpaid at the end of the fiscal year.

Criteria:

State Administrative Manual (SAM) sections 8340 and 10608 require departments to accrue expenditures at fiscal year-end and record liabilities in accounts showing to whom amounts are due. SAM section 7981 requires departments to review their expenditure accruals periodically for material changes.

Government Code section 12461 requires the State Controller's Office (State Controller) to issue an annual financial report that is prepared in accordance with GAAP. The State Controller provides guidance to departments on the preparation of their year-end financial statements in its Year-End Financial Reports Information GAAP Basis manual. To prepare its financial report, the State Controller annually requests that departments submit GAAP-related adjustments for the funds they manage.

Codification of Governmental Accounting and Financial Reporting Standards section 1600 states that financial statements for governmental funds should be presented using the current financial resources measurement focus and the modified accrual basis of accounting. The current financial resources measurement focus and modified accrual basis of accounting require expenditures to be reported when the related liability has been incurred except in certain limited circumstances.

Codification of Governmental Accounting and Financial Reporting Standards section N50 states that for nonexchange transactions, recipients should recognize revenues, and providers should recognize expenditures, in the period when all applicable eligibility requirements are met. This includes incurring an allowable cost under an expenditure-driven grant.

Codification of Governmental Accounting and Financial Reporting Standards section 2250 states that an error results from mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that existed at the time the financial statements were issued about conditions that existed as of the financial statement date.

Codification of Governmental Accounting and Financial Reporting Standards section 1800 states that for interfund reimbursements, repayments from the funds responsible for particular expenditures or expenses to the funds that initially paid for them and reimbursements should not be displayed in the financial statements.

SAM section 7630 requires amounts due to private persons or organizations for outstanding obligations for goods and services received that have not been paid, to be recorded as Accounts Payable.

Recommendations:

To ensure that its financial statements are properly presented at fiscal year-end, DHCS should do the following:

- Develop detailed accrual methodologies and update them annually.
- Update its initial accrual calculations for material changes that occur prior to the issuance of the ACFR and communicate these changes to the State Controller.
- Adopt review procedures to identify material entry errors.
- Improve internal communications among program and accounting staff who prepare the GAAP accruals by developing a policy that requires program staff to notify accounting staff of any factors that affect accruals, such as the presence of recoupments within accrual calculations.
- Provide additional guidance and training to program and accounting staff on the requirements of GAAP including but not limited to the development of GAAP-compliant accruals and the proper recognition of expenditures and revenues.

Department's View and Corrective Actions:

DHCS described several actions it will take to address our recommendations. It indicated that it instituted an annual process for reviewing and updating its accrual methodologies and is working to further refine this process. DHCS also stated that it has updated its procedures to now include instructions to review previously submitted GAAP entries for material changes before the issuance of the ACFR, and it will review its fiscal procedures and strengthen its internal review process to identify and mitigate material entry errors before finalizing its entries. In addition, DHCS explained that it will improve its internal communications by updating its training and offering technical assistance to DHCS staff to improve their understanding of GAAP requirements, including proper accrual development.

VARIOUS DEPARTMENTS PREPARING YEAR-END FINANCIAL REPORTS

Reference Number: 2024-5

Condition:

Similar to fiscal year 2022–23, multiple state departments did not prepare their year-end financial reports in accordance with generally accepted accounting principles (GAAP) for fiscal year 2023–24. Most of these departments operated programs during fiscal year 2023–24 that incurred expenditures material to the State’s financial statements. Additionally, all of these departments have encumbered significant amounts on active contracts expected to incur additional costs in future fiscal years. For example, departments operating programs within the Environmental and Natural Resources Fund reported \$10.6 billion in encumbered agreements at June 30, 2024. The preparation of financial reports based on improper policies and procedures raises the risk of material misstatement to the State’s Annual Comprehensive Financial Report (ACFR). As a result, most of these departments continued to reassess their year-end practices and submit the necessary corrections to the State Controller’s Office (State Controller) thereby contributing to the ACFR’s late publication. Moreover, we performed additional audit procedures to mitigate the risk of material misstatement related to the improper policies and procedures.

Most of the state departments we reviewed limit their reporting of liabilities to invoices received from grantees or contractors during a brief predetermined period. However, we found that in many instances, these entities are not submitting timely invoices to the State. Rather, they may be waiting months or years before requesting payment. In such circumstances, departments are required to estimate the liability the State owes for these unbilled incurred costs.

The lack of necessary estimates is a recurring concern for many of these departments. We issued a finding for fiscal year 2022–23 recommending that seven departments—the California Air Resources Board (CARB), the California Energy Commission (Energy), the Department of Parks and Recreation (State Parks), the High Speed Rail Authority (HSRA), the State Water Resources Control Board (SWRCB), the Department of Water Resources (DWR), and the Department of Public Health (Public Health)—adopt GAAP-compliant policies and procedures. During the current year audit, most of these agencies worked on addressing the finding by revising their year-end accrual procedures. Although we noted varying levels of completeness of these policies and procedures, many of them were not yet finalized at the time of our audit. Consequently, we continue to identify all of these departments as still needing to take further action.

Additionally, some of these departments administer programs that provide payments to grantees in advance of meeting eligibility requirements. Accounting standards specify that providers should recognize expenditures only when all applicable eligibility requirements are met. We noted instances at both CARB and Energy where advance payments were incorrectly included as part of their year-end accruals. If the departments do not account for advances properly, their actions may lead to a risk of material misstatements in the State’s financial statements.

When grantees or contractors submit large invoices on an irregular basis, the preparation of estimates plays a critical role in financial reporting. For example, SWRCB limited its reporting of liabilities and expenditures for fiscal year 2023–24 to invoices received shortly after fiscal year-end. However, this approach did not account for all the liabilities in need of reporting. Consequently, we performed additional procedures to ensure that the financial statements were not materially misstated. During this process, we identified numerous grantees and contractors with large contracts but little or no recent paid activity, indicating that SWRCB has incurred significant liabilities that it has not yet been invoiced for.

Despite the various attempts that these state departments have made to improve their practices for developing accruals for fiscal year 2023–24, they still lack formal policies and procedures to ensure that they are accurately identifying and reporting their liabilities and expenditures. Departments have the responsibility for tracking material expenditures and properly recording them in the State’s financial statements. Therefore, this issue continues to pose a significant risk of material misstatements persisting in the State’s financial statements.

Criteria:

Departments are responsible for maintaining a system of controls over financial reporting. The design and operation of these controls should permit management and staff, in the normal course of performing their duties, to prevent, or detect and correct, misstatements to the financial reports, in a timely manner.

State Administrative Manual sections 8340 and 10608 require departments to accrue expenditures at fiscal year-end and record liabilities in accounts showing to whom amounts are due. SAM section 7981 requires departments to review their expenditure accruals periodically for material changes.

Codification of Governmental Accounting and Financial Reporting Standards section 1600 specifies the use of the modified accrual basis of accounting in governmental-fund financial statements. Under this basis, departments should recognize expenditures in the period they incur the liability, if measurable.

Codification of Governmental Accounting and Financial Reporting Standards section N50 states that for nonexchange transactions, recipients should recognize revenues, and providers should recognize expenditures, when all applicable eligibility requirements are met. This includes incurring an allowable cost under an expenditure-driven grant. For cash and other assets given in advance in nonexchange transactions, providers should report them as advances (assets), and recipients should report them as liabilities until they incur allowable costs and meet all eligibility requirements.

Recommendation:

To ensure the proper reporting of expenditures, departments should develop GAAP-compliant policies and procedures on how to prepare year-end accruals and train their staff to follow them.

Departments' View and Corrective Actions:

CARB, Energy, State Parks, SWRCB, DWR, and Public Health agreed with our recommendation and indicated they would implement it.

HSRA stated that it had addressed our finding from the prior year by implementing procedures to properly accrue expenditures in compliance with GAAP and the SAM. HSRA also stated that it provided us with finalized accrual policy and procedure documents during this year's audit. Additionally, HSRA asserts that our office did not find any material misstatements in its financial reports.

Comment:

To provide clarity and perspective, we are commenting on the response from HSRA:

We disagree with HSRA's response that it has fully addressed the finding. Several procedure documents that HSRA provided to us were labeled as draft documents and were confirmed to be drafts by its senior staff. Further, HSRA submitted an adjustment of \$163 million to its financial statements after we had begun the fiscal year 2023–24 audit, underscoring the necessity for HSRA to implement GAAP-compliant policies and procedures to avoid the need for subsequent accounting adjustments.

CALIFORNIA DEPARTMENT OF FORESTRY AND FIRE PROTECTION

Reference Number: 2024-6

Condition:

In prior fiscal years, we reported that the California Department of Forestry and Fire Protection (CalFire) did not reconcile its accounts to the State Controller's Office's (State Controller) records in a timely manner. During fiscal year 2023–24, CalFire continued to complete its reconciliations late. For example, the department did not complete its monthly reconciliations for September 2023 through November 2023 until February 2024. Consequently, the reconciliations for some months were extremely late—more than 110 days late for July 2023 and August 2023. These delayed reconciliations also contributed to CalFire's delay in submitting its year-end financial reports to the State Controller in October 2024. The monthly account reconciliation serves as an important internal control because it enables departments to detect fraud and to identify and resolve errors or omissions in the financial information that is ultimately reported in the State's Annual Comprehensive Financial Report. We inquired of CalFire the reason why it continues to complete its monthly reconciliations late. CalFire's chief of accounting attributed its delays to necessary updates to the Financial Information System for California (FI\$Cal) that did not occur until September 2023 and the resolution of 75 requests for technical assistance initiated by the department that affected its month-end close. Nevertheless, CalFire stated that it has been in regular communication with its control agencies with the goal of meeting its reporting requirements.

Criteria:

State Administrative Manual (SAM) section 7901 requires that departments reconcile their accounts to those accounts maintained by the State Controller to disclose errors as they occur. Departments should analyze differences and make corrections to their accounts or request corrections to the State Controller's accounts so that information between both systems is complete and accurate. Corrections to errors must be made as soon as possible, and reconciling differences must be resolved before financial reports are prepared to ensure the accuracy of these reports. Reconciliations shall be prepared monthly within 30 days of the end of the preceding month.

SAM section 7930 requires that departments submit their year-end financial reports to the State Controller by August 31 for all funds.

Recommendations:

- CalFire should perform its monthly reconciliations to the accounts maintained by the State Controller in a timely manner, and it should do so before submitting timely financial reports to the State Controller.
- CalFire should redesign internal business processes that are affecting the timeliness of monthly reconciliations.

Department's View and Corrective Actions:

CalFire stated that it has encountered several challenges that have hindered its ability to complete timely monthly reconciliations since the implementation of FI\$Cal and is actively working with its control agencies to address the issues noted in our finding.

CALIFORNIA ENERGY COMMISSION

Reference Number: 2024-7

Condition:

In the prior fiscal year, we reported that the California Energy Commission (Energy) did not complete its monthly reconciliation of its accounts to the State Controller's Office's (State Controller) records in a timely manner. During fiscal year 2023–24, Energy continued to complete its reconciliations late. Specifically, Energy did not complete its fiscal year 2023–24 reconciliations of its accounts until August 2024. Additionally, Energy did not complete its bank reconciliations in a timely manner. Energy did not complete its bank reconciliations until February 2025, which is eight months after the fiscal year-end. Both types of reconciliations began beyond the state requirement of preparing reconciliations within 30 days of the preceding month. Both the monthly account reconciliation and the bank reconciliation serve as important internal controls because they enable departments to detect fraud and to identify and resolve errors or omissions in the financial information that is ultimately reported in the State's Annual Comprehensive Financial Report.

Energy stated that the late submission of fiscal year 2022–23 financial reports affected when it was able to start its fiscal year 2023–24 workload, including the reconciliations. Energy also attributed its delays to staffing issues in its accounting office that it is currently working to address.

Criteria:

State Administrative Manual (SAM) section 7901 requires that departments reconcile their accounts to those accounts maintained by the State Controller to disclose errors as they occur. Departments should analyze differences and make corrections to their accounts or request corrections to the State Controller's accounts so that information between both systems is complete and accurate. Corrections to errors must be made as soon as possible, and reconciling differences must be resolved before financial reports are prepared to ensure the accuracy of these reports. Reconciliations shall be prepared monthly within 30 days of the preceding month.

SAM section 7923 requires departments to reconcile their bank account balances with the like accounts maintained in the Centralized Treasury Trust System (CTS). Departments must reconcile their general cash, revolving fund cash, and agency trust fund cash accounts with their CTS Account Statement bank balance, and they must adjust for deposits in transit, outstanding checks, and other reconciling items.

Recommendations:

- Energy should perform its monthly reconciliations and submit its financial reports to the State Controller in a timely manner.

- Energy should proactively address its organization's succession planning to ensure that when key staff leave, the department can still perform reconciliations promptly. This effort may include conducting cross-training of other existing staff positions, requesting funding for additional positions, or exploring the possibility of contracting for external assistance to provide additional support.
- Energy should redesign internal business processes that are affecting the timeliness of monthly reconciliations.
- Energy should work with the Department of Finance and the State Controller to obtain any additional training for staff to ensure that they can properly perform monthly reconciliations and do so in a timely manner.

Department's View and Corrective Actions:

Energy agreed with our recommendation to perform monthly reconciliations and submit timely financial reports to the State Controller. It stated that it has implemented corrective actions, including cross-training its staff and using external support. Additionally, Energy stated that it is actively recruiting and will initiate discussions with the Department of Finance to request additional resources to ensure that its accounting office is appropriately staffed.

DEPARTMENT OF PARKS AND RECREATION

Reference Number: 2024-8

Condition:

In the prior fiscal year, the Department of Parks and Recreation (State Parks) did not complete its monthly reconciliation of its accounts to the State Controller's Office's (State Controller) records in a timely manner or not at all. During fiscal year 2023–24, State Parks continued to complete its reconciliations late or not at all. Specifically, State Parks did not prepare monthly reconciliations for four months of the fiscal year and did not complete the reconciliations for seven other months until after the 30-day requirement as required by the *State Administrative Manual* (SAM). Consequently, State Parks submitted year-end financial reports to the State Controller more than a month late. The monthly account reconciliation serves as an important internal control because it enables departments to detect fraud and to identify and resolve errors or omissions in the financial information that is ultimately reported in the State's Annual Comprehensive Financial Report.

State Parks' chief of accounting stated that the department did not perform a reconciliation for certain months or performed its reconciliation for other months beyond the 30-day timeline because of staffing issues. Specifically, at the beginning of fiscal year 2023–24, the individual who was responsible for the monthly reconciliations left State Parks, and the department was unable to fill that position until the end of 2023. Additionally, State Parks noted that it had experienced delays with closing its accounting periods that were contributing to late reconciliations.

Criteria:

SAM section 7901 requires that departments reconcile their accounts to those accounts maintained by the State Controller to disclose errors as they occur. Departments should analyze differences and make corrections to their accounts or request corrections to the State Controller's accounts so that information between both systems is complete and accurate. Corrections to errors must be made as soon as possible, and reconciling differences must be resolved before financial reports are prepared to ensure the accuracy of these reports. Reconciliations shall be prepared monthly within 30 days of the preceding month.

SAM section 7930 requires that departments submit their year-end financial reports to the State Controller by August 31 for all funds.

Recommendations:

- State Parks should perform its monthly reconciliations to the accounts maintained by the State Controller and submit timely financial reports to the State Controller.

- State Parks should proactively address its organization's succession planning to ensure that when key staff leave, the department can still perform reconciliations promptly. This effort may include conducting cross-training of other existing staff positions, requesting funding for additional positions, or exploring the possibility of contracting for external assistance to provide additional support.
- State Parks should redesign internal business processes that are affecting the timeliness of monthly reconciliations.
- State Parks should work with the Department of Finance and the State Controller to obtain any additional training for staff to ensure that they can properly perform monthly reconciliations and do so in a timely manner.

Department's View and Corrective Actions:

State Parks stated that it agrees with the finding and indicated that it is in the process of refining its policies and procedures to ensure compliance with SAM guidelines. State Parks also stated that it will continue to participate in the Department of Finance's training on month-end and year-end closes.

DEPARTMENT OF PARKS AND RECREATION

Reference Number: 2024-9

Condition:

As we have reported in previous fiscal years, the Department of Parks and Recreation (State Parks) has not reconciled its capital asset account balances for buildings and related improvements to a subsidiary inventory ledger. Therefore, State Parks has not been reporting complete and accurate information to the State Controller's Office (State Controller) for inclusion in the State's Annual Comprehensive Financial Report (ACFR). During fiscal year 2023–24, we again found that State Parks lacked a comprehensive inventory of its capital assets and therefore continues to be unable to reconcile its account balances. As a result, for fiscal year 2023–24, State Parks reported the same capital assets to the State Controller that it reported in fiscal year 2017–18. Furthermore, we found that several of State Parks' policies describing how it will update its capital asset inventory do not ensure that its records will be in compliance with generally accepted accounting principles (GAAP). For example, its policies do not address the impairment or improvement of capital assets, and its policies on capitalizing work-in-progress costs are inconsistent with GAAP. Based on the historical level of funding made available to State Parks for capital assets, these issues do not pose a material risk of misstatement to the State's fiscal year 2023–24 ACFR. Nevertheless, it is important for State Parks to implement our recommendations to avoid a possible material misstatement in the future.

State Parks' staff explained that the department began tracking its capital assets through an online asset management application in January 2025, stating that this process would improve the department's ability to implement our prior recommendation that State Parks update the Financial Information System for California (FI\$Cal) to reflect its subsidiary capital asset records. However, State Parks also explained that the issues it encountered when uploading these records from the asset management application to FI\$Cal have delayed the department from implementing our recommendation. Although State Parks' chief of accounting stated that the department remains committed to addressing our recommendations, as of August 2025, State Parks has not provided an expected completion date.

Criteria:

Codification of Governmental Accounting and Financial Reporting Standards section 1400.102 states that capital assets should be reported at historical cost. The cost of a capital asset should include ancillary charges necessary to place the asset into its intended location and condition for use. Ancillary charges include costs that are directly attributable to asset acquisition, such as freight and transportation charges, site preparation costs, and professional fees. Interest cost incurred before the end of a construction period should not be capitalized as part of the asset's historical cost. Donated capital assets should be reported at their acquisition value plus ancillary charges, if any.

Codification of Governmental Accounting and Financial Reporting Standards section 1400.104 states that capital assets should be depreciated over their estimated useful lives unless they are inexhaustible, are intangible assets with indefinite useful lives, or are infrastructure assets reported using the modified approach.

State Administrative Manual (SAM) section 8650.1 states that to maintain accountability of capital assets, departments are required to maintain a record of all property, whether capitalized or not, in a property accounting or inventory system.

SAM section 8650.2 states that when capital assets are acquired, departments will record certain information in their systems including the date acquired, property description, owner fund, and historical cost or other basis of valuation.

SAM section 7924 directs departments to reconcile acquisitions and dispositions of capitalized assets and property with the amounts recorded in the property register. The reconciliation should be done monthly or at least quarterly, depending on the volume of transactions.

SAM section 8652 states that departments are to make a physical count of all property and reconcile the count with their accounting records at least once every three years.

Recommendations:

To ensure that it properly reports its capital assets in its year-end financial statements, State Parks should take the following actions:

- Develop policies and procedures for capital asset accounting and reporting that comply with GAAP.
- Conduct a comprehensive inventory of capital assets.
- Update its subsidiary capital asset records in FI\$Cal to reflect the results of the inventory and ensure that its year-end financial reports reflect any necessary restatements.
- In accordance with SAM section 8652, conduct a physical count of all property and reconcile the count with its accounting records at least once every three years.

Department's View and Corrective Actions:

State Parks agrees with the findings and stated that it will take the following actions:

- Enhance its policies and procedures to ensure compliance with GAAP.
- Complete a comprehensive inventory, which is currently underway, with all districts and divisions reviewing FI\$Cal capital asset records.
- Update its FI\$Cal capital asset records to reflect any necessary restatements from its comprehensive inventory.
- Conduct physical property inventories at least once every three years in accordance with SAM section 8652.

CALIFORNIA DEPARTMENT OF RESOURCES, RECYCLING AND RECOVERY

Reference Number: 2024-10

Condition:

In prior fiscal years, the California Department of Resources, Recycling and Recovery (CalRecycle) did not complete bank reconciliations or reconcile its accounts to the State Controller's Office's (State Controller) records in a timely manner. During fiscal year 2023–24, CalRecycle continued to complete its reconciliations late. Specifically, seven of the 12 monthly bank reconciliations and 10 of the 12 monthly reconciliations to the State Controller's records were completed late. Both types of reconciliations began beyond the state requirement of preparing reconciliations within 30 days of the preceding month. Both the bank reconciliation and the monthly account reconciliation serve as important internal controls because they enable departments to detect fraud and to identify and resolve errors or omissions in the financial information that is ultimately reported in the State's Annual Comprehensive Financial Report.

Compounding these issues, CalRecycle submitted its year end financial reports for fiscal year 2023–24 in August 2024 two months before it completed its June 2024 bank reconciliation in October 2024. This sequence is concerning because the completion of bank reconciliations are a necessary control for ensuring that the information in the financial reports is accurate.

CalRecycle noted that its late completion of fiscal year 2022–23 financial reports was a significant contributing factor to the delayed completion of reconciliations during fiscal year 2023–24. Specifically, CalRecycle prioritized completing its 2022–23 year-end financial reports to meet due dates established by the State Controller and the Department of Finance for submission of these reports. As a result, CalRecycle prioritized submitting them before directing its attention to the fiscal year 2023–24 reconciliations.

Criteria:

State Administrative Manual (SAM) section 7901 requires that departments reconcile their accounts to those accounts maintained by the State Controller to disclose errors as they occur. Departments should analyze differences and make corrections to their accounts or request corrections to the State Controller's accounts so that information between both systems is complete and accurate. Corrections to errors must be made as soon as possible, and reconciling differences must be resolved before financial reports are prepared to ensure the accuracy of these reports. Reconciliations shall be prepared monthly within 30 days of the preceding month.

SAM section 7923 requires departments to reconcile their bank account balances with the like accounts maintained in the Centralized Treasury Trust System (CTS). Departments must reconcile their general cash, revolving fund cash, and agency trust fund cash accounts with their CTS Account Statement bank balance, and adjust for deposits in-transit, outstanding checks, and other reconciling items.

Recommendations:

- CalRecycle should perform its monthly bank reconciliations and reconciliations to the accounts maintained by the State Controller in a timely manner, and it should do so before submitting timely financial reports to the State Controller.
- CalRecycle should proactively address its organization's succession planning to ensure that when key staff leave, the department can still perform reconciliations promptly. This effort may include conducting cross-training of other existing staff positions, requesting funding for additional positions, or exploring the possibility of contracting for external assistance to provide additional support.
- CalRecycle should redesign internal business processes that are affecting the timeliness of monthly reconciliations.
- CalRecycle should work with the Department of Finance and the State Controller to obtain any additional training for staff to ensure that they can properly perform monthly reconciliations and do so in a timely manner.

Department's View and Corrective Actions:

CalRecycle concurred with our finding and indicated that it is committed to implementing our recommendations. CalRecycle noted that the delays in completing their reconciliations were because of competing priorities which placed additional strain on reconciliation workflows. CalRecycle stated that it is actively implementing process improvements and cross training staff. Additionally, it has established a new accounting unit position to assist with ensuring timely completion of fiscal processes going forward.

STATE WATER RESOURCES CONTROL BOARD

Reference Number: 2024-11

Condition:

In prior fiscal years, we reported that the State Water Resources Control Board (SWRCB) did not complete its monthly reconciliations of its accounts to the State Controller's Office's (State Controller) records in a timely manner. During fiscal year 2023–24, SWRCB continued to complete its reconciliations late. In particular, SWRCB did not begin performing its fiscal year 2023–24 reconciliations of its accounts to the State Controller's records until March 2024, which is nine months into the fiscal year and well beyond the state requirement of preparing reconciliations within 30 days of the preceding month. The monthly account reconciliation serves as an important internal control because it enables departments to detect fraud and to identify and resolve errors or omissions in the financial information that is ultimately reported in the State's Annual Comprehensive Financial Report.

SWRCB stated that its late completion of its fiscal year 2022–23 financial reports was a significant contributing factor to the delayed completion of reconciliations in fiscal year 2023–24. SWRCB noted that it had made progress in catching up on its reconciliations during the fiscal year.

Criteria:

State Administrative Manual section 7901 requires that departments reconcile their accounts to those accounts maintained by the State Controller to disclose errors as they occur. Departments should analyze differences and make corrections to their accounts or request corrections to the State Controller's accounts so that information between both systems is complete and accurate. Corrections to errors must be made as soon as possible, and reconciling differences must be resolved before financial reports are prepared to ensure the accuracy of these reports. Reconciliations shall be prepared monthly within 30 days of the preceding month.

Recommendations:

- SWRCB should perform its monthly reconciliations in a timely manner.
- SWRCB should proactively address its organization's succession planning to ensure that when key staff leave, the department can still perform reconciliations promptly. This effort may include conducting cross-training of other existing staff positions, requesting funding for additional positions, or exploring the possibility of contracting for external assistance to provide additional support.
- SWRCB should redesign internal business processes that are affecting the timeliness of monthly reconciliations.

- SWRCB should work with the Department of Finance and the State Controller to obtain any additional training for staff to ensure that they can properly perform monthly reconciliations and do so in a timely manner.

Department's View and Corrective Actions:

SWRCB acknowledges and understands the importance of performing timely reconciliations. In particular, SWRCB agrees with our recommendations and has begun implementing some of them. Additionally, SWRCB will continue to develop plans and processes based on our recommendations to comply with reconciliation requirements.

Financial Audit Team for the *State of California: Financial Report for the Fiscal Year Ended June 30, 2024*, Report 2024-001, and the *State of California: Internal Control and Compliance Audit Report for the Fiscal Year Ended June 30, 2024*, Report 2024-001.1

Staff:

- Theresa Farmer, CPA, Project Manager
- Nicholas Kolitsos, CPA, Project Manager
- Conor Bright, CPA, Senior Auditor
- Nathan Briley, JD, CPA, Senior Auditor
- Ana Clark, CPA, Senior Auditor
- Angela Dickison, CPA, Senior Auditor
- Natalia Lee, CPA, CFE, Senior Auditor
- Richard Marsh, CPA, Senior Auditor
- Mateo Amaral
- Lisa Ayrapetyan, CPA
- Raj Bhandal
- Amanda Chan, CPA
- Anil Cherukara
- Brian Dunn, CPA
- Curtis Ebo
- Eliana Flores, CPA
- Stephen Franz
- Matt Gannon
- Ghazaleh Ghaderi, CPA
- Sarah Hartstrom, CPA
- Kim Johnson
- David Leca
- Marcel Martinez
- Lisa Mironyuk
- Eddie Ortiz
- Vanessa Quintero
- Zhin Pyoung Rhee
- Luis Rodriguez
- Harjot Singh, CPA

Data Analytics:

- Michelle Baur
- Brandon Clift, CPA
- Ryan P. Coe, MBA, CISA
- R. Wade Fry, MPA
- Aren Knighton, MPA
- Kurtis Nakamura, CFE, CIA
- Shauna Pellman, MPPA, CIA

Legal Counsel: Joe Porche