

# COUNTY OF SACRAMENTO

DEPARTMENT OF FINANCE - AUDITOR-CONTROLLER DIVISION - INTERNAL AUDIT UNIT

**INTERNAL AUDIT REPORT**  
**SUBRECIPIENT CONTRACT PROGRAM**  
**RISK ASSESSMENT AUDIT**  
**DEPARTMENT OF HEALTH SERVICES**



**Audit Committee Submittal Date 01/08/2021**

## SUMMARY

---

### Background

County of Sacramento Department of Health Services (DHS) includes the Divisions of Public Health, Primary Health and Behavioral Health Services. Behavioral Health services includes Alcohol and Drug Services (ADS) and Mental Health Services. The core purpose of the DHS is to improve the lives of families and individuals connecting them to the appropriate services.

Sacramento Countywide Risk Assessment Study assessed DHS's Subrecipient Contract Award process as a high-risk area for the Sacramento County operation. Accordingly, we conducted this performance audit to assess the sub-recipient contract award process.

DHS had 97 and 150 subrecipients for ADS, Public Health, and Mental Health Services in fiscal years 2017-18 and 2018-19, respectively.

### Audit Objective

To assess and identify key processes and controls of DHS's Subrecipient Contract Program, and design tests to verify that key controls are in place and functioning as intended for the period from July 1, 2017 through July 31, 2019.

We reviewed documents related to sub-recipients pre-award contract progress for proper recording and consistency with contract terms, required by Section 200 of Title 2 Code of Federal Regulation (2 CFR) - *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (a.k.a. Uniform Grant Guidance).

We also reviewed the contract award process for compliance with the DHS Contracts Process Reference (CPR).

### Summary

Based on our audit, except for several exceptions reported in the Attachment I, *Schedule of Recommendations*, we are not aware of other exceptions regarding to DHS's internal controls related to managing the Subrecipient Contract Award Process for the period from July 1, 2017 through June 30, 2019.

.



## County of Sacramento

---

October 30, 2020

Dr. Peter Beilenson, Director  
Department of Health Services  
7001-A East Parkway, Suite 1100  
Sacramento, California 95823

The Sacramento Countywide Risk Assessment Study assessed the Department of Health Services (DHS) management of the County of Sacramento's Subrecipient Contract Award process as a high-risk area. Accordingly, we have audited DHS's internal controls related to managing the Subrecipient Contract Award Process for the period from July 1, 2017 through June 30, 2019.

We conducted this performance audit in accordance with *Generally Accepted Government Auditing Standards*. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

The objectives of the audit are to assess DHS's activities with regard to subrecipient monitoring and review DHS's internal controls surrounding contracts with subrecipients pre-award and as the contracts progress, including communication and monitoring.

Management is responsible for the design, implementation, and maintenance of effective internal controls to ensure compliance with Federal and State regulatory requirements, all applicable laws and regulations and contractual agreements.

The scope of our audit will include DHS's internal control activities and processes for the subrecipient contract process from July 1, 2017 to June 30, 2019.

The audit methodology utilized to conduct this performance audit included:

### Internal Control Review

- We conducted a preliminary survey of the internal control environment and identified key processes and controls for DHS's subrecipient contract process, including processes and controls for contract award process, invoice payment/claim submission, monitoring and complying with the Sacramento County Contract Policy.

Dr. Peter Beilenson, Director  
Department of Health Services  
October 30, 2020

Document Review:

- Reviewed Sacramento County Contract Policy
- We reviewed DHS's written policies and procedures surrounding pre-award of contracts selection process.
- We reviewed DHS's written policies and procedures surrounding subrecipient contract reimbursement, program monitoring, and fiscal monitoring.
- We reviewed other documents related to subrecipients pre-award and as the contracts progress for proper recording and purpose consistent with contract terms, and Section 200 of Title 2 Code of Federal Regulation (2 CFR) – (*Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*) (a.k.a. *Uniform Grant Guidance*) for Federal awards.
- We reviewed DHS's annual risk assessment of its subrecipients.
- We reviewed DHS's fiscal and program monitoring reports.
- We followed-up on DHS's corrective action plans based on results of program and fiscal monitoring reports.

Testing:

- We tested 30 subrecipient contracts for compliance with Uniform Grant Guidelines (for Federal awards), and applicable laws, regulations, and statutes.
- We tested six (6) subrecipient contracts' compliance with the Sacramento County Contract Policy.
- We tested DHS's key internal control processes for processing 15 subrecipients' invoices and claims to the State.
- We tested DHS's payments made to 15 subrecipients for compliance with the respective contracts, completeness, reasonableness, and the use of proper accounting methods.
- We tested DHS's program and fiscal monitoring for 23 subrecipients to ensure controls are in place and functioning as intended.

In connection with this audit, there are certain disclosures that are necessary pursuant to *Generally Accepted Government Auditing Standards*.

As required by various statutes within the California Government Code, County Auditor-Controllers or Directors of Finance are mandated to perform certain accounting, auditing, and financial reporting functions. These activities, in themselves, necessarily impair *Generally Accepted Government Auditing Standards'* independence standards. Specifically, "auditors should not audit their own work or provide non-audit services in situations where the amounts or services involved are significant/material to the subject matter of the audit."

Dr. Peter Beilenson, Director  
Department of Health Services  
October 30, 2020

Although the Director of Finance is statutorily obligated to maintain the accounts of departments, districts or funds that are held in the County Treasury, we believe that the following safeguard and division of responsibility exist. The staff that has the responsibility to perform audits within the Auditor-Controller Division has no other responsibility of the accounts and records being audited including the approval or posting of financial transactions that would therefore enable the reader of this report to rely on the information contained herein.

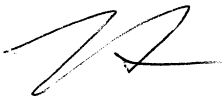
Based on our audit, except for several exceptions reported in the Attachment I, *Schedule of Recommendations*, we are not aware of other exceptions regarding to DHS's internal controls related to managing the Subrecipient Contract Award Process for the period from July 1, 2017 through June 30, 2019.

DHS's management responses to the recommendations identified during our engagement are described in Attachment I, *Schedule of Recommendations*. We did not perform procedures to validate DHS's management responses to the recommendations and, accordingly, we do not express opinions on the responses to the recommendations.

This report is intended solely for the information and use of the Sacramento County Board of Supervisors, those charged with governance, Sacramento County Audit Committee, Sacramento County Executive, and DHS's management, and should not be used for any other purpose. It is not intended to be, and should not be, used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Sincerely,

BEN LAMERA  
DIRECTOR OF FINANCE



By: Hong Lun (Andy) Yu, CPA  
Audit Manager

Attachment I, *Schedule of Recommendations*

**County of Sacramento**  
**Department of Health Services**  
**Risk Assessment – Subrecipient Contract Award Program**  
**Performance Audit**  
**Schedule of Recommendations**  
**For the Period from July 1, 2017 to June 30, 2019**

1. **Scope of Subrecipient Audit Report Review**

Comment

DHS uses an “Audit Review Checklist” to document its review of its’ subrecipient audited financial statements. The checklist identifies the audit report’s type of opinion, the required federal funding schedules, and if a management letter was provided with the report.

We selected 23 subrecipients that DHS rated as high risk or medium risk for testing. We noted that the Audit Review Checklists included with the subrecipient audit reports did not mention if DHS performed additional fiscal analysis. While DHS provided a sample of three financial ratios it uses, our testing did not note the ratios inclusion as part of the DHS review.

Increasing the scope of review to include additional financial analysis such as, cash flow, historical trend analysis, and comparative analysis would assist DHS in identifying potential financial viability issues with a subrecipient and implement corrective action plans sooner. In addition, the scope review should include review of sensitive disclosures in the financial statements such as related party transactions.

Based on our review of the 23 subrecipients’ financial statements, we noted the following:

1. Two instances of the subrecipients not having sufficient cash to pay their current obligations. DHS was aware that one of the subrecipients with financial difficulties was acquired by another entity. The subrecipients’ financial difficulties could significantly affect the subrecipients’ services provided to the County.
2. Another instance where the subrecipient’s Directors (a related party) were leasing a facility to the subrecipient with rent increases of 40% for each of the 2 years covered by the audited financial statements. While the increases may have been justified, it appears that DHS did not inquire as to the reasonableness of the rent expense increases. Related party transactions may result in or give the appearance of conflicts of interest when government funding is involved.

Recommendation

We recommend DHS expand the scope of its financial review of its subrecipient audit reports to included additional financial analysis such as cash flow, historical trend analysis, and comparative analysis. DHS should assess the subrecipients’ fiscal risks to consider applying additional monitoring for the subrecipients to ensure proper accountability and compliance with program requirements and achievement of performance.

**County of Sacramento  
Department of Health Services  
Risk Assessment – Subrecipient Contract Award Process  
Performance Audit  
Schedule of Recommendations  
For the Period from July 1, 2017 to June 30, 2019**

We also recommend DHS follow up with subrecipients for sensitive disclosure in their audit reports such as related party transactions. DHS should inquire subrecipients whether any reported related party transactions are reasonable and whether the subrecipients have any safeguard to prevent conflict of interest to maintain the highest standard and integrity of government operations when contracting with subrecipients for public programs.

Management's Response

DHS is aware that two subrecipients included in the DOF testing have financial difficulties. However, there are currently very few substance use disorder (SUD) youth treatment providers, which are also, Drug Medi-Cal certified in the Sacramento County area. These subrecipients are two out of the only three SUD youth treatment providers available to us to contract with. In addition, one of the subrecipients provides adult outpatient services and is Sacramento County's only contracted substance use disorder treatment provider conducting outpatient perinatal services to pregnant and parenting women. The range of services provided through these subrecipients are crucial in providing treatment and recovery services for alcohol and drug abuse.

Most importantly, ADS contracts with an array of community-based providers throughout Sacramento County and they are crucial in implementing ADS's mission to promote a healthy community and reduce the harmful effects associated with alcohol and drug use, while remaining responsive to, and reflective of the diversity among individuals, families and communities.

DHS does not pay for rent costs, rather direct services which are typically provided by home and community-based providers. These direct services are part of an integrated SUD treatment programs which provides in-home case management, SUD outpatient treatment, drug testing, DUI safety classes, sober living housing, and any other similar services. For this reason, DHS did not inquire as to the reasonableness of the rent expense increases. Going forward DHS will inquire

As part of the Request for Proposal (RFP) process, DHS performs financial analysis such as calculating and reviewing financial ratios using the audited financial statements. Financial analysis plays a role in assessing our providers; as such, DHS will expand the scope of its financial review of its subrecipient audit reports to include additional financial analysis such as cash flow, historical trend, and comparative analysis. It is, however, crucial to consider the types of specific services and availability of Behavioral Health Service providers in our community that can meet the needs of our clients.

**County of Sacramento  
Department of Health Services  
Risk Assessment – Subrecipient Contract Award Process  
Performance Audit  
Schedule of Recommendations  
For the Period from July 1, 2017 to June 30, 2019**

**2. Subrecipient Financial Statement Submission Requirement**

Comment

During our testing of subrecipient contracts we noted that one contract with funding of \$10,975,000 contained language in Exhibit D Section VI Audit/Review Requirements stating in part, “*Annual Audited financial statements and accompanying Auditor’s Report and notes is required from Contractor ...*” also in Exhibit A, Section X Audit/Review Requirements Modified. A. states in part, “*County may accept alternate financial documents, as agreed by both parties.*”

The subrecipient submitted an audit report of its parent company that included only the balance sheet and related footnotes and not a complete set of financial statements. DHS accepted the audit of the parent company’s balance sheet as an alternate financial document.

Based on our review of the parent company’s audited consolidated balance sheet as of December 31, 2018, we noted significant concerns as follows:

- The parent company is a For Profit Corporation. In accordance with United States Generally Accepted Accounting Principles (GAAP), the parent company’s completed financial statements should include balance sheet, income statement, statement of change in equity, statement of cash flows, and footnotes. While the audited consolidated balance sheets include footnotes, it did not include other required components of completed financial statements. The audit report does not include disclosure for the departure from GAAP.
- \$253 million (76 %) of the \$332 million total assets was Goodwill and other intangible assets.
- \$88 million (24 %) of the \$332 million total assets was tangible assets (such as cash, accounts receivable, and capital assets). Total liabilities was \$302 million, which was more than 2.5 times of total tangible assets.
- Total Liabilities exceeded tangible assets by \$214 million.
- \$44 million accumulated deficit and other comprehensive loss was included in the stockholders’ equity.
- The subrecipient’s individual financial information was not presented separately.

Based on above information, it appeared that the parent company had significant financial issues. However, since the subrecipient did not provide its financial report to DHS, the subrecipient’s financial situation cannot be assessed.

The subrecipient is a for-profit company. In accordance with Section 200.501 (h) of Title 2 Code of Federal Regulation (2 CFR) – (*Uniform Administrative Requirements, Cost Principles,*



**County of Sacramento  
Department of Health Services  
Risk Assessment – Subrecipient Contract Award Process  
Performance Audit  
Schedule of Recommendations  
For the Period from July 1, 2017 to June 30, 2019**

*and Audit Requirements for Federal Awards*) (a.k.a. Uniform Grant Guidance) “for for-profit subrecipients (DHS),..... the pass-through entity is responsible for establishing requirements, as necessary, to ensure compliance by for-profit subrecipients. The agreement with the for-profit subrecipient must describe applicable compliance requirements and the for-profit subrecipient's compliance responsibility. Methods to ensure compliance for Federal awards made to for-profit subrecipients may include pre-award audits, monitoring during the agreements, and post-award audits.”

Without a complete set of financial statements, DHS does not have adequate information to determine the subrecipient’s ability to generate sufficient cash to pay its bills and continue to provide sufficient financial resources for providing services to the County.

Recommendation

We recommend DHS to request the subrecipient to provide its own annual financial reports for review and then take proper action as needed.

Management’s Response

DHS acknowledges the recommendation; however, the for-profit subrecipient does not provide the complete audited financial statements of its own or parent company due to the proprietary nature of the information. The subrecipient asserts that the audited financial statements are not public records and has a legal basis claim of confidentiality.

Due to the above reason, DHS established a common ground and accepted the parent company’s balance sheet (with the required footnotes). DHS is using the balance sheet to assess the company’s risk of liquidity by using four types of Ratio Analysis.

In addition to the fiscal reviews performed by DOF, and annual reviews of audited financial statements done by DHS, Contract Monitors for each division are responsible for conducting mid-year and/or annual onsite reviews of services and subrecipient services for programmatic and fiscal requirements. If issues and/or findings are identified during the monitoring review, a corrective action plan (CAP) is obtained from the subrecipient.

**3. Monthly Reconciliation for Claims between Subrecipients and State**

Comment

DHS relies on Avatar (electronic health record system) and manual processes to track payments to its subrecipients and to submit claims to the California Department of Health Care Services (DHCS). We noted that amounts invoiced and claimed between DHS, subrecipients, and DHCS might change over time, which creates overpayments and underpayments.

**County of Sacramento  
Department of Health Services  
Risk Assessment – Subrecipient Contract Award Process  
Performance Audit  
Schedule of Recommendations  
For the Period from July 1, 2017 to June 30, 2019**

During our testing of the billing process for DHS's Alcohol and Drug Services (ADS) and Mental Health Programs, we noted DHS did not have documents supporting monthly reconciliations between amounts paid to subrecipients and amounts claimed from the DHCS.

Performing a monthly reconciliation of the amounts paid to the subrecipients to the amounts claimed from the DHCS would ensure that the invoices paid to the subrecipients are being claimed timely from the DHCS.

Recommendation

We recommend DHS explore creating a routine report within Avatar that reconciles or compares amounts paid to subrecipients to amounts claimed from DHCS.

Management's Response

DHS billing process for ADS and MH Programs was explained to the auditor during the risk assessment audit fieldwork at DHS and no concerns were expressed by the auditor.

1. In addition, Avatar reports and reconciliation documents were provided to the auditor. The reports and documents provided supported reconciliations between amounts paid to subrecipients and amounts claimed to DHCS. The two reports available within Avatar are described below. The Phase II Program Charge Status report is a report by service date which will give the current claim status of all Medi-Cal charges for a given date range (e.g. a month) for a selected program. Over time, this report will change depending on what has been adjudicated by DHCS.
2. The Revenue Reporting Group (RRG) is a code assigned to a program that determines how revenue will be reported for many of the basic system-generated billing reports. This report shows the claim summary total for services claimed to DHCS by guarantor and claim date. Also, this report is used by the Accounting Manager to reconcile the amounts paid to the subrecipient to the amounts claimed to DHCS prior to the Drug Medi-Cal Certification for Federal Reimbursement forms are signed.

Lastly, amounts invoiced and claimed between DHS, subrecipients, and DHCS change over time, which creates overpayments and underpayments; however, all costs are settled and reconciled during the annual cost report and cost report audit. The annual cost report is a financial report that captures the overall cost of providing Mental Health and Substance Use Prevention and Treatments services.

**County of Sacramento**  
**Department of Health Services**  
**Risk Assessment – Subrecipient Contract Award Process**  
**Performance Audit**  
**Schedule of Recommendations**  
**For the Period from July 1, 2017 to June 30, 2019**

Upon completion of the reconciled cost reports for all the subrecipients, cost settlements occur with each of the subrecipients and DHS. Upon submission of the reconciled cost reports to DHCS and at the completion of the DHCS audit, cost settlements occur between DHS and DHCS. The cost report and DHCS audit reconciles and captures the overall costs. Upon cost settlement, overpayment and underpayment, if any, will be settled. The cost report process ties all services by provider and service functions and reconciles to DHCS approved costs and units information.

**4. Competitive Procurement Process**

Comment

During our review of contracts, we noted that Behavioral Health had 111 subrecipient contracts receiving federal funds. We selected 11 subrecipient contracts (totaling \$19,053,884) to test that provided services during our audit period. We noted three contracts (contract amounts \$408,251, \$1,143,456, and \$2,138,327 respectively) of the 11 contracts tested were amended to extend the term of the contract multiple times without reissuing a Request for Proposal (RFP) or other competitive procurement process. These three subrecipient contracts went over ten (10) years without a RFP being reissued. Subsequent to our audit period ended on June 30, 2019, two of the contracts had an RFP reissued and the third contract had terminated.

Uniform Grant Guidance, Section 200.319(a) states in pertinent part, “*All procurement transactions must be conducted in a manner providing full and open competition ...*”

The County Contract Manual Section 13.02, Contracts Awarded by Competitive Selection, states, “*Contracts awarded on the basis of a law requiring competitive selection may be modified or amended only if the contract so provides or if so authorized by the law requiring competitive selection. (See Pub. Contract Code § 10366 and Gov. Code § 11010.5.)*”

Therefore, DHS did not comply with Uniform Grant Guidance, Public Contract Code, Government Code, and County Contract procedures.

Renewing contracts with subrecipients over multiple years does not ensure DHS is getting the most qualified service provider at the best price.

Recommendation

DHS should establish policy and procedures to ensure its contracts comply with Uniform Grant Guidance, Public Contract Code, Government Code, and County Contract Manual. DHS should also review all subrecipient contracts to identify any contracts that were extended without

**County of Sacramento  
Department of Health Services  
Risk Assessment – Subrecipient Contract Award Process  
Performance Audit  
Schedule of Recommendations  
For the Period from July 1, 2017 to June 30, 2019**

proper competitive procurement process. Then, DHS should take proper action regarding the contracts that were extended without proper competitive procurement process.

Management's Response

While acknowledging the UGG requirement for competitive procurement processes, as mentioned in management response finding 1, the nature and uniqueness of Behavioral Health Services (ADS and MH Programs), the limited number of service providers in specific areas, and the potential for negatively impacting and disrupting care for our BHS clients, are additional factors considered in contracting for services.