AUDIT/FISCAL COMMITTEE

Margaret Furman, Chair

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AUDIT/FISCAL COMMITTEE

Introduction

The Audit/Fiscal Committee investigates matters pertaining to sound financial practices as they apply to county and other governmental agencies, such as:

Assessor/Recorder
Auditor Controller/Treasurer/Tax Collector
Purchasing Department
Cities/Municipalities
School Districts and Community College Districts
Special Districts

Because of its broad interagency scope, the Audit/Fiscal Committee coordinates its activities with other jury committees. This year, that coordination consisted of disseminating internal audit findings to the committees affected.

The committee conducted investigations regarding the following:

Assessor
Auditor
Controller
Purchasing
Recorder
Tax Collector
Treasurer

Final Reports written by this committee are:

Assessor
Auditor-Controller

ACCOUNTING COMPUTER SYSTEM

BACKGROUND

San Bernardino County is the largest county in the contiguous United States, encompassing 20,000 square miles; and it has a Gross Domestic Product (GDP) greater than several states. In addition, San Bernardino County is the employer of over 18,000 persons, and conducts business in much the same manner as a large corporation, particularly in the area of its Financial Management System. Just like any large employer, it needs to be on the cutting edge of technology to stay competitive.

FINDINGS

1. In the 2003-2004 Grand Jury report, the Audit/Fiscal Committee addressed the issue of the outdated Financial Management System the county was using (AMS Advantage version 2.1.1), and the problems that will occur if the system was not upgraded. The Grand Jury made this recommendation to the Auditor/Controller-Recorder (ACR) who, in response to the recommendation, was in agreement. (See Attachment #1)

   In the interviews the Grand jury conducted with the ACR and staff members, there was no opposition to upgrading the system; and in fact, in the years following the report, there were some efforts to upgrade or replace the system. These efforts fell short of the mark due to miscommunications between departments, and budget restraints. The bottom line is, seven years later, the county is **still** using AMS Advantage version 2.1.1 as its Financial Management System.

   The Grand Jury is very aware of budgetary problems plaguing the entire nation, from the smallest of villages to the federal level. The county efficiently managing its assets should be very high on its list of priorities.

RECOMMENDATIONS

11-03 Acquire the AMS Advantage Version 4.0 System (or the most current version) to upgrade the Financial Management System; and put a procedure in place that mandates periodic updating. (Finding 1)

11-04 With the acquisition of a new computer system comes the need for additional technical support. Insure employees have the necessary training in order to best operate, and support, the new system. (Finding 1)

Responding Agency	Recommendations	Date Due
Auditor/Controller- Treasurer/Tax Collector	11-03, 11-04	August 30, 2011

ATTACHMENT #1

2003-04 GRAND JURY REPORT
RESPONSE FORM

GROUP: FISCAL **DATE: July 23, 2004**
DEPARTMENT: AUDITOR/CONTROLLER-RECORDER
SUBMITTED BY: LARRY WALKER
AUDITOR/CONTROLLER-RECORDER

FINDINGS – AGREE

RECOMMENDATION: 04-07:

Purchase the AMS Advantage Version 3.0 System to upgrade the Auditor/Controller-Recorder's financial management system and the Purchasing Department's Procurement software system.

RESPONSE:

The ACR agrees that the Auditor/Controller-Recorder's financial management system and the Purchasing Department's Procurement software system should be updated. Upgrading to the current vendor's product, AMS Advantage Version 3.0, is one option but we believe it would be beneficial to consider other possible software solutions as well. Accordingly, the ACR presented an agenda to the Board of Supervisors on May 18, 2004 to approve and authorize release of a Request for Proposal (RFP) for the improvement or replacement of the current Financial Accounting System (FAS). The RFP process allows the County to properly evaluate all qualified vendors and make a decision on the best system currently available. The Board of Supervisors unanimously approved the item and the RPF was released on May 18, 2004. Four proposals were received by the June 22, 2004 deadline.

The RFP selection committee met on June 30, 2004 to rate the proposals. The evaluation committee's recommendation was presented to the FAS Steering Committee for review on July 1, 2004. An agenda item will be prepared for the Board of Supervisors approval of a contract with the successful vendor in August 2004. The new FAS will include many new modules such as for the purchasing functions.

LOCAL COST IMPACT:

The projected contract cost to purchase and implement an upgrade or new financial accounting system is estimated to be $5,000,000.

ASSESSOR'S OFFICE

BACKGROUND

The Audit/Fiscal departments of the County are audited by several State agencies.

FINDINGS

1. From an internet search, our committee discovered that the California Board of Equalization (BOE) had completed an extensive Assessment Practices Survey of the San Bernardino County Assessor's Office. This document is the current report of their BOE audit. The perspective of the BOE was very helpful in assisting the Grand Jury understand mechanics of the Assessor's function. Instructions on the cover page of the Survey state that the responses to the BOE from the Assessor's Office should be sent to the Grand Jury. The report was not provided to the Grand Jury and we found it during our own independent investigation.

2. The Grand Jury made an appointment with the Assessor to discuss the nine areas the BOE had pointed out for improvement. We also inquired of the Chief Executive Officer (CEO) as to which office in the county kept a log of the state audits. We were informed that no one is assigned that task because the state audits are random and timing cannot be anticipated.

RECOMMENDATIONS

11-05 As a courtesy, the BOS provide the Grand Jury copies of all financial audits completed by state agencies including copies of all replies. (Findings 1, 2)

Responding Agency	Recommendations	Date Due
Chief Executive Officer	11-05	September 30, 2011

COUNTY INTERNAL AUDITS

BACKGROUND

§925 of the California Penal Code authorizes the grand jury investigation of county officers, departments or functions; operation, accounts and records; investigation and reports.

The Grand Jury examined the Comprehensive Annual Financial Report (CAFR), for Fiscal Years Ending (FYE) June 30, 2009 and June 30, 2010, prepared by the Office of the Auditor/Controller-Recorder/Treasurer/Tax Collector. The CAFR provides detailed financial information regarding the County's financial position and activities prepared in accordance with generally accepted accounting principles of the Governmental Accounting Standards Board (GASB). Staff of the controller's accounting department showed us the Power-Point training program used to train staff in the forms and procedures needed for year round accounting including steps taken for the closing of the "books" (General Ledger) at the end of the fiscal year. Controller's staff provided us a hard-copy of the training manual and CDs on grant audits, airports and fire, and special districts.

During the closing, accrual packages are prepared to identify any inter-fund transactions not recorded during the fiscal year and to match the revenue and expenditures to the proper accounting periods. "Booking" these adjustments into the computerized general ledger results in the final accounting data that is available for the report writing tool that produces the official financial reports e.g. the CAFR. The financial statements are the responsibility of management.

Before the CAFR is released to the public it is necessary to have a Certified Public Accounting (CPA) firm express an opinion on it. The Board of Supervisors (BOS) contracts with an outside independent CPA firm that plans and performs an audit, according to Governmental Auditing Standards. The outside auditors consider if management's control, e.g. internal control, over financial reporting is sufficient for the CPA firm to rely upon that control in planning their audit. The outcome of the audit is to be able to render an opinion on the financial statements. To do this, the CPA firm needs to obtain reasonable assurance that the financial statements are free of material misstatement.

From the Auditor-Controller's Department we received copies of 2009 management letters from the outside CPA firm. Two examples that demonstrate the CPA/client relationship are:

1. The CPA firm observed that while most departments submit proper documentation supporting their year-end accruals, there were certain accrual packages that did not contain sufficient documents causing both Auditor-Controller/Recorder (ACR) and the outside auditors to perform additional research to obtain proper documentation. The outside auditors recommended the ACR implement stronger internal controls over the year-end accrual packages as insufficient documentation increases the risk of misstatement of the financial statements. The ACR concurred with this recommendation and responded that they will modify the year-end closing process to ensure sufficient appropriate support is present for the accrual packages. *The 2010 management letter reported that improvements have been made.*
2. The CPA firm observed that from their test work of the year-end property tax receivables they noted that the County uses an excel spreadsheet to accumulate, analyze and determine the year-end property tax receivable amounts. Through recalculations performed over certain line items/totals the audit identified certain formulas within the cells on the spreadsheet were not properly linked. They recommended particular attention be placed when this spreadsheet is rolled forward for the next fiscal year to ensure that the cells are properly linked to prevent the risk of misstatement. The ACR concurred with this recommendation and responded that a detailed procedure to initialize this annual worksheet has been developed and the worksheet has been enhanced to contain check figures to ensure accuracy and facilitate management review. *The 2010 management letter reported this problem has been corrected.*

We received an organizational chart with the new staffing assignments (after the reorganization of the County Audit Fiscal segment) that report to the person with the combined roles of Auditor-Controller/Treasurer/Tax Collector/Director of Central Collections and Clerk.

Members examined quarterly internal audit reports prepared by the County Internal Audits Section (IAS). We received information about the role and responsibility of the Audit Committee, and performance schedules for internal audits including risk assessments.

The committee conducted several individual and group interviews of financial staff members and leaders and had one meeting with the County outside CPA firm. Information was compared to data released to the public on the San Bernardino County website <sbcounty.gov/acr>, other county websites, and our internet research.

Based on our investigation, the Grand Jury concludes that the internal audit function in the County fiduciary sectors is the most important safeguard of public funds; and is the foundation to the entire financial reporting system.

This conclusion is based on The Institute of Internal Auditors (IIA) that developed the globally accepted definition of internal auditing, as follows: “Internal Auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes. Independence is established by the organizational and reporting structure.”

FINDINGS

1. As a result of The American Recovery and Reinvestment Act passed by Congress on February 13, 2009 state and local governments may be able to qualify for significant financial aid. Control procedures over Federal expenditures are required and they must be properly working to prevent unallowable expenditures. Management would be subjected to significant responsibility upon receipt of these funds. To bring

accounting systems up to these standards, new internal controls may need to be established to meet the stringent reporting requirements of the federal agencies.

An analysis of how Federal expenditures are currently handled by the Controller's Division is explained in Management Letters to the Board of Supervisors dated March 28, 2011, FYE June 30, 2010, and dated March 19, 2010, for FYE June 30, 2009. These describe the observations made by the outside auditors during their audit and their recommendations on ways the Controller's Office could improve compliance in the handling of federal programs. This information, along with the response of management is found on the Auditor Controller-Recorder website.

2. In a December 4, 2009 Management Letter for fiscal year ended June 30, 2009 from the County's outside auditors to the Audit Committee, "It was noted that the county had not recorded a loan receivable that resulted from an agreement approved by the Board of Supervisors in fiscal year 1998 between the County and the City of Adelanto. The principal amount of the loan was approximately $11 million with accumulated accrued interest of approximately $6 million" The auditors noted that although the loan was being tracked in the property tax section of the Auditor-Controller/Recorder Office, the loan was never communicated to the general accounting section of the ACR for recording in the County's general ledger.

   While the CPA firm states it believes this to be an isolated incident, they recommended all county departments need to be notified that any loans that the County enters into during the fiscal year should be immediately reported to the ACR, along with the supporting documentation to properly book the loan or keep track of the loan at the ACR. Also, at year-end the departments should be proactive on reporting the ending balances as of June 30 of the fiscal year on the accrual packages (if they are keeping track) that are submitted to the ACR.

   The response from the County was to concur and staff stated that the "ACR will notify the Clerk of the Board to include ACR-General Accounting on the distribution list of board agenda items approving loans, advances, investments or repayment schedules crossing years.” *The 2010 management letter reported that no new situations like this had been discovered.*

3. The standards for conducting government internal audits are set by the US Government Accounting Office (GAO) and the Institute of Internal Auditors (IIA). GAO and IIA state that the combination of auditing and controllership responsibilities impair the independence of the audit function and as such disqualify any resulting audit report as not meeting the independence and objectivity standards in fact or appearance. In San Bernardino County, the chief financial officer is the Auditor-Controller. Thus the combination of these two functions does not meet this standard of independence and objectivity. IAS staff agrees that this is a de facto conflict.

   Statements from more than one member of the auditing staff, reporting on Treasurer’s Investments as of September 30, 2009 and December 31, 2009, stated that “On February 25, 2010 the Board of Supervisors consolidated the elected offices of the Treasurer-Tax Collector and the Auditor-Controller/Recorder. As a result, the auditor, auditee, and subject matter of this report are within the same department”.

   These reports with this wording were distributed to both the Board of Supervisors and the Grand Jury with apparently no alarm expressed of the conflict the BOS created by allowing the consolidation after the prior Treasurer-Tax Collector vacated his elected office and an elected position was eliminated by assigning the tasks of Treasurer/Tax Collector to the elected position of Auditor-Controller/Recorder. The Grand Jury however, finds this situation problematic.

4. According to our investigation the IAS performs financial statement audits to develop staff and increase the reliability of the County’s audited financial statements. In two situations internal audits were performed by employees in the

office of the Auditor/Controller-Recorder who hold Certified Public Accounting (CPA) credentials; these were printed on county letterhead stating that the audit is an “Independent Auditor’s Report.” On the face of it, this is misleading. An employee has duties to his employer and is directed by the employer; but an independent auditor cannot be obligated in any manner to the client or independence is lost. The words “Independent Auditor’s Report” do not per se make the auditor independent. The Grand Jury commends the IAS department for using an employee with expertise as a CPA to develop staff but there is potential here for misunderstanding of independent functions.

5. Our research of the organization of internal audit departments in other California counties shows that in Ventura and Riverside Counties the internal auditor reports to the Auditor-Controller as we do in San Bernardino County. Twenty-four of the fifty-eight California Counties have combined Assessor-Recorder’s, and at least 10 Counties including Sacramento, Fresno and Santa Clara have combined Auditor-Controller/Treasurer/Tax Collector, functions.

   It is notable that the Grand Jury found no county where as many important positions are held concurrently by one person as is the case with the San Bernardino County Auditor-Controller/Treasurer/Tax Collector/ and County Clerk. The combining of tasks occurred on the February 25, 2010 consolidation when the offices of Auditor-Controller/Recorder and Treasurer/Tax Collector were made into a single office. While the combination of offices is allowable under Government Code §24300, the Grand Jury finds, in practice, in San Bernardino County the Controller’s Office, not the Auditor’s Office, does the risk assessment that determines which departments are to be audited. This chain of authority may not have been anticipated when the consolidation was deemed to be beneficial to the County.

   San Bernardino County is not out of the norm in combining the Controller/Auditor function. However, we are not the first Grand Jury to point out the inherent problems in this and to recommend a separation of the Auditor’s function from the

Controller's function. Orange County (OC) has organized an Internal Audit Department that reports directly to the Board of Supervisors and is connected to the Controller's function. Currently the OC Director of Internal Audit is a CPA and Certified Auditor with numerous professional awards.

The recommendation to have the OC top internal auditor removed from the controller's function came from the 2007-2008 Orange County Grand Jury. That Grand Jury stated that they wanted to ensure the independence of the internal audit function from the direct influence of management. They understood the difficulty of auditing the boss.

To accomplish this goal, the OC Grand Jury asked the Board of Supervisors to exercise their authority in California Government Code §25250 (governing financial powers), and §26881, and §26883 (governing clerks and county controllers) for authority to determine who shall conduct biennials audits of County Officers and who shall perform internal audits. Their research concluded that they could reassign internal audit responsibilities to a separate Internal Audit Department that would conduct financial, compliance, and performance audits of all county departments.

The San Bernardino County Grand Jury finds that the OC method of separation of the Controller's function from the Auditor's function has merit. In OC, the BOS chose to have the head of the Internal Audit Department report directly to them.

6. Staff in the Internal Audits Section (IAS) was reduced. Three years ago, the IAS had twenty positions, with most of them filled. The current lack of funding impacts all aspects of county government in this era of post 2008 financial-melt-down; and hard decisions need to be made. When budget cuts are required, priorities must be set.

7. The IAS is currently operating with eleven full-time positions. The organizational chart specifically identifies a Chief Deputy Auditor with a secretary, a Management Services Manager, two Systems Accountant Level III, four Systems Accountant

Level II, one Accountant Level III, and one Accountant Level II. The positions for another Accountant Level II and a Public Service Employee are vacant due to recent promotions.

The IIA's International Standards for the Professional Practice of Internal Auditing require that the chief audit executive (in San Bernardino this would be the Chief Deputy Auditor) report to a level within the organization that allows the internal audit activity to fulfill its responsibilities. To achieve necessary independence, best practices suggest the chief audit executive should report directly to the Audit Committee or its equivalent. For day to day administrative purposes, the chief audit executive should report to the senior executive of the organization.

8. Although for FYE 2010 the IAS reviewed department accrual packages designated as high risk by the Controller's Division General Accounting Section, some internal audits are not being performed.

   The Grand Jury received a letter from the office of the Auditor/Controller/Treasurer (ACT) explaining why there were no audit reports for the quarter ended September 30, 2010. We were reminded that, "As discussed during our recent meeting, this office has the responsibility to pay employees and vendors, produce financial reports, and perform audits. During times of reduced resources, the first three listed activities are deemed a higher priority. Internal audit activity is deferred much as fixed asset maintenance is for other entities in difficult economic environments."

   The Grand Jury received a schedule of audits accomplished for FYE June 2008 and 2009. Although the internal audit guidelines say all County Departments and Special Districts are to be audited every year, at the time they provided us with this data the Department stated they can't accomplish that with their seven auditors and four support personnel. They prioritize their tasks based on their evaluation of High, Medium, or Low Risk for the County Departments and fall back on the every-five-year-rule mandated for Special Districts. The risk level is determined by the

Controller Division's General Account Section. The numbers in the financial statements are only as good as the systems that produce them.

9. According to the Auditor-Controller/Recorder/Treasurer/Tax Collector, and County Clerk, in the letter to the Board of Supervisors accompanying the CAFR we learned it is "the responsibility for both the accuracy of the presented data and the completeness and fairness of the presentation, including all disclosure, rests with the County." Also in the CAFR, we know the role of the outside CPA firm does not include examining the effectiveness of internal control and it does not provide assurances on internal control. This demonstrates that the responsibility for the value of the data rests upon the client. In this case the County of San Bernardino.

   This conclusion is confirmed in the second page of the letter to the Board of Supervisors in the section under Internal Controls. "The County's internal accounting control system exists to provide reasonable, but not absolute, assurance that assets are safeguarded against loss or unauthorized disposition and to provide reliable records for preparing financial statements and maintaining accountability for assets."

   According to the Audit Committee charter: Members of the Audit Committee are:

   1. Chair and Standing Member: Auditor/Controller- Tax Collector (ACT)
   2. One member of the Board of Supervisors, or other representative appointed by the Chair of the Board of Supervisors. This representative shall serve for a two year period coterminous with the term of the Chair of the Board and appointed by the new Chair on the taking of office.
   3. The Chief Financial Officer (CFO), or representative appointed by the CFO, will also be a Standing Member.
   4. Two public members; the terms of which shall be for a period of three years, staggered by one year. Both public members must be certified public accountants (CPAs) and have an understanding of generally accepted

governmental accounting principles and financial statements and knowledge of the standards issued by the Institute of Internal Auditors (IIA).

a. One of which is selected by the Chair of the Board of Supervisors
b. The other is selected by the Auditor-Controller/Treasurer

10. In San Bernardino County, the role of the Audit Committee is multifaceted. The Audit Committee receives and examines the Single Audit opinion by the outside independent auditing firm including the management letter. Members also review the audit activities of the Auditor-Controller's office and review the accounting process that develops the Comprehensive Annual Financial Report (CAFR). In that role the Audit Committee would be opining about internal controls and the function of internal audits. The Audit Committee also reviews the Fraud Waste and Abuse hotline. Using an Audit Committee that meets at least on a quarterly basis was the recommendation of the outside auditors. This will accomplish good internal control structure and good communication between financial functions within the county.

    The concept is favorably received by the Grand Jury. In fact, the implementation of an enhanced Audit Committee could well be considered the acceptable outcome from the 2008-2009 Grand Jury recommendation which called for better oversight of internal audits.

    The spread of expertise on the Audit Committee includes two department heads or their appointees. One of the department heads (the ACT) is elected. There is another elected official, or his/her appointee, and two financial professionals well versed in accounting. No one sitting on the Audit Committee presently fills the role of a citizens' watchdog.

RECOMMENDATIONS

11-06 The Board of Supervisors (BOS) increase the authority and scope of the Audit Committee by empowering it to see that the procedures for accounting for funds in federally funded grants is implemented according to the concurrence, agreements, and promises of the Controller's Office. (Finding 1)

11-07 The Board of Supervisors authorize the Audit Committee to look into the internal controls procedures of all County departments, and other entities for which the BOS sits as the governing body such as the Redevelopment Agency, to determine if upgraded internal controls would benefit these accounting centers. Consideration should be given to implementing uniform standards in all agencies and departments irrespective of whether they are subject to mandated or non-mandated audits. (Finding 2)

11-08 That the BOS authorize the Audit Committee to monitor the property tax allocation schedules of the Property Tax Division in the Treasurer-Tax Collectors Office as this relates to property tax increment payments to or from cities, special districts or redevelopment agencies; and that this monitoring of payments to/from cities or agencies is done each year irrespective of when the State of California conducts its audits. (Finding 2)

11-09 The Board of Supervisors consult with appropriate State Agencies to determine if the combination of the functions of Treasurer-Tax Collector and the Auditor-Controller is compatible with standards of good governance and fiduciary responsibility. A ruling from the State Attorney General be requested to determine if the County violated voter rights when it eliminated the elected office of Treasurer-Tax Collector when it became vacant and subsequently combined the duties of that office with another elected office which appears to create a conflict of interest. (Finding 3)

11-10 The use of the term "Independent Auditor" be reserved for only those audits done by outside firms or agencies and not be used by employees of the county when auditing elements of the County financial systems. (Finding 4)

11-11 The San Bernardino County Board of Supervisors enhance and improve the quality, efficiency, and performance of the internal audit function by using their authority to hire a Chief Audit Executive as a Civil Service employee. The independence of the internal audit function will enhance the accountability of the Chief Audit Executive in performing his/her internal financial, compliance, and performance audits. This Chief Audit Executive is to report directly to the San Bernardino County Chief Executive Officer (CEO) for administrative matters and to seek guidance on the scope and performance of the audit function from the Audit Committee. This chain of responsibility is different from the OC model but as we point out elsewhere in this report, in San Bernardino County there already is in place an Audit Committee that reports to the Board of Supervisors. (Finding 5)

11-12 Audit all County Departments and Special Districts every year. (Finding 6)

11-13 The Chief Deputy Auditor report to the County CEO for administrative issues. (Finding 7)

11-14 The Chief Deputy Auditor report to the Audit Committee to inform them of the issues coming up on the audit and look to them for direction and accountability. (Finding 8)

11-15 The County Board of Supervisors extend an invitation to each year's sitting Grand Jury to attend the quarterly meetings of the Audit Committee. (Finding 10)

Responding Agency	**Recommendations**	**Date Due**
Board of Supervisors	11-06 through 11-09 11-11, 11-14, 11-15	August 30, 2011
Auditor/Controller-Treasurer	11-10, 11-12	August 30, 2011
Chief Executive Officer	11-13	September 30, 2011