Review of
Budgetary Controls for
Planning and Development
Services Department

DATE: February 27, 2003

File Number #2316

Director:	**Peter Hughes, Ph.D., CPA**
Deputy Director:	**Eli Littner, CPA**
Audit Manager:	**Michael Goodwin, CPA**
Senior Auditor:	**Lily Chin, CPA**

INTERNAL AUDIT DEPARTMENT

COUNTY OF ORANGE

Review of Budgetary Controls for

Planning and Development Services Department

TABLE OF CONTENTS

Review of Budgetary Controls for
Planning and Development Services Department

BACKGROUND

In 1995, Board Resolution 95-271 established the Internal Audit Department as a separate department from the Auditor-Controller's Office. The Internal Audit Department reports directly to the Board of Supervisors and quarterly to the Audit Oversight Committee (AOC), an advisory committee. The AOC consists of the Chairman and Vice Chairman of the Board of Supervisors, the County Executive Officer (CEO), the Auditor-Controller, and a public member.

The Internal Audit Department entered into this engagement on December 17, 2003 with the full support of the Board of Supervisors, the CEO, and the Auditor-Controller in response to concerns regarding the adequacy of Planning and Development Services Department's responses to questions regarding its unexpected and unplanned June 30, 2002 budget deficit of $2,432,281.

Planning and Development Services Department (PDSD) states in its Business Plan that PDSD is charged by the Board of Supervisors (Board) with safeguarding the quality of life in unincorporated Orange County by ensuring the safety of construction and development; efficient and equitable administration of the permitting and entitlement process; a range of available, quality housing; and protection of the environment and preservation of critical habitat. PDSD's fiscal year 2002-2003 budget was $33,207,280, and their staffing level was reported at 202. Their responsibilities are accomplished through planning, zoning, subdivision, grading and construction permitting and inspections as well as community code enforcement.

OBJECTIVE

This report of observations reflects the results of our review of selected controls regarding the developing, reviewing, approving, and monitoring PDSD's annual budget. The Director of PDSD retained the services of a forensic auditor/consultant during August 2002 to examine and evaluate PDSD's accounting controls and to review actual expenditures and budget documents for accuracy and propriety. Therefore, the focus of our review was on high-level budgetary controls. As such, we assessed management's reviews and approvals of budget documents and reports prepared by PDSD, and submitted to the CEO's Budget Office and the Auditor-Controller's Office.

EXECUTIVE ANALYSIS

ROLES AND RESPONSIBILITIES

The primary responsibility for the accuracy and effective implementation of annual budgets and operational plans ultimately rests with the director of each of the County's departments. The role of the CEO Budget Office in the budget process is primarily to provide the structure and process for the annual budget cycle, to provide advice and guidance about the budget process, and to ensure the timely submissions of budget reports in accordance with their requirements. The CEO Budget Office's role in the budget review and approval process is to raise critical questions whenever they see significant variances in revenues and expenditures being proposed or when the departments present their assumptions for revenue or expenditure enhancements or reductions. The CEO Budget Office's responsibility is to monitor the material and significant assumptions for revenue enhancement and/or expenditure reductions to see they are implemented as planned.

SUMMARY CONCLUSION

PDSD Management agreed with our observation that they had no effective plan or timetable for avoiding the deficit that occurred in the Building and Safety Fund 113 at June 30, 2002. Based on how the financial events at PDSD unfolded for us, PDSD management failed to take timely and appropriate actions to increase fees and further ensure permit revenues fully covered departmental expenditures once the surplus was depleted and could no longer contribute to the operation of the department. In addition, the CEO Office did not effectively monitor PDSD to see that their plan for a fee increase was presented to the Board and subsequently implemented. The fee increase was a critical factor relied upon during the budget process (December 2001 through February 2002) to meet revenue projections and avoid a deficit in Fund 113.

Because of the fiscal oversight issues we encountered in our review, we are recommending with the concurrence of County Counsel, the Auditor-Controller, the interim management of PDSD, and the Interim CEO that a separate and independent audit of funds 113 and 071 be contracted out. This audit will cover the three years since PDSD took over the financial and accounting functions in 1999 from the Public Facilities and Resources Department.

Additionally, the Internal Audit Department will conduct Control Self-Assessment workshops in PDSD at the request of the Acting PDSD Director to facilitate improvements to communications and management processes.

We noted several areas that could be improved, and those are presented in the Observations and Recommendations section.

Our review revealed the following information and internal control issues regarding the reported budget overrun, ($2,432,281), in PDSD for the fiscal year ended June 30, 2002**.**

1. **PDSD Management had adequate financial and budget reports to monitor both revenues and expenditures.**

   We found that PDSD had available numerous internal financial reports such as annual and quarterly budget reports, budget status reports, and the annual business plan for the CEO. The internal reports were run and available with monthly data, and some such as the cash balance report were generated weekly. When we reviewed these reports, we found them to be comprehensive in providing details of the business activities of Building and Safety Fund 113 (Fund 113) funded by user fees and PDSD's Fund 071 (Fund 071) funded by the General Fund.

   The fiscal reports showed revenue sources and expenditure activity by expense account category during the month for the current year, the approved budget for the year by line item, the remaining balances in the accounts including reserve usage, and several years of prior activity for trend analysis and comparison purposes. With these reports, PDSD Management should have been able to monitor their permit revenues, expenditures, and reserve usage and to act well in advance of running out of money by pursuing a fee increase and/or reducing expenditures. (See Observations & Recommendations Nos. 1-5)

2. PDSD Management did not have an effective plan for increasing fees once the Fund 113 reserves were spent.

   Management did not develop a plan for increasing permit fees once the $16,083,582 reserve in Fund 113 at the beginning of fiscal year 1999-2000 was spent. Although the $16,083,582 reserve was spent down over the course of three years, PDSD Management should have known where they were in spending down the reserve balance, when they needed to initiate a fee increase taking into account the amount of time and effort needed to prepare a package for Board approval, or if they also needed to reduce expenditures prior to running out of money.

   The reserve amount and fee increase issues should have been a high visibility management concern in the last year of reserve availability because the PDSD planned budget for 2002-2003 showed the reserve being spent down to $9,704 by June 30, 2002, and no longer available to subsidize expenditures for more than one day from that date forward.

   In fact, PDSD Management confirmed their thinking on fee increases and staffing plans in the 2002 Business Plan on page 11 by stating the following: "Permits are down at this time. However, our trend analysis indicates that the second and fourth quarters historically are the peak periods. March [2002] is expected to increase. If revenue does not occur over time, then fees will need to increase to cover operational costs. We are not considering any reductions in staff as we know that Rancho Mission Viejo and the Brea Tonner developments are coming online."

Consequently, a fee increase effective on or before July 1, 2002 was absolutely essential for PDSD continuing operations. Reserves would no longer be available to subsidize expenditures and Fund 113 operations would continue to incur a deficit. (See Observations and Recommendations No. 2)

3. **The spending of Fund 113 reserves was identified in budget reports prepared for PDSD Management and the CEO Budget Office.**

We found internal reports being prepared monthly for each business element in PDSD. On July 2001, the monthly report for Fund 113 operations specifically disclosed the intent to spend the entire reserve by June 30, 2002. In addition this report disclosed the month end reserve balance as well as budgets for the current year and several years of actual expenditures and revenues for comparison and trending purposes. Once the Board approved a 28% reduction in permit fees and then an additional 5% reduction two years later, permit revenues decreased significantly, and the reserve balance in Fund 113 was a critical resource to pay continuing operational expenses. The monthly report for Fund 113 showed a steady decline as the reserve was being used to supplement revenues in order to pay budgeted expenditures. In addition, PDSD prepared annual and quarterly budget reports for the CEO Budget Office on Fund 113 and indicated the amount of reserves being spent each year and the balance of reserves remaining at the end of the fiscal period.

The critical year for the reserves was the fiscal year 2001-2002 budget for the Building and Safety Fund 113. This budget disclosed management's intent to spend the entire available reserve to supplement that year's expenditures. PDSD reported that Fund 113 reserves at June 30, 2002 would be $9,704. For the prior fiscal year 2000-2001, PDSD reported using $4,890,488 of the reserves in Fund 113, and in the 1999-2000 fiscal year, PDSD reported using $4,171,431. (See Observations and Recommendations No. 3-4)

4. **Building permits were in a decline from 1999 to 2002.**

Building permits related to residential and commercial construction are a significant revenue source for PDSD Fund 113 operations. Building permit information was showing a steady decline over the last three years. There was a 10% decline in 2000, 12% decline in 2001, and a 13% decline in 2002 for a total of a 31% decline over these three years. (See Observations and Recommendations No. 1, 2, 4)

5. **PDSD's Management did not self-initiate plans to reduce expenditures to match declining permit revenues.**
PDSD's Management did not self-initiate plans to reduce expenditures to offset the declining level of building permits and rapidly falling revenues. PDSD's stated solution in their Business Plan was to increase revenues through a Board approved fee increase. Business continuity planning is normally the responsibility of PDSD senior management, and we saw no evidence that they took appropriate and necessary actions to ensure that this essential and critical fee increase occurred in time to offset the loss of reserves after June 2002. Moreover, we did not see a business continuity plan for expenditure reductions if something went wrong with the timing or the amount of the fee increase approved. (See Observations and Recommendations No. 1, 2, 4, 6)

6. **The supporting justification presented by PDSD in the August 2002 Agenda Item Transmittal (AIT) requesting a loan of $8 million contained incomplete information.**
The AIT prepared to request an emergency infusion of "temporary funds" on August 20, 2002 did not include a specific plan for repaying the temporary loan. Instead the AIT contained a generic sentence as follows: "As revenues are received, retransfers will be made with interest equal to the rate earned by the Treasurer Tax-Collector on commingled funds." The key question not answered in that AIT was: how could PDSD in a deficit operating condition have extra revenues above current expenditures for repayment of any amount loaned? In addition, PDSD's request did not include the following relevant and critical facts that should have been provided for the Board's consideration:

a. Building permits for residential and commercial construction were in a steep decline over the last three years;
b. PDSD internal data predicted only marginal improvement in the economy and increased building activity;
c. PDSD could repay the loan only by raising its rates significantly – an action that only the Board of Supervisors could approve; and
d. Significant legal constraints limited PDSD's ability to recover revenue shortages in the fee calculation.

(See Observations and Recommendations No. 4 and 7)

7. **The CEO Budget Office relied on information provided by PDSD for their analysis of PDSD's budgetary situation prior to approving their loan request.**
When PDSD met with the CEO Budget Office on August 11, 2002 to inform them of a critical cash crisis, the Auditor-Controller had already confirmed that Fund 113 was in deficit and that PDSD needed a loan immediately to meet payroll and disbursement obligations. In the short time they had available to act, the CEO Budget Office explored with PDSD management how the deficit in Fund 113 occurred and how much cash was needed for payrolls and pending disbursements. They also received and relied upon PDSD's assurances that they had plans in place to raise rates, to increase revenues, and also to reduce expenditures. (See Observations and Recommendations No. 4 and 7)

8. **Auditor-Controller made an error in the overhead allocation from General Fund Agency 071.**
The Auditor-Controller staff out-stationed to PDSD makes this overhead calculation and allocation as part of the contracted duties performed and records it quarterly. Because of the questions raised regarding the correctness of the significantly increased allocation applied for this current year, the Auditor-Controller reviewed the overhead calculation for a three-year period (2000-2002) and concluded the amount originally calculated and charged was in error. The Auditor-Controller, therefore, proposed to correct the overhead account by $1,505,800 for the last three years and restore this amount to Fund 113 reserves. Once this adjustment is entered into the accounts, the overrun at June 30, 2002 would be reduced from negative $2,432,281 to a negative of $926,481. (See Observations and Recommendations No.8)

In the course of our review, we identified eight related areas in budgeting for improvement. These areas are presented below under the caption **Observations and Recommendations**.

OBSERVATIONS AND RECOMMENDATIONS

1. STRATEGIC PLANNING

The County has the opportunity to reassess its core business objectives for PDSD's long-term role in the County of Orange. Some specific questions the County should address include the following:

a) What is the projected business activity and workload of PDSD for the next three to five years? Does the County have unmet issues such as storm-water run-off which PDSD could handle as part of its core responsibilities?
b) Does the County want to outsource or transfer a portion or the entire function to a city or cities or to private contractors? For example, does the County want to fund a permanent core unit that is capable of delivering services up to a predetermined workload while utilizing private contractors or cities for any work exceeding such internal capabilities?
c) Should aspects of some or all of PDSD be combined with Public Facilities and Resources Department (PFRD)?

Recommendation No. 1:
The County should address its long and short-term strategic plans for PDSD prior to committing significant resources to corrective action plans. We recommend the CEO Office formally address the above and other such strategic issues and identify the fiscal impact, service quality, staffing levels, and customer preferences for each of the strategic opportunities for consolidation, resource sharing, co-sourcing, and partnering opportunities with the private sector and cities.

Management Response:
Concur. Corrective action plans (e.g., fee adjustment and cost reduction plan) are a top priority in order to address the Department's current deficit spending. The CEO will, at the same time, be reviewing workload, contracting options, organizational placement scenarios, and other strategic issues to determine the best course of action.

2. STAFFING, PROJECTED WORKLOAD AND ANNUAL BUDGET

PDSD's staffing levels and budget proposals would benefit from being more closely tied into permit activity and individual workload studies. PDSD should examine their current measures and refine them where and if appropriate by utilizing the insights of both management and staff to ensure the professional experience of all levels of the organization are brought to bear on these critical budget influences.

Recommendation No. 2:
We recommend that PDSD conduct new workload studies. These workloads should be developed in conjunction with the level of service PDSD wants to provide to its customer as well as to benchmark data from other city and county operations.

Management Response:
Concur. Effort is underway to identify methodologies that can be used.

3. OWNERSHIP AND ACCOUNTABILITY

PDSD could benefit from the assignment of ownership roles and responsibilities within their department. The important areas to address are accountability and communication for budgeting, strategic planning responsibilities, and capital expenditure justifications.

Recommendation No. 3:
We recommend PDSD establish clearly defined ownership and accountability for all individuals involved in the internal budget process. This includes ensuring all parties are clear as to how their work is utilized by others, and by developing reports that are useful for the recipients, and by providing clear understanding of their responsibilities concerning the information developed.

Management Response:
Concur. In addition to this recommendation, the CEO believes that the Auditor-Controller and the Director of the Planning and Development Services Department should jointly review their Agreement to make certain there is a clear understanding as to the roles and responsibilities of each department regarding accounting and fiscal matters, including monitoring revenues, expenditures, and trends.

Auditor-Controller Response:
Concur. The Auditor-Controller's Office will continue to maintain a formal accounting agreement specifying the duties and responsibilities of the PDSD Accounting Unit. The current agreement was last updated on July 11, 2000 and was signed by the Auditor-Controller and the Director of PDSD. The agreement will be reviewed with the new management of PDSD and updated with changes as needed, through mutual agreement.

4. REVIEWS AND APPROVALS

PDSD budgetary projections of revenues and expenditures, overhead calculations, and staffing levels assessments could benefit from formal quarterly reviews by the CEO Office and the PDSD Director. PDSD's permit activity levels are subject to frequent and volatile changes and warrant more frequent collective assessments of the impact on revenue projections. Developing a collaborative process in which budgetary issues are discussed periodically with the Department Head and CEO/Budget Office would help ensure critical issues are communicated, and appropriate and timely actions are taken. Some of the critical issues for review and discussion should include PDSD's annual revenue projections, budget, strategic plans, and staffing levels.

<u>Recommendation No. 4A:</u>
We recommend that the CEO Office develop a collaborative process for budgetary projections and staffing levels ensuring these are reviewed and approved by the PDSD Director and the CEO Budget Office on a quarterly basis. Variances should be identified, and any significant variances should be reported and resolved. This new review process should be documented and retained for reference. The applicability and benefit of such reviews should be considered on a countywide basis for all self-sustaining funds.

<u>Management Response:</u>
Concur. Departments that administer selected program funds, including the Planning and Development Services Department and the Building and Safety Fund, currently provide budget and projected revenue and cost information for the Quarterly Budget Reports. More frequent and formalized budget meetings would be useful to augment this process.

<u>Recommendation No. 4B:</u>
We recommend that the CEO Budget Office identify both critical budget components and revenue assumptions associated with self-sustaining funds and also develop a process to effectively monitor significant budget variances as actual business activity for the fiscal year occurs.

<u>Management Response:</u>
Concur. CEO is working with the Auditor-Controller's Office to develop early warning tools to assist in detecting potential budgetary problems.

5. TRAINING AND DEVELOPMENT

Management and fiscal and budget staff would benefit from additional formal training in the County's financial and budgetary policies, procedures, and financial reports. The County has resources, such as staff and financial tools available, to orient, train, and advise departmental personnel on financial and budgetary matters. The Auditor-Controller's "CAPS University" training courses Electronic Report and Management Imaging (ERMI), the Financial Managers Forum are examples of such training opportunities. Joint efforts in developing internal courses on budgetary policies and procedures that lead to a County "certification" would be helpful in ensuring all appropriate staff countywide have prerequisite familiarity with job expectations, budget reports, expenditures and revenue data, and accounting policies and procedures.

Recommendation No. 5:

We recommend that the CEO Office, Auditor-Controller's Office, Internal Audit Department, and CEO/Human Resources join resources to develop formal training on budget and fiscal issues. This training should lead to the awarding of a County certificate to critical fiscal staff members. The completion of such courses should be a mandatory prerequisite for identified fiscal positions.

Management Response:

Concur. Training and a certification program could provide an additional level of preparation and qualification for these positions. Existing programs like GOFA Certified Public Finance Officers Program could also be considered.

Auditor-Controller Response:

Concur. The Auditor-Controller's Office is available to assist in the development of the accounting portions of this training program.

6. COST STUDY

A cost study should be undertaken immediately to identify necessary and reasonable costs associated with the ongoing operations of PDSD. The definitions of necessary and reasonable costs should be tied into productivity measurements for rendering quality and responsive services to the building community. PDSD should identify and evaluate alternative approaches to grouping costs, setting rates, and billing for services. In particular, PDSD should seriously consider the advantages and disadvantages of direct billing actual time and material for all or a subset of services.

The time and material cost recovery methodology is already successfully being used by PDSD for grading and micro-billing and is recognized as an emerging best practice in the industry. Preliminary analysis revealed that PDSD's cost accounting and billing system would easily accommodate a time and material billing approach. Our research has revealed that when properly administered, direct billing (time and material) for actual services rendered introduces a higher level of accountability and greater equity in charges and customer satisfaction.

Recommendation No. 6:
We recommend that the CEO Office establish a committee comprised of representatives of the Auditor-Controller's Office, PDSD, CEO Budget Office, and Internal Audit Department to evaluate the acceptable costing and billing models. Active participation from the affected building community (both large and small contractors) should be obtained and documented.

Management Response:
Concur. The existing stakeholders, who are comprised of most of the parties mentioned in the observations preceding this recommendation, have reviewed cost and billing models. Ongoing dialogue will be continued.

Auditor-Controller's Response:
Concur. The Auditor-Controller's office is assisting in the development of a new PDSD billing process based on time and materials. We are working concurrently with PDSD, CEO, and County Counsel on this and have obtained input from the building community. A proposed ordinance to implement a time and materials billing process is being developed for Board consideration.

7. LOANS FROM THE GENERAL FUND

The CEO Office may have an informal internal policy regarding temporary transfers (loans) from general funds to County departments. However, we are not clear that the fiscal situation occurring in PDSD is covered because the fiscal crisis in PDSD resulted from overspending until they were in deficit in Fund 113, and not a "cash deficit due to timing of receipt of revenues." Regardless, the CEO Budget Office recognized the urgency of quick action to prevent a worsening of PDSD fiscal crisis. Furthermore, PDSD did not identify in their request the affect of statutory constraints, or time restrictions specific to the department that limited their ability to repay the County, or for the County to recover on such loans.

Recommendation No. 7:
We recommend that the CEO Office develop specific guidelines for loaning general funds to County self-sustaining funds. Specifically, this policy needs to address the ability to repay the loan in accordance with a specific timetable for repayment and possible recourse if unable to repay. Such information and any statutory restrictions on repayment should be presented to the Board for their review prior to acting on such loan approval requests. A quarterly status report to the Board should be provided until repaid.

Management Response:
Concur. While quarterly information on loans to other funds is already part of the Quarterly Budget Report, the addition of written guidelines, including repayment provisions and recourse if unable to pay, would be helpful.

8. PDSD OVERHEAD COST CALCULATIONS

The internal controls over the process for determining PDSD overhead charges require a careful reassessment to provide assurance that allocations reflect correct and appropriate costs. To determine the correctness of selected overhead allocations made by the Auditor-Controller, we will be conducting separate reviews of selected Auditor-Controller's overhead calculations and allocations to County departments.

Recommendation No. 8:
We recommend that the Auditor-Controller, the CEO Office, and PDSD establish a working group to review the PDSD overhead methodology to ensure that all appropriate and allocable costs are included in PDSD's overhead calculations. Furthermore, any policy issues surfacing should be documented and the current overhead calculation process be documented and periodically revalidated.

Management Response:
Concur.

Auditor-Controller's Response:
Concur. The Auditor-Controller's office will participate in the recommended working group and will document issues that are identified. Further, we reviewed the overhead amount charged to Fund 113 and submitted corrections to that amount. We will also establish a peer review process for departments' overhead calculations, including PDSD's.

ACKNOWLEDGEMENT:
We wish to acknowledge the cooperation of former Director Thomas B. Mathews, Acting Director Larry Leaman, and Assistant Director Bryan Speegle of the Planning and Development Services Department management; PDSD/Fiscal and Program Services management and staff; former CEO Michael Schumacher, Ph.D, Interim CEO James D. Ruth, Assistant CEO Walter Krause, CFO Gary Burton, and Manager of the CEO Budget Office Steve Dunivent; David E. Sundstrom, Auditor-Controller; Jan Walden, Assistant CEO, Director of the Human Resources; and Benjamin P. deMayo, County Counsel for making themselves and their staff available and cooperating fully in the performance of this review.

We commend Management for their proactive responses in addressing our recommendations.

Attachment A: CEO Management Response

County of Orange MEMO

DATE: February 26, 2003

TO: Peter Hughes, Director, Internal Audit Department

FROM: James Ruth, Interim County Executive Officer

SUBJECT: **Draft Report Budgetary Controls for Planning and Development Services Department (Draft Report)**

The County Executive Office submits the following response to the Draft Report, dated February 21, 2003, and its recommendations as follows:

It is recommended that the sentence commencing in the sixth line of the first paragraph under the heading, "SUMMARY CONCLUSION," on Page 2, be amended to read as follows: "In addition, the CEO office did not monitor PDSD to see that their plan for a fee increase was presented to the Board."

Recommendation No. 1: The County should address its long and short-term strategic plans for PDSD prior to committing significant resources to corrective action plans. We recommend the CEO formally address the above and other such strategic issues and identify the fiscal impact, service quality, staffing levels, and customer preferences for each of the strategic opportunities for consolidation, resource sharing, co-sourcing, and partnering opportunities with the private sector and cities.

Management Response: Concur. Corrective action plans (e.g., fee adjustment and cost reduction plan) are a top priority in order to address the Department's current deficit spending. The CEO will, at the same time, be reviewing workload, contracting options, organizational placement scenarios, and other strategic issues to determine the best course of action.

Recommendation No. 2: We recommend that PDSD conduct new workload studies. These workloads should be developed in conjunction with the level of service PDSD wants to provide to its customer as well as to benchmark data from other city and county operations.

Management Response: Concur. Effort is underway to identify methodologies that can be used.

Attachment A: CEO Management Response Continued

Mr. Hughes
February 26, 2003
Page 2

Recommendation No. 3: We recommend PDSD establish clearly defined ownership and accountability for all individuals involved in the internal budget process. This includes ensuring all parties are clear as to how their work is utilized by others, and by developing reports that are useful for the recipients, and providing clear understanding of their responsibilities concerning the information developed.

Management Response: Concur. In addition to this recommendation, the CEO believes that the Auditor-Controller and the Director of the Planning and Development Services Department should jointly review their Agreement to make certain there is a clear understanding as to the rolls and responsibilities of each department regarding accounting and fiscal matters, including monitoring revenues, expenditures, and trends.

Recommendation No. 4A: We recommend that the CEO develop a collaborative process for budgetary projections and staffing levels ensuring these are reviewed and approved by the PDSD Director and the CEO Budget Office on a quarterly basis. Variances should be identified and any significant variances should be reported and resolved. This new process should be documented and retained for reference. The applicability and benefit of such reviews should be considered on a countywide basis for all self-sustaining funds.

Management Response: Concur. Departments that administer selected program funds, including the Planning and Development Services Department and the Building and Safety Fund, currently provide budget and projected revenue and cost information for the Quarterly Budget Reports. More frequent and formalized budget meetings would be useful to augment this process.

Recommendation No. 4B: We recommend that the CEO Budget Office identify critical budget components and assumptions associated with self-sustaining funds and also devote a process to effectively monitor significant budget variances as actual business activity for the fiscal year occurs.

Management Response: Concur. CEO is working with the Auditor-Controller's Office to develop early warning tools to assist in detecting potential budgetary problems.

Recommendation No. 5: We recommend that the CEO, Auditor-Controller's Office, Internal Audit, and CEO/Human Resources join resources to develop formal training on budget and fiscal issues. This training should lead to the awarding of a County certificate to critical fiscal staff members. The completion of such courses should be a mandatory prerequisite for identified fiscal positions.

Attachment A: CEO Management Response Continued

Mr. Hughes
February 26, 2003
Page 3

Management Response: Concur. Training and a certification program could provide an additional level of preparation and qualification for these positions. Existing programs like GOFA Certified Public Finance Officers Program could also be considered.

Recommendation No. 6: We recommend that the CEO establish a committee comprised of representatives of the Auditor-Controller's Office, PDSD, CEO Budget Office, and Internal Audit to evaluate the acceptable costing and billing models. Active participation from the affected building community (both large and small contractors) should be obtained and documented.

Management Response: Concur. The existing stakeholders, who are comprised of most of the parties mentioned in the observations preceding this recommendation, have reviewed cost and billing models. Ongoing dialogue will be continued.

Recommendation No. 7: We recommend that the CEO develop specific guidelines for loaning general funds to County self-sustaining funds. Specifically, a policy needs to address the ability to repay the loan in accordance with a specific timetable, and possible recourse if unable to repay. Such information should be presented to the Board for their review prior to acting on such loan approval requests. A quarterly status report to the Board should be provided until repaid.

Management Response: Concur. While quarterly information on loans to other funds is already part of the Quarterly Budget Report, the addition of written guidelines, including repayment provisions and recourse if unable to pay, would be helpful.

Recommendation No. 8: We recommend that the Auditor-Controller, the CEO, and PDSD establish a working group to review the PDSD overhead methodology to ensure that all appropriate and allocable costs are included in PDSD's overhead calculations. Furthermore, any policy issues surfacing should be documented and the overhead calculation process be periodically revalidated.

Management Response: Concur.

Attachment B: Auditor-Controller Management Response

AUDITOR-CONTROLLER
COUNTY OF ORANGE

HALL OF FINANCE AND RECORDS
12 CIVIC CENTER PLAZA, ROOM 202
POST OFFICE BOX 567
SANTA ANA, CALIFORNIA 92702-0567

(714) 834-2450 FAX: (714) 834-2569

www.oc.ca.gov/ac

JOHN H. NAKANE
CHIEF ASSISTANT AUDITOR-CONTROLLER

JAMES M. McCONNELL
ASSISTANT AUDITOR-CONTROLLER
CENTRAL OPERATIONS

SHAUN M. SKELLY
ASSISTANT AUDITOR-CONTROLLER
AGENCY ACCOUNTING

MAHESH N. PATEL
ASSISTANT AUDITOR-CONTROLLER
INFORMATION TECHNOLOGY

DAVID E. SUNDSTROM, CPA
AUDITOR-CONTROLLER

February 19, 2003

TO: Larry Leaman, Interim Director
Planning and Development Services Department

SUBJECT: Response to Draft Report on Budgetary Controls for the Planning and Development Services Department

We reviewed the draft report prepared by the Internal Audit Department on the Planning and Development Services Department (PDSD). Although this report focuses on high-level budgetary controls, the Auditor-Controller is referenced in several of the recommendations. Following are our responses to these areas of the report.

Ownership and Accountability (No. 3). Concur. The Auditor-Controller's Office will continue to maintain a formal accounting agreement specifying the duties and responsibilities of the PDSD Accounting Unit. The current agreement was last updated on July 11, 2000 and was signed by the Auditor-Controller and the Director of PDSD. The agreement will be reviewed with the new management of PDSD and updated with changes as needed, through mutual agreement.

Training and Development (No. 5). Concur. The Auditor-Controller's Office is available to assist in the development of the accounting portions of this training program.

Cost Study (No. 6). Concur. The Auditor-Controller's Office is assisting in the development of a new PDSD billing process based on time and materials. We are working concurrently with PDSD, CEO, and County Counsel on this and have obtained input from the building community. A proposed ordinance to implement a time and materials billing process is being developed for Board consideration.

Attachment B: Auditor-Controller Management Response Continued

Larry Leaman, Interim Director
Planning and Development Services Department
February 19, 2003
Page 2

PDSD Overhead Cost Calculations (No. 8). Concur. The Auditor-Controller's Office will participate in the recommended working group and will document issues that are identified. Further, we reviewed the overhead amount charged to Fund 113 and submitted corrections to that amount. We will also establish a peer review process for departments' overhead calculations, including PDSD's.

David E. Sundstrom
Auditor-Controller

SS:lr (PDSD Budgetary Controls Resp/agency)

cc: Peter Hughes, Director, Internal Audit Department