

Internal Audit Department

O R A N G E C O U N T Y
6th Largest County in the USA

FIRST FOLLOW-UP AUDIT INTERNAL CONTROL AUDIT: COUNTYWIDE FEE DEVELOPMENT MONITORING PROCESS

AS OF DECEMBER 15, 2010

Our First Follow-Up Audit found the County Executive Office, Auditor-Controller and Clerk of the Board fully implemented six (6) recommendations, partially implemented one (1) recommendation, and have not implemented one (1) recommendation from our original audit report dated April 20, 2010.

During the First Follow-Up Audit, a new issue came to our attention and we have developed a **new recommendation** regarding the potential impact of Proposition 26 on the Countywide Fee Development Monitoring Process. The County Executive Office, Auditor-Controller, and Clerk of the Board provide oversight of department/agency fee requests submitted to the Board of Supervisors for approval.

AUDIT NO: 1033-B
(ORIGINAL AUDIT NO. 2922)

REPORT DATE: JANUARY 25, 2011

Director: Dr. Peter Hughes, MBA, CPA, CIA
Deputy Director: Eli Littner, CPA, CIA
Senior Audit Manager: Michael Goodwin, CPA, CIA
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RISK BASED AUDITING

GAO & IIA Peer Review Compliant – 2001, 2004, 2007, 2010



American Institute of Certified Public Accountants Award to Dr. Peter Hughes as 2010 Outstanding CPA of the Year for Local Government



2009 Association of Certified Fraud Examiners' Hubbard Award to Dr. Peter Hughes for the Most Outstanding Article of the Year – Ethics Pays



2008 Association of Local Government Auditors' Bronze Website Award



2005 Institute of Internal Auditors' Award to IAD for Recognition of Commitment to Professional Excellence, Quality, and Outreach



GAO & IIA Peer Review Compliant - 2001, 2004, 2007, 2010

Providing Facts and Perspectives Countywide

RISK BASED AUDITING

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OC Fraud Hotline (714) 834-3608

Letter from Dr. Peter Hughes, CPA

Transmittal Letter



Audit No. 1033-B January 25, 2011

TO: Thomas Mauk, County Executive Officer
David Sundstrom, Auditor-Controller
Darlene Bloom, Clerk of the Board

FROM: Dr. Peter Hughes, CPA, Director
Internal Audit Department

SUBJECT: First Follow-Up Audit: Internal Control
Audit: Countywide Fee Development
Monitoring Process, Original Audit No.
2922, Issued April 20, 2010

We have completed a First Follow-Up Audit of internal controls over the Countywide Fee Development Monitoring Process. Our audit was limited to reviewing, as of December 15, 2010, actions taken to implement the **eight (8) recommendations** from our original audit. We conducted this First Follow-Up Audit in accordance with the *FY 10-11 Audit Plan and Risk Assessment* approved by the Audit Oversight Committee and Board of Supervisors (BOS).

The results of our First Follow-Up Audit are discussed in the **OC Internal Auditor's Report** following this transmittal letter. Our First Follow-Up Audit found the County Executive Office, Auditor-Controller, and Clerk of the Board fully **implemented six (6) recommendations, partially implemented one (1) recommendation, and one (1) recommendation has not been implemented**. During the Follow-Up Audit, a new issue came to our attention and we have developed a **new recommendation** regarding the potential impact of Proposition 26 on the Fee Development Monitoring Process.

Each month I submit an **Audit Status Report** to the BOS where I detail any material and significant audit findings released in reports during the prior month and the implementation status of audit recommendations as disclosed by our Follow-Up Audits. Accordingly, the results of this audit will be included in a future status report to the BOS.

Other recipients of this report are listed on the **OC Internal Auditor's Report** on page 5.

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Countywide Fee Development Monitoring Process
Audit No. 1033-B***

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OC Internal Auditor's Report



Audit No. 1033-B

January 25, 2011

TO: Thomas Mauk, County Executive Officer
David Sundstrom, Auditor-Controller
Darlene Bloom, Clerk of the Board

FROM: Dr. Peter Hughes, CPA, Director
Internal Audit Department

A handwritten signature in blue ink, reading "Peter Hughes", is placed over the "FROM:" line.

SUBJECT: First Follow-Up Audit of Internal Control Audit:
Countywide Fee Development Monitoring Process,
Original Audit No. 2922, Issued April 20, 2010.

Scope of Review

We have completed a First Follow-Up Audit of the Internal Control Audit of the Countywide Fee Development Monitoring Process. Our audit was limited to reviewing, as of December 15, 2010, actions taken to implement **eight (8) recommendations** from our original audit.

Background

We conducted an internal control audit of the Countywide Fee Development Monitoring Process, which included an evaluation of monitoring and oversight controls; compliance with department and County policies; and evidence of process efficiencies and effectiveness. The **County Executive Office/County Budget Office (CEO)**, **Auditor-Controller Cost, Revenue & Budget (A-C)**, and **Clerk of the Board (COB)** have monitoring and oversight responsibilities over department/agency fee requests submitted for Board of Supervisors' approval. Their oversight responsibilities include ensuring that proposed revenues are related to the services provided and do not exceed the estimated costs of providing the services. In FY 2008/2009, County departments/agencies generated \$461 million in revenue from non-property tax sources (primarily for licenses, permits, franchises and charges for services) by charging fees to cover the cost of services provided to the public.

The recommendations pertained to CEO and A-C monitoring and oversight of department/agency fee requests; proper completion of *Fee Checklist Forms*; compliance with County fee development policies and procedures; adhering to requirements for *Agenda Staff Report (ASR)* submission; enhancing fee policy for preparing department/agency fee requests and the impact on fee studies in unstable economic times; and maintaining a comprehensive master listing of County Fees.

Results

Our First Follow-Up Audit indicated the CEO, A-C and COB **fully implemented six (6) recommendations, partially implemented (1) recommendation and one (1) recommendation has not been implemented.** During the Follow-Up Audit, a new issue came to our attention and we have developed a **new recommendation** regarding the potential impact of Proposition 26 on the Fee Development Monitoring Process. We believe the remaining two (2) recommendations and one (1) new recommendation are still appropriate and efforts should be made to fully implement them. Based on the Follow-Up Audit we conducted, the following is the implementation status of the **eight (8) original recommendations**, along with the new recommendation No. 9 regarding Proposition 26, along with a response from the CEO and A-C. See *Attachment A* for a description of Report Item Classifications.



1. **Auditor-Controller Receipt of Departmental Fee Studies and Fee Checklist Forms** (Control Finding) Auditor-Controller evaluate ways to ensure they receive all fee studies and *Fee Checklist Forms* timely from departments/agencies in order to fulfill their review responsibilities.

Current Status: **Implemented.** A-C Cost, Revenue & Budget issued an email memo to Financial Managers' Forum (FMF) members, and made an announcement at the September 2010 FMF meeting, presenting members with a revised *Fee Checklist Form*. The announcement and memo informed the FMF that the Clerk of the Board will not accept or agendize any ASR for new and/or revised fees without concurrence from both the CEO's office and the Auditor-Controller's office on a completed *Fee Checklist Form*.

We reviewed all new and/or revised fees submitted to the Board of Supervisors between April 20, 2010 and December 7, 2010 (2 fee revision requests). Both new/revised fee packages contained *Fee Checklist Forms* that were signed and reviewed by the CEO and A-C offices with no exceptions. Because of the actions taken and assurance from the Clerk of the Board that no fee requests will be accepted or agendized without proper CEO and A-C approval on the *Fee Checklist Forms*, and no exceptions were noted, we consider this recommendation implemented.

2. **Auditor-Controller Review of Departmental Fee Studies and Fee Checklist Forms** (Control Finding) Auditor-Controller evaluate the appropriate level of review required for fee studies and *Fee Checklist Forms*, document their level of review to comply with CAM R-3 and ensure their reviews of *Fee Checklist Forms* are documented with each submission to the Board of Supervisors.

Current Status: **Implemented.** A-C Cost, Revenue & Budget worked with CEO/Budget and modified the *Fee Checklist Form* to document their level of review to comply with County Accounting Manual (CAM) R-3. The *Fee Checklist Form* was modified to add verbiage that the CEO and A-C perform "limited reviews" of the fee data, which CAM R-3 Clause 3.5.2 requires. We noted that the A-C documented their review on both tested *Fee Checklist Forms*. Because the A-C evaluated and documented their level of review, we consider this recommendation implemented.

3. **CEO Review of Fee Checklist Forms** (Control Finding) CEO/Budget ensure it signs all *Fee Checklist Forms* to document their review and approval.

Current Status: **Implemented.** CEO/Budget discussed with its staff their policy on reviewing and approving new or revised fees to ensure that all ASRs are reviewed for reasonableness and justification and *Fee Checklist Forms* are signed. Our testing found that CEO/Budget documented their review on the *Fee Checklist Forms* we tested with no exceptions noted. Therefore, we consider this recommendation implemented.

4. **Fee Checklist Forms Not Presented to the Board of Supervisors** (Control Finding) The County Executive Office, Auditor-Controller, and the Clerk of the Board jointly ensure that departmental *Fee Checklist Forms* accompany ASRs as required for applicable new and/or revised fees.



Current Status: Implemented. CEO/Budget, A-C Cost, Revenue & Budget and Clerk of the Board staff discussed how to ensure departmental *Fee Checklist Forms* accompany ASRs for applicable new and/or revised fees. The A-C sent a memo to County financial staff stating that the Clerk of the Board will not accept or agendize any ASR for a new or revised fee without concurrence from both the CEO's office and the Auditor-Controller's office on the completed *Fee Checklist Form*. Our testing found that both fee revision packages contained *Fee Checklist Forms* were signed and reviewed by the A-C and CEO. Because of the actions taken, we consider this recommendation implemented.

5. Required Information Not in ASRs (Control Finding)

County Executive Office and Clerk of the Board jointly ensure ASRs for new and/or revised fees document the amount of revenue expected to be generated and contain the required CEQA exemption disclosure.

Current Status: Implemented. CEO/Budget and Clerk of the Board provided reminders to their staff of the requirement for departments/agencies to document the amount of revenue expected to be generated and the required CEQA exemption disclosure. Both fee packages we reviewed contained ASRs that documented the amount of revenue expected and the required CEQA exemption disclosure. No exceptions were noted. Based on the actions taken, we consider this recommendation implemented.

6. Enhancement of Fee Development Policy (Control Finding)

Auditor-Controller, in conjunction with the County Executive Office, take measures to revise CAM No. R-3 to clearly identify the extent of reviews performed on department/agency fee studies and requests submitted for Board approval. Also, the Auditor-Controller and County Executive Office should evaluate whether CAM No. B-2 should be enhanced to include standardized instructions and templates for conducting department/agency fee requests and studies.

Current Status: Partially Implemented. A-C Cost, Revenue & Budget discussed this recommendation with CEO/Budget, and modified the *Fee Checklist Form* to document the A-C's level of review to in compliance with CAM R-3. The *Fee Checklist Form* was modified to state that the CEO and A-C only perform limited reviews of fee data, which CAM R-3 currently requires. However, the A-C and CEO/Budget have not yet decided on whether to include standardized instructions and templates for conducting fee studies, nor has the A-C made any revisions to CAMs R-3 or B-2.

Because the A-C, in conjunction with CEO/Budget, revised the *Fee Checklist Form* to identify the extent of their reviews of fee requests, but have not yet evaluated enhancing CAMs R-3 and B-2 to include standardized instructions and templates, we consider this recommendation as partially implemented.

Planned Action:

The Auditor-Controller plans on reviewing CAMs R-3 and B-2 as part of a comprehensive review of the Accounting Manual during FY 2010-2011 and will evaluate the policy in conjunction with CEO/Budget. The Auditor-Controller and CEO/Budget also plan on including new regulations related to Proposition 26 as part of the policy update (see [Observation #9 below](#)).



7. **Fee Policy During Economic Downturns** (Control Finding)

Auditor-Controller, in conjunction with the County Executive Office, enhance the fee setting policy to address issues impacting fee setting strategies and calculations of future costs in times of economic instability, specifically in the areas of using prior year cost data, projected merit and general salary increases, and CPI indexes used for establishing fees.

Current Status: Not Yet Implemented. The Auditor-Controller and County Executive Office have not yet reviewed this subject or revised CAMs R-3 or B-2 to address issues impacting fee setting strategies and calculations in times of economic instability.

Planned Action:

The Auditor-Controller, in conjunction with CEO/Budget, will review CAMs R-3 and B-2 as part of a comprehensive review of the Accounting Manual during FY 2010-2011, and will evaluate the existing fee setting policy to address issues impacting fee setting strategies and calculations of future costs in times of economic instability.

8. **Comprehensive Listing of Fees** (Control Finding)

County Executive Office and Auditor-Controller evaluate whether preparing and maintaining a comprehensive master listing of County fees would be cost-beneficial and a useful management tool for monitoring and oversight of countywide fee development.

Current Status: Implemented. CEO/Budget has completed a countywide fee inventory and has prepared two documents: (1) *County of Orange Review of County Charges for Services FY 2010-11*; and (2) *County of Orange Review of County Fees Charged to the Public FY 2010-11*. The reports show by department a description of fees; the respective cost basis; whether full cost recovery is being obtained; and comments added by CEO/Budget staff. Because of actions taken to establish and maintain a master listing of fees, we consider this recommendation implemented.

9. **Observation No. 9 – Impact of Proposition 26** – **NEW RECOMMENDATION**

(Control Finding) In November 2010, Proposition 26 was passed by California voters. Proposition 26 requires that certain state and local fees are approved by two-thirds vote. Fees include those that address adverse impacts on society or the environment caused by the fee-payer's business. The impact of Proposition 26 expands the definition of a tax which classifies some fees and charges as taxes that the government formerly imposed with a simple majority vote. As a result, more revenue proposals, formerly fees but now taxes, require approval by two-thirds of the Legislature or by local voters. Prior to the passage of Proposition 26, elected officials at the state and local levels could legislate higher revenue proposals by classifying them as fees in order to pass with a simple majority instead of a two-thirds majority required by law for taxes.

We were informed by CEO/Budget that certain components of fee charges, such as overhead, may not specifically allowed by Proposition 26. CEO/Budget is awaiting a legal opinion from County Counsel regarding the impact of Proposition 26 on the fee setting process.

OC Internal Auditor's Report



Recommendation No. 9

Auditor-Controller and County Executive Office work with County Counsel to determine the impact of Proposition 26 on the fee setting process, and incorporate any resulting policy changes impacting the fee setting process in CAMs R-3 and B-2.

County Executive Office Management Response:

The County Executive Office concurs with the recommendation. Following the passage of Proposition 26, the County has been participating in a statewide working group to identify the challenges associated with the implementation of Proposition 26. The County Executive Office and the Auditor-Controller have met with County Counsel to request an opinion on how the proposition may impact existing fees and the fee setting process. In January 2011, County Counsel issued an opinion that provides guidance on the general steps to follow in implementing the requirements of Proposition 26. The County Executive Office will work with the Auditor-Controller to incorporate the necessary changes to the accounting procedures.

Auditor-Controller Management Response:

Concur. The Auditor-Controller and the County Executive Office met with County Counsel to request an opinion on how the proposition may impact existing fees and the fee setting process. The Auditor-Controller received a memorandum from County Counsel dated December 22, 2010, that provides guidance on the general steps to follow in implementing the requirements of Proposition 26. Our office is in the process of reviewing the issue and will collaborate with County Executive Office, Clerk of the Board, and follow up with County Counsel if necessary, to implement new and/or revise procedures as a result of Proposition 26. The Auditor-Controller will review CAM R-3 as part of a comprehensive review of the Accounting Manual during FY 2010-11, address issues arising from Proposition 26, and revise the Fee Checklist Form as required to include the impact of Proposition 26.

We appreciate the assistance extended by the County Executive Office, Auditor-Controller, and Clerk of the Board during our Follow-Up Audit. If you have any questions, please contact me directly or Eli Littner, Deputy Director at 834-5899, or Michael Goodwin, Senior Audit Manager at 834-6066.

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

Members, Board of Supervisors
Members, Audit Oversight Committee
Bob Franz, Deputy CEO, Chief Financial Officer
Frank Kim, County Budget Officer, CEO/Budget Office
Michelle Aguirre, Administrative Manager, CEO/Budget Office
Shaun Skelly, Chief Deputy Auditor-Controller
Jan Grimes, Director, A-C Central Accounting Operations
Kathy Permenter, Manager, A-C Cost, Revenue & Budget
Susan Long, Manager, A-C Cost, Revenue & Budget
Susan Novak, Chief Deputy Clerk of the Board of Supervisors
Robin Stieler, Board Services Manager, Clerk of the Board of Supervisors
Foreperson, Grand Jury



ATTACHMENT A: Report Item Classifications

For purposes of reporting our audit observations and recommendations, we will classify audit report items into three distinct categories:

▶ **Critical Control Weaknesses:**

Serious audit findings or a combination of Significant Control Weaknesses that represent critical exceptions to the audit objective(s) and/or business goals. Management is expected to address Critical Control Weaknesses brought to their attention immediately.

▶ **Significant Control Weaknesses:**

Audit findings or a combination of Control Findings that represent a significant deficiency in the design or operation of internal controls. Significant Control Weaknesses generally will require prompt corrective actions.

▶ **Control Findings:**

Audit findings concerning internal controls, compliance issues, or efficiency/effectiveness issues that require management's corrective action to implement or enhance processes and internal controls. Control Findings are expected to be addressed within our follow-up process of six months, but no later than twelve months.

OC Internal Auditor's Report



ATTACHMENT B: County Executive Office Management Response

From: Kim, Frank (HOA)
Sent: Wednesday, January 19, 2011 10:32 AM
To: Goodwin, Mike
Subject: RE: Draft Follow-Up Report with One New Recommendation

Mike,

Here is my draft response to the new recommendation:

The County Executive Office concurs with the recommendation. Following the passage of Proposition 26, the County has been participating in a statewide working group to identify the challenges associated with the implementation of Proposition 26. The County Executive Office and the Auditor-Controller have met with County Counsel to request an opinion on how the proposition may impact existing fees and the fee setting process. In January 2011, County Counsel issued an opinion that provides guidance on the general steps to follow in implementing the requirements of Proposition 26. The County Executive Office will work with the Auditor-Controller to incorporate the necessary changes to the accounting procedures

Frank Kim, Director
County Budget Office
Orange County, California
Phone: 714.834.3530
Fax: 714.834.6658

OC Internal Auditor's Report



ATTACHMENT C: Auditor-Controller Management Response

From: Permenter, Kathy
Sent: Thursday, January 20, 2011 5:39 PM
To: Goodwin, Mike
Cc: Grimes, Jan; Skelly, Shaun; Novak, Susan; Dean, Michael; Kim, Frank (HOA); Sundstrom, David; Quach, Sarah [AC]
Subject: RE: Draft Follow-Up Report with One New Recommendation

Mike,

The Auditor-Controller reviewed the Planned Actions for Recommendations Nos. 6 and 7 stated on the Exit Draft Report 1033-B report. No revision is necessary.

Auditor-Controller response to new recommendation No. 9:

Concur. The Auditor-Controller and the County Executive Office met with County Counsel to request an opinion on how the proposition may impact existing fees and the fee setting process. The Auditor-Controller received a memorandum from County Counsel dated December 22, 2010, that provides guidance on the general steps to follow in implementing the requirements of Proposition 26. Our office is in the process of reviewing the issue and will collaborate with County Executive Office, Clerk of the Board, and follow up with County Counsel if necessary, to implement new and/or revise procedures as a result of Proposition 26. The Auditor-Controller will review CAMs R-3 as part of a comprehensive review of the Accounting Manual during FY 2010-11, address issues arising from Proposition 26, and revise the Fee Checklist Form as required to include the impact of Proposition 26.

Please let me know if you have any questions.

Kathy Permenter
Manager, Auditor Controller Cost, Revenue & Budget
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