MONTEREY COUNTY

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March 5, 2007

The Honorable Russell D. Scott
2007 Presiding Judge of the Superior Court
County of Monterey
240 Church Street
Salinas, CA 93901

Dear Judge Scott,

Pursuant to Penal Code Section 933(b) of the State of California, as the elected Auditor-Controller of the County of Monterey, please find attached my responses to the "Monterey County Civil Grand Jury – 2006 Final Report".

Sincerely,

Michael J. Miller

Michael J. Miller, CPA, CISA, CITP

Attachment

Attachment

Office of the Auditor-Controller

Response to the "Monterey County Grand Jury – 2006 Final Report"

Section 2 – 2004 Grand Jury Report Agency Response

R 2.1 – Monterey County should adopt a policy to assure that a finance training session for the Board of Supervisors is held annually.

The recommendation will be implemented.

If it is the pleasure of the Board of Supervisors, the Office of the Auditor-Controller will conduct an annual finance training session.

R 2.2 – Monterey County should adopt a policy to assure that the two special study sessions called for in the 2004 Monterey County Civil Grand Jury Report are held annually.

The recommendation will be implemented.

If it is the pleasure of the Board of Supervisors, the Office of the Auditor-Controller will continue to conduct special study sessions. In 2006, the Office of the Auditor-Controller provided special study sessions on the State of California "Triple Flip" property tax legislation, the Education Revenue Augmentation Fund III (ERAFIII) and on the Property Tax in lieu of Vehicle License Fees revenue swap. For 2007, our office intends to provide sessions on the Federal A-87 Cost Plan preparation and on the Annual Monterey County Property Tax Rate book.

R 2.3 – The Monterey County Board of Supervisors, with the Auditor-Controller and County Administrative Offices, should create internal service funds for the purposes of managing vehicles, equipment, and information technology needs.

The recommendation is being considered.

Per California Government Code, the Auditor-Controller "is the *Chief Accounting Officer* of the County and as such *shall prescribe*, and shall exercise a general supervision, including the ability to review departmental and countywide internal controls, over the accounting forms and *the method of keeping the accounts of all offices*, departments and institutions under the control of the board of supervisors and of all districts whose funds are kept in the county treasury" (emphasis added).

Internal Service Funds (ISF) are an accounting mechanism Therefore, it is the Auditor-Controller that has the legal authority to "prescribe" if and when ISF's are appropriate. This is an important distinction. Because ISF's are accounting tools, it is necessary that

professional accountants be empowered to practice accounting as is most appropriate for the County.

ISF's are a viable and appropriate solution for the County, and the Office of the Auditor-Controller has instituted ISF's as a mechanism to account for the self-insurance needs of the County. As we move toward the re-engineering process in our ERP implementation, the use of additional ISF's is being considered and discussed with our clients, including the CAO, the Information Technology Department and Public Works Department.

R 2.4 – The Monterey County Board of Supervisors, together with the County Administrative Officer and the Information Technology Manager, should assure that appropriate rights are extended to the Chief Security and Privacy Officer to allow all systems to be audited on a regular basis.

The Office of the Auditor-Controller agrees with this recommendation, with one caveat.

Given the level of technology available today, it is imperative to protect not only electronic information, but other physical assets as well, including paper records and physical security. Therefore, extending the appropriate rights to the Chief Security and Privacy Officer (CSPO) to audit all systems on a regular basis is imperative.

The caveat: The right to *independently* audit all systems already exists in the Office of Auditor-Controller. Auditing is not a technology function. Therefore, we believe that the CSPO should report to the Auditor-Controller working with the Internal Audit Division to independently assess not only the Information Technology Department (ITD), but all County security and privacy needs as well. The CSPO working with audit professionals like Certified Information Systems Auditors (CISA) and Certified Information Technology Professionals (CITP) will be able to provide the professional, independent audit services needed for this important control.

Additionally Information Security as a technology function is an old paradigm. Industry leaders like the Gartner Group have recognized the practical need to have this function reside in an independent office. It is an internal control and therefore a business function that is, per California Government Code (see above) primarily under the purview of the Auditor-Controller.

This is not to say that the ITD should not employ a team of security professionals. On the contrary, the ITD should continue to have a team of security experts for technology specific security issues. It is the CSPO that should reside in an independent department. This will position the CSPO to more objectively assess the security of all departments as well as ITD.

R 2.5 – Recommendation 6.1 of the 2004 Monterey County Civil Grand Jury Report regarding State Criminal Alien Assistance Program funds should be implemented.

This is outside the purview of the Office of the Auditor-Controller and therefore will not comment.

Section 3 – CORE/Enterprise Resource Planning

R 3.1 – The County Administrative Officer and the Auditor should take immediate steps to being the preparation for implementing a new information systems to replace the existing antiquated system, using an outside consultant as required to assure that the change progresses as smoothly as possible.

The recommendation has been implemented.

R 3.2 – The system should be implemented in two stages. The first stage would include the financial and audit processes, and the second the human resource and payroll processes.

The recommendation will likely be implemented.

By necessity, the system will be implemented in at least two stages. However, logistics will likely dictate that more than two stages are necessary to completely implement the full benefits of an ERP.

R 3.3 – Monterey County should use the audit report contained in the 2004 Grand Jury Report as a guide to final development of the new system.

The recommendation has been implemented.

R 3.4 – The steering committee already in place should be strengthened to include all departments.

The recommendation should not be implemented.

The apparent intent of this recommendation is a good one, that being to ensure that the needs of all departments are considered when implementing business solutions around our ERP implementation. However, business solutions ought to be directed by business process experts.

The intent of the ERP steering committee is to provide overall direction for business solutions. Monterey County has excellent department heads, each are proficient in their own fields of expertise. The ERP steering committee has four program department heads that represent client departments. Throughout the process, all departmental business needs will be evaluated. It is important that business process experts (administrative departments) understand the needs of their clients and using their experience and training, bring the appropriate business solutions to bear. That is how the ERP steering committee is set up and how it is intended to function.

As a practical matter, a steering committee must be nimble and able to make decisions quickly and decisively. A steering committee containing all 28-plus department heads could not properly function.

R 3.5 – Implementation of the new system should be firmly programmed, and quarterly reports to the Board of Supervisors should be required to assure progress.

The recommendation will be implemented.

R 3.6 – Monterey County should consolidate and centralize information security operations.

The recommendation should be implemented.

See response above to Recommendation R 2.4.

R 3.7 Methods should be established for assuring that the spending and accountability functions of County agencies are separate, with specific checks and balances.

The recommendation will be implemented.

The processes described by the Grand Jury in this recommendation can best be expressed as strengthening countywide internal controls. Although internal controls are the responsibility of all County management, as described above in the response to recommendation R 2.4, the primarily responsibility for internal controls rest with the Office of the Auditor-Controller.

The County can greatly improve on the efficiency and effectiveness of internal controls through the realization and inclusion of such processes in the ERP implementation.

Section 4 – Human Resources

Preface:

There is no department that is more impacted by the Human Resources (HR) function than the Office of the Auditor-Controller. This is because the Auditor-Controller produces the paychecks for the County. Since calculating payroll is dependent on HR information, it is not possible to provide timely, accurate payroll without a well-functioning HR mechanism.

F 4.1 – Monterey County senior executive managers should ensure that the current HR processes and procedures, and their associated manuals, are revised as necessary so that key HR functions are administered in a consistent, fair, and equitable manner across all departments.

The recommendation should be implemented.

F 4.2 – Monterey County senior executive managers should create a re-centralized HR Department that will provide countywide consistency, accountability, and accuracy of HR processes. This should be done without substantially detracting

from the individual department managers' current level of HR recruitment, screening, and hiring services provided by their individual HR staff. These actions should be retained at the individual department level in order to address specific requirements of individual departments.

The recommendation should be implemented.

I believe the recommendation will allow individual departments to retain HR experts within their department to ensure timely service, while at the same time, receive strong, professional policy oversight and direction.

R 4.3 – In re-establishing a central HR department, focus should remain on maintaining and increasing levels of customer services that are currently provide by independent decentralized HR organizations spread throughout the County.

The recommendation should be implemented.

Section 8 – Monterey County 457 Eligible deferred Compensation Plan

Preface:

It is important when discussing the County of Monterey 457 Deferred Compensation Plan (the plan) to inform readers that beginning in September 2006, upon recommendation of the then "Plan Advisory Committee", the Board of Supervisors changed administration of the plan.

Prior to September 2006, plan administration was comprised of a single individual acting as the "Plan Administrator"; that individual having the sole discretion to administer the plan within the adopted guidelines of the Board of Supervisors. In addition, a "Plan Advisory Committee" was available to the Plan Administrator to provide guidance and advice when requested.

After September 2006, the "Plan Advisory Committee" was converted to the " Plan Administrative Committee", replacing the sole individual with a committee to act as the plan administrator. Therefore, administration of the plan has not been transferred to the Treasurer/Tax Collector (TTC) as indicated in the Jury report, but rather the committee has elected the TTC to chair the new committee.

Except where noted, the following comments pertain to the old administrative method.

Responses to Recommendations:

R 8.1 – Monterey County should put the contract for the County's 457 Eligible Deferred Compensation Plan up for competitive bid. This would lead to a greater likelihood of acquiring the best possible service at the lowest cost to the County.

The recommendation is in progress.

The Plan Advisory Committee in various manners has recommended this since 2003.

In October 2006 a contract was let with Arnerich Massena and Associates, Inc. to provide the Plan Administrative Committee with assistance in producing a Request for Proposals (RFP) for vendors to provide administrative and investment services (management services). The process is due to be completed no later than March 31, 2008 if a new vendor(s) is selected; much earlier if the current vendor is retained.

R 8.2 – AON Consulting recommendations should be implemented.

The recommendation will not be implemented.

The process of procuring and creating the AON reports was fundamentally flawed.

Although there are some worthwhile recommendations in the audit reports, most if not all of them were previously recommended by the Plan Advisory Committee, and for the most part have been implemented or are in the process of being implemented.

The issues with the AON Consulting audit reports are worth discussing in the context of this response to the Grand Jury.

The following serious issues exist around the contracting for audit/review services, contract management, the audit/review process, draft report creation and distribution, and final report creation, control and issuance.

- The contract with AON Consulting was let "under the direction…(of) the County's counsel". Although the County Counsel's office may be capable of providing legal services, it is clear that the department is not qualified or responsible to direct contracts for audit services.

- Other than to review the fiscal provisions of the contract, the Office of the Auditor-Controller was not contacted by the County Counsel or the Plan Administrator prior, during or after signing the contract.

- AON Consulting made no attempt to interview any Auditor-Controller personnel to discuss the operations of the County plan, despite the fact that the Auditor-Controller was a member of the Plan Advisory Committee (and is an original member of the Plan Administrative Committee), and that the Office of the Auditor-Controller is primarily responsible for most of the internal operations of the plan, including document processing, payroll deductions, internal accounting, reconciliations (both internal and external), fund transfer approval and internal financial reporting.

- AON Consulting issued two separate reports in "DRAFT" format <u>only</u>. These drafts were discussed with the Plan Advisory Committee for the first and only time in the August 2006 Deferred Compensation Committee meeting. The committee expressed serious concerns with the content of the draft reports. Final

reports were never issued by AON Consulting. This calls into question how and why draft reports were provided to the Grand Jury and how this aspect of the contract was managed, and by whom.

- After the August 2006 Deferred Compensation Committee meeting, the Office of the Auditor-Controller requested copies of both AON draft reports and of the AON contracts. This request was rejected, citing "attorney-client privilege". When it was pointed out that the "client" is the County of Monterey, the documents were provided.

- On January 5, 2007, after receiving the 2006 Grand Jury Report, The Office of the Auditor-Controller contacted the previous Plan Administrator questioning if final reports had been issued. AON Consulting indicates that after being contacted by the previous Plan Administrator staff on, or about that same day (January 5, 2007), AON Consulting agreed to allow the previous Plan Administrator to issue the draft reports as final reports. This circumvents control of the reports and thus the "direction of County Counsel" for management of the AON contracts, destroys any semblance of audit/review independence thus violating basic audit/review principles, thus renders the reports useless. In over 25 years as a professional auditor, I have not experienced this.

- Reports that were represented as "Final" were presented to the Auditor-Controller on January 10, 2007 by previous Plan Administrator staff "responding to your previous question" asked of the previous Plan Administrator. It was not disclosed that the contractor did not issue the reports, nor that the provided reports were issued after the Grand Jury report was issued. On the contrary, included with the response was the sentence; "AON Consulting did issue final reports regarding the operational audit they conducted for the 457 Deferred Compensation Plan."

- The so-called "Final" reports were virtually the same as the "Draft" reports, including the dates; one dated May 25, 2005 and the other dated June 22, 2006. The only difference is that the word "Draft" was removed from the reports.

As a professional auditor, I have seldom, if ever seen a more egregious combination of; a poorly managed contract, an utter disregard for professional auditing principles, disingenuous responses to questions asked by an elected County Official and a complete waste of taxpayer dollars. The cost of these two reviews is in excess of $35,000.

What is worse, one of the basic reasons the taxpayers in this County go through the expense and process of electing an Auditor-Controller was circumvented; that being to ensure that audits and audit services are conducted in a professional and independent manner, making government more transparent. Therefore, to better serve the citizens of the County:

- The Office of the Auditor-Controller will implement a policy, with Board approval, requiring all audit and review contracts and services are under the direction and control of the Office of the Auditor-Controller. This type of policy is already in place in many California Counties.

R 8.3 – The County should provide additional information to County employees regarding participation in the plan.

The recommendation has been implemented.

The new Plan Administrative Committee has and continues to work with Great West to inform County employees regarding participation in the plan.

R 8.4 – The new County plan administrator should continue to aggressively administer the plan according to County regulations.

The recommendation has been implemented.

As indicated above, significant improvements to the plan have already been implemented, and the Plan Administrative Committee plans to continue to aggressively administer and improve the plan.