



County of Orange

County Executive Office

September 10, 2019

Honorable Kirk H. Nakamura
Presiding Judge of the Superior Court of California
700 Civic Center Drive West
Santa Ana, CA 92701

Subject: Response to Grand Jury Report, "If It Ain't Broke, Don't Fix It"

Dear Judge Nakamura:

Per your request, and in accordance with Penal Code 933, please find the County of Orange response to the subject report as approved by the Board of Supervisors. The respondents are the Orange County Board of Supervisors and the County Executive Office.

If you have any questions, please contact Lala Oca Ragen of the County Executive Office at 714-834-7219.

Sincerely,

Frank Kim
County Executive Officer

Enclosure

cc: Orange County Grand Jury
Lala Oca Ragen, Assistant Deputy Chief Operating Officer, County Executive Office



**Responses to Findings and Recommendations
2018-19 Grand Jury Report:**

“If It Ain’t Broke, Don’t Fix It”

On June 18, 2019, the Grand Jury released a report entitled “If It Ain’t Broke, Don’t Fix It.” This report directed responses to findings and recommendations to the Orange County Board of Supervisors (Board) and the Auditor-Controller. Below is the response from the Board; the Auditor-Controller will be filing its response separately.

FINDINGS AND RESPONSES:

F2. The need for the Auditor Controller’s “Community and Government Relations” team has been questioned by the Board of Supervisors.

Response: **Agrees with the finding.** The Orange County Board questioned the need for these positions and took action on June 26, 2018, to reduce funding totaling the amount required for five positions with the working titles of Director of Community & Government Affairs, Legislative & Analytics Manager, Public Information Officer, Executive Communications Manager, and Executive Assistant effective July 1, 2018. These positions did not have direct oversight, or duties aligned with, accounting or auditing.

F3. The Grand Jury has determined that the Board of Supervisors had the right to take the action it did. However, independence, transparency and accountability may be flawed in a structure where people report to those that are being held accountable.

Response: **Disagrees partially with the finding.** It is undisputed that the Board had the right to take the action it did. Specifically, the Board serves as the constitutional governing board of the County of Orange (County), and has a duty under Government Code section 25303, to supervise the conduct of all County officers to ensure faithful performance of their duties, and to require County officers to make reports and present their books and accounts for inspection. Moreover, managing the County’s financial affairs is entrusted to the Board, and under the County Budget Act, the Board is responsible for adopting the County’s annual budget.

However, in regard to independence, transparency, and accountability being flawed in a structure where people report to those who are being held accountable, the Board

disputes this part of the finding. The Board contends that the exact opposite is true because the Auditor-Controller's office performs extensive management duties for the County's accounting, financial, and core business systems functions. In effect, if internal audit was under the Auditor-Controller, the Auditor-Controller's office would be auditing itself. For context:

- Budget: The Auditor-Controller's Fiscal Year 2019-20 budget has 433 budgeted positions and budgeted appropriations totaling \$31.5 million broken out by Auditor-Controller (\$16.6 million), CAPS+ Centralized Support (\$11.4 million), and Property Tax System Centralized Support (\$3.5 million).
- Central Accounting Operations: The Auditor-Controller serves as the Chief Accounting Officer for the County. The Auditor-Controller performs many centralized accounting services such as general ledger, accounts payable and disbursements, payroll, financial reporting, cost, revenue, budget, capital assets, etc. and is responsible for setting Countywide accounting policies and maintaining the County's key accounting processes and systems.
- Property Taxes: Property taxes are a significant revenue source for the County, cities, schools, special districts, etc. Each year, the Auditor-Controller allocates and distributes about \$6 billion in property taxes.
- Satellite Accounting Operations: The Auditor-Controller provides accounting services (known as Satellite Accounting) under agreements to seven County departments including some of the largest departments, such as Health Care Agency, Social Services Agency, John Wayne Airport, and OC Waste & Recycling.
- Information Technology Systems and Support: The Auditor-Controller has its own Systems Operations Division that supports and maintains several key enterprise systems including CAPS+ Financial and Purchasing, CAPS+ Human Resources and payroll.

Generally Accepted Governmental Accounting Standards (GAGAS) require that in all matters, auditors and audit organizations be independent from the audited entity. In addition, the Institute of Internal Auditors (IIA) standards state that organizational independence is effectively achieved when the chief audit executive reports functionally to the Board. This includes the Board approving decisions regarding the appointment and removal of the Chief Audit Executive. The IIA standards also state that a conflict of interest is a situation in which the internal auditor, who is in a position of trust, has a competing professional or personal interest. The Countywide Controller's extensive management duties as described above present, exactly, this kind of conflict.

Because of this, the optimal positioning of the Internal Audit function is under the Board, as a separate, independent department with a primary mission of providing auditing services and no other operational or management duties. For Fiscal Year 2019-20, 31% of the reviews included in Internal Audit's Audit Plan directly relate to the Auditor-Controller's office or areas in which the Auditor-Controller's office is involved. In addition, in the last five years, over half (51%) of internal audits conducted directly related to the Auditor-Controller office or areas in which the Auditor-Controller's office is involved.

For Internal Audit to report to the Auditor-Controller with both management responsibilities and accounting and financial duties, while being subject to audit, presents a clear conflict of interest. For these reasons, the restructuring of Internal Audit demonstrates the independence, transparency and accountability that could not otherwise be achieved under the previous reporting relationship, while at the same time improving the independence, transparency, and accountability in the Auditor-Controller's office.

In addition, a previous Orange County Grand Jury issued a report supporting Orange County's model where internal audit is a separate function reporting directly to the Board. Most recently, the 2007-08 Grand Jury recommended that "the Internal Audit Department remain independent and continue to report directly to the Board of Supervisors. The Grand Jury found that the current organizational reporting structure provides maximum auditor independence and reinforces Board accountability for the financial security of the County."

F4. The Grand Jury found no evidence of inefficiency in the Auditor Controller's office prior to realignment of the Internal Audit Department to the Board of Supervisors.

Response: Disagrees wholly with the finding. As previously mentioned, the Board reduced funding totaling the amount required for five positions with the working titles of Director of Community & Government Affairs, Legislative & Analytics Manager, Public Information Officer, Executive Communications Manager, and Executive Assistant effective July 1, 2018. These positions did not have direct oversight, or duties aligned with, accounting or auditing.

In addition, the realignment of Internal Audit requiring it to report to the Board, the highest authority with no direct operational or management duties, aligned the internal audit function with both GAGAS and IIA standards. This improves the effectiveness of the function by making it more independent, transparent, and accountable.

Thus, the July 1, 2018 realignment of Internal Audit as an independent body addressed the previous inefficiencies and conflict of interest that are inherent in an auditor-controller's direct management of the audit function. The Auditor Controller's prior direct management of the Internal Audit function did not ensure Board supervision of all County operations in fulfillment of its County stewardship and leadership responsibilities. These include proper authorization for the use of public resources including the County logo, an objective review and timely processing of Board-requested payments and ability to conduct an unqualified independent audit of the County's financial and accounting activities.

F5. Realignment of the Internal Audit Department from the Auditor Controller to the Board of Supervisors has reduced staff mobility and cross training and may have adversely affected morale.

Response: Disagrees wholly with the finding. It is important to note that Internal Audit existed as a department from 1995-2015. In 2015, the Board approved

the transfer of the internal audit function to the Auditor-Controller's office, where it remained until 2018. In June 2018, the Board voted to reestablish Internal Audit as a separate department.

Based on a 2019 survey conducted of Internal Audit staff, staff have indicated there is increased transparency, independence, and accountability by having Internal Audit as a separate department. Furthermore, Internal Audit has taken the steps to establish a cross-training program within the department. Functional auditors will work on projects with Information Technology auditors and vice versa. This increases employee morale by enabling auditors to learn new skills and increase their value.

In terms of mobility, Internal Audit Department auditors have not regularly transferred to controller functions. However, Internal Audit continues to recruit talented accountants. For example, three of the last four Senior Auditors hired by Internal Audit were accountants promoted from the Auditor-Controller's office.

F6. Fifty-seven counties in California have combined departments of the Auditor-Controller and Internal Audit; Orange County is the only county to have separate Auditor Controller and Internal Audit Offices, raising a question of efficiency and effectiveness.

Response: **Disagrees partially with the finding.** Although Orange County is the only California County with separate Auditor-Controller and Internal Audit offices, upon closer examination of the structures of audit and controller functions within California counties, Orange County is not the only county with an audit function ultimately reporting to the Board. In addition, some of the smaller counties in California do not even have formal internal audit functions.

As of 2019, ten (17%) of the 58 California counties have internal audit functions that ultimately report to the Board through either an appointed Auditor-Controller or Chief Executive Officer. This reporting structure is followed by Los Angeles County and San Diego County, the two largest counties by population, with Orange County being the third largest. Furthermore, the five largest counties by population in the United States outside of California (Cook, Harris, Maricopa, Miami-Dade, and Dallas) have structures similar to Orange County wherein the audit function ultimately reports to the highest governing body. In addition, three of those counties (Cook, Maricopa, and Miami-Dade) have the same structure as Orange County with separate internal audit functions with no controller duties reporting directly to the highest governing body.

In terms of efficiency and effectiveness, as stated above, relevant auditing standards require that in all matters, auditors and audit organizations be independent from the audited entity. This type of organizational independence is effectively achieved when the chief audit executive reports functionally to the Board. Because of this, we continue to believe that the optimal positioning of the Internal Audit function is under the Board as a separate department with a primary mission of providing auditing services and no other operational or management duties. In addition, there is no duplication of effort or

inefficiencies as a result of a separate Internal Audit Department as the roles and responsibilities of the two departments do not overlap.

F7. Disagreements between the Board of Supervisors and the Auditor Controller's Office over Supervisor mailers and a controversial pension payment were argued in the public arena, creating public dismay as well as distrust between the departments.

Response: **Disagrees wholly with the finding.** During a regularly scheduled meeting a Department/Agency head or designated representative may be called upon for discussion for item on the agenda, if opinions expressed are different from any Board member, the resulting Board actions are not invalidated at a meeting/public forum that is held in conformance with statutory authority. In addition, transparency is improved when issues are discussed in public meetings. No claims of public dismay or distrust were received.

RECOMMENDATIONS AND RESPONSES:

R1. By September 30, 2019, the Board of Supervisors should reevaluate the effect of the realignment on efficiency, effectiveness, staff and the public perception. (F1, F2, F3, F4, F5, F6, F7)

Response: **The recommendation will not be implemented because it is not warranted or is not reasonable.** By a majority vote, on June 26, 2018, the Board already decided it was more effective to re-establish the Internal Audit Department independent from the Auditor-Controller, reporting directly to the Board effective July 1, 2018. That action of the Board reflects its statutory duty to supervise the official conduct of all County officers to ensure they faithfully perform their duties and may require them to make reports and present their books and accounts for inspection. Managing the County's financial affairs is entrusted to the Board and is an essential function of the Board.

R2. By September 30, 2019, the Board of Supervisors should provide the public with an explanation for Orange County remaining unique among California's 58 counties. (F6).

Response: **The recommendation will not be implemented because it is not warranted or is not reasonable.** As previously stated, although Orange County is the only California County with separate Auditor-Controller and Internal Audit offices, Orange County is not the only county with an audit function ultimately reporting to the Board. Please refer to the Board's response above to finding F6 as inaccurate. Specifically, as of 2019, ten (17%) of the 58 California counties have internal audit functions that ultimately report to the Board through either an appointed Auditor-Controller or Chief Executive Officer. This reporting structure is followed by Los Angeles County and San Diego County, the two largest counties by population, with Orange County being the third largest. Furthermore, the five largest counties by population in the

United States outside of California (Cook, Harris, Maricopa, Miami-Dade, and Dallas) have structures similar to Orange County wherein the audit function ultimately reports to the highest governing bodies. In addition, three of those counties (Cook, Maricopa, and Miami-Dade) have the same structure as Orange County with separate internal audit functions with no controller duties reporting directly to the highest governing bodies.

In addition, Orange County's internal audit structure is in compliance with relevant auditing standards that require that in all matters, auditors and audit organizations be independent from the audited entity, and that organizational independence is effectively achieved when the chief audit executive reports functionally to the Board.

R3. By September 30, 2019, the Board of Supervisors and County elected officials should discuss and resolve differing opinions in a constructive and professional manner, without airing disagreements in a public forum. (F1, F2, F7)

Response: **The recommendation will not be implemented because it is not warranted or is not reasonable.** Rule 42 of the Board Rules of Procedure states that a Department/Agency head or designated representative with a matter on the agenda shall be available "for the purpose of providing information to the Board and shall attend any Board meeting when requested to do so by a Board member or the CEO or when, in the judgment of the Department/Agency head, the Board will probably require additional information." The Rules of Procedure are adopted pursuant to Government Code section 25003 and "are intended to expedite transaction of the business of the Board in an orderly fashion." As such, if during a regularly scheduled meeting a Department/Agency head or designated representative is called upon for discussion and expresses opinions that are different from any Board member, the resulting Board actions are not invalidated at a meeting/public forum that is held in conformance with statutory authority. In addition, transparency is improved when issues are discussed in public meetings. Thus, it is the Board's regular practice to discuss and resolve differing opinions among Board members and County officials in accordance with Rule 42 of the Board Rules of Procedure.

R4. By September 30, 2019, the Board of Supervisors should reevaluate their decision to remove \$1 million from the Auditor Controller's budget and reallocate some or all of those dollars back to the Auditor Controller in order to fully staff the department and complete an Action Plan based on the Values Institute work on morale. (F3, F5)

Response: **The recommendation will not be implemented because it is not warranted or is not reasonable.** The Board of Supervisors adopted the FY 2019-20 Budget on June 25, 2019. Managing the County's financial affairs is entrusted to the Board and is an essential function of the Board.