

2002-2003 SANTA CLARA COUNTY CIVIL GRAND JURY

REVIEW OF AUDITS AND FINANCIAL REPORTS

Summary

The 2002-2003 Santa Clara County Civil Grand Jury (Grand Jury) examined documents received from government entities throughout the county. Among these were:

- financial reports
- audited financial statements
- budgets
- audit reports

It conducted a review of the activities of all city internal auditors. As a result of its reviews, the Grand Jury has several findings and recommendations.

Background

The Grand Jury reviews the financial reports and statements to determine whether or not they have been issued. An assessment is made of their timeliness and completeness.

A. Terms Defined

Specialized terms are used in this report, and in the interest of clarity, the following simplified definitions are offered:

- Comprehensive Annual Financial Report (CAFR): A legally mandated annual financial report defined by the Government Accounting Standards Board that includes all the income, expenses, special funds, or designated funds that are part of a government entity's financial activities.
- Government Accounting Standards Board (GASB): The national accountancy board that establishes the standards to be used in all governmental accounting.
- Special Districts: These are special districts that have taxing authority. The district is governed by a board of directors, which may be a city or town council. A special district may be a part of a city or cut across city lines. Some enterprise funds (funds that charge a fee for

facilities or services) are special districts. For example, the Loma Prieta Resource Conservation District is a special district. The California State Controllers Office lists 32 functions for special districts.

- Joint Powers Agencies (JPA): These agencies cross geopolitical boundaries to address a common responsibility. They are governed by representatives from the government entities sharing their authority. Several cities getting together to jointly provide a wastewater treatment system or expanded library facilities are examples of a JPA. School districts getting together to jointly provide student transportation services is also a JPA.
- Management Reports and Process Audits: In addition to financial reports, the Grand Jury reviewed the results of management reports and process audits. Management reports are overviews with general recommendations. Process audits involve the testing of a system with specific recommendations. For example, a management report states that the system for reviewing timecards allows unsigned timecards to be entered into the payroll records. A process audit indicates that 12% of the timecards are not signed by the employee, and that 20% are not signed by the supervisor. A recommendation on a process audit is specific, such as; *change the policy to return all unsigned timecards to the supervisor's manager for action.*

B. Comprehensive Annual Financial Reports

As part of its watchdog responsibilities, the Grand Jury annually receives copies of the legally mandated CAFRs for the county, the cities and towns within Santa Clara County, and a limited number of JPAs and special districts.

This fiscal year was the first year that government agencies with revenues in excess of \$100 million were to comply with the requirements of Statement 34 of the GASB. As noted, GASB is a national standards board that defines the accounting practices and reporting standards of government agencies in California. Statement 34, issued in June 1999, requires government entities to provide budget, budget performance and comparison information, a management discussion and analysis section, and the current value of capital assets in their CAFRs. The Grand Jury examined CAFRs and their compliance with Statement 34. Statement 34 information adds to the usefulness of the reports, but does require additional review time.

The Grand Jury received 14 CAFRs. Eight entities had revenues in excess of \$100 million and thus were required to meet the GASB Statement 34 requirements in their latest annual reports. The eight were Santa Clara County, the Santa Clara Valley Water District, the Santa Clara Valley Transportation

Authority, and the cities of Mountain View, Palo Alto, San Jose, Santa Clara, and Sunnyvale. Several entities indicated within their CAFRs that they were still working to finalize such items as the current value of capital assets.

Based on the size of their revenue, Gilroy and Monte Sereno are not required at this time to provide CAFRs. Therefore, they submitted audited financial statements. Two entities, Los Altos and Los Altos Hills, did not have their final reports available. (See Table 1 below)

TABLE 1

Comprehensive Annual Financial Reports Received

<u>ENTITY</u>	<u>REPORT</u>
Campbell	CAFR
Cupertino	CAFR
Gilroy	Statement
Los Altos	Not available
Los Altos Hills	Not available
Los Gatos	CAFR
Milpitas	CAFR
Monte Sereno	Statement
Morgan Hill	CAFR
Mountain View	CAFR
Palo Alto	CAFR
San Jose	CAFR
Santa Clara	CAFR
Saratoga	CAFR
Sunnyvale	CAFR
Santa Clara County	CAFR

Santa Clara County Water District	CAFR
Santa Clara Valley Transportation Authority	CAFR

C. Budgets

As already noted, under the guidelines of GASB Statement 34, reporting government entities must provide budget and budget performance information in their CAFRs. Based on the phasing requirements of Statement 34, entities with revenues in excess of \$100 million are required to include this information in the 2001-2002 report. This year, the Grand Jury requested budget information along with the other reports. The Grand Jury used these publications for reference in the course of its oversight function. Budgets were received from:

- Campbell
- Mountain View
- San Jose
- Santa Clara
- County of Santa Clara (Preliminary only)

This year, budgets were not required of the other cities in the county as their prior year revenue did not exceed \$100 million.

D. Audits

The Grand Jury did not routinely request audit information from school districts or JPAs, with the exception of the Santa Clara Valley Transportation Authority. A limited number of special district reports were requested. Appendix A is a list of audit reports received and reviewed by the Grand Jury.

Each audit report was reviewed to determine if any additional action or follow up by the Grand Jury would be beneficial. Eighteen reports required follow up (see Follow-up column in Appendix A). Follow up actions included Grand Jury requests for additional information, responses, implementation schedules, or referral to future Grand Juries for further inquiry.

E. Internal and Independent Auditors

The Grand Jury surveyed the county's cities and towns to determine what level of internal or independent audits were routine to each city. For the first time, the Grand Jury requested that all cities and towns provide their process audits and

management reports. The Grand Jury received and evaluated sixty-eight audits of all types (see Appendix A).

There is an internal auditor for the County of Santa Clara. The internal auditor for the County of Santa Clara is used to audit state and federal grants, as is required by those grants.

Of the 15 cities and towns within Santa Clara County, only Palo Alto, San Jose and Sunnyvale have internal auditors. San Jose and Palo Alto auditors report directly to their city councils in open meetings. Sunnyvale's internal auditor is under the oversight of the city manager.

When the internal auditor reports directly to the city council in open meetings, the public is fully aware of the actions of the auditor, including the reasons for a recommendation to expand or terminate an audit. All reports and recommendations made, along with the staff responses, become part of the public record. There is no requirement for meetings between the city manager and his staff to be public.

In addition, the City of Santa Clara has established the function of city auditor and assigned it to the city clerk's office. This function is limited to independently verifying support data for disbursements, but does not provide any process audit.

All entities which were checked used independent auditors for their annual reports. Entities without internal auditors used independent auditors or oversight agencies for audits of specific funds or functions. The Grand Jury found the smaller entities had determined the hiring of a full-time internal auditor was not fiscally feasible and relied on contracted independent auditors for selected process audits.

F. Conclusions

The process audit information gathered gives the Grand Jury confidence that reasonable efforts are being made to provide the citizens of the county with efficient and responsive services. There are indications that stronger support for the implementation of audit recommendations by the appropriate governing boards would lead to even greater improvement in services and programs. Examples from the cities of Palo Alto and San Jose audit recommendation status reports follow:

- Palo Alto report of September 2002 lists 53 recommendations, 29 of which were holdovers from the November 2001 report. Four recommendations (7.6%) have been implemented, of which two are from 1997 and two from 1999. The balance, 49 (90.7%), are "in process," with eight from April 1998.

- The San Jose report of the 6 months ending December 31, 2002 shows 94 recommendations not yet implemented. The earliest of these is from 1988. Of these 94 recommendations, 22 (23.4%) have been implemented, 57 (60.6%) are only partially implemented and 13 (13.8%) have not been implemented. One was rejected and one, from 1995, continues to be deferred.

Finding I

The internal auditor for the City of Sunnyvale reports to the city manager. Two management/performance audits were terminated in the early stages because of the need for major restructuring of the departments under audit. These were the audits of the Transportation Operations Department and the Roadside and Median Right-of-Way Services Department. Since the audits were terminated without the public receiving the information that would have been available with a direct report to the city council by an independent internal auditor, the public has limited ability to evaluate the operations of the departments and the effectiveness of the restructuring. Not reporting to the city council in open forum provides an opportunity for public perception of a cover up, which negates the value of internal auditors as independent evaluators.

Recommendation I

The Grand Jury recommends that the City of Sunnyvale have the internal auditor report directly to the City Council.

Finding II

The City of Santa Clara has designated a city auditor function and assigned it to the city clerk, who is independently elected. Current auditing activities are limited to verification of expenditures and associated documentation.

Recommendation II

The Grand Jury recommends that the City of Santa Clara expand the responsibilities of the city auditor function to include internal audit responsibilities and separate this function from the office of the city clerk.

Finding III

Seven cities/towns did not provide the Grand Jury with management reports or process audits. They are:

- Campbell
- Gilroy
- Los Altos
- Los Altos Hills
- Los Gatos
- Monte Sereno
- Santa Clara

Milpitas submitted a single audit on internal financial controls.

The failure of the smaller cities/towns to perform regular management reports or process audits is understandable. However, for our more moderate-sized or larger cities, such as Campbell, Gilroy, Milpitas and Santa Clara, to ignore these tools of good management is to overlook potential improvements in providing high quality, efficient services to their citizens.

Recommendation III-1

The Grand Jury recommends that all cities or towns that do not currently include the Grand Jury on their routine distribution list for financial reports, CAFRs, budget, and audit reports add the Grand Jury to their list.

Recommendation III-2

The Grand Jury recommends that the cities of Campbell, Gilroy, Milpitas and Santa Clara implement a program of process audits and process adherence, providing copies of the audits and staff responses to the Grand Jury.

Recommendation III-3

The Grand Jury recommends that Los Altos, Los Altos Hills, Los Gatos, and Monte Sereno develop plans for the review of procedures and compliance, providing the information, results and recommendations to the Grand Jury.

PASSED and **ADOPTED** by the Santa Clara County Civil Grand Jury on this 29th day of May, 2003.

Fred de Funiak
Foreperson

Ron R. Layman
Foreperson Pro Tem

Patricia L. Cunningham
Secretary

APPENDIX A

FY 2002-2003 AUDITS, FINANCIAL REPORTS AND LETTERS RECEIVED

ENTITY OR FUND	DEPT	TYPE	Recmd	Follow Up
County				
Controller Audit	Controller	IA		Y
Professional Group, Valley Health Svcs	SCVHHS	IA	6	
Data Center Operations	SCVHHS	IA	7	
Employee Benefits	HR	Mgmt	9	Y
Grants				
Juvenile Crime Enforcement	Probation	IA	5	Y
Auto Insurance Fraud	DA	IA		
Organized Auto Fraud Interdiction Prog.	DA	IA		
Workers Comp. Fraud	DA	IA		
Funds				
SCC Law Library		IA		
Child Development Program	Soc Svcs	IA		
School Districts				
Gavilan Joint Community College District		Fiscal	5	
Joint Powers Agencies				
Santa Clara Valley Water District		CAFR		
Special Districts				
Loma Prieta Resource Conserv. Dist.		Fiscal		N
Saratoga Public Financing Authority		Fiscal		
Burbank Sanitary District		CAFR		
Saratoga Cemetery District		Fiscal		
CITY OF CUPERTINO				
Single Grant Audit	Finance	IA		
Cupertino RDA	RDA	IA		
CAFR Mgmt Letter	Finance	IA		
CITY OF MILPITAS				
Internal Control Structure	Finance	Fiscal	1	
CITY OF MORGAN HILL				
Morgan Hill RDA Housing Fund Requirements	RDA	Mgmt	3	
Morgan Hill Police Property & Evidence Op's	Police	Mgmt		Y
Board of Corrections Insp. of MH Holding Fac.	Police	Mgmt	3	
Development Process Services	Comm Dev't	Mgmt	39	Y
Health Inspection of Morgan Hill Holding Facility	Police	Mgmt	3	
Risk Management Audit	Finance	Mgmt	26	Y
CAFR Management Report	Finance	Fiscal	3	Y
CITY OF MOUNTAIN VIEW				
Foothill Disposal Co. Compliance Audit	City	Mgmt		
Cash Handling Procedures 1999	Various	Study	16	
Cash Handling Procedures 2002	Various	Mgmt	15	
Library Organization Review	Library Svcs	Mgmt	58	

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FY 2002-2003 AUDITS, FINANCIAL REPORTS AND LETTERS RECEIVED

ENTITY OR FUND	DEPT	TYPE	Recmd	Follow Up
CITY OF PALO ALTO				
Utility Risk Mgmt Procedures	Utilities Op's	Mgmt	24	Y
Contract Processing Times		Study		
Internal Control Structure	Finance	Mgmt	7	Y
Compliance with Prop 111	Finance	Mgmt		
Public Improve Corp. FY2001 & 2002	Finance	Fiscal		
Regional Water Quality Control Plant FY 2001	Finance	Fiscal		
Cable Coop Franchise Year End 2000 & 2001	Finance	Fiscal		
Bicycle/Ped FY2000 & 2001	Finance	Fiscal		
Payroll Procedures & Practices	Finance	Fiscal	10	Y
CITY OF SAN JOSE				
Cash Handling/Refund	Building	Mgmt	6	Y
Customer Service Call Center	Admin	Mgmt	2	
Petty Cash & Change Funds	City Hall	Mgmt		
Property Mgmt Operations	Public Works	Mgmt	12	Y
Rental Dispute Program	Neigh Svcs	Mgmt	6	
San Jose Arena Mgmt		Mgmt	8	
San Jose Office of Equality Assurance	OEA	Mgmt	10	
Hayes Renaissance Center Compliance with Agreement		Mgmt	3	Y
Survey of Real Property Inventory		Mgmt		Y
Neighborhood Clean-Up Program	Planning	Mgmt	7	
Project Technology Education (Tech Q III)				
Vehicle Replacement Program	Gen Svcs	Mgmt	15	
CITY OF SARATOGA				
CAFR Mgmt Report	Finance	Fiscal		
CITY OF SUNNYVALE *				
Review Program 763 Status	PW, Fleet Svcs	Review		
Sun/GIS One Stop Permitting			30	
Cable TV	TCI Cable		14	
Housing Division Operations	Housing	Mgmt	9	Y
Federal Equitable Sharing Program 2001, 2002	Housing	Fiscal		
Mini Program Performance	Public Works	Review	4	
Standby Processes	PW, Bldg, IS	Mgmt	9	Y
Library Collection Program 636	Library	Mgmt	8	
Library Services Program 637	Library	Mgmt	3	
Library Learning Program 638	Library	Mgmt	9	
Cash Receipts Process				Y
Purchasing Card Review				
OTHER AGENCY AUDITS				
Juvenile Confinement Facilities		Inspection		
*The City of Sunnyvale had two audits that were not completed: Transportation Operations Audit was halted pending reorganization, and Accounts Payable was never completed.				

Appendix Key

Column headings:

Entity or Fund	Name of audit report
Dept	Department included in the audit
Type	Type of report
IA	Internal Audit
Fiscal	Financial Audit only
Mgmt	Management or process audit
CAFR	Comprehensive Annual Financial Report
Study	Study with recommendations
Review	Review of status of recommendations
Inspect.	Inspection report
Recmnd	Number of Recommendations in Audit Report
Follow-up	Follow-up actions by Grand Jury