

# **INTERNAL CONTROLS IN THE COUNTY OF SANTA BARBARA**

## **SUMMARY**

The 2017-18 Santa Barbara County Grand Jury (Jury) received a request for investigation about the County of Santa Barbara's (County) system of internal controls following the fraud perpetrated in the Department of Public Works that came to light in September 2017. The Jury investigated the internal controls of the County.

Despite the clean audit opinions on the finances of the County of Santa Barbara provided over many years by independent auditors, the 2017-18 Santa Barbara County Jury found significant residual risks to the County's finances. The Jury found significant control risks in the County's management of its financial resources. These risks occur from the failure of elected officials and department heads to promulgate, apply and integrate financial management guidelines and IT systems in a consistent and fully rigorous manner and to hold staff accountable in financial management. The Jury also learned that financial training of some staff in some divisions and/or departments is lacking.

## **METHODOLOGY**

The Jury reviewed numerous documents including, but not limited to, the Consolidated Annual Financial Reports (CAFR) from fiscal years (FY) 2013-14 through 2016-17, the County's budgets for FY 2017-18 and 2018-19. Also reviewed were County guidelines and policies on various financial matters, and a version of a loss report on the fraud contracted by the Auditor-Controller. The Jury interviewed current and former staff from the Office of the Auditor-Controller, the Sheriff's Office, the Fire Department, the Department of Behavioral Wellness, the Department of Public Works (DPW), and the County Executive's Office. The Jury also interviewed several elected officials.

For this report, the Jury defines the following terms:

- "Financial staff" - anyone who manages funds of the County of Santa Barbara.
- "2015 Internal Control Guidelines, California Local Agencies" (CA Guidelines) - the guidelines published by the State Controller, per California Government Code, section 12422.5.
- "Internal Control Policy" - the document issued by the Office of the Auditor-Controller to all "Agencies, Departments and Districts governed by the Board of Supervisors," effective March 2018, which serves to "communicate and document the Internal Control Policy for the County of Santa Barbara."
- "2017 DPW Fraud" - the discovery, investigation, indictment, and arrest of suspects in the theft of approximately \$2 million from the DPW.
- "The Loss Analysis" - the report examining the 2017 DPW Fraud.
- "FIN" - the Financial Information Network, an IT system used to manage public finance in the County.

## **INTERNAL CONTROLS IN THE COUNTY OF SANTA BARBARA**

- “ERP” - Enterprise Resource Planning software, commonly applied to such business processes as human resources, finance and accounting, service provision, and technology management.

### **OBSERVATIONS AND ANALYSIS**

#### **Risks Posed by the Financial Structure of the County**

The structuring of the County Government into 26 departments, five of which are led by elected officials, creates management costs, which lead to control risks. The division of fiduciary responsibility in the County government, among and between elected and appointed officials, creates substantial management costs and hence substantial control risks. The size and complexity of revenues and expenses in the County’s budget create potential financial control risks

The County’s average annual revenue in FYs 2015-16 and 2016-17 was approximately \$900 million. This revenue consisted of service charges (27 percent), grants and other contributions (40 percent), and various taxes (33 percent), of which property taxes (29 percent of all revenue) were the largest. The heavy reliance on property taxes, and the way those taxes are managed by an independent software module in the County’s overall financial management system, create fiduciary risks specific to the management of that source of public revenue. The Jury was informed that there may be a potential for fraud in reimbursements of property taxes made through County Assessor’s and Treasurer’s Offices. Transparent management of potential property tax reimbursements related to the Thomas Fire and Debris Flow is another related issue. A similar potential for fraud may exist because FIN does not provide any reconciliation between the court-ordered warrant payments (through the Sheriff’s Civil Bureau) and the payments made by the Auditor-Controller’s Office.

The majority of “grants and other contributions” (line items on the financial reports) are from the State and Federal Governments and must be managed and audited separately from other revenues. The single audit report (a compliance audit of federal awards to the County and other funds passed through California state agencies) of 2016-17 noted the spending of \$137.8 million from federal awards, including loans to the County. Because such awards are subject to the single audit, in the opinion of the Jury, they probably receive greater attention from County management because of the need to maintain credibility with federal and state granting agencies.

The County’s average spending in 2015-16 and 2016-17 was approximately \$842 million.<sup>1</sup> Nearly 90 percent of spending was in three principal groups: “Public Safety” (composed of the District Attorney’s office, the Public Defender and the Probation Department, the Sheriff’s Office, and the Fire Department); “Health and Public Assistance” (composed of Behavioral Wellness, Child

---

<sup>1</sup> Pensions for County employees are managed by the independent Santa Barbara County Employees Retirement System (SBCERS), which has a separate Board from that of the County Board of Supervisors, independent management, and a separate audit.

## **INTERNAL CONTROLS IN THE COUNTY OF SANTA BARBARA**

Support Services, Public Health, and Social Services); and “Community Resources and Public Facilities” (composed of the Community Services and Public Works Departments). The number of small programs and individual transactions create complex financial management costs<sup>2</sup> in the areas of Public Safety (35 percent of expenses), Health and Public Assistance (43 percent of expenses). The Jury notes that salaries and benefits for the three principal groups averaged more than 60 percent of annual expenses for the entire County; the amount of county spending on salaries and benefits and personnel contracts creates a higher likelihood of financial management risks, such as the creation of fictitious employees or fictitious vendors. Another potential for fraud may exist because FIN does not provide any reconciliation between the court-ordered warrant payments (through the Sheriff’s Civil Bureau) and the actual payments made by the Auditor-Controller’s office.

Moreover, the Jury finds that a lack of standardization of qualifications of financial management personnel across the various County departments creates other control risks. Examples are differences in academic qualifications (no accounting degree for accounting positions), personal financial reporting requirements (such as bankruptcy), and scrutiny of potential conflicts of interest.

### **Risks Posed by the County’s Financial System**

The most important tool in the County’s financial system is the Financial Information Network (FIN), which was developed in the County Office of the Auditor-Controller (OAC) in the 1990s and has since been refined and managed in the OAC. Unlike some other governmental entities, the County does not use a single Enterprise Resource Planning (ERP) system to manage its finances. The FIN is used to manage most financial transactions in County Government, with the exceptions of accounts payable and receivable.

Independent audits of County finances, including the annual CAFR, the single audit reports, and the annual audits of Santa Barbara County Employee Retirement System (SBCERS), typically find few material deficiencies, as seen in the Jury’s review of the independent auditors’ management letters to the Santa Barbara County Board of Supervisors (BOS) over the fiscal years 2002-03 through 2016-17. The general audit finding of few material deficiencies indicates that the County is financially well managed. The 2016-17 Single Audit Report, prepared by an independent auditor, did note, however, some deficiencies in internal control related to the County’s FIN software system.

### **Financial Information Network**

Every staff person interviewed by the Jury acknowledged that FIN does not meet the everyday financial needs of their Department. Therefore, each operations department has created (or had created) a separate system to complement FIN. The cost of this duplication of effort cannot be estimated with precision but is likely significant. For example, two staff in the Auditor-

---

<sup>2</sup> For the purposes of this report, management costs are defined as the financial, time, and effort costs of supervising the work of others.

## **INTERNAL CONTROLS IN THE COUNTY OF SANTA BARBARA**

Controller's Office maintain FIN at the same time as staff in other departments maintain complementary systems.

The Jury was informed that FIN lacks many modern capacities of ERP software, including real-time review of transactions within programs and between managerial units, adequate error warnings, appropriate internal and external security features, and adequate reporting and accountability features.

Weaknesses in FIN identified by the Jury included, but were not limited to the following:

- There is no requirement for users to change their password. Many staff interviewed have never changed their password, despite working at the County for many years. As of the writing of this report, the Auditor-Controller's Office has not updated FIN to require periodic changes of passwords, even after investigation of the 2017 DPW fraud suggested this may have been a key element that allowed the fraud.
- Password requirements in FIN user accounts do not comply with the County's IT policies. Passwords are weak, are not required to change often enough, and are easily stolen.
- A key element that contributed to the fraud was the fact that there was no second approval (signature) required to create a temporary vendor number. A temporary vendor number is always 999999, which is assigned to a vendor, such as a consultant, supplying services to the County and is intended to be used for a single transaction; as such, there is no accumulation of payments by vendor.
- There is no "Encumbrance" feature in FIN that allows tracking of amounts committed against available amounts for a given fund.
- Almost every staff person interviewed listed as FIN's biggest failing the lack of accounts payable and accounts receivable features. Departments have usually had to create and maintain their own accounts payable and/or accounts receivable software outside the FIN system.
- A FIN session will never "time out."
- FIN does not allow for "fixed asset management."
- FIN lacks sufficient ability to run reports in real time.
- FIN lacks "full payroll integration" (ability to run payroll timesheet data with corresponding fiscal information).
- Staff in various County departments are unfamiliar with data recovery procedures in FIN and this unfamiliarity risks data loss, which may prevent the Auditor-Controller's Office from fulfilling its fiduciary duties.
- The Auditor-Controller has failed to implement a policy to manage upgrades in FIN. Upgrades are not consistently prepared, approved, documented or communicated to staff and these failures may put parts of the FIN network at risk.
- The source code of FIN is not adequately protected and might be at risk of fraud.
- A full and formal IT audit has never been done of the FIN.
- Not all managers and staff currently using FIN are required to sign an annual financial disclosure.

The Jury notes that many of the noted weaknesses of FIN result in costly duplications of efforts by staff in other departments.

## **INTERNAL CONTROLS IN THE COUNTY OF SANTA BARBARA**

Some staff observations concerning FIN were:

- It's "...an auditing system, not a budget system."
- "It's structured for the Auditor-Controller's Office to do the CAFR."
- Some program managers, division heads and other non-financial staff in the operational departments are not very well versed in FIN.
- "FIN was supposed to save money, but does not."
- "FIN is really just a 'check writing system'."
- "It's hard to modify FIN for any department."

The Jury notes that the County has not contracted an independent evaluation of the benefits and costs of acquiring, installing and maintaining financial management software from a major vendor.

### **Control Risks**

The 2017 DPW Fraud highlighted risks to public funds in the County of Santa Barbara. The Jury notes that many of these risks are inherent in the structure of public finance in the County, and others arise from specific management decisions, notably the continued use of the FIN system.

Based on its review of relevant documents and on many interviews with elected and appointed officials of the County, the Jury found significant control risks in the County's management of its financial resources. These risks occur from the failure of elected officials and department heads to promulgate, apply and integrate financial management guidelines and IT systems in a consistent and fully rigorous manner and to hold staff accountable in financial management. The Jury also learned from several interviewees that financial training and knowledge of some senior management in some divisions and/or departments was lacking, which creates financial risks, in that some did not fully understand the context and consequences of their actions.

Additional risks were found in the following areas:

- Applying the County's financial guidelines, where the Jury found a failure to use the County's financial rules in a consistent manner across the departments;
- Reporting within the departmental and County-wide administration, which does not follow a policy of requiring annual formal and written statements for financial transactions;
- Adequate knowledge of conflicts of interest among managers, some of whom were unaware of best practices in identifying and resolving conflicts of interest; and
- Failing to quickly apply lessons learned from the DPW Fraud as noted later in this report.

### **Potential Contributing Factors to the 2017 DPW Fraud**

The Jury notes that the following may have contributed to the 2017 DPW Fraud:

- The Internal Audit Division of the Auditor-Controller's Office was understaffed. Staffing had fallen from a high of ten full-time equivalent (FTE) positions before the 2008 Recession to five FTE positions, three of which were vacant at the time the fraud was discovered. In addition, although this division bears the day-to-day responsibility of auditing internal controls in other departments, several staff interviewed both within and outside the Auditor- Controller's Office, told the Jury that, unlike in some other counties where internal auditors are "hired in," it is a "training ground."

## **INTERNAL CONTROLS IN THE COUNTY OF SANTA BARBARA**

- Every department in the County is expected to have its own system of internal controls. Although some staff in the different operational departments were familiar with the CA Guidelines and County guidelines and tried to follow them, others were not as familiar.
- Although the Auditor-Controller's Office has issued guidelines over the years, the Jury learned that some of the guidelines were not readily available, including an outdated document on countywide internal controls. The Auditor-Controller has not routinely audited operational departments for compliance.
- Weaknesses in the Financial Information Network (FIN) may have contributed to the fraud.

### **Risk Mitigation After the 2017 DPW Fraud**

In the fall of 2017, following the discovery of the fraud, the Jury was informed by several senior staff interviewed that an outside consultant would be hired to conduct "an in-depth investigation into the strengths and weaknesses" of the internal controls within the County. An outside consultant was hired. However, the report issued by the consultant was not an "in-depth investigation into the strengths and weaknesses" of the internal controls within the County. It was a report to determine the amount of the fraud for insurance purposes. The Jury notes that the BOS has never required staff to commission such an evaluation by an outside agent.

The actions taken by County management in response to the 2017 fraud in the Department of Public Works were slow. Staff members were not required to change FIN passwords, temporary vendor numbers are still used even if there has been more than one transaction with the entity, and paper checks are still often used in place of ACH (Automated Clearing House) transfers, increasing the risk of theft or loss.

The Jury notes that several actions have occurred since the 2017 DPW Fraud and the subsequent Loss Analysis. These include, but are not limited to, quarterly meetings by the Auditor-Controller with the chief financial officers of the departments, and the issuance of an "Internal Controls Policy." In addition, DPW has given internal control training to its entire accounting staff, and DPW accounting supervisors and managers attended a webinar training on fraud and internal controls.

### **Other Observations**

Several staff interviewed were not familiar with the definition of "conflict of interest" and/or could not recall an example of a conflict of interest in their career.

The Jury notes based on its interviews with County staff that they believe the Internal Audit Division has a low priority with the County Executive Office and the BOS.

## **CONCLUSION**

Annual financial audits of the County of Santa Barbara are presented in the Consolidated Annual Financial Reports and in the "single audit" of intergovernmental funds passed through the State of

## **INTERNAL CONTROLS IN THE COUNTY OF SANTA BARBARA**

California and the Federal Government. The independent auditors' reports, which are part of the annual CAFR, typically conclude that the County's financial statements, including the single audit reports, present fairly the County's financial position in all material respects in accordance with generally accepted accounting principles.

Despite the clean audit opinions on the finances of the County of Santa Barbara provided over many years by independent auditors, the 2017-18 Santa Barbara County Jury found significant residual risks to the County's finances. These risks were in the areas of promulgating and applying guidelines for financial management, especially those on internal controls, lack of knowledge of financial management among some senior staff, and in the use of an outdated and incomplete financial management system that requires departments to write and maintain their own complementary software. Many of these failures may have contributed to a \$2 million embezzlement by a County of Santa Barbara employee discovered in 2017.

### **FINDINGS AND RECOMMENDATIONS**

#### **Finding 1**

The Internal Audit Division of the Santa Barbara County Auditor-Controller's Office had a funded and filled staff of 10 FTE prior to the 2008 recession. Just prior to the discovery of the 2017 fraud, the funded staff had fallen to 5 FTE, and only 2.5 of those were filled.

#### **Recommendation 1**

That the Auditor-Controller maintain the number of Internal Audit Division staff at the funded level.

#### **Finding 2**

The financial management guidelines issued by the County of Santa Barbara Auditor-Controller are not applied consistently in operational departments, nor is compliance with those guidelines routinely audited by the Auditor-Controller.

#### **Recommendation 2a**

That County Board of Supervisors direct staff to use the consistent application of financial guidelines issued by the Auditor-Controller's Office as part of the annual personnel management process.

#### **Recommendation 2b**

That the Auditor-Controller's Office establish an audit schedule for County administration at all levels to ensure their proper compliance with the County financial management guidelines.

#### **Recommendation 2c**

That the Santa Barbara County Sheriff, District Attorney, Auditor-Controller, Clerk Recorder-Assessor-Registrar of Voters and Treasurer-Tax Collector-Public Administrator require consistent application of financial guidelines issued by the Auditor-Controller's Office as part of the annual personnel management process.

## **INTERNAL CONTROLS IN THE COUNTY OF SANTA BARBARA**

### **Finding 3**

Knowledge of financial management and risks by managers in some departments in the County of Santa Barbara is insufficient.

### **Recommendation 3a**

That the Santa Barbara County Board of Supervisors direct staff to require training in financial management (including County financial guidelines, FIN, and reporting and accountability procedures) for all department and program heads.

### **Recommendation 3b**

That the County Board of Supervisors direct staff to make successful completion of this training a part of staff evaluations.

### **Recommendation 3c**

That the Santa Barbara County Sheriff, District Attorney, Auditor-Controller, Clerk Recorder-Assessor-Registrar of Voters and Treasurer-Tax Collector-Public Administrator direct all program managers to require mandatory training in financial management (including County financial guidelines, FIN, and reporting and accountability procedures) for all department and program heads.

### **Finding 4**

Knowledge of potential conflicts of interest among some senior County of Santa Barbara employees is inadequate.

### **Recommendation 4**

That the Board of Supervisors develop procedures for the conduct of annual training on conflict of interest policy for all relevant categories of employees.

### **Finding 5**

There is no consistent policy of requiring program heads, division heads, or department heads within Santa Barbara County departments to account for spending under their control to their superiors and/or to the CEO through an annual formal and written statement.

### **Recommendation 5a**

That the Santa Barbara County Board of Supervisors direct all program heads, division heads, and department heads to sign annual statements to their managers, stating that all funds under their control have been managed in compliance with County financial management guidelines and the County's Internal Control Policy.

### **Recommendation 5b**

That The Santa Barbara County Sheriff, District Attorney, Auditor-Controller, Clerk Recorder-Assessor-Registrar of Voters and Treasurer-Tax Collector-Public Administrator direct all program managers to sign annual statements to their supervisors, stating that all funds under their control have been managed in compliance with County financial management guidelines and the County's Internal Control Policy.

## **INTERNAL CONTROLS IN THE COUNTY OF SANTA BARBARA**

### **Finding 6**

The Jury found that the importance of the work of the Internal Audit Division within the Office of the Auditor-Controller and of internal controls generally has a low priority across County government.

### **Recommendation 6**

That the Board of Supervisors direct staff to incorporate performance measures into the budget process to highlight the importance of internal controls for every department in County government.

### **Finding 7**

It was stated by senior staff that a comprehensive investigation into the strengths and weaknesses of the internal controls in the County would be conducted by an outside consultant after the fraud; no such investigation took place.

### **Recommendation 7**

That the Board of Supervisors direct staff to contract a complete independent evaluation and audit of internal controls, including the issuance of an opinion on the effectiveness of such controls and recommendations for improvement.

### **Finding 8**

The Jury found that the actions taken by Santa Barbara County management in response to the 2017 fraud in the Department of Public Works were slow and inadequate.

### **Recommendation 8**

That the Santa Barbara County Board of Supervisors direct staff to issue a public report stating the steps taken and their effective dates to strengthen public financial management in the County following the 2017 Department of Public Works fraud.

### **Finding 9**

The Financial Information Network is an insufficient and inefficient system with many weaknesses that have caused most departments to create, or to have created, complementary financial software. Some of the weaknesses in FIN may have contributed to the 2017 Department of Public Works fraud.

### **Recommendation 9a**

That the Santa Barbara County Board of Supervisors direct staff to commission an independent evaluation of the benefits and costs of acquiring, installing and maintaining Enterprise Resource Planning software from a major vendor. The evaluation should:

- be procured competitively and should exclude any firm or individual that has previously worked with the County to avoid conflicts of interest;
- compare major software options, analyze where such options have been used in governments of comparable size to the County;

## **INTERNAL CONTROLS IN THE COUNTY OF SANTA BARBARA**

- present a full analysis of the costs of and benefits of current financial management software used in the Auditor-Controller's Office and throughout the County Government; and
- give a proper comparison to the costs and benefits of Enterprise Resource Planning software.

### **Recommendation 9b**

That the Enterprise Resource Planning evaluation be presented at an open session of the Santa Barbara County Board of Supervisors to allow public comment.

### **Recommendation 9c**

That all Santa Barbara County staff using FIN, or its eventual successor, submit annual financial disclosure.

### **Finding 10**

The Jury found that minimum professional and academic qualifications for financial staff positions are not standardized nor consistent throughout departments in Santa Barbara County.

### **Recommendation 10**

That policy throughout Santa Barbara County be standardized with respect to the minimum academic and other professional qualifications of financial staff.

### **Finding 11**

Some Santa Barbara County staff commented that there might be significant other potential financial risks in Santa Barbara County, including management of property tax reimbursements and warrant payments through the Sheriff's Civil Bureau.

### **Recommendation 11a**

That the Santa Barbara County Board of Supervisors direct staff to commission an independent audit of the property tax reimbursements made through the Santa Barbara County Assessor's Office during the past 10 years.

### **Recommendation 11b**

That the Board of Supervisors direct staff to commission an independent audit of civil warrant payments made through the County Sheriff's Office during the past 10 years.

## **REQUEST FOR RESPONSE**

Pursuant to *California Penal Code Sections 933 and 933.05*, the Santa Barbara County Grand Jury requests each entity or individual named below to respond to the enumerated findings and recommendations within the specified statutory time limit:

Responses to Findings shall be either:

Agree

Disagree wholly

Disagree partially with an explanation

## **INTERNAL CONTROLS IN THE COUNTY OF SANTA BARBARA**

Has been implemented, with a brief summary of implementation actions taken  
Will be implemented, with an implementation schedule  
Requires further analysis, with analysis completion date of no more than six months after the issuance of the report  
Will not be implemented, with an explanation of why

### **Santa Barbara County Board of Supervisors—90 days**

Findings 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11  
Recommendations 2a, 3a, 3b, 4, 5a, 7, 8, 9a, 9b, 9c, 10, 11a, 11b

### **Santa Barbara County Sheriff—60 days**

Findings 3, 4, 5, 11  
Recommendations 2c, 3c, 5b,

### **Santa Barbara County Auditor-Controller—60 days**

Findings 1, 2, 3, 4, 5, 6, 7, 9  
Recommendations 1, 2b, 3c, 5b

### **Santa Barbara County Clerk Recorder-Assessor-Registrar of Voters—60 days**

Findings 3, 4, 5  
Recommendations 2c, 3c, 5b

### **Santa Barbara County District Attorney—60 days**

Findings 3, 4, 5  
Recommendations 2c, 3c, 5b

### **Santa Barbara County Treasurer-Tax Collector-Public Administrator—60 days**

Findings 3, 4, 5, 11  
Recommendations 2c, 3c, 5b