FINAL CLOSE-OUT

SECOND FOLLOW-UP AUDIT

AUDIT OF COUNTYWIDE **PENSION PRACTICES**

ORIGINAL AUDIT NO. 2913

AS OF APRIL 13, 2011

original audit contained three (3) findings and Our recommendations. One (1) recommendation was closed in our First Follow-Up Audit report dated October 18, 2010. Our Second and Final Follow-Up Audit found the remaining two (2) recommendations fully implemented. We performed the original audit of certain Human Resources records and related documents for the period from July 1, 2006 through June 30, 2009 to respond to the recommendation made to the Internal Audit Department in the Orange County Grand Jury report entitled "The Guardian of Last Resort."

> AUDIT NO: 1017-A REPORT DATE: MAY 9, 2011

Director: Dr. Peter Hughes, MBA, CPA Deputy Director: Eli Littner, CPA, CIA Senior Audit Manager: Alan Marcum, CPA, CIA Audit Manager: Kenneth Wong, CPA, CIA

RISK BASED AUDITING

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

AICPA 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

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Internal Audit Department

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. 1017-A May 9, 2011

- TO: Carl H. Crown, Director Human Resources Department
- **FROM:** Dr. Peter Hughes, CPA, Director Internal Audit Department
- SUBJECT: Second and Final Follow-Up Audit of Countywide Pension Practices, Original Audit No. 2913, Issued March 26, 2010

We have completed a Second and Final Follow-Up Audit of Countywide Pension Practices. Our audit was limited to reviewing, as of April 13, 2011, actions taken to implement the **two (2) recommendations** remaining from our First Follow-Up Audit report dated October 18, 2010 where **one (1) recommendation** was closed from our original audit. We conducted this Second 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 Second and Final Follow-Up Audit are discussed in the **OC Internal Auditor's Report** following this transmittal letter.

Each month I submit an **Audit Status Report** to the BOS where I detail any critical 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 3.

Table of Contents



Second and Final Follow-Up Audit of Countywide Pension Practices Audit No. 1017-A

As of April 13, 2011

Transmittal Letter	i
OC Internal Auditor's Report	1

OC Internal Auditor's Report

Audit No. 1017-A

May 9, 2011

TO:	Carl H. Crown, Director
	Human Resources Department

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

ter Hughes

SUBJECT: Second and Final Follow-Up Audit of Countywide Pension Practices, Original Audit No. 2913, Issued March 26, 2010

Scope of Review

We have completed a Second and Final Follow-Up Audit of Countywide Pension Practices. Our audit was limited to reviewing, as of April 13, 2011, actions taken to implement the remaining **two (2) recommendations** from our original audit report.

Background

We performed an audit of certain Human Resources records and related documents for the period from July 1, 2006 through June 30, 2009 in response to the recommendation made to the Internal Audit Department in the Orange County Grand Jury report entitled "The Guardian of Last Resort" on the Public Administrator/Public Guardian, dated May 9, 2009. We determined if additional instances of questionable pension practices exist in agencies other than the Public Administrator/Public Guardian's Office. In addition, we identified internal control weaknesses for which we provided recommendations for improvement.

Results

Our Second and Final Follow-Up Audit indicated that the **two (2) remaining** recommendations were fully implemented.

1. <u>Questionable Promotion and Salary Increases</u> (Control Finding)

We recommended that the Human Resources Department advise all appropriate levels of management on the impact of salary increases and future pension costs.

<u>Current Status:</u> **Closed (First Follow-Up Audit).** During our review of a sample of employee salary increases in our original audit, we identified two instances where employees received a promotion and large "End-of-Career" salary increases at departments other than the Public Administrator/Public Guardian's Office. Based upon our review of documentation, the two promotions and salary increases did not technically violate Human Resources Department (HRD) policies and procedures, but were questionable management actions. It should be noted that the three instances of questionable promotion and salary increases identified by the Grand Jury and the Internal Audit Department represented a negligible portion of the retirees with 778 of the 781 (99.62%) not open to such an apparent challenge.



HRD partially concurred with the finding and recommendation on questionable promotion and salary increases. HRD's management response indicated that although the three questionable actions were within policy, the circumstances surrounding these actions and lack of documentation allowed for the decisions to be called into question. HRD indicated that County department executives and department human resources managers are usually not aware of a person's retirement intentions since the employee is not obligated to provide advance notice of their intended retirement date. HRD further indicated that the compliance rate as stated in the findings, 99.62%, demonstrates that "end-of-career" salary increases were overwhelmingly in compliance with both the letter and intent of County Policy. HRD concluded that an educational effort was not deemed necessary due to the very high compliance rate. Because HRD accepted the risk of not taking further action, we consider the recommendation to be closed.

2. <u>Authorization of Salary Increases</u> (Control Finding)

We recommended that the Human Resources Department require pre-authorization of permanent and temporary promotions from the County Executive Officer for proposed and/or cumulative salary increases exceeding 15% prior to submission to the Board of Supervisors for their review and approval.

<u>Current Status:</u> **Implemented.** During our First Follow-Up audit, we noted that HRD developed new procedures to ensure that proper salary increase documentation is recorded when a department/agency sets salary levels above the bottom of the range for individual employees in the classifications of Administrative Manager, Executive Manager, and Law Enforcement Manager. In a memorandum to all department and agency HR managers, *Salary Increase Documentation and Approval Policy*, dated July 23, 2010, the Director of Human Resources provided new procedures to strengthen HR policies and procedures within the County. The new procedures for a salary increase of 15% or greater requires pre-approval from the Human Resources Director, the Deputy County Executive Officer (for non-elected department/agency heads), and the County Executive Officer. The request for a salary increase of 15% or more must be approved prior to making a job offer.

During our Second Follow-Up Audit, we noted that the Human Resources Department reminded the department and agency HR managers attending the HR Leadership Forum of the requirements in the memorandum on salary increases of 15% or more granted to Administrative Managers, Executive Managers, and Law Enforcement Managers. The attendees were reminded that pre-approval is required from the Director of Human Resources Department and County Executive Office prior to making a job offer with a salary increase of 15% or more. As for equity and compaction salary increases pursuant to the Memorandum of Understanding for Administrative Manager, documentation is required to be completed and maintained in the respective salary increase recipient's personnel file. The attendees were reminded that the required forms are available on the Human Resources Department intranet site.

We reviewed all salary increases of 15% or more effective on or after October 19, 2010 and identified that two (2) Administrative Managers had received increases. During our review we found that approval for the salary increases of 15% or more granted complied with HRD's new policies and procedures. Because both salary increases received pre-approval prior to the update of their salary amount, we consider this recommendation fully implemented.



3. Monitoring Salary Decisions (Control Finding)

We recommended that the Human Resources Department take appropriate actions to ensure monitoring of management salary increases are documented, reviewed and maintained on file for third party confirmation.

<u>Current Status:</u> **Implemented.** HRD monitors all salary changes for Administrative Managers, Executives, and Law Enforcement Managers. The monitoring process includes an evaluation of whether documentation is maintained on file to support the salary changes. We found that HRD reviews a report for monitoring salary change decisions and evaluates and documents the compliance of each salary action with policies and procedures. Because HRD ensures salary decisions are adequately documented and maintained on file in accordance with policies and procedures, we consider this recommendation fully implemented.

We appreciate the cooperation and assistance extended to us by the personnel of the Human Resources Department during our Second and Final Follow-Up Audit. If you have any questions, please contact me directly or Eli Littner, Deputy Director at 834-5899, or Alan Marcum, Senior Audit Manager at 834-4119.

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

Members, Board of Supervisors Members, Audit Oversight Committee Thomas G. Mauk, County Executive Officer Bob Leys, Assistant Director, HR/Services and Support Diane Greek, Manager, HR/Services and Support Foreperson, Grand Jury Darlene J. Bloom, Clerk of the Board of Supervisors