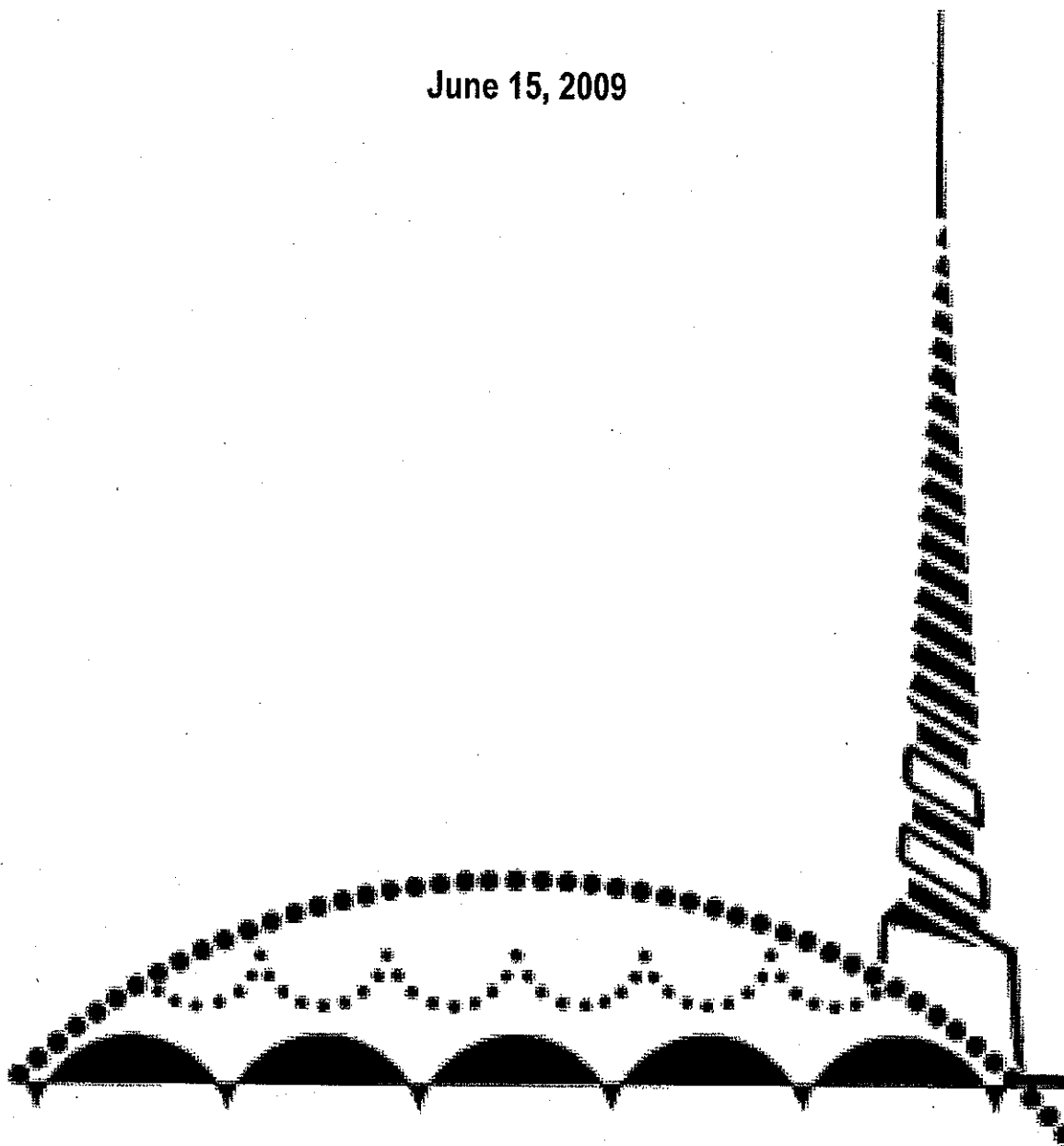


2008-2009 MARIN COUNTY CIVIL GRAND JURY

# Marin's faulty system of checks and balances

June 15, 2009





## SUMMARY

“Our mission is excellent service.” These words greet visitors to Marin County’s official website. To fulfill its mission the County needs to ensure that its policies are carried out and that its operations are well managed in compliance with applicable law. Achieving these objectives requires a reliable system of internal controls, those checks and balances designed to ensure that County operations are efficient and effective. Marin County’s system of internal controls needs an upgrade if it is to succeed in its mission to provide excellent service to its citizens.

One mark of a well-functioning system of internal controls is proper stewardship of the County’s money. Financial statements prepared on a timely basis and validated by an independent auditor provide essential information on the resources available to carry out the County’s work. Unfortunately, financial statements have not been prepared on a timely basis since fiscal year 2006. This failure is due in large part to problems in implementing a costly new information technology system known as MERIT, which stands for Marin Enterprise Resource Integrated Technology. The system is designed to allow all County departments to exchange and monitor a variety of information including finance, payroll, budget, work orders and personnel.

The County has been attempting to get MERIT working properly since 2006. The result is that personnel, particularly in the Auditor-Controller’s Office, have been diverted away from their normal duties. Thus, an important financial information and control mechanism has been impaired, with serious adverse consequences. For example, the County has been unable to collect over \$2 million in reimbursements from the state because it has not yet provided the proper supporting financial statements. We recognize that many of the historic MERIT implementation issues have been resolved and MERIT is now meeting the needs of many users.

Another mark of a properly functioning system of internal controls is regular institutional assessment and evaluation of the way County departments carry out the policies adopted by the Board of Supervisors. For example, the Marin Audit Advisory Board, formed in 2004, has the responsibility of monitoring the County’s financial and performance audits. In practice, however, this important group has only met formally three times in its five-year existence, and its contribution to effective internal controls has been minimal.

The Internal Audit group within the Auditor-Controller’s office is another example of a critical oversight tool not being used effectively. This group is responsible for monitoring the design and proper functioning of internal controls and procedures. It helps department managers monitor compliance with important details of County policies and procedures

that may be overlooked in the press of day-to-day business. Regrettably, it has followed only a limited program of department evaluations, focusing largely on audits required by law. As a result, the County has not had the benefit of internal audit information on poorly functioning departments, nor of ideas to improve efficiency and effectiveness.

The Grand Jury believes that these flaws in the County's system of checks and balances should be corrected and the process should begin with a redoubled effort to make MERIT work properly. Not only has the MERIT situation resulted in unprecedented delays in preparing the County's financial statements, but the ability of departments such as Human Resources and the Marin County Employees' Retirement Association to provide services to their constituents has also been compromised because too much staff time was devoted to working around MERIT-caused deficiencies.

The Grand Jury believes that not only have the MERIT problems *contributed to* a breakdown in the County's system of internal controls, but they were also *caused by* insufficient attention to internal controls that resulted in poor decision-making.

Some officials told the Grand Jury that the County bought a system that was too big and complex for Marin's size and was also not particularly well suited to government accounting. In addition, the County implemented too many features, too quickly, and with insufficient resources, testing and input from users. It is possible that if better decision-making and planning processes had been in place, some of the setbacks could have been avoided. The County might have selected a more suitable product or monitored its implementation more closely. Accordingly, the Grand Jury recommends that the County undertake a review of the MERIT project to develop lessons learned that can be applied to future major projects.

The passage of Measure B in November 2008 established the office of Director of Finance to replace the functions of Treasurer-Tax Collector and Auditor-Controller with one office responsible for all financial management functions. In establishing the Director of Finance Office, the Board of Supervisors has an excellent opportunity to assess its internal controls and shore up areas in need of improvement. By rejuvenating its system of internal controls, the County will promote the good management practices that will enable it to fulfill its mission of providing excellent service to its citizens.

## METHODOLOGY

One charge of the Civil Grand Jury is to investigate and report on departments of the County. This report began as a departmental review of the Auditor-Controller's Office but evolved into a review of certain aspects of the County's internal control environment.

The Grand Jury interviewed personnel in the offices of the Auditor-Controller, Treasurer-Tax Collector, County Administrator, Information Services and Technology Department as well as a member of the Board of Supervisors. Representatives from external

independent auditors were also interviewed. Relevant documents were reviewed and the Internet was used to identify best practices and procedures. The principal documents and best practices reviewed are listed in the **Bibliography**.

## **DISCUSSION**

A dramatic example of what happens when an organization's system of internal controls is not working optimally is what occurred when the County selected and tried to implement MERIT, its new information technology system. MERIT is a key part of the County's information nervous system and is intended to help the County process transactions more efficiently and effectively, and to simplify the management of the vast sums of information collected and disseminated within county government. This information should enable people to provide better service and make better decisions. Unfortunately, it hasn't worked out as planned. MERIT is not working smoothly almost three years after it went live, and the botched implementation has left a trail of troubles, many of which could have been avoided or minimized if oversight systems had been working effectively.

### **MERIT's muddle**

In 2005 County leadership began replacing Marin's financial accounting system because the vendor no longer supported the existing system. This was seen as an opportunity to modernize administrative functions by adopting a system that would integrate the activities of all departments and would also allow the use of accrual accounting instead of cash accounting. The County hoped to thereby reduce costs and provide better customer service. The replacement project was initiated by the Auditor-Controller and co-sponsored by the County Administrator. It was directed by the Auditor-Controller's Office with the Assistant Auditor-Controller as project manager.

The County chose a system it calls MERIT that some believe is too big and complex for Marin's size. Some also believe it is not particularly well suited for government accounting, even though similar software is used by Sacramento, Santa Clara and San Luis Obispo counties as well as the Marin Municipal Water District. The Grand Jury has been told that the installation and implementation was botched in a number of ways including:

- Prior to installation, the County agreed to upgrade to the latest release of the software, which was not widely used by governments at the time.
- The project implementation partner (Deloitte Consulting LLP) appears to have provided insufficient technical talent.
- The County's project manager and project team relied on the implementation partner to make MERIT software work for Marin. The team did not have project management experience. They were overwhelmed by the complexity and were not able to recognize problems as they developed.
- There was insufficient testing and too little customer and user involvement.

- County personnel were insufficiently prepared and inadequately trained.
- Too many functions were implemented at once and errors were made in the way the system was configured.
- The start-up of Phase I (financial system) in July 2006 was rushed; this rushed start continued with Phase II (human resources, payroll, budget planning and work order system) in January 2007.

The botched implementation left a serious accounting mess with many financial transactions in need of correction. Some errors were generated during the data conversion process and others by problems in the data exchange between the payroll module and the general ledger. In other cases, entries to incorrect accounts were made by employees with inadequate training. The Auditor-Controller Office's, and in particular the Accounting section, spent thousands of hours checking and correcting entries and reclassifying data. The staff was under a lot of stress and a number of temporary hires were needed to cope with the situation. This group should be commended for its efforts. Nevertheless, it was not until November 2008—nearly a year and a half after the fiscal year ended—that the financial statements for the fiscal year ending June 30, 2007 were in a condition for the County's external independent auditors to begin their audit. Those financial statements were not issued until April 21, 2009. Under state and federal rules, those statements should have been issued no later than March 31, 2008. Work is finally starting on the audit for the fiscal year 2008, which is expected to be completed later in 2009. According to knowledgeable Grand Jury sources, such a significant delay is unprecedented.

There are practical adverse consequences related to the delayed issuance of the annual financial statements. State government, federal government and other grantor agency payments can be withheld until the proper financial statements are submitted. The Grand Jury has been told that because of this delay Health & Human Services has not been able to claim reimbursement for social services programs. In order to claim reimbursement, the California Department of Social Services requires the County to submit a cost plan approved by the State Controller. That plan cannot be prepared until the financial statements are completed. The delayed reimbursement amount is currently about \$2.5 million. The County should eventually receive these funds but it has lost the use of that money in the meantime. The Grand Jury has been told that two other programs have threatened to withhold reimbursement because the audited financial statements have not been issued.

Bond rating agencies, banks, and others in the financial markets do not have current information. This would make it difficult for the County to borrow and may cause it to pay a higher interest rate. The County is in technical violation of those contracts that require a copy of the audited financial statements within a contractually agreed number of days after the end of the fiscal year.

### The cost of MERIT's muddle

MERIT has also been very expensive. The installation and operating costs of MERIT from the kickoff in 2005 to the end of April 2009 are roughly \$28.6 million. The main components of the MERIT costs (in millions) are:

Consultants/Services	\$16.7
Salaries and benefits	9.8
Software/Supplies	1.5
Outside Training	.3
Miscellaneous	.3
<b>Total</b>	<b>\$28.6 million</b>

These costs understate the actual outlays because substantial payroll costs incurred in departments to fix or work around MERIT issues are not included. The consulting fees are particularly high because the County is thin both in staff and experience. Substantial MERIT-related consulting fees are still being incurred. For fiscal year 2009 these fees slightly exceed \$1 million.

### Where does MERIT stand?

In March 2007, responsibility for the MERIT project management moved from the Auditor-Controller's Office to the Information Services and Technology Department. This move was positive. A "get well" program was instituted to get MERIT working the way it should. Representatives from different departments that are major users of MERIT have formed a group to initiate system improvements. Expectations have been clarified, communications and teamwork have improved and a corrective plan has been undertaken.

Many of the MERIT implementation issues have been resolved and MERIT is meeting the needs of many users. Nevertheless, viewpoints on how well and smoothly MERIT is working varied widely among those interviewed by the Grand Jury. We observed a widespread perception among County staff that MERIT is still not working properly. This perception makes some employees reluctant to put in the effort to master their use of MERIT.

### What needs to be done now?

The County should redouble efforts to make MERIT work properly. The necessary staff and funding should continue to be provided. The Grand Jury believes that the following additional steps should be taken:

- **Address the use of consultants.** Consultants are currently performing some critical tasks that cannot be done by County employees because of their lack of training and experience. The County needs to address which skills it makes sense

to bring in-house through training or hiring, and which it should procure from consultants.

- **Ramp-up training.** The need for more training was a consistent theme heard from County employees. Employees should be required to take appropriate ongoing training to allow them to use MERIT fully and correctly. The Assistant Auditor-Controller has deferred MERIT training for his staff in order to focus on the problems caused by the botched MERIT implementation. Getting staff properly trained in MERIT and governmental accounting should be a top priority for the Auditor-Controller's Office. This training should also help that office become more supportive of MERIT.
- **Decide whether to expand MERIT functions.** When MERIT first went live over 20 modules were expected to come online. Implementation problems caused the County to turn off or otherwise postpone the utilization of all but a few of the modules. As MERIT became stabilized, more functions were activated. MERIT promises future benefits from the activation of more functions. Given the outlook for budget shortfalls and the upcoming retirement of a number of experienced accountants over the next three to five years, a structured assessment should be made as to what additional functions are cost effective and when those functions should be activated. Proper planning is also needed to avoid future implementation problems.
- **Lessons-learned review.** The Board of Supervisors and top County management need to take a hard look at how and why the MERIT debacle occurred in order to develop a list of lessons learned that can be applied to future large-scale projects.

#### How did it happen?

The Grand Jury believes that many of the reasons for the MERIT debacle can be traced to insufficient attention to the County's system of internal controls. This is the system of checks and balances within governments that provides reasonable assurance, based on monitoring and reporting, that the County is operating effectively and efficiently, in compliance with applicable laws and regulations, and that its financial reporting is reliable. A well-functioning system of internal controls has top managers with an intense interest in competence and accountability, rigorous risk-assessment processes, and comprehensive reporting and communication procedures.

The Grand Jury has learned that some of the other components of the County's internal controls have not been functioning optimally. The Marin Audit Advisory Board has been moribund and the Internal Audit group has been functioning at a low level.

#### Audit Advisory Board

The Marin County Audit Advisory Board was formed in 2004 to assist the Auditor-Controller in maintaining a high level of public accountability through effective and efficient operations, compliance with laws and regulations, and reliable financial reporting. The Audit Advisory Board's charter provides that it is to meet at least twice a

year, be chaired by the Auditor-Controller and be composed of up to six members appointed by the Auditor-Controller:

- Board of Supervisors (two members).
- County Administrator or his/her designee.
- Auditor-Controller.
- Assistant Auditor-Controller.
- At-large member.

The Audit Advisory Board's role is to assist the Auditor-Controller to ensure that public accountability is maintained by putting into practice appropriate internal controls, an independent internal audit function, and independent external audits. It is charged to:

- Review annual audit plans and advise the Board of Supervisors whether adequate staff and funding are available.
- Review audit recommendations and their implementation.
- Work with County departments and internal audit to resolve audit issues of countywide significance in a timely manner.

In fact, the Audit Advisory Board has functioned simply as "window dressing" and has acted as a board in name only. It has only met formally three times in its five-year existence. It has not delved seriously into issues, has never met with the external auditors to review their recommendations and concerns, and an at-large member has never been appointed. According to professional organizations such as the Government Finance Officers Association and the American Institute of Certified Public Accountants, it is not consistent with best practices to have the Auditor-Controller or Director of Finance chair this board and also appoint the members. It makes it difficult for the board to fairly review the officer who appointed them.

In order for the Audit Advisory Board to be effective, its charter, structure and functions should be updated, incorporating accounting industry best practices. The charter should specify the composition, qualifications and reporting structure of the board, who appoints its members and who chairs the Board.

#### **Internal Audit**

The Internal Audit group reports to a Deputy Auditor-Controller. Its primary responsibility is helping management monitor the design and proper functioning of internal control policies and procedures. Its charter was approved by the Board of Supervisors in the 1970s and does not appear to have been updated since. This charter provides that the Auditor-Controller is authorized to direct a broad comprehensive program of internal auditing. Among other things, the Auditor-Controller is responsible for:

- Developing and executing a comprehensive audit program for the evaluation of the fiscal management and internal controls provided over all County activities.

- Examining the effectiveness of all levels of fiscal management in their stewardship of resources.
- Recommending improvement of fiscal management and internal controls designed to safeguard resources and promote County growth.

Internal auditors can play a valuable role in conducting performance audits, as well as special investigations and studies. Financial managers, with the assistance of internal auditors, should periodically evaluate relevant internal control procedures to satisfy themselves that those procedures are adequately designed to achieve their intended purpose, have actually been implemented, and continue to function as designed. Over at least the past five years the Internal Audit group has followed a limited audit program focused largely on required audits. Comprehensive assessments that could help the County become more effective and efficient have not been undertaken.

One audit report the Grand Jury reviewed concerning the Public Guardian was on the right track but didn't appear to go deep enough or have sufficient follow up; it nibbled around the edges. Additional digging would have helped identify a number of internal control issues. An audit report concerning the Community Services Project Funds for the period July 1, 2006 through June 30, 2007 was not issued until April 30, 2008. A 10-month delay from the audit of the period to release a report diminishes the value of the report. County entities with revenues from fees charged to the public for services rendered, such as the County airport Gness Field, have not been routinely audited by the Internal Audit group.

Since the MERIT implementation began in 2005, the Internal Audit staff has been reduced and its already limited production declined further. In fiscal year 2004, five people authored 15 audit reports. In fiscal year 2008, one person authored all nine reports. The staffing in 2004 was six. The current staffing consists of an audit manager and 1.5 auditors (two experienced auditors, one of whom works half time in Internal Audit and half time in the Payroll group in a non-audit capacity). Internal Audit lacks a systems auditor to monitor the integrity of MERIT and other financial systems.

The Internal Audit charter should be updated to incorporate accounting industry best practices. A review should be undertaken to determine to whom Internal Audit should report to provide it the greatest amount of independence. The staffing of Internal Audit should be reviewed and job descriptions updated. A determination should be made as how to best audit the integrity of MERIT and other financial systems. Namely, should the County hire a systems auditor or have the systems reviewed by an outside auditor?

#### **Director of Finance Office**

As the result of the passage of Measure B last November, the Board of Supervisors will appoint a Director of Finance who will consolidate the offices of Auditor-Controller and Treasurer-Tax Collector. Interviews are underway for a Director of Finance who will

initially take over the Auditor-Controller functions. The incumbent elected Auditor-Controller retired last December and was replaced in the interim by the Assistant Auditor-Controller. The consolidation of offices will occur either at the expiration of the remaining term of current Treasurer-Tax Collector on December 31, 2010 or his earlier resignation. The new Director of Finance, when appointed, will report to the County Administrator.

The transition to a Director of Finance offers the Board of Supervisors a great opportunity to address the shortcomings in the County's financial structure and rebuild its internal management controls.

## **FINDINGS**

The Grand Jury finds that:

- F1.** An effective system of internal controls provides reasonable assurance based on monitoring and reporting that there is effectiveness and efficiency in County operations, reliability of financial reporting and compliance with applicable laws and regulations.
- F2.** MERIT is a key part of the County's information nervous system. Its function is to distribute information throughout County departments to enable people to provide better service and make better decisions.
- F3.** The implementation of MERIT was botched. A review of what went wrong has not been conducted. Significant resources and effort have been utilized since 2006 to get MERIT stabilized and working smoothly. More needs to be done.
- F4.** Consultants are currently performing critical tasks that cannot be done by County employees because of their lack of training or experience.
- F5.** MERIT has untapped functions that can provide future benefits.
- F6.** The need for more MERIT training was a consistent theme heard from County employees. The Auditor-Controller's Office staff has not been provided with sufficient training in MERIT and governmental accounting.
- F7.** A Director of Finance will be appointed initially to oversee the Auditor-Controller's Office. The offices of Auditor-Controller and Treasurer-Tax Collector will be consolidated into the office of Director of Finance by the end of 2010.
- F8.** The Marin County Audit Advisory Board has not been effective.
- F9.** The County's Internal Audit charter has not been updated in many years.

**F10.** The Internal Audit group reports to a Deputy Auditor-Controller and has a current staff of a manager and 1.5 auditors. In recent years, the Internal Audit group has largely limited its audits to those that are required by law.

**F11.** The Internal Audit group has no systems auditor to monitor the integrity of MERIT and other financial systems.

**F12.** The County's audited financial statements for fiscal year ended 2007 were issued April 21, 2009. Work is underway on the audit of the fiscal year 2008 financial statements.

## **RECOMMENDATIONS**

The Grand Jury recommends that the Board of Supervisors:

- R1.** Redouble efforts to ensure MERIT is working properly. The necessary staff and funding should be provided.
- R2.** Direct staff to determine which MERIT skills it makes sense to bring in-house through training and hiring and which it should procure through outside consultants.
- R3.** Direct staff to determine what additional MERIT functions are cost effective and when those functions should be activated.
- R4.** Order a review of the MERIT selection and implementation process to develop lessons learned.
- R5.** Require appropriate ongoing training to allow employees to use the available functions of MERIT fully and correctly. Additionally, direct the Assistant Auditor-Controller and the new Director of Finance to ensure that staff receives appropriate government accounting training.
- R6.** Re-launch the Audit Advisory Board as an effective board and update its charter, structure and function of the board to conform to accounting industry best practices.
- R7.** Update the Internal Audit charter following accounting industry best practices.

## REQUEST FOR RESPONSES

Pursuant to Penal Code Section 933.05, the Grand Jury requests responses from the following governing body:

- Marin County Board of Supervisors: All **Findings** and **Recommendations**

The governing body indicated above should be aware that the comment or response of the governing body must be conducted in accordance with Penal Code Section 933 (c) and subject to the notice, agenda and open meeting requirements of the Ralph M. Brown Act.

California Penal Code Section 933 (c) states that "...the governing body of the public agency shall comment to the presiding judge on the findings and recommendations pertaining to matters under the control of the governing body." Further, the Ralph M. Brown Act requires that any action of a public entity governing board occur only at a noticed and agendized public meeting.

The Grand Jury invites responses from the following individuals:

- Matthew Hymel, County Administrator
- Bryon Karow, Acting Auditor-Controller
- David Hill, Manager, Information Services and Technology

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Reports issued by the Civil Grand Jury do not identify individuals interviewed. Penal Code Section 929 requires that reports of the Grand Jury not contain the name of any person, or facts leading to the identity of any person who provides information to the Civil Grand Jury. The California State Legislature has stated that it intends the provisions of Penal Code Section 929 prohibiting disclosure of witness identities to encourage full candor in testimony in Civil Grand Jury investigations by protecting the privacy and confidentiality of those who participate in any Civil Grand Jury investigation.