



COUNTY OF HUMBOLDT

For the meeting of: 11/23/2020

File #: 20-1533

To: Board of Supervisors

From: Supervisor Virginia Bass and Supervisor Rex Bohn

Agenda Section: Initiated by Board Member

SUBJECT:

Fiscal Operations and Financial Condition Arising from the Operational Gaps Created by the Auditor-Controller's Office (Budget Ad Hoc - Supervisor Virginia Bass and Supervisor Rex Bohn)

RECOMMENDATION(S):

That the Board of Supervisors:

1. Take direct action and develop concrete steps to protect the County's fiscal operations, financial condition, and reputation arising from the operational gaps by the Auditor-Controller's Office.

SOURCE OF FUNDING:

All County Funds

DISCUSSION:

It is highly unusual to bring fiscal operational issues into a Board meeting. However, we are faced with highly unusual circumstances. Over the past several months, the Board of Supervisors has received several concerns from various entities, including other public agencies and vendors regarding the actions of the Auditor-Controller. Of note, these concerns center around delays in payments, transfers and reconciliation of accounts. We have also heard from staff that there continue to be significant delays in the Auditor-Controller posting financial transactions, which at this point is putting the County at serious risk of potentially losing millions in reimbursement from state and federal agencies. Not receiving reimbursement from state and federal agencies would have massive implications, including service reductions, staff furloughs and/or lay-offs. This also negatively impacts current-year and future financial planning, as well as the completion of labor negotiations.

As the Board of Supervisors is the entity charged with governance for the County of Humboldt, we believe as the Budget Ad Hoc that it is time for the Board to take direct action and develop concrete steps to protect the County's fiscal operations, financial condition, and reputation arising from the operational gaps created by the Auditor-Controller's Office.

For discussion purposes, we are highlighting only specific examples of the gaps in the functions carried out by Auditor-Controller's Office that have negatively impacted the efficient and accurate

governing of the County and other public agencies who utilize the County Treasury. The examples are reflected in the following categories:

- Cost Allocation Plans for Fiscal Year (FY) 2019-20 and 2020-21
- Delay in Closing the Books for FY 2019-20
- Over 12-Month Delay in Reconciling Cash and Investment Accounts
- Delays in the Quarterly Cash Count, and Interest Apportionment
- Labor Negotiations
- Other Issues

1. Cost Allocation Plans for Fiscal Year (FY) 2019-20 and 2020-21

a. Delay in Posting the Cost Allocation Plan for FY 2019-20

Since 1974, countywide cost allocation plans have been submitted for review and approval by the State Controller's Office (SCO). Since this time, each California county has been required to receive from the SCO either a provisionally or formally approved countywide cost allocation plan (CAP) before any indirect costs or direct billings for central support services may be reimbursed by state and federal agencies, as stated in the SCO's *Handbook of Cost Plan Procedures for California Counties*. For Humboldt County, this reimbursement is possible when the Auditor-Controller posts the CAP charges following the aforementioned approval from the SCO.

Humboldt County received the SCO's approval, through a Negotiation Agreement (NA) (Attachment 1), for its Fiscal Year 2019-20 CAP on May 6, 2020. The NA contains language approving the Central Service costs and the internal service fund costs (or direct charge centers).

As of this writing, the Auditor-Controller has not posted all of the SCO-approved CAP charges for FY 2019-20. Approximately \$12.67 million in internal service fund and \$4.6 million in central service charges have not been posted.

In addition, an independent third-party review of the charges (Attachment 2) by a reputable consulting firm has affirmed that the unposted CAP charges are legally compliant and are consistent with industry standards.

The CAP is a federally authorized function pursuant to the Federal Office of Management and Budget Circular *Title 2 Code of Federal Regulations* (2 CFR part 200) to distribute central service costs (Auditor-Controller, County Administrative Office, County Counsel, Treasurer-Tax Collector, Facility Management) and internal service costs, which are also known as "billed central services" (ADA, Purchasing, Insurance, Information Technology/Communications) to departments that receive those services. These are essentially overhead charges that can be "billed" to state and federal agencies as the county is carrying out programs mandated by the State of California and United States Government. However, the charges need to be posted to the county's General Ledger in order for departments to claim those costs to state and federal agencies. Deadlines for those

claims are varied, but some have past and others extended.

For example, the deadline has passed to submit cost reports (or claims) for Targeted Case Management (TCM) Medi-Cal funding for the Department of Health and Human Services - Public Health Nursing, and staff received an extension until Dec. 1. The deadline to submit claims for Medicare and Medi-Cal reimbursements for Sempervirens (SV) bed days (in Behavioral Health) is Nov. 30, and no extensions are allowed. The claim deadline for Medi-Cal Administrative Activities (MAA) funding across several branches of DHHS is Dec. 30. Submitting claims for just these programs without the charges described above results in the following potential losses: TCM \$860,000; SV \$500,000; and MAA \$25,000.

Countywide, the negative impact of the Auditor-Controller's Office not posting the CAP charges means an estimated loss of state and federal dollars in the amount of \$14.2 million for fiscal year 2019-20. The \$14.2 million is a portion of the amount not yet posted, giving the dangerous impression to state and federal agencies that these funds are no longer needed by the County.

If the County were to lose out on these reimbursements, there would be a domino effect. It would create negative balances in 4 funds (ADA, Liability, Purchasing and Workers Compensation) estimated at \$3.7 million, and the General Fund would lose out on \$4.6 million in revenue.

To illustrate the gravity of the delayed posting:

The ADA fund, as well as all other operating internal service funds, operates like a checking account for ADA services. Going negative is like over drafting the checking account. The only way to bring it positive is to transfer money from somewhere else, like a savings account. The General Fund, the county's best source of funding for local needs, would be that savings account for ADA and the other funds listed above. Due to the county's strong financial stewardship in the past, this transfer would be possible, but it is highly unusual and terribly unsustainable. In effect, Humboldt County would be subsidizing the state and federal governments, and losing out on \$14.2 million for local needs if this came to pass. A transfer this large would all but wipe out the General Fund and the county would rely on its meager reserves for any future revenue shortfalls and/or emergencies.

b. Almost 12-Month Delay in Submitting the Cost Allocation Plan for FY 2020-21 to the State

Pursuant to the SCO's *Handbook of Cost Plan Procedures for California Counties* all CAPs must be submitted to the SCO at least 6 months prior to the fiscal year for which plans are to be used. For Humboldt County, the CAP for FY 2020-21 was due for submission to the SCO on December 31, 2019. However, the County's CAP for FY 2020-21 has not been submitted to the SCO as of this writing and is almost twelve months overdue.

If, at the beginning of a fiscal year, a county has not submitted and received approval from the SCO for its cost plan for that year, there will be no basis for federal and state reimbursement of indirect costs.

The negative impact of not having an SCO-approved CAP for FY 2020-21 means the County's costs reflected in the CAP cannot be claimed to state and federal agencies, and would result in an estimated loss of federal and state dollars in the amount of \$15.3 million for fiscal year 2020-21, or \$4.7 million in central service costs (Auditor-Controller, County Administrative Office, County Counsel, Treasurer-Tax Collector, Facility Management) and \$10.6 million in internal service fund (ADA, Purchasing, Insurance, Information Technology/Communications) costs that are currently being incurred.

A loss of \$15.3 million in reimbursements will create an estimated deficit totaling \$16.9 million across 5 funds (ADA, Information Technology, Liability, Purchasing and Workers Compensation). Similar to the consequences of not posting SCO-approved costs, the County again would need to turn to the General Fund to clear up the negative fund balances, and considering the uncertain economy this fiscal year, would likely need to use the General Reserve.

As previously stated, the FY 2020-21 CAP was due to the SCO on Dec. 31, 2019 (6 months before the date the plan becomes effective).

In addition, it is presumed work on the CAP for FY 2021-22 has not begun, posing significant planning concerns in developing the FY 2021-22 budget, which begins in February 2021.

2. Delay in Closing the Books for FY 2019-20

In the normal course of financial accounting and reporting, the County's books are closed by the Auditor-Controller following a reasonable period of time after the end of a given fiscal year. Closing the books means that all financial transactions have been properly recorded and accounted for in the County's accounting system. After the County's books are closed, the County's financial statements are ready to be prepared. The independent auditors would audit these financial statements.

In the past, closing the County's books was completed in September or early October, approximately three months after the end of the prior fiscal year. We are informed that the County's books for the FY 2019-20 have not been closed, almost five months after year-end.

The delay in closing the County's books for FY 2019-20 is another significant issue affecting the County. The effect of this delay is not being able to claim for state and federal dollars in a timely manner, compounding the CAP issue above, as well as not knowing the results of the County's operations and financial condition, which provides an incomplete financial picture which delays quarterly budget reports to the Board, and therefore spending on supplemental one-time costs, as well as delayed negotiations with bargaining units.

3. Over-12 Month Delay in Reconciling Cash and Investment Accounts

In accordance of the Government Code 26905, which states, the auditor shall reconcile the cash and investment accounts as stated on the auditor's books with the cash and investment accounts as

stated on the treasurer's books at the close of business of the preceding month. This Government Code mandated activity is important to ensure proper financial internal controls as well as appropriate interest apportionment to those agencies invested in the county treasury. Cash and investment accounts have not been reconciled in accordance with Government Code Section 26905 since last Fall. Other agencies such as special districts and schools districts are impacted by this lack of reconciliation.

4. Delays in the Quarterly Cash Count and, Interest Apportionment

Pursuant to Division 2, Article 2, Section 26920 and 26922 of the Government Code the Auditor-Controller is required to conduct a quarterly count of the money in the County Treasury. The quarterly cash count of the money in the County Treasury includes all of the various funds (or accounts) held there, including schools, special districts, and the county General Fund.

The purpose of the cash count is to determine whether the Statement of Money in the County Treasury reasonably states the cash and investments deposited with the Treasury. This is important because those accounts are valued in the tens of millions of dollars and they earn significant interest.

Quarterly, the Treasurer is required to determine how much interest should be apportioned across all interest-bearing funds based on the average daily balance of those funds throughout each quarter. The average daily balance cannot be calculated until the Auditor-Controller posts and reconciles all transactions that took place during that quarter. Interest is then equitably distributed to all treasury pool participants including the schools and community college, special districts, and the County's General Fund.

The General Fund has not received an interest apportionment since the second quarter of FY 2018-19. This apportionment has been routine in the past.

The General Fund relies on the timely apportionment of interest to fund critical local services such as law enforcement, emergency response, indigent defense and general relief, among others. Government Code Section 53647 states "Interest on all money deposited belongs to, and shall be paid quarterly into the general fund of, the local agency represented by the officer making the deposit, unless otherwise directed by law". It is estimated the General Fund is owed \$1.3 million in interest earnings.

In addition, pursuant to Revenue and Taxation Code Section 5151, the County Treasurer shall advise the State Controller of the county pool apportioned rate, and of computations made in deriving that rate, no later than 90 days after the end of each fiscal year. The County Treasurer is unable to comply with Revenue and Taxation Code 5151 due to the delays in cash reconciliations for which the Auditor-Controller's Office is responsible.

5. Labor Negotiations

Only on the rarest of occasions are details of labor negotiations made public. This information is protected by State law to protect the integrity of the negotiations processes. While staff will not reveal details of those negotiations in this report, we can say in light of everything noted above it is currently impossible for staff to provide the Board of Supervisors with the information that it needs to make an informed decision about economic bargaining authority for the current round of labor negotiations.

For example, we do not know for sure whether the Auditor will post the Cost Allocation Plan for FY 2019-20 [or whether the Auditor will post only a certain portion of the CAP] and those costs claimed. If they are not posted, we do not know whether the General Fund will backfill those lost revenues, or if the County will revert to some combination of furloughs and layoffs, etc. to make up for the loss of millions of dollars in revenue. We do not know whether the Auditor will move \$1.3 Million interest earnings to the General Fund, as required by state law.

Our negotiations will look dramatically different if the General Fund needs to spend millions of dollars in response to these issues. If the county were to agree to wage and/or benefit increases at this time, with all of these unknowns surrounding the General Fund, it puts the County's financial well-being at risk. Our bargaining teams cannot faithfully agree to wage and/or benefit increases in this environment, to the detriment of our public servants. The County's bargaining team and staff are particularly frustrated because negotiations are being delayed which are very important to our dedicated law enforcement staff, public health staff, and other County employees who do the hard work to get our community through this pandemic.

6. Other Issues

We summarize below additional issues that we have been made aware of:

- Increase in audit findings despite an increase in staffing of 25 percent, or 3 full-time equivalents, since the current Auditor-Controller's arrival. The 2018 and 2019 audits had 16 findings. The four prior audits had seven findings combined.
- During the normal course of their operations, outside agencies and special districts rely on the County to disburse funds for which the County is the fiduciary and not the owner. There have been multiple concerns from outside agencies reflecting a recurring and pervasive theme of delays in payments and lack of communication from the Auditor-Controller's Office.
- There have been complaints of delay in payments to local businesses and community-based organizations, and vendors around the county. In accordance with County Code Section 245 et. seq. the county's purchasing agent, the County Administrative Officer or designee, shall purchase for the county and its departments all materials, supplies, furnishings, equipment, livestock and other personal property. This also includes engaging independent contractors to perform services for the county and its departments through professional service agreements

(PSA), subject to statutory limits and procedures. Contained in the county's PSAs is language to the following "Payment for services rendered, and costs and expenses incurred, pursuant to the terms and conditions of this Agreement will be made within thirty (30) days after the receipt of approved invoices." In addition, invoices received from vendors and local businesses require payment in 30-days. The effect of delayed payments is reduced cash flow for vendors, local businesses and community-based organizations. Another effect is increased costs to the county as some local businesses have increased costs to the county as a result of delayed payments.

FINANCIAL IMPACT:

Pertaining to the FY 2019-20 CAP issue alone:

Not being able to seek reimbursement from state and federal agencies for an estimated \$14.2 million in fiscal year 2019-20 SCO-approved cost allocation plan charges could result in significant financial consequences for the county including critical service reductions and the furloughs and lay-offs of County employees.

STRATEGIC FRAMEWORK:

This action supports your Board's Strategic Framework by providing community-appropriate levels of service .

OTHER AGENCY INVOLVEMENT:

Not applicable.

ALTERNATIVES TO STAFF RECOMMENDATIONS:

Not applicable.

ATTACHMENTS:

1. Negotiation Agreement Countywide Cost Allocation Plan
2. Limited Study of Internal Service Fund Charges for Services

PREVIOUS ACTION/REFERRAL:

Board Order No.: N/A

Meeting of: N/A

File No.: N/A