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 County of Humboldt, California

From: Macias Gini & O’Connell LLP

Date: September 28, 2020

Subject: Limited Study of Internal Service Fund Charges for Services

This document summarizes the results of a Limited Study (Study) performed by Macias Gini & O’Connell LLP (MGO) to determine if the County of Humboldt’s (County) practices related to the development and recording of internal service fund (ISF) charges for services generally comply with industry regulatory guidance and peer agency practices. The Study was requested due to significant delays in processing and recording transactions in the County’s financial reporting system for certain ISFs. The Study found that County practices generally comply with industry standards.

SCOPE AND METHODOLOGY

The Study was conducted in September 2020 of the process of developing and recording ISF charges for services for the fiscal year ended June 30, 2020 for the following ISFs identified by the County Administrative Office (CAO).

Financial Reporting Fund (reported in County Basic Financial Statements)	Operational Budget Unit
Information Technology	Information Technology (3550)
Communications	Communications (3521)
ADA Compliance	ADA Compliance (3552)
Central Services	Purchasing & Disposition Team (3555)
Insurance Funds	Workers’ Compensation (3523) Liability (3524) Purchased Insurance Premiums (3528) Risk Management Administration (3520) Employee Benefits (3522) Medical Plan (3525) Dental Plan (3526)

- The Study consisted of performing the following procedures:
- a. Identified industry guidelines issued by the California State Controller’s Office (SCO)
 - b. Obtained the County’s corrective action plan related to the SCO’s field review of the County’s cost allocation and ISF practices
 - c. Gained an understanding of the methodologies used to develop charges for services and preparation of journal entries to record through discussions with the County Administrator’s Office and ISF managers
 - d. Reviewed documentation, including supporting worksheets, budgets, and journal entries, etc.
 - e. Inquired of practices through discussion with the following peer County agencies; Mendocino, Santa Clara, San Mateo, and Sonoma
 - f. Inquired with the SCO about the results of the field review
 - g. Inquired of the cost plan preparation with the County’s cost plan consultant

OBSERVATIONS AND RECOMMENDATIONS

Industry Guidance

Our research and discussions revealed that the most applicable guidance for California counties is the *Handbook of Cost Plan Procedures for California Counties* (SCO Handbook) dated August 2016, issued by the California State Controller's Office. The purpose of the SCO Handbook is to “assist California counties in the understanding and the application of the cost principles and standards established by the Federal Office of Management and Budget Rules and Regulations Title 2, Code of Federal Regulations, Part 200 (2 CFR Part 200) for state and local governments...and contains the latest policies and procedures for the preparation and application of Countywide Cost Allocation Plans...”

The SCO Handbook provides guidance on cost recovery methodologies through cost plans and ISF charges for services, including timing, reconciliations of budget to actual costs, and minimum required documentation to support the methodologies. The SCO Handbook is the basis for performing field reviews, audits, etc. of county cost plans and ISFs, including the field review performed of Humboldt County.

MGO identified the key guidance from the SCO Handbook related to ISFs and compared to County practices. The County generally complies with the following (page number references refer to the SCO Handbook):

- Analyze 60 day working capital (pg 38 and 65)
- Obtain actuarial report for self-insurance programs (pg 38 and 67)
- Maintain adequate supporting documentation (pg 56)
- Understand the components and methodology used to develop departmental charges and accounting for over/under billings (pg 58)
- Reconcile to budget (pg 61)
- Understand the services provided, expenses incurred, departments that receive services, methodology for billing rates, and accounting for over/under of actuals to budgeted (pg 63)
- Charge sufficient revenue to recover costs, essentially breaking even over time (pg 64)
- Bill users of ISFs directly and equitably (pg 64)
- Adjust for deficits or surpluses (pg 64)

Additionally, we noted that Section 2130 of the SCO Handbook states that the minimum required documentation in the development of a cost plan is the agency's budget, plus supporting documentation, including a reconciliation of the budget to the cost plan information. This guidance should be applicable to ISFs. MGO noted that although this information is prepared by the County's ISF managers, the documentation was not initially provided along with the journal entry submission to the Auditor-Controller's Office for review.

SCO Field Review

In August 2020, the SCO performed a field review of the County's FY 2019-20 cost plan, and provided the County with a field review report (dated October 15, 2019) which included the results and guidance for corrective action. The County's responses to the field review findings were submitted to the SCO and acknowledged and accepted in a follow-up letter (dated March 5, 2020). During MGO's inquiry with the SCO about the results of the field review, the SCO noted that during future field reviews of the County's cost plan, the SCO will verify that these agreed upon expectations are met.

During MGO's inquires of the County Administrator's Office and ISF managers, it was noted that all were aware of the SCO field review results and are implementing methodology revisions for the FY 2020-21 cost plan.

Business Process

See Attachment A for a flowchart of the County's ISF process. The processes used at the County are similar for all of the ISFs reviewed. The charges are calculated by ISF managers during the budget development process and documented in supporting schedules (Excel). Charges for each ISF are included in the proposed budget by the County Administrative Office. Charges are developed around mid-year, for example January, and distributed to County departments for inclusion into departmental budgets. In May-June of each year the Board holds budget hearing and in June adopts the annual budget for the following fiscal year, including the ISF charges.

The ISF charges for services are recorded in the County's accounting system through journal entries submitted by ISF departments as either stand-alone submissions or a component of regularly scheduled payroll entries. For stand-alone journal entries, ISF managers record the charges through an annual journal entry submitted to the Auditor-Controller's Office (ACO). Upon review and approval, the Auditor-Controller's Office posts the journal entry into the County's accounting system.

Documentation Supporting Journal Entries

MGO obtained supporting schedules and workflow narratives from the ISF managers that provided the documentation for the development of budgeted charges and journal entry amounts. For the ISFs included in the scope of the Study, MGO verified that the supporting schedules agreed to the journal entry and the adopted budget amounts submitted, with the exception of the Central Services ISF (Purchasing & Disposition Team (3555)). The initial journal entry and documentation submitted to the ACO for the Central Services ISF did not agree to the adopted budget for FY 2019-20 and was later determined to relate to FY 2020-21. This error was acknowledged and a new, corrected journal entry is in review for submission to the ACO.

Peer Agency Surveys

Most California counties utilize ISFs for tracking and accounting for various activities, such as insurance programs, central service functions, and IT services. As such, MGO's Study included surveying several of the County's peer County agencies and comparing practices. The County agencies surveyed were Santa Clara, Mendocino, San Mateo and Sonoma. Based on inquiries, the County's practices of ISF cost recovery methodologies appear to be comparable with the counties surveyed.

Below is a summary of the responses received from the survey of peer County agencies (along with Humboldt County's practices):

	Humboldt County	Mendocino County	Santa Clara County	San Mateo County	Sonoma County
ISF charges are supported by detailed schedules used to support the annual budget development, which typically include considerations of prior period actual costs and assumptions affecting the upcoming year.	Yes	Yes	Yes	Yes	Yes
ISF net position balances are monitored for compliance with the 60 day working capital guideline. If excessive, the County either demonstrates a reasonable plan for near future use, returns funds to the customers, reduces future charges or makes other adjustments.	Yes	Yes	Yes	Yes	Yes
For self-insurance funds, charge methodologies incorporate results of actuarial studies.	Yes	Yes	Yes	Yes	Yes
Journal entries to post/record charges agree to the annual budget for the given year, as adopted by the Board of Supervisors. Exceptions resulting from uncertain/unexpected circumstances occurring during the year (ex. new MOU, emergency project, etc.) are documented and incorporated in the charges and reconciled back to the adopted budget.	Yes	Yes	Yes	<i>County personnel were not available to address this item.</i>	Yes
The County periodically revises its practices on a prospective basis based on findings and recommendations from desk and field reviews performed by the State Controller's Office.	Yes	Yes	Yes	Yes	Yes

	Humboldt County	Mendocino County	Santa Clara County	San Mateo County	Sonoma County
Journal Entry posting	Journal entries are posted either during the fiscal year or after the fiscal year closes.	Accounting entries are made annually at the beginning of the year for General Liability, Worker's Comp and Unemployment insurance. However, for health insurance, entries are booked bi-weekly with payroll postings.	The charges are posted by departments (not Auditor-Controller's Office) in journal entries either monthly or annually.	The charges are submitted by departments to the Auditor-Controller's Office for posting during the fiscal year, either monthly, quarterly or annually.	The charges are posted by departments (not Auditor-Controller's Office) in journal entries either with the payroll or on individual entries twice a year.
Auditor Controller's Role	When posting a journal entry, the Auditor-Controller reviews detailed worksheets that support the submission by departments and compares to the County budget.	Monitoring of fund balances when preparing the cost plan. Journal entries are posted by the Auditor-Controller's Office which makes sure the departments have budgeted the correct amounts and the amounts reconcile with the budget spread. Once budget is approved, the auditor journals those amounts to the departments as actual charges.	The Auditor-Controller's Office role is to spot check the amounts when preparing the cost plan. The Auditor-Controller does not post the journal entries, this is done by operating departments.	The Auditor-Controller's Office records journal entries after a review of supporting documentation. For supporting documents, The Auditor-Controller's Office reviews journal entries, source documentation of departmental calculations, including agreeing amounts and reviewing the accounting treatment.	<i>County personnel were not available to address this item.</i>

Journal Entry Posting Status

The schedule below summarizes journal entries have been submitted by the ISF managers to the ACO that are not yet posted in the County's accounting system. This is of concern since the fiscal year ended June 30, and the goal for posting journal entries is late September.

Journal entries remaining unposted would reflect inaccuracies in the County's accounting records and put the County at significant financial risk for cost reimbursements for County programs and grants that are subject to reimbursement from State and Federal agencies.

Also, such amounts would be considered during the annual financial audit when the auditor forms an opinion on whether the financial statements are materially correct. Through inquiries of the County Administrative Office and the ISF managers, we noted a lack of clarity regarding what should be included in the submission package to the ACO. In our review of department correspondence, ISF managers timely responded to questions and inquiries of the ACO related to the submission, however they did not receive timely clarification from the ACO of additional requests for information, thus uncertainty remains of the expectations and status of posting the ISF charges to the County's financial system. The County should establish a minimum documentation requirement list for departments to follow that meets the guidelines of the SCO Handbook of required minimum documentation and the more detailed requirements of the ACO.

Unposted ISF Charges	
Fund/Budget Unit	Amount
Information Technology (3550)	\$ 4,336,109
Communications (3521)	279,480
ADA Compliance (3552)	2,393,095
Purchasing & Disposition Team (3555) (Revised)	292,797
Workers' Compensation (3523)	4,928,907
Liability (3524) & Purchased Insurance Premiums (3528) (submitted on same JE)	4,775,748
Total	\$ 17,006,136

Cost Allocation Plans and ISF Charges

The County continues to experience difficulties in timely preparing its Cost Allocation Plan (CAP). For FY 2019-20, the CAP was not approved until May 2020, after the completion of a field review conducted by the SCO. The SCO provided a number of observations and recommendations for corrective action. None of the issues identified by the SCO resulted in revision to the 2019-20 CAP. Any revisions to allocation methodologies and information tracking and capture as a result of the SCO field review were expected to be incorporated into the 2020-21 CAP development. MGO's discussions with the County Administrative Office and select ISF managers included an overview of the implementation of the corrective action plan prospectively through revisions to methodologies and information capture.

Looking forward, the County should develop a plan to get back on track to develop timely CAPs and ISF charges. The deadline for submitting the CAP to the SCO for the next fiscal year, FY 2020-21, was December 31, 2019. The FY 2020-2021 CAP has not yet been prepared by the County and must be approved by the SCO before reimbursable costs from State and federal programs can be claimed for reimbursement. Lack of an approved CAP will hinder receipt of program expenditure reimbursement of State and federal monies. The SCO Handbook states:

***Section 1150:** Countywide cost allocation plans have been submitted for review and approval by the State Controller's Office since 1974. Since this time, each California county has been required to have received from the State Controller's Office either a provisionally or formally approved countywide cost allocation plan before any indirect costs or direct billings for central support services may be reimbursed by state and federal agencies.*

***Section 1190:** If, at the beginning of a fiscal year, a county has not submitted and received approval for its cost plan for that year, there will be no basis for federal and state reimbursement of indirect costs.*

Recommendations

MGO identified the following recommended action items the County should consider.

1. The County Auditor-Controller's Office should immediately identify the specific supporting documentation required to be submitted and/or consider for posting of the outstanding FY 2019-20 journal entries and post the entries upon receipt of the information from the ISF managers.
2. The Auditor-Controller should identify and provide a list of required supporting information needed for inclusion in the journal entry submission package for ISF charges. The documentation should include a reconciliation between budgeted charges and journal entry amounts, including explanations for any differences.
3. The County should prepare and submit its FY 2020-21 CAP, due December 31, 2019, to the State Controller's Office for approval to avoid further delays in posting journal entries and claims for cost recovery.
4. The County follow a timeline for ISFs that complies with industry guidelines and peer agency practices. The County should consider the following timeline:
 - Dec 31. Submit Cost Allocation Plan to the State Controller's Office for approval.
 - January 1-March 31. Prepare proposed budget for the ISF funds and operating departments.
 - June 30. Board approves budget including ISF fund activity.
 - July 1-July 31. Post journal entries in accounting system.
5. MGO acknowledges that the Auditor-Controller has the responsibility to prepare the annual Countywide Cost Allocation Plan and submit it to the State Controller's Office. However, the County Administrative Office should be allotted time each year during the development of the CAP to review and comment on the Draft CAP prior to submission to the SCO, allowing the County Administrative Office an opportunity to provide policy and programmatic perspective and gain insight for budgetary considerations.
6. The County Administrative Office should work with departments to determine the frequency of when ISF charges for services should be posted. Depending on the nature of the activities, ISF charges could post monthly, quarterly or annually.
7. The County should consider whether a more robust study of ISFs and/or the cost allocation plan is necessary.

DISCLAIMER

The observations and recommendations reported do not constitute an examination made in accordance with attestation standards, the objective of which would be to express an opinion or conclusion, respectively, MGO does not express such an opinion. The sufficiency of the Limited Study is solely the responsibility of the County of Humboldt. MGO makes no representation regarding the sufficiency of the procedures performed to disclose all significant matters or reveal errors in the underlying information, instances of fraud, or illegal acts, if any. MGO has no obligation to update this memo or to revise the information contained herein to reflect events and transactions occurring subsequent to the date of this memo. This memo is intended solely for the information for management of the County of Humboldt and is not intended to be, and should not be, used by anyone other than the specified party.

cc: Amy Nilsen, Scott Miles
Attachment A: ISF Process Flowchart

County of Humboldt: Internal Service Fund (ISF) Practices

