

# OFFICE OF AUDITS & ADVISORY SERVICES



## INTERNAL SERVICE FUNDS AUDIT

### *FINAL REPORT*

Chief of Audits: Juan R. Perez  
Audit Manager: Laura R. Flores, CIA, CFE, CGAP  
Senior Auditor: Tatiana Foster, CPA, CFE  
Auditor II: Ida Miclat, CPA

Intentionally Left Blank



# County of San Diego

**TRACY M. SANDOVAL**  
DEPUTY CHIEF ADMINISTRATIVE OFFICER/  
AUDITOR AND CONTROLLER

AUDITOR AND CONTROLLER  
OFFICE OF AUDITS & ADVISORY SERVICES  
5530 OVERLAND AVENUE, SUITE 330, SAN DIEGO, CA 92123-1261  
Phone: (858) 495-5991

**JUAN R. PEREZ**  
CHIEF OF AUDITS

January 22, 2015

TO: Tracy M. Sandoval, Deputy Chief Administrative Officer/Auditor and Controller  
FG3/Auditor and Controller

FROM: Juan R. Perez  
Chief of Audits

**FINAL REPORT: INTERNAL SERVICE FUNDS AUDIT**

Enclosed is our report on the Internal Service Funds Audit. We have reviewed your response to our recommendations and have attached them to the audit report.

The actions taken and/or planned, in general, are responsive to the recommendations in the report. As required under Board of Supervisors Policy B-44, we respectfully request that you provide quarterly status reports on the implementation progress of the recommendations. The Office of Audits & Advisory Services will contact you or your designee near the end of each quarter to request your response.

Also attached is an example of the quarterly report that is required until all actions have been implemented. To obtain an electronic copy of this template, please contact Tatiana Foster at (858) 495-5667.

If you have any questions, please contact me at (858) 495-5661.

**JUAN R. PEREZ**  
Chief of Audits

AUD:TF:aps

Enclosure

c: Tracy L. Drager, Assistant Auditor and Controller  
Damien Quinn, Group Finance Director, Finance & General Government Group

## INTRODUCTION

---

**Audit Objective** The Office of Audits & Advisory Services (OAAS) completed an audit of the Internal Service Funds (ISFs). The objective of the audit was to evaluate the use of ISFs and assess policies and procedures for establishing and accounting for department's rates.

**Background** Governmental accounting systems are organized and operated on a fund basis. A fund is defined as a fiscal and accounting entity with a self-balancing set of accounts which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations.

Governmental accounting systems are classified into three fund categories: governmental funds, proprietary funds, and fiduciary funds. ISFs are considered proprietary funds and may be used for activities that provide goods and services to other funds or departments or other governments on a cost reimbursement basis. The use of ISFs is only appropriate if the sponsoring government is the predominant user of the services.

The County of San Diego (County) administers nine funds classified as ISFs, including:

- Employee Benefits Fund
- Facilities Management Fund
- Fleet Service Fund
- Information Technology Fund
- Jail Stores Commissary Fund
- Public Liability Insurance Fund
- Purchasing Fund
- Road and Communication Equipment Fund
- Special District Loans Fund

County departments are responsible for managing funds day-to-day activities, while the Auditor and Controller Department (A&C) is responsible for reporting financial transactions.

**Audit Scope & Limitations**

The scope of the audit focused on ISFs records for the period of July 1, 2006 through December 31, 2013. OAAS selected the following ISFs for detail testing:

**Table 1. FY 2012-13 Fiscal Data for Selected ISFs**

ISF	Department	Revenue	Expense	Unrestricted Fund Balance
Employee Benefits	Human Resources	\$35,943,000	\$56,049,000	\$(28,648,000)
Public Liability Insurance	County Counsel	\$13,771,000	\$7,622,000	\$14,833,000
Jail Stores Commissary	Sheriff	\$7,379,000	\$4,333,000	\$5,948,000
Special District Loans	Public Works and A&C	\$0	\$4,000	\$905,470

**Employee Benefits Fund and Public Liability Insurance Fund:**

These funds were created on April 20, 1994 in support of the General Accounting Standards Board (GASB) Statement 10 "Accounting and Financial Reporting for Risk Financing and Related Insurance Issues". The Employee Benefit Fund was established to account for workers' compensation and unemployment insurance expenses, including claims payment, insurance cost, and other administration cost. The Public Liability Insurance Fund was established to account for all of the County's public liability claims and related expenses in compliance with the applicable provisions of the law.

**Jail Stores Commissary Fund:** This fund was established on June 18, 1965 to account for the Jail Commissary Store's (Commissary) activities. The Commissary allows inmates in County's detention facilities to purchase snacks, hygiene items, stationary, over-the-counter medications, and phone time. In addition, the public can purchase gift packs and phone time for the inmates' use. The fund generates a profit that is transferred to the Inmate Welfare Fund on a quarterly basis.

**Special District Loans Fund:** This fund is comprised of the following:

- *County Service Area (CSA) Fund No. 35900* – established on April 15, 1968 with the purpose to loan money to CSAs for road maintenance and improvements. Fund balance as of June 30, 2013 is \$50,470.
- *Permanent Road Division (PRD) Fund No. 35925* – established on August 6, 1998 with an opening balance of \$800,000 transferred from Fund No. 35900. The fund was created with the purpose to loan money to PRDs outside the County maintained road system at a time when the majority of CSAs were reorganized into PRDs.<sup>1</sup> Fund balance as of June 30, 2013 is \$800,000.
- *District Development Fund No. 35950* – established on April 17, 1962 with the purpose to loan money to sanitation districts for engineering or construction improvement services. Fund balance as of June 30, 2013 is \$55,000.

This audit was conducted in conformance with the International Standards for the Professional Practice of Internal Auditing prescribed by the Institute of Internal Auditors as required by California Government Code, Section 1236.

**Methodology**

OAAS performed the audit using the following methods:

- Interviewed key personnel from A&C, Sheriff's Department, Department of Public Works (DPW), Department of Human

---

<sup>1</sup> CSAs were reorganized into PRDs in 1998 because PRDs offer the additional benefits of time savings, cost savings, and no funding source restrictions.

Resources (DHR), and County Counsel on policies, procedures, and processes related to ISFs.

- Reviewed applicable accounting standards, County policies and procedures related to ISFs activities.
- Reviewed Federal and State laws and regulations related to cost allocation methodologies.
- Analyzed cost of utilizing different cost recovery methodologies for Employee Benefits and Public Liability Insurance Funds.
- Evaluated the Public Liability Fund's reserve cash balance for the last seven years and assessed its adequacy.
- Conducted benchmark research with ten counties to identify methodologies used to account for workers compensation, unemployment, and public liability activities.<sup>2</sup>

## AUDIT RESULTS

---

### Summary

Within the scope of the audit, there is reasonable assurance that policies and procedures used to establish and account for department's rates are adequate. In addition, through our evaluation of the use of ISFs, we determined the following:

- ISF is the best mechanism to account for Employee Benefit and Public Liability Insurance activities because it allows avoiding large fluctuations in the amount charged to user departments from one period to the next.
- ISF is a permissible mechanism to account for Special District Loans activities.
- ISF is not an adequate mechanism to account for Jail Stores Commissary activities.

Other exceptions related to the Jail Stores Commissary Fund and Special District Loans Fund were noted. These exceptions are described in the body of this report.

---

<sup>2</sup> Counties selected for benchmark research include: Orange County, Los Angeles County, Kern County, Sacramento County, Contra Costa County, Riverside County, San Bernardino County, Alameda County, Santa Clara County, and Fresno County.

**Finding I: Misclassification of Jail Stores Commissary Fund as an ISF**

Based on the nature of the Commissary's accounting transactions and operational activities authorized by Penal Code Section 4025,<sup>3</sup> the Jail Stores Commissary Fund does not meet the requirements to be classified as an ISF. The Commissary serves external costumers and does not provide goods or services to other funds or departments within the County on a cost-reimbursement basis. As such, the Commissary activities better suit accounting requirements established for an enterprise fund. According to GASB Codification Section 1300.109, an enterprise fund may be used to report any activities for which a fee is charged to external users for goods or services.

This fund was initially established as an ISF in 1965. According to A&C, the determination of the fund as an ISF may have been adequate at the time. However, changes in legislation may have modified the activities cited in Penal Code Section 4025<sup>4</sup> which could have affected the fund classification. Further, A&C has not evaluated the County's Comprehensive Annual Financial Report (CAFR) internal service fund classification to ensure compliance with legislation and reporting requirements. Therefore, the misclassification of the Jail Stores Commissary Fund as an ISF was not detected.

**Recommendation:** To comply with GASB, A&C should:

1. Reclassify the Jail Stores Commissary Fund to an enterprise fund.
2. Establish a process to evaluate ISF classification on a periodic basis to ensure compliance with current legislation and reporting requirements established by GASB.

**Finding II: Excessive Profit Accumulated in the Jail Stores Commissary Fund**

Penal Code Section 4025 requires that all profit generated by the Commissary be deposited in the Inmate Welfare Fund and be expended by the Sheriff's Department for the benefit, education, and welfare of the inmates confined within the jail.

OAAS found that the Sheriff's Department accumulated excessive profit generated by the Store's activities in the Jail Stores Commissary Fund. Specifically, as of December 31, 2013, accumulated profit amounted to \$5,140,000 in the fund balance.

On a quarterly basis, the Sheriff's Department only transfers budgeted profit to the Inmate Welfare Fund. Historically, actual profit has been greater than budgeted amounts. As a result, the ISF continued to accumulate excessive fund balance over the years.

<sup>3</sup> According to the Penal Code Section 4025, the sheriff of each county may establish, maintain and operate a store in connection with the county jail and for this purpose may purchase confectionery, tobacco and tobacco users' supplies, postage and writing materials, and toilet articles and supplies and sell these goods, articles, and supplies for cash to inmates in the jail. The sale prices of the articles offered for sale at the store shall be fixed by the Sheriff. Any profit shall be deposited in an inmate welfare fund to be kept in the treasury of the county.

<sup>4</sup> Penal Code Section 4025 has been amended in 1970, 1982, 1984, 1987, 1989, 1993, 2002, and 2007.

While the accumulated profit was not transferred on a timely basis to the Inmate Welfare Fund to be used for the benefit of the inmates; OAAS determined that these funds have not been used improperly. The funds remain in the Jail Stores Commissary Fund awaiting transfer.

**Recommendation:** To comply with Penal Code Section 4025 requirements, the Sheriff's Department should:

1. Identify accumulated profit in the Jail Stores Commissary Fund and process the transfer to the Inmate Welfare Fund.
2. Establish a process to reconcile budgeted profit to actual profit on a periodic basis (at least annually) and transfer the difference to the Inmate Welfare Fund.

**Finding III: Internal Controls Over Special District Loans Fund Need Improvement**

Audit work identified the following issues related to the Special District Loans Fund:

**PRD Fund No. 35925 Balance Exceeds Fund Authority** – PRD Fund No. 35925 has a fund balance of \$800,000 which exceeds fund's authority level by \$300,000. This fund was opened via a Board Resolution pursuant to the authority of Government Code (GC) Section 23014. According to the GC, a county may appropriate available monies to a revolving fund not to exceed \$500,000 to be used by any county sanitation district, county flood control district, or county maintenance district, located within the county for the acquisition of real or personal property, environmental impact studies, fiscal analysis, engineering services, or the construction of structures or improvements need. Subsequent to the fund establishment, the Board of Supervisors adopted Board Policy J-16, which also limits fund appropriations to \$500,000.

Maintaining funds in excess of \$500,000 in the PRD Fund is out of compliance with the GC Section 23014 requirement and with the County's Board Policy J-16. In addition, it prevents the efficient and effective use of excess funds.

**District Development Fund No. 35950 and CSA Fund No. 35900 are Dormant Funds** – There has been no activity in these funds for more than 12 years; however these funds remain open. Specifically, based on Oracle's records,<sup>5</sup> Fund No. 35950 and Fund No. 35900 had no activity since June 2000 and May 2002, respectively. Maintaining inactive funds open results in unnecessarily retaining monies that could be more effectively used for other purposes.

Although A&C has a process in place to identify necessary modifications to existing trust fund authority due to policy or regulatory changes, this process has not been extended to ISFs. Also, in FY 2013-14, A&C

---

<sup>5</sup> Oracle is the County's accounting system of records which was implemented in 2000.

established a process to identify all County funds with zero balance that had no activity for three fiscal years and will request departments to assess the need to close these funds. However, this process has not been applied to inactive funds with balances other than zero.

Generally accepted internal control standards require periodic evaluation of funds to determine the operational need for funds to remain open and to determine whether the authority for the use of the funds is still in accordance with current legislation.

**Recommendation:** To strengthen internal controls over ISFs, the following recommendations should be implemented:

1. In coordination with A&C, DPW management should perform the following:
  - a. Decrease the fund balance of PRD Fund No. 35925 from \$800,000 to \$500,000 and transfer the difference to the appropriate fund.
  - b. Assess whether there is an operational need for District Development Fund No. 35950 and CSA Fund No. 35900 to remain open. If these funds are no longer needed, close the funds and transfer the remaining balances to the appropriate fund.
2. A&C should perform the following:
  - a. Extend existing process to identify necessary modifications to ISFs due to policy or regulatory changes.
  - b. Establish a process to identify dormant ISFs with balances other than zero and initiate their review in coordination with departments to determine whether the fund should be closed.

## Office of Audits & Advisory Services

C Compliance    R Reliability    E Effectiveness    A Accountability    T Transparency    E Efficiency

VALUE

**DEPARTMENT'S RESPONSE  
(AUDITOR AND CONTROLLER)**



# County of San Diego

**TRACY M. SANDOVAL**  
DEPUTY CHIEF ADMINISTRATIVE OFFICER/  
AUDITOR AND CONTROLLER  
(619) 531-5413  
FAX: (619) 531-5219

FINANCE & GENERAL GOVERNMENT GROUP  
1600 PACIFIC HIGHWAY, SUITE 166, SAN DIEGO, CA 92101-2422

January 20, 2015

RECEIVED

JAN 21 2015

OFFICE OF AUDITS &  
ADVISORY SERVICES

TO: Juan R. Perez, Chief of Audits  
Office of Audits and Advisory Services

FROM: Tracy L. Drager  
Assistant Auditor & Controller

DEPARTMENT RESPONSE TO AUDIT RECOMMENDATIONS: INTERNAL SERVICE FUNDS  
AUDIT

**Finding I: Misclassification of Jail Stores Commissary Fund as an ISF**

**OAAS Recommendation:**

To comply with GASB, A&C should:

1. Reclassify the Jail Stores Commissary Fund to an enterprise fund.

**Action Plan:** Auditor and Controller (A&C) agrees with this audit recommendation.

A&C has, since this audit was initiated, reported the Jail Stores Commissary Fund in the Comprehensive Annual Financial Report for the year ended June 30, 2014 as an enterprise fund and will continue to do so going forward.

**Planned Completion Date:** Completed

**Contact Information for Implementation:** Maryann Reed, Manager, Auditor & Controller, Financial Accounting and Reporting Division (858) 694-2197.

2. Establish a process to evaluate ISF classification on a periodic basis to ensure compliance with current legislation and reporting requirements established by GASB.

**Action Plan:** Auditor and Controller (A&C) agrees with this audit recommendation.

A&C will create a process to evaluate ISF classification on an annual basis as it pertains to ensuring compliance with current legislation and reporting requirements established by GASB.

ASSESSOR/RECORDER/COUNTY CLERK  
AUDITOR AND CONTROLLER  
CHIEF ADMINISTRATIVE OFFICE  
CIVIL SERVICE COMMISSION

CLERK OF THE BOARD  
COUNTY COMMUNICATIONS OFFICE  
COUNTY COUNSEL  
COUNTY TECHNOLOGY OFFICE

GRAND JURY  
HUMAN RESOURCES  
RETIREMENT ASSOCIATION  
TREASURER-TAX COLLECTOR

Department Response to Audit Recommendations:  
Internal Service Funds Audit  
Page Two  
January 20, 2015

**Planned Completion Date: April 30, 2015**

**Contact Information for Implementation:** Maryann Reed, Manager, Auditor & Controller,  
Financial Accounting and Reporting Division (858) 694-2197.

**Finding III: Internal Controls Over Special District Loans Fund Need Improvement**

**OAAS Recommendation:**

3. A&C should perform the following:
  - a. Extend existing process to identify necessary modifications to ISFs due to policy or regulatory changes.
  - b. Establish a process to identify dormant ISFs with balances other than zero and initiate their review in coordination with departments to determine whether the fund should be closed.

**Action Plan:** Auditor and Controller (A&C) agrees with this audit recommendation.

A&C will incorporate the identification of any necessary modifications and identification of dormant ISFs in conjunction with the annual evaluation process of ISFs that will be created in response to Finding I.

**Planned Completion Date:** April 30, 2015

**Contact Information for Implementation:** Maryann Reed, Manager, Auditor & Controller,  
Financial Accounting and Reporting Division (858) 694-2197.

If you have any questions, please contact me at (858) 694-2324

  
TRACY L. DRAGER  
Assistant Auditor & Controller

AUD:TD:lr

**DEPARTMENT'S RESPONSE  
(DEPARTMENT OF PUBLIC WORKS)**



# County of San Diego

**RICHARD E. CROMPTON**  
DIRECTOR

DEPARTMENT OF PUBLIC WORKS  
5510 OVERLAND AVE, SUITE 410  
SAN DIEGO, CALIFORNIA 92123-1237  
(858) 694-2212 FAX: (858) 694-3597  
Web Site: [www.sdcounty.ca.gov/dpw/](http://www.sdcounty.ca.gov/dpw/)

January 20, 2015

RECEIVED

JAN 20 2015

TO: Juan R. Perez  
Chief of Audits

OFFICE OF AUDITS &  
ADVISORY SERVICES

FROM: Richard E. Crompton, Director  
Department of Public Works (O-332)

## DEPARTMENT RESPONSE TO AUDIT RECOMMENDATIONS: INTERNAL SERVICE FUNDS AUDIT

### **Finding I:** Internal Controls Over Special District Loans Fund Need Improvement

#### **OAAS Recommendation: To strengthen internal controls over ISFs, the following recommendations should be implemented:**

1. In coordination with A&C, DPW Management should perform the following:
  - a. Decrease the fund balance of PRD Fund. No. 35925 from \$800,000 to \$500,000 and transfer the difference to the appropriate fund.
  - b. Assess whether there is an operational need for District Development Fund No. 35950 and CSA Fund No. 35900 to remain open. If these funds are no longer needed, close the funds and transfer the remaining balances to the appropriate fund.

#### **Action Plan:**

DPW will include adjustments as part of the Second Quarter Budget Status Report Board Letter for FY 2014-15 and will request the Auditor and Controller to transfer the excess funds to the County General Fund.

- a. Adjustment to reduce PRD Fund No. 35925 from \$800,000 to \$500,000 and to transfer the \$300,000 to the County General Fund.

Mr. Perez  
January 20, 2015  
Page 2

- b. Adjustment to close the remaining balance in District Development Fund No. 35950 and CSA Fund No. 35900 and to transfer to the County General Fund. These funds are no longer needed for operation.
2. A&C should perform the following:
- a. Extend existing process to identify necessary modifications to ISFs due to policy or regulatory changes.
  - b. Establish a process to identify dormant ISFs with balances other than zero and initiate their review in coordination with departments to determine whether the fund should be closed.

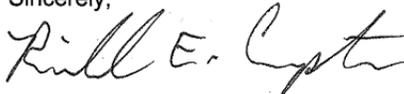
**Action Plan:** DPW will defer to Auditor and Controller to respond on this recommendation.

**Planned Completion Date:** March 20, 2015

**Contact Information for Implementation:** Amparo Suter, DPW Unit Manager

If you have any questions, please contact me at (858) 694-2233.

Sincerely,



RICHARD E. CROMPTON  
Director

**DEPARTMENT'S RESPONSE  
(SHERIFF'S DEPARTMENT)**



COUNTY OF SAN DIEGO

INTER-DEPARTMENTAL CORRESPONDENCE

RECEIVED

January 13, 2015

JAN 20 2015

TO: Juan R. Perez, Chief of Audits O-305
Auditor & Controller

OFFICE OF AUDITS &
ADVISORY SERVICES

FROM: William D. Gore, Sheriff O-41

DEPARTMENT RESPONSE TO AUDIT RECOMMENDATIONS: INTERNAL SERVICE FUNDS AUDIT

Finding II: Excessive Profit Accumulated in the Jails Stores Commissary Fund

OAAS Recommendation: To comply with Penal Code Section 4025 requirements, the Sheriff's Department should:

- 1. Identify accumulated profit in the Jail Stores Commissary Fund and process the transfer to the Inmate Welfare Fund.
2. Establish a process to reconcile budgeted profit to actual profit on a periodic basis (at least annually) and transfer the difference to the Inmate Welfare Fund.

Action Plan: The Sheriff's Department agrees with this finding. As stated in the audit report, while the accumulated profit was not transferred in a timely basis to the Inmate Welfare Fund, the funds have not been used improperly.

To correct the error, \$4.57 million is planned to be transferred from the Jail Stores Commissary Fund to the Inmate Welfare Fund in the FY 2014-15 Second Quarter Budget Status Report.

The Sheriff's Department Inmate Services Division will calculate actual profit as part of the year-end financial closing process each fiscal year and will transfer the actual profit to the Inmate Welfare Fund.

Planned Completion Date: The actual profit will be calculated as part of fiscal year and closing in August 2015.

Contact Information for Implementation: Michelle Aguinaldo, Inmate Services Division Assistant Manager, (619) 661-2837.

WILLIAM D. GORE, SHERIFF

[Handwritten signature of Jill Serrano]

Jill Serrano, Chief Financial Officer
Management Services Bureau