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## Audit and Review of County Financial Statements

### Issue

To what extent (i) is San Mateo County fulfilling its duties under law to properly audit or cause to be audited San Mateo County's financial statements and the financial statements of the various districts and governmental entities within San Mateo County, and (ii) are such results being properly reviewed and acted upon by appropriate county agencies, elected officials and the San Mateo County Civil Grand Jury?

### Background

Section 25250 of the California Government Code (Section 25250) requires a county, through its board of supervisors to conduct certain audit-related functions. The following excerpts from Section 25250 define those obligations. A county must, at least biennially:

“examine and audit, or cause to be audited, the financial accounts and records of all officers having responsibility for the care, management, collection, or disbursement of money belonging to the county or money received or disbursed by them under authority of law.”

“This financial examination or audit may be performed in coordination with the investigations conducted by the grand jury under Section 925 of the Penal Code... In connection with the requirements of this section..., the board of supervisors may employ the services of an independent certified public accountant or licensed public accountant to perform an examination of the financial statements in accordance with generally accepted auditing standards.”

A county grand jury under California Penal Code Section 925 (Section 925) also has obligations. The Grand Jury

“*shall* investigate and report on the operations, accounts, and records of the officers, departments, or functions of the county ...” [emphasis added]

“The investigations may be conducted on some selective basis each year, but the grand jury shall not duplicate any examination of financial statements which has been performed by or for the board of supervisors pursuant to Section 25250 of the Government Code. This provision shall not be construed to limit the power of the grand jury to investigate and report on the operations, accounts, and records of the officers, departments, or functions of the county. The grand jury may enter into a joint contract with the board of supervisors to employ the services of an expert as provided for in Section 926.”

The 2006-2007 San Mateo County Civil Grand Jury (Grand Jury) decided to investigate whether San Mateo County (County) and its Board of Supervisors are fulfilling their obligations under Section 25250, and the role and responsibility of the Grand Jury itself in connection with the audits and investigations provided for under Section 25250 and Section 925.

## **Investigation**

Members of the Grand Jury reviewed documents related to the County’s financial statements for the fiscal years ended June 30, 2005 and 2006, including the following:

- Comprehensive Annual Financial Report (CAFR) prepared by the County Controller (Controller)
- Report to Board of Supervisors and Grand Jury issued by Macias Gini & O’Connell LLP, the County’s independent auditors (Independent Auditors)
- A letter agreement dated March 11, 2003, as amended (the Engagement Letter) between the Board of Supervisors and the Grand Jury, on one hand, and Macias Gini & O’Connell LLP, on the other. This agreement describes the conduct of audits of the County’s financial statements for the fiscal years 2003-2008
- The Controller’s Office Audit Plan for the fiscal year 2006-2007
- Numerous financial statements and reports related to many of the approximately 90 governmental entities (Districts) operating within the County. The Grand Jury did not systematically analyze or review these statements and reports.

The Grand Jury interviewed representatives of the Controller’s Office and representatives of the Independent Auditors. The Grand Jury also considered the role of the Board of Supervisors in connection with the County’s responsibilities under Section 25250.

## Findings

- The County Controller annually prepares and issues a Comprehensive Annual Financial Report (CAFR) that contains, among other information, the County's general purpose financial statements and notes thereto and an independent auditors' report, as required by Section 25250. The CAFR is due by December 31 of each year and has been completed and filed by such time in the fiscal years reviewed by the Grand Jury. The CAFR is in addition to numerous other financial statements and audits prepared in connection with County financial matters. The financial statements in the CAFR for the fiscal years reviewed by the Grand Jury, except as noted, were audited by the Independent Auditors, whose unqualified opinion was included. The CAFR also contains, as required by the Government Finance Officers Association (GFOA):
  - An introduction prepared by the Controller
  - An extensive management discussion
  - Analysis of the financial statements
  - Notes to the financial statements
  - Various other unaudited supplementary information
- The Independent Auditors prepare an annual "Report to Board of Supervisors and Grand Jury." It is referred to in this report as the SAS 61 letter, or the "Management Letter" because it is similar to the management letter issued by auditors in connection with their audits of financial statements of non-governmental entities. The Management Letter includes, among other things:
  - For the fiscal year ended June 30, Information related to the auditors' responsibilities
  - Significant accounting policies
  - Audit adjustments
  - Disagreements with management, and difficulties with the audit
  - Information regarding material weaknesses, if any, in the County's financial controls and procedures, with recommendations for improvement
- 2005 certain reports related to the County's financial statements were delayed because of delays in the completion of the San Mateo County Medical Center financial statements.

- The Management Letter for the fiscal year ended June 30, 2005 is dated May 23, 2006, and was received by the Controller in August 2006, more than a year after the end of the County's fiscal year. The Management Letter for the fiscal year ended June 30, 2006 is dated November 9, 2006 (the last day of the Independent Auditors' field work) and was received by the Controller in late April 2007, nearly 10 months after the end of the County's fiscal year. The Grand Jury was told that some of the delay resulted from the need to complete the Single Audit<sup>1</sup> (due March 31<sup>st</sup>) before release of the Management Letter. Release of the Management Letter also had to await the completion of financial statements not yet prepared by the Controller but incorporated into the County's financial statements.
- The Engagement Letter covers audits for fiscal years 2003-2008. Supplemental pre-audit communications (covering details of how the audit would be performed, what would be reviewed, etc.) were received from the Independent Auditors to the Board of Supervisors and the Grand Jury.
- The Independent Auditors helped the Grand Jury understand audit issues related to the County's financial statements and their helpful assistance was important to the investigation. The Independent Auditors can be a significant resource for future grand juries.
- Historically, the Grand Jury has had little involvement in the process of auditing the County's financial statements or reviewing the independent audits.
- On February 4, 2003, the Board of Supervisors created an Audit Committee consisting of two Supervisors and the Controller (or his representative) to oversee the audit of the County's financial statements, however no Board members were appointed, and the committee never met.
- On October 4, 2005, the Board of Supervisors created an Audit/Management Committee to oversee performance audits of County departments and functions, and to evaluate the recommendations and their implementation. Two supervisors were appointed as members.
- On December 12, 2006, the Board of Supervisors consolidated the two audit committees; and two Supervisors were appointed to the new Audit/Management Review Committee. The consolidated committee last met on January 31, 2007 to review a performance audit of the Housing Department. Neither the prior Audit Committee nor the consolidated committee has met with the Independent Auditors. The consolidated committee appears to have the purpose of reviewing operational audits rather than the role of a traditional audit committee.

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<sup>1</sup> The Single Audit is done for Federal grant purposes.

- The Controller annually determines whether the Districts have completed financial statement audits, but neither the Controller nor the Grand Jury reviews such reports.
- The County Counsel annually provides a letter to the Independent Auditors regarding lawsuits against the County involving amounts exceeding a certain materiality threshold, currently \$500,000. The letter specifically excludes matters handled by other lawyers. Apparently, claims covered by insurance or other contracts are not reported by the County Counsel. The Independent Auditors do communicate with outside legal counsel based on information received from the County during the course of the audit. Claims (incurred but not reported) covered by insurance or other contracts are analyzed by the Independent Auditors in the course of the audit and reported in the CAFR.
- The Government Finance Officers Association has “Recommended Practices for Public Agencies” that recommend the formation of an Audit Committee, the primary purpose of which shall be to independently oversee the audit of the Government Code-required financial statements.
- The Government Finance Officers Association awarded a “Certificate of Achievement for Excellence in Financial Reporting” to the Controller for the 2005-2006 CAFR, the 7th consecutive year that the County has received this award.
- The 2006-2007 San Mateo Civil Grand Jury has written a separate letter to the Hon. John L. Grandsaert, Judge of the Superior Court and Grand Jury Judge, recommending that the rules governing Grand Jury operations be amended to provide for the establishment of an Audit Committee.

## **Conclusions**

The County prepares financial statements required under Section 25250 in a timely manner and has them independently audited.

The Board of Supervisors does not have a separate audit committee to deal with audit-related issues, a much needed governmental function; one should be established.

The time schedule for the Independent Auditors to prepare, discuss with the County and deliver the Management Letter makes it difficult for the Board of Supervisors and the Grand Jury to identify early on financial issues that might affect the County’s financial condition. The Board of Supervisors should be more diligent in its insistence that the Management Letter be delivered in a timely fashion.

Numerous Special District financial reports are not reviewed by County officials or the Grand Jury.

The Grand Jury has no formal procedures for handling audit issues related to its obligations under Section 925; it should establish such procedures.

## **Recommendations**

The Grand Jury recommends that the San Mateo County Board of Supervisors:

1. Establish an Audit Committee to advise the Board of Supervisors regarding the selection of San Mateo County's independent auditors and regarding a review of the County's financial statement auditing process. The Audit Committee should be composed solely of members of the Board of Supervisors.
2. Establish an Audit Committee pursuant to a resolution containing substantially the matters set forth in Exhibit A to this report.

The Grand Jury recommends that the San Mateo County Controller:

1. Establish procedures to identify those financial reports of the approximately 90 governmental entities operating within San Mateo County that evidence material weakness or other financial irregularities and report such conditions to the Grand Jury.
2. Meet with the Grand Jury at least annually to review the Grand Jury's responsibilities under California Penal Code Section 925, the Comprehensive Annual Financial Report, the performance of the independent auditors, and any other matters relating to San Mateo County's financial statements that are appropriate.
3. Work with the independent auditors to ensure that the Report to Supervisors (management letter) is delivered promptly following completion of the audit.

The Grand Jury recommends that future San Mateo County Civil Grand Juries establish an audit committee. This audit committee should advise the entire Grand Jury regarding its duties under California Penal Code Sections 925 and 926 and shall have the objectives and responsibilities as set forth in Exhibit B of this report. The Grand Jury should establish procedures for reviewing the financial reports of the approximately 90 governmental entities operating in the County to identify actual and potential financial problems.

## **EXHIBIT “A”**

### Board of Supervisors

#### Audit Committee Resolution

COMMITTEE	The Board of Supervisors (the “Board”) of San Mateo County (the “County”) has established a standing committee to be known as the Audit Committee (the “Committee”).
OBJECTIVES	The purpose of the Committee is to act in an advisory capacity to the Board, recommending the selection of the County’s independent auditors and reporting annually to the Board of Supervisors and to the Grand Jury regarding the County’s auditing, accounting and control functions and financial reporting process.
COMPOSITION	The Committee’s composition shall consist of two (2) members of the Board. One of the members so appointed will be designated by the Board as the Chairperson of the Committee. It is desirable for one member of the Committee to have past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background which results in the individual’s financial sophistication.
SCOPE OF ACTIVITIES	<p>The Committee shall exercise the following powers and duties:</p> <ul style="list-style-type: none"><li>(a) Recommend to the Board and the Grand Jury the firm of independent auditors to be selected to audit the County financial statements;</li><li>(b) Meet with the County’s independent auditors at least annually and review the scope of the annual audit (inclusions and exclusions), any open questions as to the choice of acceptable accounting principles to be applied and all other matters relating to the auditors’ relationship with the County;</li><li>(c) Advise the Board as to the auditors’ performance, including the scope and adequacy of the auditors’ review;</li><li>(d) Recommend, where appropriate, the removal or replacement of the independent auditors;</li></ul>

- (e) Review the County's annual financial statements, including the footnotes, and discuss such statements with the auditors prior to release of the County's annual report;
- (f) Receive and consider the auditors' comments and suggestions as to internal audit and control procedures, adequacy of staff, and other matters;
- (g) Receive and review periodic reports of the County's Controller and internal audit staff; meet with the Controller and internal audit staff to review and approve the internal audit staff to examine and approve the internal audit programs; review the executive management's responses to internal audit staff reports; review the adequacy of the County's internal audit staff and report thereon to the Board;
- (h) Approve non-audit services to be rendered to the County by the independent auditors, if any, after considering the effect on audit independence;
- (i) Meet with and obtain reports and information from such County officials, employees, suppliers and others as the Audit Committee shall determine to be necessary in carrying out their duties as set forth above;
- (j) Take, or recommend that the Board take, appropriate action to oversee the independence of the outside auditors;
- (k) Receive and review periodic written statements from the independent auditors delineating all relationships between the auditors and the County; and
- (l) Engage in an active dialogue with the auditors with respect to any disclosed relationships or services that may impact the objectivity and independence of the auditors.

## MEETINGS

The Committee shall hold regular meetings on such days as it shall determine. Other meetings of the Committee will be held at the request of the Chairperson of the Committee. Minutes shall be regularly kept of the Committee proceedings, by a person appointed by the Committee to do so.



AGENDA

Prior to each regularly scheduled meeting, the Committee will receive a prepared agenda for the meeting. Other topics for discussion may be introduced at the meeting at the request of any Committee member.

ATTENDANCE

Such County officials and other employees of the County, as the Committee may regularly or from time-to-time designate, shall attend the meetings.

OUTSIDE ASSISTANCE

Subject to the prior approval of the Board, the Committee is authorized to engage or employ such outside professional or other services as in its discretion may be required to fulfill its responsibilities.

## **EXHIBIT "B"**

Grand Jury

Audit Committee

### COMMITTEE

The San Mateo County Grand Jury ("Grand Jury") has established a standing committee to be known as the Audit Committee (the "Committee").

### OBJECTIVES

The purpose of the Committee is to be responsible for (i) advising the Grand Jury regarding its duties under California Penal Code Section 925, (ii) jointly with the Board of Supervisors (Board) recommending the selection of the County's independent auditors and (iii) reporting annually to the Grand Jury regarding the County's auditing, accounting and control functions and financial reporting process.

### COMPOSITION

The Administration & Finance Committee may serve as the Audit Committee or the Grand Jury may establish and appoint a separate committee. One of the members so appointed will be designated by the Grand Jury Foreperson as the Chairperson of the Committee. It is desirable for one member of the Committee to have past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication.

### SCOPE OF ACTIVITIES

The Committee shall exercise the following powers and duties:

- (a) Recommend to the Board and the Grand Jury the firm of independent auditors to be selected to audit the County financial statements;
- (b) Meet with the County's independent auditors and Controller at least annually and review the scope of the annual audit, any open questions as to the choice of acceptable accounting principles to be applied and all other matters relating to the auditors' relationship with the County;
- (c) Advise the Grand Jury as to the auditors' performance, including the scope and adequacy of the auditors' review;

- (d) Recommend, where appropriate, the removal or replacement of the independent auditors;
- (e) Review the County's annual financial statements, including the footnotes, and discuss such statements with the auditors prior to release of the County's annual report;
- (f) Receive and consider the auditors' comments and suggestions as to internal audit and control procedures, adequacy of staff, and other matters;
- (g) Receive and review periodic reports of the County's Controller and internal audit staff; meet with the Controller and internal audit staff to review and approve the internal audit programs; review the executive management's responses to internal audit staff reports;
- (h) Meet with the request and obtain reports and information from such County officials, employees, suppliers and others as the Audit Committee shall determine to be necessary in carrying out their duties as set forth above; and

Engage in an active dialogue with the auditors with respect to any disclosed relationships or services that may impact the objectivity and independence of the auditors.

August 20, 2007

Hon. Joseph L. Grandsaert  
Judge of the Superior Court  
Hall of Justice  
400 County Center; 2<sup>nd</sup> Floor  
Redwood City, CA 94063-1655

Hon. Joseph L. Grandsaert:

Regarding the recommendations in the Grand Jury AUDIT AND REVIEW OF COUNTY FINANCIAL STATEMENTS Report to the Controller:

1. Establish procedures to identify those financial reports of the approximately 90 governmental entities operating within San Mateo County that evidence material weakness or other financial irregularities and report such conditions to the Grand Jury.

**Response:** The Controller concurs with this recommendation.

Government Code Section 26909 requires the county auditor to perform an annual audit or contract with a CPA to perform an annual audit of the accounts and records of every special purpose district within the county. The Code Section further requires the special purpose districts to file a report thereof with the county auditor within 12 months of the end of the fiscal year or years under examination. For entities in the County that fall under the purview of this statutory authority given to the County Controller, the Controller has established procedures for reviewing compliance with the Code Section. The Controller will submit an annual report to the Grand Jury that will identify reports that disclosed material weaknesses or other financial irregularities and provide details of such conditions.

2. Meet with the Grand Jury at least annually to review the Grand Jury's responsibilities under California Penal Code Section 925, the Comprehensive Annual Financial Report, the performance of the independent auditors, and any other matters relating to San Mateo County's financial statements that are appropriate.

**Response:** The Controller concurs with this recommendation.

At the behest of the Grand Jury, the Controller will meet to review their responsibilities under California Penal Code Section 925, the Comprehensive Annual Financial Report, the performance of the independent auditors, and any other matters relating to San Mateo County's financial statements that are appropriate.

3. Work with the independent auditors to ensure that the Report to Supervisors (management letter) is delivered promptly following completion of the audit.

**Response:** The Controller concurs with this recommendation.

The Controller's Office will continue to work with the independent auditors to ensure that the Report to Supervisors is delivered promptly following completion of the audit. The Controller's Office will also propose that future contracts with independent auditors of the County's financial statements include a clause to ensure timely delivery of this report.

Respectfully submitted,

Tom Huening  
Controller

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cc: Thomas F. Casey III  
Dennis O'Rourke



**COUNTY OF SAN MATEO**  
**Inter-Departmental Correspondence**

County Manager's Office

**DATE:** September 20, 2007  
**BOARD MEETING DATE:** October 2, 2007  
**SPECIAL NOTICE:** None  
**VOTE REQUIRED:** Majority

**TO:** Honorable Board of Supervisors  
**FROM:** John L. Maltbie, County Manager  
**SUBJECT:** 2006-07 Grand Jury Response

**Recommendation**

Accept this report containing the County's responses to the following 2006-07 Grand Jury report: Audit and Review of County Financial Statements.

**VISION ALIGNMENT:**

**Commitment:** Responsive, effective and collaborative government.

**Goal 20:** Government decisions are based on careful consideration of future impact, rather than temporary relief or immediate gain.

This activity contributes to the goal by ensuring that all Grand Jury findings and recommendations are thoroughly reviewed by the appropriate County departments and that, when appropriate, process improvements are made to improve the quality and efficiency of services provided to the public and other agencies.

**Discussion**

The County is mandated to respond to the Grand Jury within 90 days from the date that reports are filed with the County Clerk and Elected Officials are mandated to respond within 60 days. To that end, attached is the County's response to the Grand Jury report regarding the Audit and Review of County Financial Statements, issued on July 11, 2007.

## **Audit and Review of County Financial Statements**

### **Findings:**

Staff is in general agreement with the Grand Jury's findings.

### **Recommendations:**

**The Grand Jury recommends that the San Mateo County Board of Supervisors:**

**1. Establish an Audit Committee to advise the Board of Supervisors regarding the selection of the San Mateo County's independent auditors and regarding a review of the County's financial statement auditing process. The Audit Committee should be composed solely of members of the Board of Supervisors.**

**Response:** Concur. The Board created and appointed two Board members to an Audit/Management Review Committee in October 2005. On April 10, 2007, the Board established five standing committees to streamline committee assignments. The standing committees, each consisting of two Board members, subsumed numerous, sometimes duplicative and often narrowly focused subcommittees to improve the County's efficiency and effectiveness in developing and setting policy. One of the Board's standing committees is the Finance and Operations Committee, which has been meeting regularly since July. A resolution with proposed changes to the committee structure will be brought to the Board in December, which will include a change indicating that the Finance and Operations Committee will serve as the County's Audit Committee.

**2. Establish an Audit Committee pursuant to a resolution containing substantially the matters set forth in Exhibit A to this report.**

**Response:** Concur. A resolution with proposed changes to the Board committee structure will be brought to the Board in December, which will include a change indicating that the Finance and Operations Committee will serve as the County's Audit Committee. If approved, the Committee will consider the scope of activities described in Exhibit A at a future meeting.