MENDOCINO COUNTY

Review Report

INTERNAL CONTROL OVER FINANCIAL REPORTING

July 1, 2020, through June 30, 2022

MALIA M. COHEN

CALIFORNIA STATE CONTROLLER

July 2024

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Sara Pierce, Acting
Auditor–Controller/Treasurer–Tax Collector
Mendocino County
501 Low Gap Road
Ukiah, CA 95482

Darcie Antle, Chief Executive Officer
Mendocino County
501 Low Gap Road
Ukiah, CA 95482

Dear Ms. Pierce and Ms. Antle:

The State Controller's Office reviewed Mendocino County's internal controls over financial reporting during the period July 1, 2020, through June 30, 2022. Our review identified internal control deficiencies and other challenges that contributed to the county's inability to prepare and submit its annual financial reports promptly.

The county should develop a comprehensive plan to address these deficiencies. The plan should identify the tasks to be performed, as well as milestones and timelines for completion. The Board of Supervisors should require periodic updates at public meetings regarding the county's progress in implementing this plan. Furthermore, we will require that the county provide the State Controller's Office with a progress update of its plan six months from the issuance date of the final report.

We appreciate the county's assistance and cooperation during the engagement, and its willingness to implement corrective actions.

If you have any questions regarding this report, please contact Efren Loste, Chief, Local Government Audits Bureau, by telephone at (916) 324-7226, or by email at eloste@sco.ca.gov.

Sincerely,

Original signed by

Kimberly A. Tarvin, CPA
Chief, Division of Audits

KAT/ac

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Contents

Review Report

Summary 1

Background 2

Review Authority 3

Objective, Scope, and Methodology 3

Conclusion 4

Follow-up on Prior Review Findings 4

Views of Responsible Officials 4

Restricted Use 5

Findings and Recommendations 6

Review Report

Summary

The State Controller's Office (SCO) reviewed Mendocino County's (the county's) internal controls over financial reporting for the period of July 1, 2020, through June 30, 2022. For certain procedures, we expanded our review to include prior-year and current-year transactions and other county operations beyond the financial reporting process.

The county has not met its statutory financial reporting deadlines for the prior two fiscal years. Our review found that the county's inability to meet required deadlines were due to a combination of the following challenges:

- Beginning in 2021, the county experienced significant leadership changes in its governmental structure. In September 2021, the then-Auditor-Controller retired. In December 2021, the county Board of Supervisors (BOS) passed a county ordinance to consolidate the Auditor-Controller's Office (ACO) and the Treasurer-Tax Collector's Office (TTCO); the consolidation was to become effective January 2, 2023, upon the election of a new Auditor–Controller/Treasurer–Tax Collector. After the December 2021 county ordinance was enacted, the Treasurer–Tax Collector retired and the Acting Treasurer–Tax Collector resigned. The ACO and the TTCO began consolidating the two offices before the 2022 election cycle, which left little time for these offices to prepare, plan, and execute the consolidation while maintaining their regular workload, including timely financial reporting.

- There was a high employee churn rate at the ACO and the TTCO, including among key personnel. The employee churn rate peaked at 40% in calendar year (CY) 2022. The departure of key personnel from the TTCO and the lack of sufficient experienced personnel at the ACO and the TTCO made it difficult for the ACO to complete financial and accounting functions. These difficulties were compounded when the ACO inherited TTCO functions.

- The county had pervasive and persistent staffing issues. The Mendocino County Civil Grand Jury (Grand Jury) noted a lack of permanent staffing in 2013 and again in 2023. During our review, ACO and TTCO staff members confirmed many of the Grand Jury's findings.

- The county accumulated a backlog of journal entries that prevented the timely completion of its financial statements. The lack of sufficient personnel at the ACO and the TTCO, and a lack of policies and procedures led to extensive delays in the journal entry submission process.

- The county's decentralized accounting system contributed to financial reporting delays. The county uses the Municipal Uniform Information System (MUNIS) for most of its departmental accounting functions. However, the county tracks some transactions with an Excel spreadsheet; and it maintains 14 bank accounts outside of MUNIS. Manually recording and tracking transactions leads to delays in reconciling accounts and financial reporting.

We also identified the following internal control deficiencies:

- The county did not reconcile its bank and general ledger balances to the county treasurer's records on an ongoing and timely basis.
- A former payroll supervisor's access to the payroll system was not adequately segregated, possibly resulting in unallowable payments.
- The county did not have an official policy and procedure manual that fully reflects its current operational processes.

Background

Mendocino County was established in 1850 when California became a state. Located on California's northern coast, the county encompasses 3,878 square miles and borders six other California counties: Humboldt and Trinity in the north; Tehama, Glenn, and Lake in the east; and Sonoma in the south.

Mendocino County is a general-law county with nine elected officials, including a five-member BOS, an Assessor–Clerk–Recorder, an Auditor–Controller/ Treasurer–Tax Collector, a District Attorney, and a Sheriff. All county officials are elected to four-year terms. The county's Chief Executive Officer is appointed by the BOS.

The county's financial accounts are organized on the basis of funds, each of which is considered a separate entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, net assets, revenues, and expenditures or expenses, as appropriate. Government resources are allocated to and accounted for in individual funds based on the purposes for which they are to be spent and the means by which the spending activities are controlled.

Annual financial reports

The county is required to complete and/or file annual financial reports, including the Financial Transactions Report (FTR), the Single Audit Report (SAR), and the Annual Comprehensive Financial Report (ACFR). Prior to January 2021, the ACO had primary responsibility for the financial year-end closing process; since its consolidation with the TTCO, that responsibility has been held by the new Auditor–Controller/ Treasurer–Tax Collector's Office (AC/TTCO).

In recent years, the county has been unable to complete and/or file these reports promptly:

- FTR – Government Code (GC) section 53891 requires that a report on the financial transactions of each local agency be submitted to the SCO within seven months after fiscal year-end or within the time prescribed by the SCO, whichever is later. The report must contain underlying data from audited financial statements prepared in accordance with generally accepted accounting principles, if this data is available. The county filed its FTRs for fiscal year (FY) 2018-19 through FY 2021-22 late, and the FY 2022-23 FTR is delinquent, as shown in the following table:

FTR for Fiscal Year	Due Date	Date Filed with SCO	Number of Days Late
2022-23	January 31, 2024	*Pending*	*Delinquent*
2021-22	January 31, 2023	February 14, 2024	379
2020-21	January 31, 2022	September 12, 2022	224
2019-20	January 31, 2021	May 15, 2021	104
2018-19	January 31, 2020	April 1, 2020	61

- SAR – Uniform Guidance (Title 2, Code of Federal Regulations, Part 200) mandates that any non-federal entity that expends $750,000 or more in federal awards during a fiscal year complete a SAR within nine months after the fiscal year-end. The county completed its SARs for FY 2018-19 through FY 2020-21 on time; however, the FY 2021-22 SAR was delinquent, as shown in the following table:

SAR for Fiscal Year	Due Date	Extended Due Date	County Completion Date	Number of Days Late
2021-22	March 31, 2023	N/A	January 19, 2024	294
2020-21	March 31, 2022	September 30, 2022	September 20, 2022	N/A
2019-20	March 31, 2021	September 30, 2021	December 23, 2020	N/A
2018-19	March 31, 2020	N/A	December 23, 2019	N/A

- ACFR – An ACFR is a set of financial statements for a state, municipality, or other governmental entity that complies with the accounting requirements established by the Governmental Accounting Standards Board. Completion of the ACFR satisfies various auditing and reporting requirements, including those in GC sections 25250 and 25253. For the ACFR to be relevant and useful, it should be completed within nine months after the fiscal year-end. The ACFR is usually completed in conjunction with the SAR. The county completed its financial statements for FY 2018-19 through FY 2020-21 on time; however, the FY 2021-22 ACFR was late, as shown in the following table:

ACFR for Fiscal Year	Due Date (Best Practice)	Extended Due Date	County Completion Date	Number of Days Late
2021-22	March 31, 2023	N/A	December 4, 2023	248
2020-21	March 31, 2022	September 30, 2022	July 14, 2022	N/A
2019-20	March 31, 2021	September 30, 2021	December 23, 2020	N/A

Review Authority

We conducted this review pursuant to GC section 12422.5, which authorizes the SCO to review “any local agency for purposes of determining whether the agency’s internal controls are adequate to detect and prevent financial errors and fraud.”

Objective, Scope, and Methodology

The objective of our review was to evaluate the county’s internal control over its annual financial reporting process to determine why the county has not submitted timely annual financial reports for FY 2020-21 and FY 2021-22. After learning of potentially unallowable payroll payments, we expanded our objective to include determining whether the unallowable payments were an isolated instance or pervasive. For certain procedures, we expanded our review to include prior-year and current-year transactions and other county operations beyond the financial reporting process.

To achieve our objective, we performed the following procedures:

- We evaluated the county's formal policies and procedures.
- We conducted interviews with county employees and observed the county's business operations to evaluate the county's internal control system for financial reporting.
- We reviewed BOS meeting minutes, county ordinances, county memos, financial data, reports, and studies that were relevant to our objective.
- We obtained payroll data to determine whether unallowable salary payments were made to county supervisory personnel.

The *Standards for Internal Control in the Federal Government* (the Green Book), issued by the Government Accountability Office, describes the fundamental components, principles, and attributes of effective internal control systems. We applied these standards to assess various aspects of the county's internal control system. This review is intended to help county management improve its internal controls over financial reporting.

Conclusion

Our review identified various challenges that contributed to the county's inability to prepare its annual financial reports promptly. Specifically, we noted that the county's changes in leadership, high staff churn rate, persistent staffing issues, backlog of journal entries, and decentralized accounting system contributed to untimely FTRs and financial statements (Finding 1).

We also noted internal control deficiencies related to bank reconciliation processes (Finding 2), segregation of payroll duties (Finding 3), and a lack of a complete, up-to-date, formal policy and procedure manual (Finding 4).

These deficiencies are described in the Findings and Recommendations section.

Follow-up on Prior Review Findings

We have not previously conducted a review of the county's internal control system.

Views of Responsible Officials

We issued a draft review report on April 11, 2024. The county's representatives responded by email on April 29, 2024, agreeing with the recommendations. The county's representatives stated that some of the recommendations are not directly related to the AC/TTCO's functions, and that the AC/TTCO is not able to independently implement recommendations. The county's representatives specifically noted that implementing recommendations in the 2023 Grand Jury report "Accountability at the County: 25 Years of Transient HR Leadership and a Hobbled HR Department" is not under the control of the AC/TTCO. The county's representatives also noted that hiring, training, and retaining competent staff are not solely under the AC/TTCO's control, as those matters involve other departments and the BOS.

Restricted Use

This report is solely for the information and use of the county and the SCO; it is not intended to be, and should not be, used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record and is available on the SCO website at www.sco.ca.gov.

Original signed by

Kimberly A. Tarvin, CPA
Chief, Division of Audits

July 1, 2024

Findings and Recommendations

FINDING 1— Untimely Financial Transactions Reports and financial statements

We noted several challenges that prevented the county from submitting its FTR and completing its financial statements by the statutory deadlines. Specifically, we identified concerns related to county leadership changes, a high employee churn rate, staffing issues, a backlog of journal entries, and decentralized accounting system.

Changes in county leadership

In 2021, the county experienced significant changes in its governmental structure. The first significant change occurred in September 2021, when its then-Auditor–Controller retired and named his chosen successor, the Assistant Auditor–Controller. The BOS declined to appoint the Assistant Auditor–Controller to the position; instead, she became Acting Auditor–Controller. An acting county auditor fulfills the duties of the position until a successor is elected to the next term of office or appointed by the BOS. The Acting Auditor–Controller won the June 2022 primary election and assumed the elected position in January 2023. In October 2023, she was suspended from her duties and the county's Deputy Executive Officer was appointed to replace her.

The second significant change occurred in December 2021, when the BOS passed County Ordinance Number 4500 to consolidate the elected offices of Auditor–Controller and Treasurer–Tax Collector "effective 12 o'clock noon on January 2, 2023." In other words, the BOS decided to merge the ACO and the TTCO in December 2021, and the offices were to be consolidated as of January 2, 2023, upon the election of a new Auditor–Controller/Treasurer–Tax Collector.

The county began consolidating the two offices before the 2022 election cycle, leaving little time for the county to prepare, plan, and execute the consolidation while maintaining its regular workload. Although the county provided us with BOS meeting agendas that reflect discussions of the consolidation, the documents lacked sufficient detail to show that the county had performed a risk assessment prior to implementing the consolidation, or that it collaborated with the ACO and TTCO to address concerns and to mitigate the effects that a merger could have on the offices. Collaboration could have helped the merging offices to anticipate and plan for structural, personnel, and technology impacts; and to mitigate risks preventing the county from fulfilling its key responsibilities, including timely financial statements and FTRs.

A strong internal control system incorporates management strategies to anticipate, identify, and respond to significant changes, including those in structure, personnel, and technology. This proactive approach ensures that risks are managed and that changes do not adversely affect the organization's objectives.

High employee churn rate in key county offices

In the last three years, insufficient staffing levels have kept the ACO and the TTCO from accomplishing their duties and responsibilities in a timely manner. This lack of permanent staffing was noted by the FY 2022-2023 Grand Jury.

The insufficient staffing has resulted in a heavier workload for the remaining staff members and contributed to the county's inability to complete its financial reports by the statutory deadlines. Adequate staffing is necessary to maintain accurate and timely accounting records.

The ACO and the TTCO have had ongoing vacancies caused by separations, promotions, and difficulty recruiting qualified staff to fill vacancies. Between CY 2021 and CY 2023, these agencies had 25 full-time positions comprised of the Auditor–Controller/Treasurer–Tax Collector, the Assistant Auditor–Controller, the Assistant Treasurer–Tax Collector, and 22 other staff including accountants and auditors. The ACO and the TTCO faced increasing employee churn rates between CY 2020 and CY 2022, peaking at 40% in CY 2022.

After the county decided to consolidate the ACO and TTCO, the Treasurer-Tax Collector retired, and the Acting Treasurer-Tax Collector resigned. The departure of key personnel in the TTCO and the lack of sufficient experienced personnel made it difficult for the ACO to complete financial and accounting functions. These difficulties were compounded when the ACO inherited TTCO functions.

It is important to maintain an adequate level of competent staffing to ensure effective internal controls in critical offices like the ACO and the TTCO. Stable and adequate staffing levels at the ACO and the TTCO are vital for the county to efficiently plan and fulfill its financial reporting objectives.

Pervasive and persistent staffing issues

On March 20, 2013, the Grand Jury released a report titled "Human Resources – A Department in Need of Attention: A County in Need of a Sustainable Workforce." The report identified four deficiencies related to human resources (HR) and recommended specific improvements.

On June 21 2023, the Grand Jury released a report called "Accountability at the County: 25 Years of Transient HR Leadership and a Hobbled HR Department." The report identified 25 new findings and 24 recommendations for the HR Department. Eight of these findings are directly connected to the previously unresolved issues from 2013.

The Grand Jury found that, due to a lack of prioritization and oversight, the county had neglected its HR Department by leaving it understaffed and without sufficient leadership. The Grand Jury noted that these problems had continued for over 10 years. Our review procedures did not duplicate the work performed by the Grand Jury; however, ACO and TTCO staff members confirmed many of the Grand Jury's findings during our review. Some of these findings include the lack of an effective performance management process, a poor workplace culture, staffing shortages, high turnover, and a lengthy hiring process.

Backlog of journal entries

The county accumulated a backlog of journal entries that had to be processed before it could finalize the financial statements. This delay contributed significantly to the county's inability to produce timely year-end financial statements. The backlog in approving journal entries resulted, in part, from a lack of sufficient personnel in the ACO and the TTCO, and a lack of policies and procedures for the county's journal entry processes.

Various county departments generate journal entries to record financial transactions, such as adjustments, allocations, and transfers. Fiscal staff members in each county department prepare these entries, which are then processed and entered into the general ledger by ACO staff members.

In January 2023 (19 months after the end of FY 2020-21), the county posted various journal entries including year-end closing entries totaling $118 million to FY 2020-21. Similarly, in August 2023 (14 months after the end of FY 2021-22), a year-end journal entry of $4 million was posted to FY 2021-2022. As a result of late accounting entries, the county's management may have based financial decisions during FY 2020-2021 and FY 2021-2022 on incomplete accounting data.

Additionally, the county's fiscal staff frequently submitted journal entries with errors, which resulted in rejections for corrections. This issue stems from the absence of formal procedures for the fiscal staff to follow, and led to extensive delays in the journal entry submission process.

Timely and correct accounting data are essential for fiscal monitoring; therefore, financial transactions must be recorded promptly and accurately. The substantial backlog and extensive turnaround time to post journal entries caused the county's available accounting data to be unreliable for timely, informed decision-making.

Decentralized accounting system

The county's decentralized accounting system is inefficient and causes delays. The county uses MUNIS, an enterprise resource planning financial software application, for its accounting function. Using MUNIS, an organization can centralize and integrate its financial data to streamline its operations. However, the county does not use MUNIS to its fullest capacity.

The county uses MUNIS for most of its departmental accounting functions. However, the county tracks some transactions, such as disbursements from its Department of Social Services, with an Excel spreadsheet. According to county staff, a recent software update disrupted the data flow between the Department of Social Services' disbursement software and MUNIS. The county has not yet reconnected the two software systems. Consequently, the county manually recorded and tracked transactions totaling $1,005,150 as of July 2022 in an Excel spreadsheet, and merged it with the rest of the financial data at the end of the fiscal year.

Additionally, the county has 14 bank accounts, with an approximate net balance of $300,827, that are maintained outside of MUNIS. One bank account, for a private trust fund, has a balance of $196,799. The 13 other accounts, with a balance of $104,028, receive deposits of fees for various county services including libraries, public health, and planning and building services in rural areas of the county. These bank accounts were established so that staff would not have to transport cash and checks from offsite locations to the county treasury in Ukiah. Staff members deposit funds in these accounts and then, at the end of each month, write a check to the county treasury for deposit.

The county did not record these deposits in its accounting software until months later, when county staff members transferred the money to the county treasury. County staff members originally thought that the county had approximately $500,000 in these 14 bank accounts outside of MUNIS; but after completing a reconciliation, they realized that the balance was closer to $300,000. The county failed to keep timely records because it did not reconcile these accounts for several months.

According to the bank statements and copies of checks that we reviewed, transactions included cash deposits and withdrawals for transfer to the county treasury. We were not able to determine whether there was any potentially fraudulent activity.

The county's practice of accounting for some of its resources outside of MUNIS delayed the financial statements. Establishing a centralized accounting system as a part of good internal controls can help improve accuracy and consistency, while enhancing financial oversight. When all financial data is in one place, generating reports and conducting analyses becomes more straightforward; as a result, strategic decision-making becomes easier. Furthermore, an effectively-used centralized accounting system allows for efficient accounting and year-end closing processes.

<u>Recommendation</u>

We recommend the county:

- For future reorganizations, conduct a risk assessment before implementing significant changes, such as consolidating two elected offices;
- Continue implementing the recommendations in the Grand Jury's 2023 report, "Accountability at the County: 25 Years of Transient HR Leadership and a Hobbled HR Department.";
- Hire, train, and retain competent staff;
- Formalize and implement policies and procedures for journal entries and the annual year-end account closing;
- Develop and implement a plan with milestones and targeted completion dates for processing the backlog of journal entries;
- Recognize revenues in MUNIS in a timely manner;

- Consider investigating the 14 bank accounts to determine whether there was any fraudulent activity; and
- Centralize county financial activity within MUNIS.

FINDING 2—Inadequate controls over bank reconciliation processes

The county does not reconcile its bank balances to the county treasurer's accounting records, nor does it reconcile cash and investment accounts between the county treasurer's records and the ACO records pursuant to GC section 26905. The county's failure to conduct complete and timely bank account reconciliations contributed to the delay of its financial reports.

Bank balance reconciliations

Due to a lack of records, it is not clear when the county last performed a complete bank reconciliation. County departments prepare informal reconciliations for their respective bank accounts, and the ACO carries out a limited reconciliation annually in June as part of the financial audit preparations. We reviewed a reconciliation of six bank accounts and found it incomplete.

We observed that the county compares a cash summary prepared by its asset management firm to its ledgers, rather than comparing the ledgers to actual bank statements. This practice could lead to undetected errors and fraudulent activity due to a lack of detail in the cash summaries.

The county appears to have difficulties preparing bank reconciliations partly due to the lack of written, up-to-date processes and procedures. Insufficient knowledge and incomplete accounting records also appear to prevent staff members from effectively performing reconciliations.

Cash and investment account reconciliations

The county does not complete the cash and investment account reconciliations required by GC section 26905, which states:

> Not later than the last day of each month, 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 as of the close of business of the preceding month to determine that the amounts in those accounts as stated on the books of the treasurer are in agreement with the amounts in those accounts as stated on the books of the auditor.

The bank balance should be reconciled to the county treasurer's balance, and the cash and investments balance in the county's general ledger should be reconciled to the total cash and investments balance in the county treasurer's records.

Timely cash reconciliations with bank records, the county treasurer's records, and the general ledger are an essential internal control. Implementing this control would allow the county to verify that all cash transactions have been recorded properly and to detect errors and fraud. Cash reconciliations would also help the county to monitor its cash flows and ensure accuracy and timeliness of withdrawals and deposits.

Recommendation

We recommend that the county:

- Reconcile bank and general ledger balances to the county treasurer's records on an ongoing and timely basis to ensure that the cash balance reported in the general ledger is complete and accurate;
- Develop a plan and complete the backlog of reconciliations; and
- Update, formalize, and implement policies and procedures to ensure that reconciliations are completed, reviewed, and approved in a timely manner.

FINDING 3— Insufficient internal controls over payroll

The county lacked sufficient internal controls over its payroll system; this deficiency might have resulted in unallowable payments to a former payroll supervisor. We reviewed the county's internal controls over payroll and the county's payroll records to identify whether any other county supervisory staff may have received unallowable payments. We did not identify any additional unallowable payments to county supervisory staff during the review period. However, we did identify internal control deficiencies related to the payroll system.

The county's payroll system allows employees in charge of the payroll process to adjust their own payroll records. Proper segregation of duties ensures that no one employee can initiate, record, authorize, and reconcile a transaction without the intervention of another person. When these incompatible duties are not separated, one person can commit and then conceal errors, misuse of assets, and fraud. We did not identify any compensating controls to mitigate this risk.

During our review, we became aware that a former payroll supervisor may have received unallowable payments. This situation led to a criminal investigation conducted by county officials. Because this matter is the subject of litigation, we make no conclusions regarding the disposition or allowability of these payments.

Chapter 3.04, "Personnel and Salary," of the Mendocino County Code of Ordinances lacks a section dedicated to miscellaneous salary adjustments, and there are no formal written policies and procedures regarding "miscellaneous pay."

Paragraph 10.12 of the Green Book states:

> Management considers segregation of duties in designing control activity responsibilities so that incompatible duties are segregated and, where such segregation is not practical, designs alternative control activities to address the risk.

Recommendation

We recommend that the county:

- Segregate the duties in the payroll adjustment process to ensure that no individual is able to create, approve, and record pay adjustments unilaterally; and
- Formalize and implement policies and procedures for the creation, approval, and recording of payroll adjustments such as "miscellaneous pay."

FINDING 4— Lack of established policies and procedures

The county does not have an official policy and procedure manual; existing written procedures have not been formalized through standardization. Furthermore, these procedures do not fully or accurately reflect the county's current operational processes. Policy updates have been sporadic and haphazard, leading to confusion among staff who found these changes unclear, contradictory, and poorly communicated.

For example, the county does not have standardized policies and procedures for journal entries. The sections of its manual pertaining to cash handling and accounting practices have not been revised since March 2014. This manual's procedures are outdated and do not reflect current procedures.

A manual that is not current or fully developed can cause confusion about roles and responsibilities, leading to mishandled transactions. It is crucial that clear and up-to-date policies and procedures are accessible to all employees, including backup personnel and new hires.

County staff members indicated that, historically, formalizing a standardized policy and procedure manual had not been a priority. However, county representatives recently stated that the county was working with a consultant to update its payroll policy manual and to provide guidance on accounting best practices.

Best practices for effective internal control emphasize the need for formal and up-to-date policies and procedures. According to Principles 10 and 12 of the Green Book, management is responsible for designing controls and documenting policies. The Green Book also emphasizes the importance of periodically reviewing and updating procedures to enable accountability and increase efficiency.

Recommendation

We recommend that the county:

- Review, update, and document its accounting policies to ensure consistency with current processes;
- Ensure that its accounting policies clearly state the authority and responsibility of appropriate parties; and
- Disseminate the accounting policies to all responsible employees and provide training when necessary.

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