

# Internal Audit Department

O R A N G E C O U N T Y  
6<sup>th</sup> Largest County in the USA

## FIRST AND FINAL CLOSE-OUT

### FOLLOW-UP AUDIT OF LADERA RANCH COMMUNITY FACILITIES DISTRICTS

AS OF JULY 31, 2012

Our First and Final Follow-Up Audit found the County Executive Office (CEO)/Public Finance, CEO/Public Finance Accounting (Auditor-Controller PFA), and OC Public Works fully implemented twenty (20) recommendations and one (1) recommendation was closed from our original audit report dated March 7, 2011. During the original audit, the six (6) Community Facilities Districts (CFDs) for Ladera Ranch received principal bond proceeds totaling \$287 million.

AUDIT NO: 1218-A  
ORIGINAL AUDIT NO: 2919

REPORT DATE: OCTOBER 25, 2012

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Deputy Director: Eli Littner, CPA, CIA  
Senior Audit Manager: Alan Marcum, CPA, CIA  
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#### RISK BASED AUDITING

GAO & IIA Peer Review Compliant – 2001, 2004, 2007, 2010



American Institute of Certified Public Accountants Award to Dr. Peter Hughes as 2010 Outstanding CPA of the Year for Local Government

GRC (Government, Risk & Compliance) Group 2010 Award to IAD as MVP in Risk Management



2009 Association of Certified Fraud Examiners' Hubbard Award to Dr. Peter Hughes for the Most Outstanding Article of the Year – Ethics Pays



2008 Association of Local Government Auditors' Bronze Website Award



2005 Institute of Internal Auditors' Award to IAD for Recognition of Commitment to Professional Excellence, Quality, and Outreach

 ORANGE COUNTY BOARD OF SUPERVISORS'  
**Internal Audit Department**

*GAO & IIA Peer Review Compliant - 2001, 2004, 2007, 2010*

*Providing Facts and Perspectives Countywide*

**RISK BASED AUDITING**

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**OC Fraud Hotline (714) 834-3608**



## Transmittal Letter



**Audit No. 1218-A    October 25, 2012**

**TO:** Robert J. Franz, Interim County Executive Officer  
Jan Grimes, Chief Deputy Auditor-Controller  
Ignacio Ochoa, Interim Director, OC Public Works

**FROM:** Dr. Peter Hughes, CPA, Director  
Internal Audit Department

**SUBJECT:** **First and Final Close-Out** Follow-Up Audit:  
Ladera Ranch Community Facilities Districts,  
Original Audit No. 2919, Issued March 7, 2011

We have completed a First Follow-Up Audit of Ladera Ranch Community Facilities Districts (CFDs). Our audit was limited to reviewing, as of July 31, 2012, actions taken to implement the **21 recommendations** from our original audit. We conducted this First Follow-Up Audit in accordance with the *FY 12-13 Audit Plan and Risk Assessment* approved by the Audit Oversight Committee and the Board of Supervisors (BOS).

The results of our First Follow-Up Audit are discussed in the **OC Internal Auditor's Report** following this transmittal letter. Because satisfactory corrective action has been taken for the 21 recommendations, **this report represents the final close-out of the original audit.**

Each month I submit an **Audit Status Report** to the BOS where I detail any critical and significant audit findings released in reports during the prior month and the implementation status of audit recommendations as disclosed by our Follow-Up Audits. Accordingly, the results of this audit will be included in a future status report to the BOS.

Other recipients of this report are listed on the **OC Internal Auditor's Report** on page 8.

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Ladera Ranch Community Facilities Districts  
Audit No. 1218-A***

As of July 31, 2012

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# OC Internal Auditor's Report



Audit No. 1218-A

October 25, 2012

TO: Robert J. Franz, Interim County Executive Officer  
Jan Grimes, Chief Deputy Auditor-Controller  
Ignacio Ochoa, Interim Director, OC Public Works

FROM: Dr. Peter Hughes, CPA, Director  
Internal Audit Department

SUBJECT: **First and Final Close-Out** Follow-Up Audit: Ladera Ranch Community Facilities Districts, Original Audit No. 2919, Issued March 7, 2011

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## Scope of Review

We have completed a First Follow-Up Audit of Ladera Ranch Community Facilities Districts. Our audit was limited to reviewing, as of July 31, 2012, actions taken to implement the twenty-one **(21) recommendations** from our original audit.

## Background

Our original audit evaluated the six (6) Ladera Ranch Community Facilities Districts. **Twenty-one (21) recommendations** were made to the County Executive Office/Public Finance (CEO/Public Finance), CEO/Public Finance Accounting (Auditor-Controller PFA) and OC Public Works in the original audit to improve controls and processes over Community Facilities Districts. During the original audit period, the Ladera Ranch Community Facilities Districts received principal bond proceeds totaling \$287 million.

## Results

Our First Follow-Up Audit found that CEO/Public Finance, Auditor-Controller PFA, and OC Public Works fully implemented twenty (20) recommendations and one (1) recommendation was closed. **As such, this report represents the final close-out of the original audit.** Based on the Follow-Up Audit we conducted, the following is the implementation status for the **twenty-one (21) recommendations**:

### 1. **Method for Special Tax Levy Calculation Should be Improved** **(Critical Control Weakness)**

We recommend Auditor-Controller PFA annually compare the debt service payments used in the calculation of the Special Tax Levy to the bonds' current debt service schedules to ensure the correct debt service payments are used.

**Current Status: Implemented.** For the most recent special tax levies, Auditor-Controller PFA compared the debt service payments used in the calculation of the Special Tax Levy to the bonds' current debt service schedules to ensure the correct debt service payments were used. In addition, Auditor-Controller PFA developed policies and procedures to ensure that principal and interest debt service payments are those that are to be paid by the County in the following calendar year. Because Auditor-Controller PFA has taken satisfactory corrective action, we consider this recommendation implemented.



## **2. Method for Special Tax Levy Calculation Should be Improved** **(Critical Control Weakness)**

We recommend Auditor-Controller PFA use the actual or reasonable interest earnings and administrative expenses that are aligned with actual historical data and adjust the subsequent Special Tax Levy for the difference between actual and estimated interest earnings and administrative expenses for the prior years.

Current Status: Implemented. Auditor-Controller PFA developed policies and procedures to ensure debt service funds are depleted at least once a year except for a reasonable carryover amount, which in the aggregate will not exceed the greater of (i) one year's interest earnings on such funds for the previous fiscal year or (ii) one-twelfth of the annual debt service with respect to the obligations for the immediately preceding fiscal year. Estimated interest earnings and administrative expenses based on actual historical data were utilized in the most recent Special Tax Levies (FYs 2011-12 and 2012-13). In addition, Auditor-Controller PFA adjusted the difference between actual and estimated interest earnings and administrative expenses for the prior years in their calculation of "reasonable carryover amount". Because Auditor-Controller PFA has taken satisfactory corrective action, we consider this recommendation implemented.

## **3. Method for Special Tax Levy Calculation Should be Improved** **(Critical Control Weakness)**

We recommend Auditor-Controller PFA management ensure a qualified and systematic supervisory review is provided and documented to enhance the integrity of the calculation of the Special Tax Levy.

Current Status: Implemented. Auditor-Controller PFA management performed a qualified and systematic supervisory review of the calculation of the Special Tax Levies and their reviews were documented. Because Auditor-Controller PFA has taken satisfactory corrective action, we consider this recommendation implemented.

## **4. Other CFD Special Tax Levy Calculations Require Additional Review** **(Significant Control Weakness)**

We recommend that Auditor-Controller PFA management perform a review of all other Community Facilities Districts (an additional seventeen [17] CFDs) to determine if the calculation of the Special Tax Levy needs to be adjusted to ensure that debt service payments agree to source documentation and estimates used are aligned with actual historical data; specifically, for administrative expenses and interest earnings. In addition, at the conclusion of the review Auditor-Controller PFA management submit the review to the Internal Audit Department for their independent validation.

Current Status: Implemented. Auditor-Controller PFA performed a review of the 23 Community Facilities Districts (six Ladera CFDs plus an additional 17 CFDs) to determine if the calculation of the Special Tax Levy requires an adjustment to ensure that debt service payments agree to source documentation and estimates used are aligned with actual historical data; specifically, for administrative expenses and interest earnings. In addition, at the conclusion of the review Auditor-Controller PFA management submitted the review to the Internal Audit Department for their independent validation.



It was determined that approximately **\$19.7 million** was over accumulated for the fiscal year 2011-12 Special Tax Levy and approximately **\$13.2 million** for the fiscal year 2012-13 that will be corrected within one to three years. Actual adjustments to reduce the over accumulation amounts were approximately **\$11 million** for fiscal year 2011-12 Special Tax Levy and approximately **\$15.7 million** for fiscal year 2012-13 Special Tax Levy. Because Auditor-Controller PFA has taken satisfactory corrective action, we consider this recommendation implemented.

**5. Controls over Notifying Tax Consultants of Changes to a Parcel's Information Needs Improvement (Control Finding)**

We recommend CEO/Public Finance make the appropriate corrections to the identified twenty-one (21) taxpayers' parcels that were undercharged and the seventeen (17) taxpayers' parcels that were overcharged.

Current Status: **Implemented.** CEO/Public Finance made corrections to the identified twenty-one (21) taxpayers' parcels that were undercharged and the seventeen (17) taxpayers' parcels that were overcharged for the fiscal year 2010-11 Special Tax Levy in which the corrections were carried forward to subsequent Special Tax Levies. Because CEO/Public Finance has taken satisfactory corrective action, we consider this recommendation implemented.

**6. Controls over Notifying Tax Consultants of Changes to a Parcel's Information Needs Improvement (Control Finding)**

We recommend Orange County Public Works ensure internal controls and processes are in place to notify the tax setting consultants of supplemental data for any amended building permits and ensure the certificate of occupancy data is accurately stated.

Current Status: **Implemented.** Orange County Public Works developed a report detailing the most up-to-date amendments/changes to a parcel's information in order to assist the tax setting consultants. Orange County Public Works and the tax setting consultants met to discuss the amendments/changes communicated in the report. Because Orange County Public Works has taken satisfactory corrective action, we consider this recommendation implemented.

**7. Special Tax Levy Collections are not Reviewed Following the Initial Year (Control Finding)**

We recommend Auditor-Controller PFA perform a review to ensure that special taxes levied are collected (including Teeter) and accurately recorded to the appropriate CFD. In addition, the review should be documented.

Current Status: **Implemented.** Auditor-Controller PFA now performs an annual review to ensure amounts approved by the Board of Supervisors for each district (including Teeter), were collected and deposited into the various districts' funds. The review is documented and approved by management. Because Auditor-Controller PFA has taken satisfactory corrective action, we consider this recommendation implemented.



## **8. Unexplained El Toro Branch Library Costs Charged to Ladera Ranch CFDs** **(Critical Control Weakness)**

We recommend CEO/Public Finance review and provide documentation to support the charge of the El Toro Branch Library capital improvement costs to the Ladera Ranch CFD's bond proceeds. Specifically, documentation in which the County determined that the capital improvements were deemed necessary to meet the increased demands. In addition, if the capital improvements were deemed necessary to meet the increased demands, CEO/Public Finance should ensure approval from the County Board of Supervisors.

Current Status: **Implemented.** CEO/Public Finance reviewed the charge of the El Toro Branch Library capital improvement costs and determined they were not proper expenditures made from the Ladera Ranch CFDs or the developer fees originating from the Ladera Ranch building permits. In addition, CEO/Public Finance determined that the CFDs and developer building fees were to finance the library costs pertaining to Ladera Ranch based on the developer agreement. A joint-use library agreement within the boundaries of Ladera Ranch with the Capistrano Unified School District is in place for the construction of the library and the purchase of library materials, furniture and equipment. Furthermore, CEO/Public Finance calculated the required funds needed to transfer to the Ladera Ranch CFDs for payment to the developer in accordance with the respective agreements.

On June 28, 2011, the Board of Supervisors approved the transfer of funds from the County's Library Fund to the Ladera Ranch CFDs. On November 22, 2011, the Board of Supervisors adopted resolutions authorizing reimbursement of the library fees to the developer, DMB Ladera. Final payment in the amount of \$760,400 was made to the developer on December 8, 2011. Because CEO/Public Finance has taken satisfactory corrective action, we consider this recommendation implemented.

## **9. Unexplained El Toro Branch Library Costs Charged to Ladera Ranch CFDs** **(Critical Control Weakness)**

We recommend CEO/Public Finance ensure project costs charged to the Ladera Ranch CFD's bond proceeds are authorized and the authorization documented regardless of the type of disbursement made (i.e., payment requests, journal vouchers, etc).

Current Status: **Implemented.** CEO/Public Finance developed and implemented policies and procedures which prohibit, except for routine administrative charges, the transfer of funds without prior written approval of the Public Finance Director or Chief Financial Officer. Based on our review of the project costs selected for testing, written authorization was documented. Because CEO/Public Finance has taken satisfactory corrective action, we consider this recommendation implemented.

## **10. Internal Controls over Monitoring Cash Available for Projects Need to be Improved** **(Significant Control Weakness)**

We recommend Auditor-Controller PFA revise the CFD Project Cost Reports to accurately reflect available funding.

Current Status: **Implemented.** Auditor-Controller PFA revised the CFD Project Cost Reports to reflect available funding.





The CFD Project Cost Reports calculate available funding based on the most recently approved Acquisition, Funding and Disclosure Agreement (AFDA) which includes unrealized interest earnings. Auditor-Controller PFA discloses the ending balance to the extent sufficient cash and appropriations are available. Because Auditor-Controller PFA has taken satisfactory corrective action, we consider this recommendation implemented.

## **11. Internal Controls over Monitoring Cash Available for Projects Need to be Improved (Significant Control Weakness)**

We recommend CEO/Public Finance determine if the cash-on-hand will be sufficient to cover estimated project costs as stated in the Acquisition, Funding, and Disclosure Agreements.

**Current Status: Implemented.** Auditor-Controller PFA revised the CFD Project Cost Reports to reflect available funding and the cash-on-hand to cover estimated project costs. Auditor-Controller PFA discloses the ending balance to the extent sufficient cash and appropriations are available. Because Auditor-Controller PFA has taken satisfactory corrective action, we consider this recommendation implemented.

## **12. Internal Controls over Transfers of Bond Proceeds from Ladera Ranch CFD Funds Need to be Improved (Significant Control Weakness)**

We recommend Auditor-Controller PFA correct the \$41,116 error in CFD 99-1.

**Current Status: Implemented.** The \$41,116 error noted in the original audit report resulted from two separate errors (\$40,000 and \$1,116) pertaining to the Ladera Ranch CFDs. In the process of correcting the \$40,000 error, Auditor-Controller PFA determined that the entire payment in the amount of \$12,515,000 was incorrectly allocated to fifteen (15) CFDs. Auditor-Controller PFA corrected the \$12,515,000 payment by re-allocating the balances to the appropriate CFDs. The \$1,116 error was a result of a transfer not corrected in the special reserve allocation spreadsheet. Auditor-Controller is preparing a Quarterly Budget Augmentation Request to obtain the Board of Supervisors approval to transfer the funds to CFD 99-1. Because Auditor-Controller PFA has taken and is in the process of taking satisfactory corrective action, we consider this recommendation implemented.

## **13. Internal Controls over Transfers of Bond Proceeds from Ladera Ranch CFD Funds Need to be Improved (Significant Control Weakness)**

We recommend Auditor-Controller PFA develop policies and procedures to ensure that monies transferred out of designated CFD funds are accurately accounted for.

**Current Status: Implemented.** Auditor-Controller PFA developed and implemented policies and procedures to ensure monies transferred out of designated CFD funds are accurately accounted for. The policies and procedures prohibit, except for routine administrative charges, the transfer of funds without prior written approval of the Public Finance Director or Chief Financial Officer. Based on our review, no transfers were made since the original audit report was issued. Because Auditor-Controller PFA has taken satisfactory corrective action, we consider this recommendation implemented.



## **14. Missing Approval for Allocating Costs Between CFDs (Significant Control Weakness)**

We recommend CEO/Public Finance develop and implement policies and procedures to ensure the district engineer has the most current governing documents and require that written authorization with justification is received from the district engineer before any changes by staff are made to the district engineers' prior written authorization.

Current Status: Implemented. CEO/Public Finance developed and implemented policies and procedures to ensure the district engineer has the most current governing documents and require that written authorization with justification is received from the district engineer before any changes by staff are made to the district engineers' prior written authorization. The policies and procedures require CEO/Public Finance to distribute copies of executed AFDA's to applicable parties within ten business days following execution of the AFDA's by all parties, but in no instance will distribution be longer than 30 days. In addition, the policies and procedures require concurrence between OC Public Works and the district engineer. If parties cannot concur, the district engineer's recommendation should be binding. Because CEO/Public Finance has taken satisfactory corrective action, we consider this recommendation implemented.

## **15. Policies and Procedures Were Not Complete (Significant Control Weakness)**

We recommend that Auditor-Controller PFA improve policy and procedures to be followed for the CFD process. Documented policy and procedures should be reviewed and approved by management and current versions need to be readily accessible for reference by personnel responsible for the CFD process.

Current Status: Implemented. Auditor-Controller PFA improved the policies and procedures by detailing all the necessary steps to take pertaining to the CFD process. The policies and procedures have been reviewed and approved by management and current versions are readily accessible for reference by personnel responsible for the CFD process. Because Auditor-Controller PFA has taken satisfactory corrective action, we consider this recommendation implemented.

## **16. Internal Controls over Monitoring Project Costs Need to be Improved (Control Finding)**

We recommend Auditor-Controller PFA record project costs on the Project Cost Reports and Statement of Sources and Uses at the time costs are approved rather than after payment has been made to ensure costs do not exceed the most recently approved AFDA.

Current Status: Implemented. Auditor-Controller PFA records project costs on the Project Cost Reports at the time costs are approved rather than after payment has been made to ensure costs do not exceed the most recently approved AFDA. Based on our review of project costs selected for testing, the project costs did not exceed the most recently approved AFDA. Because Auditor-Controller PFA has taken satisfactory corrective action, we consider this recommendation implemented.



## **17. Internal Controls over Monitoring Project Costs Need to be Improved** **(Control Finding)**

We recommend Auditor-Controller PFA complete a reconciliation between the Project Cost Reports and Statement of Sources and Uses to the general ledger on a regular basis to ensure all project costs that should have been recorded were recorded correctly.

Current Status: **Implemented.** Auditor-Controller PFA completes a reconciliation between the Project Cost Reports to the General Ledger on a monthly basis to ensure all project costs were recorded correctly. Based on our review, Auditor-Controller PFA completed the reconciliations on a monthly basis. Because Auditor-Controller PFA has taken satisfactory corrective action, we consider this recommendation implemented.

## **18. Internal Controls over Monitoring Project Costs Need to be Improved** **(Control Finding)**

We recommend Auditor-Controller PFA supervisors perform and document their supervisory reviews of Project Cost Reports, Statement of Sources and Uses, and the reconciliation to the general ledger.

Current Status: **Implemented.** Monthly supervisory reviews of Project Cost Reports, Statement of Sources and Uses, and the reconciliation to the general ledger are performed and documented. Because Auditor-Controller PFA has taken satisfactory corrective action, we consider this recommendation implemented.

## **19. Administrative Costs Are Incorrectly Charged to the Acquisition and Construction Fund** **(Control Finding)**

We recommend Auditor-Controller PFA charge administrative costs to the debt service fund and transfer administrative costs claimed in the acquisition and construction fund to the debt service fund.

Current Status: **Closed.** Auditor-Controller PFA obtained bond counsel's opinion that the County has the discretion to pay the administrative charges from the Acquisition and Construction Funds for the Ladera Ranch CFDs. As such, it is not necessary for Auditor-Controller PFA to charge administrative costs to the debt service fund and transfer administrative costs claimed in the acquisition and construction fund to the debt service fund. Therefore, we consider this recommendation closed.

## **20. Acquisition, Funding and Disclosure Agreement (AFDA) and Amendments Include Anticipated Interest Earnings** **(Control Finding)**

We recommend CEO/Public Finance only include actual interest income earned when initiating an AFDA amendment to ensure financial obligations are met without the County having to subsidize costs.

Current Status: **Implemented.** CEO/Public Finance includes actual interest income earned when initiating AFDA amendments.



Since the issuance of the original audit report, there has only been one AFDA amendment to the Ladera Ranch CFDs in which appropriations were decreased by \$1,025,007 to reflect a reduction in estimated earnings that were not realized. Because CEO/Public Finance has taken satisfactory corrective action, we consider this recommendation implemented.

## **21. Acquisition, Funding and Disclosure Agreement (AFDA) Amendments Not Signed (Control Finding)**

We recommend that the Chief Financial Officer develop a process to ensure that CFDs Acquisition, Funding and Disclosure Agreement (AFDA) Amendments are properly executed (signed).

**Current Status: Implemented.** CEO/Public Finance developed and implemented policies and procedures to ensure Acquisition, Funding and Disclosure Agreement (AFDA) Amendments are properly executed (signed). CEO/Public Finance developed and implemented a checklist to track the status of any CFDs governing documents (i.e., AFDA). In addition, the policies and procedures require CEO/Public Finance to distribute copies of executed AFDAs to applicable parties within ten business days following execution of the AFDAs by all parties, but in no instance will distribution be longer than 30 days. Because CEO/Public Finance has taken satisfactory corrective action, we consider this recommendation implemented.

We appreciate the assistance extended to us by the County Executive Office (CEO)/Public Finance, CEO/Public Finance Accounting (Auditor-Controller PFA), and OC Public Works during our Follow-Up Audit. If you have any questions, please contact me directly at 834-5475 or Alan Marcum, Senior Audit Manager at 834-4119.

### Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

Members, Board of Supervisors  
Members, Audit Oversight Committee  
Denise Steckler, Director, A-C/Satellite Accounting Operations  
Suzanne Luster, Interim Public Finance Director/Manager, CEO/Public Finance Accounting  
Mary Fitzgerald, Director, OC Public Works Administrative Services  
Harry Persaud, Manager, OC Public Works Planned Communities  
Howard Thomas, Manager, A-C/OC Public Works Accounting  
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Susan Novak, Clerk of the Board of Supervisors