

Internal Audit Department

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

COUNTY EXECUTIVE OFFICE **AUDIT ALERT**

OPPORTUNITY TO CLARIFY CLASSIFICATIONS OF FORMER EMPLOYEES HIRED AS WORKING RETIREES OR CONTRACTORS

This **Audit Alert** addresses an issue identified during our quarterly Computer Assisted Audit Technique (CAAT) reviewing for possible employee-vendor conflicts of interest. The issue identified is not a conflict of interest, but instead a possible conflict with the County Procurement Manual threshold (\$50,000) for BOS approval of sole source contracts due to a former employee hired as both a contractor and working retiree within the same year (no overlapping service dates).

While the one exception highlighted is in itself non-consequential, we raise these points to assist in future situations of a similar nature and provide an opportunity for the CEO to further clarify working retiree-contractor relationships in the County.

We identified three (3) recommendations to better clarify working relationships with former employees and reduce policy confusion. CEO concurred with all three (3) of our recommendations.

The purpose of an Audit Alert is to promptly bring to the management's attention important potential issues for their immediate assessment and, if necessary, corrective action. The process incorporates an accelerated management response timeline to ensure the timely completion and dissemination of audit issues.

AUDIT NO: 1041-E
REPORT DATE: DECEMBER 21, 2010

Director: Dr. Peter Hughes, MBA, CPA, CIA
Deputy Director: Eli Littner, CPA, CIA, CISA
Senior Audit Manager: Autumn McKinney, CPA, CIA, CISA
Audit Manager: Carol Swe, CPA, CIA, CISA

RISK BASED AUDITING

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



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



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 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

Dr. Peter Hughes **Ph.D., MBA, CPA, CCEP, CITP, CIA, CFE**
Director Certified Compliance & Ethics Professional (CCEP)
Certified Information Technology Professional (CITP)
Certified Internal Auditor (CIA)
Certified Fraud Examiner (CFE)
Certified in Financial Forensics (CFF)
E-mail: peter.hughes@iad.ocgov.com

Eli Littner **CPA, CIA, CFE, CFS, CISA**
Deputy Director Certified Fraud Specialist (CFS)
Certified Information Systems Auditor (CISA)

Michael Goodwin **CPA, CIA**
Senior Audit Manager

Alan Marcum **MBA, CPA, CIA, CFE**
Senior Audit Manager

Autumn McKinney **CPA, CIA, CISA, CGFM**
Senior Audit Manager Certified Government Financial Manager (CGFM)

Hall of Finance & Records

12 Civic Center Plaza, Room 232
Santa Ana, CA 92701

Phone: (714) 834-5475

Fax: (714) 834-2880

To access and view audit reports or obtain additional information about the OC Internal Audit Department, visit our website: www.ocgov.com/audit



OC Fraud Hotline (714) 834-3608



Transmittal Letter



Audit No. 1041-E December 21, 2010

TO: Thomas G. Mauk
County Executive Officer

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

SUBJECT: **Audit Alert** - Opportunity to Clarify
Classifications of Former Employees Hired
as Working Retirees or Contractors

Attached is our **Audit Alert** for an Opportunity to Clarify Classifications of Former Employees Hired as Working Retirees or Contractors.

Each month I submit an **Audit Status Report** to the Board of Supervisor (BOS). Accordingly, the results of this **Audit Alert** will be included in a future status report to the BOS.

Unlike our traditional audit reports, we will not perform a follow-up audit for this **Audit Alert** in six months. However, depending on materiality, any recommendations not implemented could be included in a future **Audit Alert**.

As always, the Internal Audit Department is available to partner with your staff so that they can successfully address or mitigate difficult audit issues. Please feel free to call me should you wish to discuss any aspect of our **Audit Alert**.

Attachments

Other recipients of this **Audit Alert** are listed on page 3.

Table of Contents



**AUDIT ALERT:
Opportunity to Clarify Classifications of Former Employees
Hired as Working Retirees or Contractors**

Audit No. 1041-E

Transmittal Letter	i
OC Internal Auditor's Report	
BACKGROUND	1
DETAILS OF ISSUE IDENTIFIED	1
POTENTIAL CONCERNS	2
RECOMMENDATIONS	2
ATTACHMENT A: CEO Response	4



Audit No. 1041-E

Date

TO: Thomas G. Mauk
County Executive Officer

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

SUBJECT: **Audit Alert** - Opportunity to Clarify Classifications of Former Employees Hired as Working Retirees or Contractors

Audit Alert

The purpose of an **Audit Alert** is to quickly bring to management's attention important potential issues for their assessment and, if necessary, corrective action.

This **Audit Alert** is not subject to the same rigor and formality of a traditional report in that we have not fully developed the issues and have not verified the accuracy of all information.

The **Audit Alerts** have an accelerated management response timeline to ensure the timely dissemination of audit issues.

BACKGROUND

Each quarter, IAD performs an automated query known as a CAAT (computer assisted audit technique) to match employee and vendor data searching for potential conflicts of interest (e.g. employees or related parties that also have vendor contracts with the County). Occasionally, the CAAT may identify other issues that are not potential conflicts of interest, but warrant further review. In this instance, we identified an issue regarding the status of a working retiree vs. contractor. We are communicating the specific details in this Audit Alert, rather than in our October 2010 Monthly CAAT report (Audit No. 1041-D).

DETAILS OF ISSUE IDENTIFIED

In October 2010, we identified one (1) instance where a retired former employee was rehired as a working retiree, subsequently awarded a contract, and then rehired as a working retiree possibly providing some similar services.

The employee retired in FY 06-07. Shortly after, the employee was rehired as a working retiree at the same hourly rate. The employee continued as a working retiree until October 2008. Shortly after, the former employee was awarded a sole source contract with an hourly rate equaling about 1.5 times (160%) of the employee's hourly rate at retirement and was paid about \$47,000 under the contract. About 5-6 months later, the former employee/contractor was rehired as a working retiree at an hourly rate equaling 80% of the employee's hourly rate at retirement (in conformance with the new working retiree policy).

Within the most recent two-year period ending 10/18/10, the former employee was paid about \$57,000 cumulatively as a contractor and working retiree, which is more than the \$50,000 threshold requiring Board of Supervisor approval of sole source contracts. We reviewed the contract scope of work and the working retiree scope of work and it appears there was one similar service provided on a specific project. As of 10/18/10, the employee is currently working for the County as a working retiree and is estimated to be finished around January 2011.



POTENTIAL CONCERNS

While this one exception highlighted in itself is non-consequential, we raise the below points to assist in future situations of a similar nature.

1. Switching back and forth between a working retiree and a contractor is not advisable because of IRS regulations regarding classifications as to whether a person is working as an employee or independent contractor, or both. When the contractor's only client is the County, this further creates complexity to the issue.
2. Switching back and forth between a working retiree and a contractor is also not advisable because of Government Code Section 31680.6 mandating limits of 960 hours worked per fiscal year for working retirees. If the working retiree exceeds the 960 hours, the retirement allowance is to be suspended.
3. Hiring a working retiree after they have worked under contract and almost reached the threshold for Board of Supervisor approval of sole source contracts (\$50,000) may be in conflict with the intention of the County Procurement Manual. Especially so if the cumulative total amount paid to the former employee exceeds the \$50,000 threshold as it did in this instance.

Because of these concerns, it is advisable to rehire retired employees in a working retiree classification rather than as a sole-source contractor, especially so if the County is the former employee's only client.

This would also apply to multiple sole source contracts awarded to former employees within a three-year period. Any contracts that are cumulatively in excess of \$50,000, regardless of how the scope of work is differentiated, should be submitted for Board of Supervisor approval.

To provide clarification and consistency when rehiring former employees, a Countywide policy/directive and procedure for "Hiring Former Employees as Sole Source Contractors," similar to the "Working Retiree Reemployment Policy," is advisable. A written form submitted by the departments to the County Finance Office for approval should be developed to provide transparency in the decisions.

RECOMMENDATIONS

Recommendation No. 1: We recommend that the County Executive Office develop a Countywide written policy/directive for hiring former employees as sole source contractors. The policy/directive should require departments to obtain County Finance Office written approval before awarding sole source contracts less than \$50,000 to former or retired employees.

County Executive Office Response: Agree with recommendation. During April 2010, the County Executive Office implemented a *Working Retiree Reemployment Policy*. The policy requires that working retirees be hired utilizing the County's "Position Action Workflow" (PAW). The PAW process encompasses a review by central Human Resources Department (HRD) and CEO/Budget. Denied requests are sent back to the department.



In addition, the CEO/Procurement Office will revise the Sole Source Justification Form to include additional questions pertaining to whether the contractor is a retired former employee and has previously been rehired as a working retiree or contractor. Departments will be instructed to submit the sole source justification form to the CEO for written approval prior to awarding contracts of less than \$50,000 to retired former employees. Estimated to be implemented by February 10, 2011.

Recommendation No. 2: We recommend that County Executive Office include in the above policy/directive that departments consider the cumulative amount of sole source contracts with former employees within a three-year period, regardless of how the scope of work is differentiated, when determining whether the contracts exceed the \$50,000 threshold for Board of Supervisor approval.

County Executive Office Response: Agree with recommendation. The revised Sole Source Justification Form will include additional requests for information that include total expenditures paid to the retired former employees regardless of scope of work or contract status. Estimated to be implemented by February 10, 2011.

Recommendation No. 3: We recommend that County Executive Office include in the above policy/directive that departments coordinate between their human resource and purchasing staff when hiring former employees to ensure that former employees do not switch back and forth between the working retiree and sole source contractor classifications.

County Executive Office Response: Agree with recommendation. The revised Sole Source Justification Form that will include additional requests for information pertaining to prior contracts and working retiree status and will provide the necessary link between the Human Resource and procurement processes. The additional information included on the Sole Source Form will allow the County's Finance/Budget Division to understand and evaluate the full scope of the contractual relationship with the retired former employee and where appropriate direct that the requesting agency seek Board approval. Estimated to be implemented by February 10, 2011.

ACKNOWLEDGMENT

We appreciate the courtesy and cooperation extended to us by the personnel of the CEO. If you have any questions regarding our **Audit Alert**, please call me directly at (714) 834-5475 or Eli Littner, Deputy Director at (714) 834-5899, or Autumn McKinney, Senior Audit Manager at (714) 834-6106.

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

Members, Board of Supervisors
Members, Audit Oversight Committee
Bob Franz, Chief Financial Officer, County Executive Office
Carl Crown, Director, Human Resources Department
Ronald C. Vienna, County Purchasing Agent, County Procurement Office
Rob Richardson, Assistant County Executive Officer
Foreperson, Grand Jury
Darlene J. Bloom, Clerk of the Board of Supervisors



ATTACHMENT A: CEO Response



County Executive Office Memorandum

December 17, 2010

To: Dr. Peter Hughes, Director, Internal Audit Department

From: Ronald C. Vienna, County Purchasing Agent

Subject: Response to Draft Audit Report 1041-E

This memorandum provides our response to Audit Report 1041-E.

Recommendation No. 1: We recommend that the County Executive Office develop a Countywide written policy for hiring former employees as sole source contractors. The policy should require departments to obtain County Finance Office written approval before awarding sole source contracts less than \$50,000 to former or retired employees.

County Executive Office Response:

County Executive Office Response: Agree with recommendation. During April 2010, the County Executive Office implemented a *Working Retiree Reemployment Policy*. The policy requires that working retirees be hired utilizing the County's "Position Action Workflow" (PAW). The PAW process encompasses a review by central Human Resources Department (HRD) and CEO/Budget. Denied requests are sent back to the department. In addition, the CEO/Procurement Office will revise the Sole Source Justification Form to include additional questions pertaining to whether the contractor is a retired former employee and has previously been rehired as a working retiree or contractor. Departments will be instructed to submit the sole source justification form to the CEO for written approval prior to awarding contracts of less than \$50,000 to retired former employees. Estimated to be implemented by February 10, 2011.

Recommendation No. 2: We recommend that County Executive Office include in the above policy that departments consider the cumulative amount of sole source contracts with former employees within a three-year period, regardless of how the scope of work is differentiated, when determining whether the contracts exceed the \$50,000 threshold for Board of Supervisor approval.

County Executive Office Response:



ATTACHMENT A: CEO Response

Agree with recommendation. The revised Sole Source Justification Form will include additional requests for information that include total expenditures paid to the retired former employees regardless of scope of work or contract status. Estimated to be implemented by February 10, 2011.

Recommendation No. 3: We recommend that County Executive Office include in the above policy that departments coordinate between their human resource and purchasing staff when hiring former employees to ensure that former employees do not switch back and forth between the working retiree and sole source contractor classifications.

County Executive Office Response:

Agree with recommendation. The revised Sole Source Justification Form that will include additional requests for information pertaining to prior contracts and working retiree status and will provide the necessary link between the Human Resource and procurement processes. The additional information included on the Sole Source Form will allow the County's Finance/Budget Division to understand and evaluate the full scope of the contractual relationship with the retired former employee and where appropriate direct that the requesting agency seek Board approval. Estimated to be implemented by February 10, 2011.