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**ORANGE COUNTY SHERIFF  
MEDICAL INSURANCE:  
COUNTY FAILURES IN  
NEGOTIATION, DOCUMENTATION,  
OVERSIGHT, AND TRANSPARENCY**

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**GRAND JURY 2014-2015**

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## EXECUTIVE SUMMARY

Orange County Deputy Sheriffs (Sheriffs) rightfully earn their medical insurance benefit, as do all qualified Orange County (County) employees. Why is the Sheriffs' benefit different from what is offered to non-Sheriff County employees? This can be attributed, in part, to three things: (1) ambiguous language in the agreement between the County and the Sheriffs; (2) a lack of initiative on the part of the County to enforce its understanding of the terms of the agreement; and (3) a lack of transparency that sometimes serves to undermine the collective bargaining process.

In 1990, the County entered into an agreement with the Sheriffs' collective bargaining unit, the Association of Orange County Deputy Sheriffs (AOCDS), that provided that the County would contribute to the cost of medical benefits to qualified AOCDS members, but shifted the responsibility to administer those benefits from the County to the AOCDS. According to the current agreement, the medical benefits provided by AOCDS are required to be "similar," but not equivalent to, what the County provides to non-AOCDS members.

The Grand Jury has determined that the benefits offered by AOCDS might be considered "similar," but the scope of who might benefit from County contributions to the AOCDS Medical Benefits Trust Fund (Trust) is broader for AOCDS members than for the County's non-Sheriff employees. Is this what the County bargained for?

At least twice since 2009, AOCDS has subsidized a portion of its retired members' medical insurance benefits; the County does not subsidize its County retirees' medical insurance benefits. Additionally, a portion of the funds deposited by the County into the Trust are being used to pay for medical insurance for some AOCDS employees, who are not Sheriff or County employees or retirees, but are offered the same medical insurance benefits as qualified active and retired County Sheriff employees.

Why are active AOCDS members allowed to pay so much less (nothing, in some cases) than their County counterparts for their Annual Required Contribution for retirement health care? Allowing this accommodation to continue for the active Sheriffs will certainly result in the County and its non-Sheriff employees having to make up the future, increasingly large, shortfall in retiree medical coverage.

Most of these inconsistencies can be attributed to ambiguous wording in the agreement, poor negotiating, and enforcement of the County's understanding of the terms of the agreement, and County politics. What does "similar" medical benefit mean? Should any of the contributions the County pays into the Trust be used to benefit AOCDS retirees? Should County funds be used to pay for medical benefits for AOCDS employees?

Is the County contributing too much per employee? Are AOCDS members not paying enough?

Additionally, it does not appear as though the County has adequately followed through on addressing issues concerning the AOCDS trust raised by the auditor the County jointly retains with the AOCDS to assess the Trust's finances every year. Finally, has the County's most senior elected officials' influence resulted in changes that materially affect the terms of the agreement that took almost two years for AOCDS and County negotiators to finalize?

The current Memorandum of Understanding expires in June 2016. Between now and then, the County and the Board of Supervisors have a lot of work to do.

## **BACKGROUND**

(See Appendix 1 for a glossary of terms used in this report.)

Orange County (County) is currently obligated to provide medical insurance benefits to its qualified current (active) and retired employees and their families. Since January 1, 1990, the County has entered into a series of memoranda of understanding with the AOCDS, the Sheriff employees' bargaining unit, whereby AOCDS would administer the medical benefits program for its members. The current Memorandum of Understanding (MOU) (County of Orange, 2014a) was entered into for the period starting in October 2012 and will be in force until June 30, 2016.

Sections 3 through 8 of Article XII of the 2012-2016 MOU, titled "On the Job Injuries, Workers' Compensation and Medical Insurance," include the terms of the Sheriffs' medical insurance agreement. Specifically, the terms require that the County pay specified amounts monthly into an AOCDS Medical Insurance Trust Fund (Trust). That trust fund was set up and is managed by the AOCDS to pay Blue Cross and Kaiser medical insurance premiums for medical benefits provided by those two medical insurance providers to qualified AOCDS active and retired employees and their families. The MOU terms also require active and retired employees to make contributions to pay a portion of their medical coverage.

### **Medical Insurance Coverage**

The MOU contains provisions that loosely define the responsibilities, obligations, and limitations of the County and AOCDS regarding payment for medical insurance coverage for qualified active and retired Sheriff employees. The AOCDS, through its Trust, is required to provide "medical benefits *similar* to those offered by the County" (MOU Art. XII, Section 4.A.). Once the County makes its monthly payment into the AOCDS Trust, the County effectively loses visibility and traceability of those funds.

### **County Medical Insurance Contributions**

The MOU includes the monthly amount the County has to pay into the AOCDS Trust. This amount increased from \$745 per month in 2010 to \$1,174 (commencing January 1, 2016) for each qualified Sheriff's employee. In addition, for qualified retired Sheriff employees, the County is required to make monthly Retiree Medical Grant payments into the AOCDS Trust.

## **Retiree Medical Plan Grants**

Since August 1993, the County has been required to administer a Retiree Medical Plan for employees, to include a Retiree Medical Grant. Eligible retirees receive Grant funds monthly that are applied towards the cost of retiree and dependent coverage in the AOCDS medical insurance plan. The specific Grant amounts are determined by multiplying \$10 by the number of full years of credited service (to a maximum of 25 years), or a maximum of \$250 per month. The Grant amount paid may not exceed the actual cost of the retiree's medical insurance premiums.

## **Sheriff Employee Medical Insurance Contributions**

Qualified active Sheriff employees are required to make monthly payments into the AOCDS Trust. The monthly payment is the difference between the monthly cost of the Sheriff's medical insurance premium and the monthly amount paid by the County into the AOCDS Trust for each Sheriff employee.

Retired Sheriff employees must also make monthly payments into the AOCDS Trust. Those payments are the difference between the monthly cost of the retired Sheriff's medical insurance premium and the monthly Retiree Medical Grant paid by the County into the AOCDS Trust. In addition, the MOU requires that the medical insurance premiums for qualified retired Sheriff employees must be at least 10% higher than the premiums for comparable medical insurance coverage for qualified active Sheriff employees.

## **Medical Insurance Reserves**

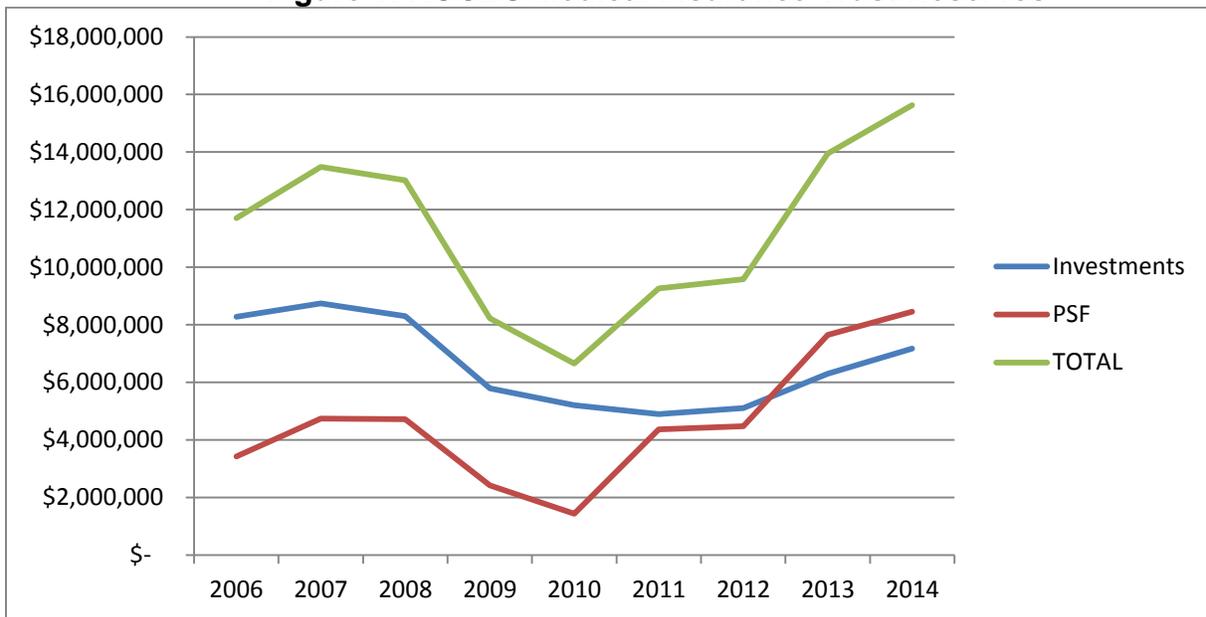
Any County contributions paid into the Trust that are not actually used to pay for medical insurance premiums are kept in the Trust as "reserve." The reserve is maintained in order to make sure AOCDS has funds available to provide medical benefits coverage in the event of unexpected significant medical claims losses.

The general reserve fund "investments" are presented in the annual Trust financial reports as "mutual funds" and "money market funds." The reported total investments, as of June 30, 2014, were valued at \$7.2 million, an increase of \$871,250 or up 13.8% from the 2013-reported amount (Lindquist LLP, 2013a, 2014a).

A second component of the AOCDS Trust "reserve" is the Blue Cross Premium Stabilization Fund (PSF). These are excess funds Blue Cross sets aside to be used for premium payments in the event of unexpected significant medical claims losses. The 2014-reported total for the PSF was \$8.4 million, an increase of \$804,975 or up 10.5% from the 2013-reported amount (Lindquist LLP, 2013a, 2014a).

As of June 30, 2014, the investments and PSF Trust reserves totaled \$15.6 million, a one-year 12% increase of \$1.7 million. In fact, since 2006, there have been only three years that have not shown an increase in total Trust reserves. The MOU neither establishes a ceiling for reserves nor specifically limits how the funds in the reserve can be used. The MOU only requires that a reserve study be completed once during the term of the agreement. Figure 1 displays the yearly changes in the Trust reserves from 2006 through 2014.

**Figure 1: AOCDS Medical Insurance Trust Reserves**



(Miller, 2007 and Lindquist LLP, 2008a, 2009, 2010a, 2011a, 2012a, 2013a, 2014a)

There were two occasions (2009 and 2010) when it was disclosed in the audited financial statements that the AOCDS Trust trustees determined that the Trust was “over-funded.” After accounting for County-paid retiree medical insurance grants, AOCDS decided to subsidize a “small portion” of the cost of the benefits for qualified retiree employees, but not active Sheriff employees (Lindquist LLP, 2009, 2010a, b). The reports do not mention the funding source; however, the Grand Jury believes that those retiree subsidies came from the AOCDS Trust’s reserve that contained County contributions the County claims it intended to be used only for active Sheriff employees.

### **County Management of the MOU**

The MOU requires that the AOCDS operate its Trust’s programs in compliance with applicable State and/or federal laws and regulations. It also mandates that the Trustees provide an annual written verification of AOCDS’s compliance with those laws and regulations, as confirmed by a certified, independent audit of the Trust.

### **Annual Financial Report**

An independent CPA is jointly retained by the County and the AOCDS to perform an annual financial audit and to prepare an annual financial report of the Trust (County of Orange, 2014b). The annual report must include an opinion on whether the AOCDS’ Trust’s financial statements are, among other things, in conformity with generally accepted accounting principles. The MOU and Scope of Work (SOW) detail the criteria by which the CPA is to be held accountable by the County and the AOCDS. The major areas that must be addressed and included in the annual audit report are as follows:

- Obtain knowledge of AOCDS’ organizational environment, including funding sources, contractual and legal requirements, economic

considerations, administrative and operating characteristics, and internal controls

- Perform substantive tests of financial statement balances to determine the accuracy of those balances
- Perform substantive tests of transactions to determine whether the transactions are valid and valued and coded correctly
- CPA's opinion on the financial statements
- Identify other significant matters, which came to the CPA's attention, such as material weaknesses in design or operation of internal controls, illegal acts, or significant fraud risks.

### **Reserves and Administrative Fees & Expenditures Reports**

Section 4.C. of the MOU states that “[t]he County shall participate and be involved in a study commissioned by AOCDS to determine the appropriate level of reserves for the Medical Insurance Trust.” A reserve study was completed in April 2009 for a prior MOU (Rael, 2009), but the AOCDS and the County have not yet performed the reserve study required by the current MOU to be completed by June 30, 2016.

The current MOU also requires the AOCDS to provide a report, prepared by a CPA firm, outlining the methods used to calculate the amounts of administrative fees and expenditures paid to AOCDS. This report, titled, “Independent Accountants’ Report on Applying Agreed Upon Procedures” was completed by Miller, Kaplan, Arase & Co., LLP on August 11, 2008, and again by the same firm on January 18, 2012 (Miller, 2008, 2012). No administrative fee or expenditure irregularities were noted by the auditor.

### **Joint Audit of the Medical Insurance Trust**

The County and the AOCDS are required by the MOU to complete an annual, independent audit of the Trust. The jointly retained CPA firm’s annual audit report must include, but is not limited to, the following elements:

- Summary of medical benefit plan highlights
- Monthly premiums for active and retired Sheriff employees, including a verification that retiree premiums are no less than 10% higher than active employee premiums
- Summary of enrollment by active and retiree Sheriff employees
- Method for setting retiree contributions, ensuring that retiree contributions are based on the difference between their premium and their Retiree Medical Grant amount
- Review of health plan renewal or contract documents
- Review and understanding of the investment options and balances of the Trust
- Explanation of how the unfunded liability is calculated
- Review of actuarial valuations of the Trust
- Review of the cash flow analysis of the mutual fund investments
- Analysis of how the amount of overhead (excluding administrative fees) is determined

Specific limitations included in the SOW with the independent auditor (Lindquist LLP) preclude Lindquist from doing the following:

- Determining the appropriate level of Trust reserves
- Auditing the administrative fee paid by the Trust to AOCDS

These two items were not included in the SOW because they are addressed in their own sections of the MOU, Sections 4.C and D, respectively (County of Orange, 2014b).

### **MOU Negotiation and Adoption/Approval Process**

Negotiations between the County and the bargaining units who represent large numbers of County employees have often been a source of confusion and frustration on both sides of the table, not to mention County residents. The current MOU for Sheriff employees covers the period from October 2012 through June 2016, but was not formally adopted by the Board of Supervisors until July 2014. The MOU includes sections explaining that the Trust is administered by the AOCDS and specifies County contributions and vaguely describes allowable uses of County contributed funds.

The negotiation process was prolonged and contentious, ultimately resulting in approval by a 3-2 vote of the Board of Supervisors. Major contributing factors to the differences between the County and the AOCDS have been what can be characterized as a healthy measure of mistrust between the parties and a lack of transparency to the public of factors affecting the outcome of the collective bargaining process. These concerns were also expressed by the public and were exacerbated not only by the lack of transparency associated with the negotiation process, but also the insufficient time allowed for the public to review and comment on the proposed MOU before it was approved by the Board of Supervisors.

### **REASON FOR THE STUDY**

The Grand Jury has received several requests to investigate various aspects of the management of medical insurance benefits being provided to active and retired County Sheriff employees. These requests, which are addressed in this report, can generally be divided into three areas of interest:

- Whether the County intended, as a matter of policy, to restrict the use of its monthly contributions to the AOCDS Trust to benefit active Sheriff employees only, and if the language in the MOU is clear enough to come to this conclusion
- Whether the County has adequately followed through on monitoring and enforcing the implementation and operation of the Trust to ensure compliance with the MOU
- Whether the negotiations process between the County and the AOCDS was adequately transparent to the public, allowed sufficient time for review and comment before the MOU was adopted, and was affected by political considerations.

Although the Grand Jury has met with representatives of AOCDS to gather information for the preparation of this report, the Grand Jury does not have jurisdiction over AOCDS because it is a private, non-profit organization. The Grand Jury, therefore, focused its investigation on the actions and responsibilities of the County with respect to negotiating, interpreting, and monitoring the AOCDS MOU.

## **METHODOLOGY**

Information for this report was developed through the following efforts by the Grand Jury:

- Reviewed the sections of the 2012-2016 MOU between the County and the AOCDS with special attention to Article XII, addressing medical insurance
- Reviewed the SOW of the Agreement for Professional Services between the County and the AOCDS and Lindquist LLP (their jointly retained audit firm) regarding the AOCDS Medical Benefits Trust
- Reviewed the Audited Financial Statements, Independent Accountants' Reports on Applying Agreed-Upon Procedures, and Auditor Management letters identifying Significant Deficiencies and offering Comments and Recommendations
- Reviewed the "Appropriate Level of Reserves" report prepared by Rael Letson, Consultants and Actuaries
- Reviewed a number of relevant published articles and blogs
- Interviewed current and former elected Orange County officials and their staff
- Interviewed Orange County senior management and their staff
- Interviewed AOCDS senior management
- Interviewed a member of executive management with the Lindquist LLP, the entity responsible for conducting the Trust's annual audits
- Interviewed a prominent attorney who is an expert in labor law

## **INVESTIGATION AND ANALYSIS**

### **Medical Insurance Coverage**

Orange County, like many other government entities and businesses across the country, changed its approach to medical insurance coverage from what is described as a "defined benefits program" to a "defined contribution program." With this change, employers were no longer required to pay the entire cost for medical insurance for their employees and retirees. Depending on final agreements between employers and employee bargaining units, employers pay either a prescribed portion of employee medical premiums or nothing at all.

Orange County opted to share the cost of medical insurance with its employees. The County provides various insurance coverage options for its employees and retirees to consider. The options (e.g., preferred provider organization-PPO, point of service-POS, and health maintenance organization-HMO) have varying amounts of coverage

and cost for the individuals and families. Each coverage option costs a specific amount for the employee or retiree who would choose from among the options and commit to sharing the cost of the medical insurance.

In April 2007, the County, in order to lower costs, changed the medical insurance benefits it would provide to active employees. The County pays a fixed share of the premium and the employee is responsible for paying the balance.

### **AOCDS Agreement to Manage Medical Insurance for its Members**

In January 1990, the AOCDS and the County agreed to an arrangement whereby AOCDS would assume responsibility to manage medical insurance plans for its active and retired Sheriff members. The County agreed to pay AOCDS a monthly amount that would be used by the Trust to pay for medical insurance premiums for AOCDS' active and retired, non-management (Peace Officer and Supervising Peace Officer), Sheriff members. Eventually, the Sheriff Department's management (i.e., Lieutenants and Captains – members of the Association of County Law Enforcement Managers) bargaining unit successfully negotiated with the County to allow Sheriff management personnel to be included in the AOCDS medical insurance program.

AOCDS explained the wisdom in preferring to administer the medical benefits program because their active and retired membership is unique among all County employees. They claimed that because many Sheriff employees are able to retire as early as 50 years of age, it is critically important to AOCDS to be able to provide affordable health care during the members' retirement years preceding age 65, at which point Medicare coverage starts. In any case, AOCDS was convinced they could provide more cost-effective and comprehensive coverage than the County for all of their members, active and retired.

### **Active vs. Retiree Medical Insurance Question**

Some assert that AOCDS was also motivated to assume responsibility for the medical insurance program so AOCDS could assist their retirees in covering a portion of the cost of their medical insurance. The County claims that it is inappropriate for AOCDS to be permitted to expand medical insurance coverage for AOCDS retirees that is beyond what other County retirees receive.

One might wonder why the County would be concerned about this, since by entering into the MOU with AOCDS the County had effectively abdicated its role in directly providing medical insurance coverage to active and retired Sheriff employees. The County agreed to an MOU that is ambiguous in some areas of concern to the County, such as whether County contributions might be used to assist retirees. The MOU stipulates that AOCDS be required to provide its membership medical coverage "similar" to that provided by the county (Section 4.A.). "Similar" cannot reasonably be interpreted to mean "identical" or to preclude the coverage offered by AOCDS from being more or less than what is generally offered by the County to its employees.

According to the MOU, as long as retiree health plan premiums are 10% higher than active AOCDS employees' health care premiums (Section 8.F.2.), why should

AOCDS be criticized for utilizing the contributions it receives from the County to provide its active and retired membership medical insurance coverage options that can be considered “similar” to County coverage?

**Is There a Limitation on How County Contributions Can Be Used?**

The Grand Jury could not find a single instance where the MOU specifically restricts AOCDS from utilizing the County’s “medical insurance contribution” funds to benefit its membership generally. In fact, Section 4.B.2. states that “(i)nsurance coverages provided through the trust fund with monies contributed by the County *shall be made available by AOCDS to all employees* in the representation unit and retirees of the representation unit *on an equal basis* regardless of membership status.” If anything, this MOU provision could easily be understood to require that AOCDS provide “equal” coverage to its active and retiree membership.

***MOU Language***

Section 3.A. of the MOU prescribes the amount of the monthly contributions the County will provide to AOCDS. Each of the provisions, allowing for progressive annual increases (Section 3.A.1. - 6.) states that “the County shall contribute \$xxx *per month for each* full-time enrolled regular, limited-term, and probationary employee on paid status in these units” (i.e., active employee) with certain exceptions that do not make a distinction between these “active” and “retired” employees.

County representatives assert that it was their intent that Section 3.A. prescribes a monthly contribution amount that should be used only to benefit active employees. Others have interpreted the words in Section 3.A. to be the means by which the County is required to calculate the monthly contributions the County is obligated to pay to the Trust. After reviewing the terms of the MOU, the Grand Jury does not interpret Section 3.A. as limiting the use of the monthly contribution to be for the benefit of active employees only.

On the other hand, the MOU (Section 4.E.4.) requires that the annual audit describe the Trust’s “(m)ethod for setting retiree contributions (e.g., confirm contributions based on difference between premium and grant amount).” The use of the abbreviation “e.g.”, meaning “for example”, rather than “i.e.”, meaning “that is”, can be interpreted to mean that the auditor is only required to describe the method for setting retiree contributions, and not necessarily support a requirement that the retiree premiums can only be paid from retiree grant funds and retiree contributions. The Grand Jury concludes that if the County had truly intended that monthly contributions only be used to benefit active AOCDS members, it should have negotiated for language in the MOU that actually reflected that intent.

***Subsidies for Retired AOCDS Members Were Allowed***

According to the Trust’s audited financial statements for 2009 and 2010 (Lindquist LLP, 2009, 2010a, b), it appears that funds the County claims it intended for active employees were used to subsidize retiree premium costs. The Notes sections for both reports clearly revealed that the Trustees had determined that the Trust was “over-funded” and, therefore, found it feasible to defray some of the increased cost of retiree medical benefits after accounting for Retiree Medical Insurance Grants. Each year, the

Trustees decided they would subsidize a “small portion” of their retiree member benefits for a one-year-period.

If the County had been concerned about whether County contributions were being used to subsidize retiree medical insurance premiums, this would certainly have been the time to challenge the practice. The County has had since 2009 to try to get this sorted out. The Grand Jury is unaware of any effort made by the County to effectively challenge the AOCDS Trust subsidy for retirees, seek a refund, or have the practice discontinued.

County executives who are responsible for developing and sustaining County public policy should decide whether it is appropriate for County funds, intended to be used for employee medical insurance coverage, to be applied inconsistently to both its active and retired employees. If the County disagrees with how County contributions are being utilized, it should both ensure that any future MOU clearly explain its intent and be specific as to any limitations on how County contributions might be used.

### **County Management of the MOU**

The County is obligated to monitor AOCDS’ implementation of the MOU so the County can be assured that the Trust is conforming to the provisions that were negotiated. That can only be done if there are adequate County controls in place, the County is assertive in its approach, and the County aggressively pursues solutions to any unresolved issues. Audit reports are one source of information the County can use to identify potential issues and shortcomings.

### **Jointly Retained Independent Auditor**

Section 4.F. of the MOU, requires the County and AOCDS to jointly retain an independent licensed CPA firm to complete an annual independent audit of the AOCDS Trust. This joint retention arrangement, by its nature, presents challenges to both the County and AOCDS. Although there is a requirement to allow both parties equal access to any data used by the auditor in completing the report, the County is at a distinct disadvantage. Virtually all of the documents and data that might be needed by the auditor are owned and controlled by AOCDS. Examples include:

- Contracts between AOCDS and the medical insurance providers it uses
- Medical history records of AOCDS membership that would be used to prepare actuarial studies to be used in setting premiums and reserves, and
- Documents accurately tracking the monthly County contributions to the Trust, enabling the County to determine how those funds were actually used.

Inexplicably, the County agreed to have a provision included in the auditor’s SOW that limits the auditor’s access to AOCDS Trust meetings prior to and during the audit. According to the MOU, the auditors may only have access “as deemed necessary by the Board of Trustees.” It is unclear to the Grand Jury why the County would agree to allow the organization that is being audited, at its sole discretion, to deny the auditor access to Trust meetings. If the auditor believes it is necessary to have access to Trust Board meetings, the auditor should be empowered to demand and obtain that access.

### **Auditor Selection Process**

The MOU requires AOCDS to choose three qualified and independent CPA firms to be considered for use by the Trust in performing the Trust's annual audit. The County is then expected to choose from among those three candidate firms which firm will actually be jointly retained to perform the annual audit.

The Grand Jury was told that among the three qualified and independent candidate firms nominated by AOCDS, only one was actually interested in doing the work. If this information were accurate, then this would have effectively defeated the purpose of the prescribed nomination process, and resulted in the County having to select the only firm that was actually interested in performing the annual audit. If this did occur, then once the County became aware that only one of the three AOCDS nominated firms would take the work, the County should have demanded that AOCDS repeat their process and select three qualified firms that would firmly commit to taking the work, if offered.

### **Auditor Significant Deficiencies, Comments, & Recommendations**

From time to time, the auditor will include Management Letters in its annual audit. These letters identify "opportunities for strengthening internal controls and operating efficiency." Those "opportunities" are further categorized as being "significant deficiencies" or "material weaknesses." A "significant deficiency" is explained in the audit reports as:

a control deficiency or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control (Lindquist LLP, 2008b).

#### ***Significant Deficiencies***

A relevant "significant deficiency" identified by the auditors was the AOCDS not having developed and documented an anti-fraud program (Lindquist LLP, 2008b) <sup>1</sup>. The audit report outlined, in detail, what such a program (not merely a policy) should contain. The Grand Jury could find no evidence that such a comprehensive program was ever developed or implemented.

### ***Comments, Recommendations & Notes***

Various annual audit reports contained notes regarding the following additional deficiencies:

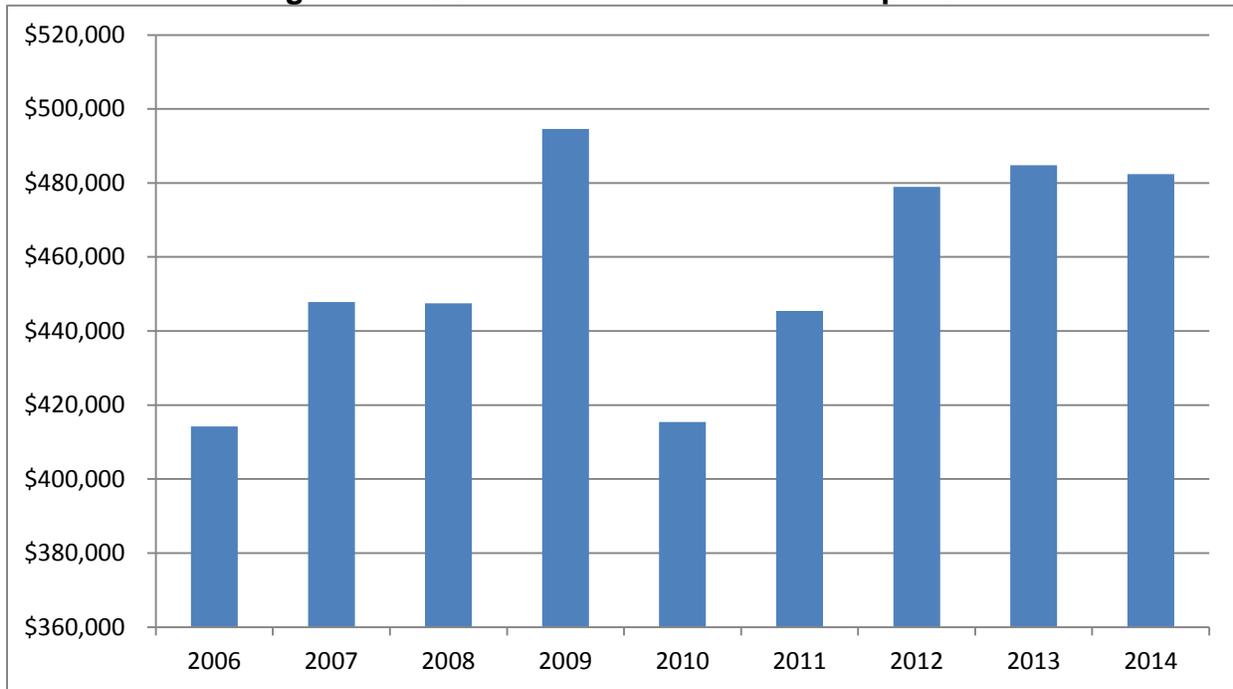
- The auditor clearly reported that AOCDS had subsidized retirees' premiums in 2009 and 2010 (Lindquist LLP, 2009, 2010a, b).
- The auditor recommended that the Trust adopt and implement accounting policies and procedure manuals (Lindquist LLP, 2008b, 2011d, 2012d, 2013d). Having these policies and procedures in place would ensure consistency in accounting practices and continued compliance with all applicable accounting rules and regulations<sup>2</sup>.
- The Trust's accounting records and practices were found to be deficient several times (Lindquist LLP, 2011c, 2012c, 2013c, 2015a)
- The auditors also recommended that the Trust adopt and implement a disaster recovery plan (Lindquist LLP 2008b, 2015b). This plan would ensure the Trust would not lose important data and information in the event of a business interruption<sup>3</sup>.
- The Trust, in 2012, was found to have understated PSF funds in the audited financials by more than \$1 million. Auditors found the error that had to be corrected in the 2013 financial statements (Lindquist LLP, 2013a).
- The auditor discovered that some retirees were not paying at least 10% more in premiums than active employees (Lindquist LLP, 2014b).
- A portion of the funds deposited by the County into the Trust are being used to pay for medical insurance for some AOCDS employees, who are not Sheriff or County employees or retirees, are offered the same medical insurance benefits as qualified active and retired County Sheriff employees.

(Lindquist LLP, 2014a).

### **MOU Required Studies**

The MOU requires that two additional reports be completed separate from the annual audits during the term of the MOU. The first report outlines the methods used in calculating the amounts of administrative fees and expenditures paid to AOCDS. The Trust's incurred administrative expenses as reported in recent annual financial statements are presented in Figure 2 below. The second report is a study to be done to determine the appropriate level of reserves for the Trust.

**Figure 2: AOCDS Trust Administrative Expenses**



(Miller, 2007 and Lindquist LLP, 2008a, 2009, 2010a, 2011a, 2012a, 2013a, 2014a)

Section 4.C. of the MOU requires the County to “participate and be involved in a study commissioned by AOCDS to determine the appropriate level of reserves” for the Trust. Unlike the requirement in Section 4.D. to prepare a report outlining the “methods used to calculate the amounts of administrative fees and expenditures paid to AOCDS” by October 1, 2011, there is no deadline for a Trust Reserve report to be completed. The Grand Jury found that, as of the writing of this Grand Jury report, the 2012-2016 MOU Trust reserve study had not yet been completed.

### **AOCDS Trust Reserve – How Much Is Enough?**

The Grand Jury reviewed the recent history of the AOCDS Trust reserves by studying the Trust’s annual audited financial statements (2007 – 2014) prepared by CPA firms jointly retained by the County and AOCDS. The two primary categories that comprise the Trust reserves are “Investments,” consisting of mutual funds and money market investments, and funds in the “Other Assets” category of the financials referred to as the “Blue Cross Premium Stabilization Fund.”

The total of these two categories of assets (Investments and PSF) represent the “reserve” funds available to the Trust. They are meant to serve as a hedge against unfavorable claim fluctuations and to absorb unusually high individual claims that may emerge from time to time.

### **County Monthly Contributions**

It appears as though funds in the Investment category are funds derived from monthly County contributions and contributions paid by active and retired participants that are not spent on payment for premiums. The PSF is created by an agreement

between AOCDS and Blue Cross. It is believed but not confirmed, because the Grand Jury did not have access to the Blue Cross-AOCDS agreement, that the PSF is comprised of funds paid to Blue Cross for health care coverage that are not yet spent on premiums or payouts. The PSF is meant to serve as a reserve for Blue Cross coverage.

The MOU (Section 3.A.1. to 6.) requires the County to make monthly “contributions” to the Trust for each covered employee. These amounts increase over time from \$745 per month through the end of December 2010, to \$1,174 per month as of January 1, 2016. That represents a 57.6% increase over a seven-year period.

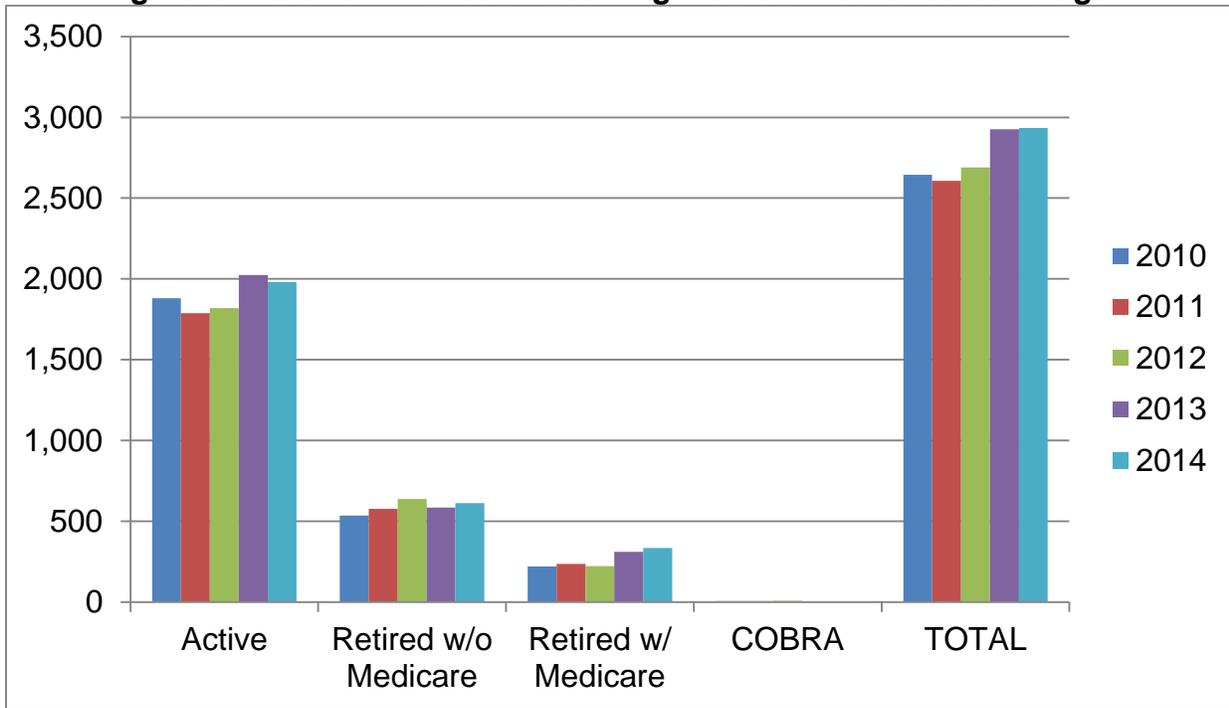
### **Size of the Reserve**

How large should the Trust’s reserve be? How many months of contributions would be appropriate to ensure the Trust will have adequate funds available to cover the risks and premium fluctuations associated with AOCDS’ active and retired membership?

As of June 30, 2014, the AOCDS Trust reserves were reported in the annual audit to be more than \$15.6 million. Investments amounted to \$7.2 million and the funds in the PSF totaled \$8.4 million.

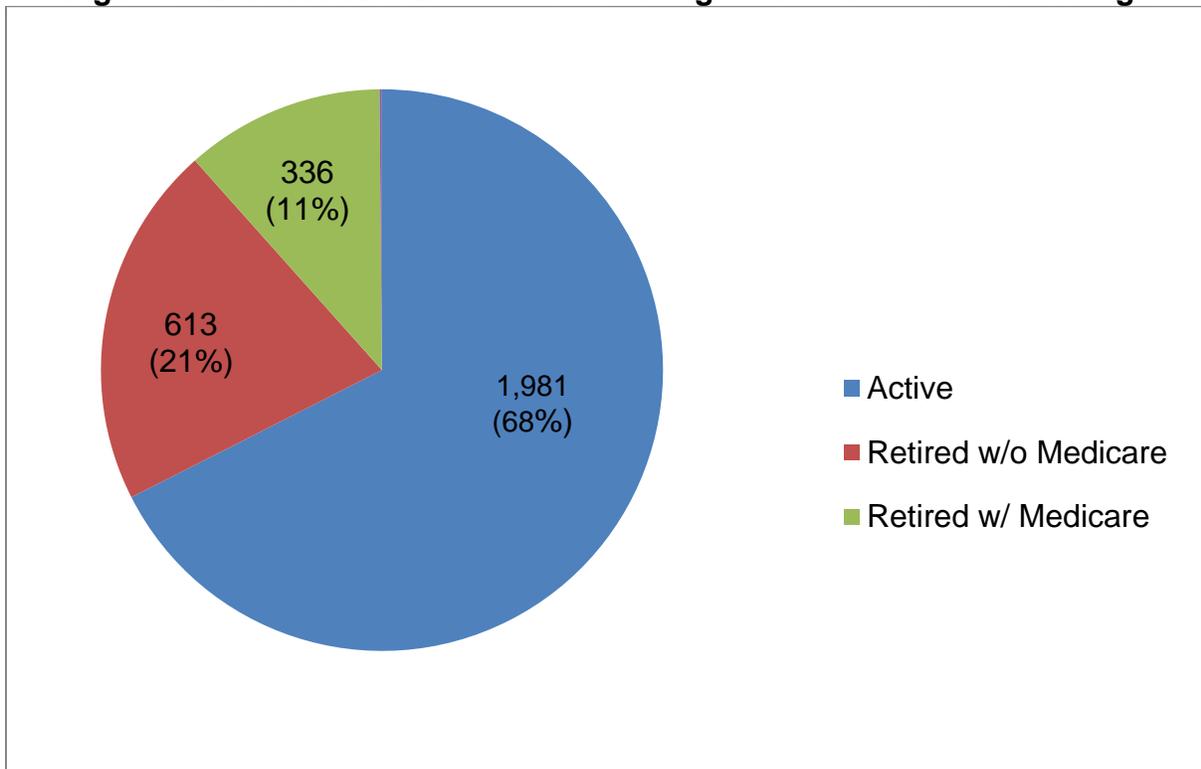
County monthly contributions to the Trust for each active Sheriff employee, as of January 2015, amount to \$1,031. The number of active Sheriff employees presented in the latest audited financial statements (June 30, 2014) was 1,981. This amounts to a total County contribution to the Trust of \$2.04 million per month or \$24.5 million per year (see Figures 3 and 4). The \$15.6 million in the AOCDS Trust reserve, as of June 30, 2014, represents 7.6 months of County contributions to the Trust. Is this adequate? Is it overfunded?

**Figure 3: AOCDS Enrollees Receiving Medical Insurance Coverage**



(Lindquist LLP, 2010b, 2011b, 2012b, 2013b, 2014b)

**Figure 4: 2014 AOCDS Enrollees Receiving Medical Insurance Coverage**



(Lindquist LLP, 2014b)

### **2009 Reserve Study**

As of the writing of this Grand Jury report, the reserve study, used to determine the appropriate level of reserves for the current MOU (Section 4.C.), had not yet been completed. The Grand Jury was, however, able to review the “Appropriate Level of Trust Reserves” memorandum prepared for the Trust for a prior MOU between the County and AOCDS (Rael Letson Consultants and Actuaries, 2009).

#### ***Areas of Uncertainty***

The April 2009 report was prepared by Rael Letson Consultants and Actuaries (Rael Letson) at a time when world, domestic, and local economic conditions were in recession. The report summarized areas of uncertainty they used in making its assessment. Some of those areas included:

- The economic situation in Southern California – “When the economy worsens, people tend to use their benefits more.”
- The worldwide economic situation – “...has resulted in the Trust experiencing major unrealized and realized losses in investments.”
- The County’s bankruptcy – “If that (the bankruptcy) were to happen again, the County’s contributions to the Trust may be reduced or stop.”
- If the Trust decides to increase the subsidy for retiree benefits – “Currently, the Trust subsidizes a portion of the premium rates above the grant money paid by the County which reduces the amount of Retirees self-payments. If the Trust implements a premium assistance plan for survivors of deceased deputies it will require even more money.”
- If the Trust decides to add any new benefit plans (e.g., dental, vision, life) or enhances current benefits.

The areas of uncertainty that AOCDS cannot control (i.e., Southern California economy, the worldwide economic situation, and the County’s long-ago bankruptcy) are no longer as relevant as they might have been in 2009. In fact, the County has recently used this reasoning to justify its demand that a new reserve study be performed as soon as possible. The Grand Jury is unaware whether AOCDS has agreed to the timing to perform such a reserve study.

The remaining areas of uncertainty (i.e., retiree subsidies, survivor benefits, and new benefit plans) are all subject to negotiation between the County and AOCDS. Future MOUs should clearly articulate and resolve any details that have been the subject of disagreement between the County and AOCDS.

#### ***2009 Recommended Reserve***

In early 2009, Rael Letson projected the Trust’s assets would be in a negative position by 2012. Obviously, with more than \$15 million in the reserve, that did not happen. Because of several factors, including an improved economy and increased County contributions, Trust reserves that amounted to \$9.6 million in June 2012 have steadily increased ever since.

### **What is an Appropriate Reserve Amount in 2015?**

Rael Letson, when confronted with all of the areas of uncertainty it identified, and with concerns that “the Trust is looking into the face of declining reserves as a result of accelerating deficits”, recommended that “measures be taken to maintain a minimum of four months of reserves at all times.” The Trust’s current reserve (\$15.6 million) represents almost 8 months of premiums, almost twice the minimum recommended by Rael Letson in 2009, when economic conditions in the County were much worse.

The Reserve Study for the current MOU does not have to be completed by any specific date, but should be expected to be completed by the end of the term of the MOU, June 30, 2016. As pointed out earlier, the County has asked that a new reserve study be performed as soon as possible. The Grand Jury thinks that perhaps the County, in its next MOU, should insist on a deadline for completion of the reserve study with the additional ability to require more reserve studies, if necessary.

### **What Happens to the Reserve if it is Found to be Overfunded?**

Nothing in the MOU addresses what should be considered an appropriate reserve amount other than to require that a reserve study be done. The MOU also does not discuss what should be done to adjust the reserve if it is determined to be too large or too small. If it is determined to be too large, the parties might consider, if it is allowable, providing for what is called a “premium holiday” where monthly County, active, and retiree contributions could be suspended for a period of time. The Trust reserve would be drawn down to an agreed upon level in order to cover the cost of the premiums during the “holiday” period.

Does AOCDS have complete discretion in determining when and at what amount the reserves are considered overfunded and what they can do with those “excess” funds? Contrary to what County non-Sheriff employees and retirees are given, can AOCDS continue to subsidize its retiree members? Can AOCDS expand coverage to survivors and add new benefits? Can this be considered “similar?” These are all very important questions to be clearly resolved in the upcoming MOU.

### **Annual Required Contribution (ARC) Issue**

Since 2007, all County employees (Sheriff and non-Sheriff) have been required to pay as much as 3.6% of their bi-weekly base salary to the County Retiree Medical Trust to offset the ARC in order to continue the retiree Grant for eligible retirees. These ongoing employee contributions ensure the sustainability of the County Retiree Medical Trust for all qualified County employees.

The 2012-2016 MOU adopted by the Board of Supervisors (at Section 8.E), potentially exempts some of those County employees included in the “55 safety formula” (e.g., Sheriff employees) from having to pay any ARC contribution as of July 1, 2015. Their ARC would, over time, be reduced from 3.6% of their base salary to as low as zero.

As of July 1, 2015, County employees who are not “55 safety formula” employees will essentially be paying the entire cost of the monthly County retiree contributions paid to the AOCDS Trust for Sheriff employee medical coverage. This

change clearly results in a significant difference between what is required of Sheriff employees and those who are not Sheriff employees.

The Grand Jury was informed that the MOU provisions leading to the elimination of the ARC for Sheriff employees was added to the MOU in a closed session of the Board of Supervisors. This session was held after the formal negotiations had been concluded by the negotiating teams representing the County and AOCDS, and effectively prevented review and comment by either of the negotiating teams before it was ultimately adopted by the Board of Supervisors.

### **MOU Negotiation and Final Approval/Adoption Process**

A number of individuals and organizations have complained that the collective bargaining process in the County, particularly with the Orange County Employees Association and AOCDS, is not sufficiently transparent. The complainants want:

- Much more transparency in the negotiation process;
- Independent, credible economic and actuarial assessments of the potential implications associated with the proposed terms of the contract; and
- Adequate time to review, comment on, and publicly debate the proposal before it is brought up for a final vote for adoption by the Board of Supervisors.

What can one conclude when a four-year MOU, whose term was to cover from late 2012 through mid-2016, was not adopted by the Board of Supervisors until July 2014? This was not the first time the County had negotiated the terms of such a contract. In one form or another, this negotiation process has been ongoing since 1990, more than 25 years.

### **Confidential MOU Negotiations**

The process for developing the current County-AOCDS contract entailed two years of confidential, behind closed doors negotiations. The negotiation sessions normally included senior representatives from the County and AOCDS and their retained labor negotiators. At times, closed session discussions might include the Sheriff and some or all of the five County Supervisors. There is clearly a need for the Board of Supervisors to conduct closed sessions for certain sensitive subjects like litigation issues and personnel matters. It is not clear, however, why closed sessions and a general lack of transparency to the process are necessary for all discussions regarding the terms of a MOU between the County and a bargaining unit.

### **Lack of Opportunity to Review and Comment**

The culmination of two years of negotiations, with limited transparency to the public, resulted in a proposed MOU not being made available for public review, until seven calendar days before the matter was to be first voted on by the Board of Supervisors. The Grand Jury believes a week is not adequate time for the public to review such a complex agreement with potentially significant short- and long-term economic implications to the County. The proposal did not contain an independent

economic and actuarial assessment of the proposed MOU and there was insufficient time for County residents to review, assess, and understand the implications and provide credible input to their Supervisors prior to the Supervisors' vote on whether to adopt the MOU.

### **The Final Stages of an Agonizing Process**

The final stages of the negotiation process for the current MOU were prolonged and somewhat contentious. Initial negotiations commenced in August 2012 with ongoing meetings held between the two official negotiating teams: AOCDS executives and their labor attorney and County executives and their labor attorney.

Over the course of the nearly two-year process, several closed session meetings with the Board of Supervisors were held to discuss the progress of the AOCDS contract negotiations. At a closed session meeting held in April 2014, the Board of Supervisors voted 5-0 to approve a proposal to AOCDS containing no changes from the previous MOU to Sheriff Annual Required Contributions (ARC) requirements. That is, the active Sheriff contributions would remain somewhat consistent with what active non-Sheriff County employees would have to contribute toward retiree medical insurance.

The County knew AOCDS wanted significant ARC reductions for its members (eliminating the ARC requirement for some), but all five Supervisors voted to reject this proposal even though doing so at this point would risk going to mediation. The Grand Jury presumes that a mediator would have proposed a suitable compromise Sheriff ARC amount, and that would certainly be a contribution larger than zero.

A little more than two months later, on June 24, 2014, a closed session meeting of the Board of Supervisors was held. Following the meeting's call to order, one of the Supervisors made a proposal to make significant changes to the AOCDS MOU proposal that had previously been approved in April by a 5-0 Board of Supervisors vote.

These proposed contract changes would essentially negate the negotiation strategy that had been unanimously agreed upon by the Board of Supervisors in April. The proposal would include the ARC reductions AOCDS had wanted and that the Board had specifically agreed to reject, preferring instead to go to mediation. The terms of this new proposal would, over time, greatly reduce Sheriff employee contributions and, in some instances, exempt Sheriff employees from having to make ARC payments for their retiree health care. If approved, this would result in the County and its non-Sheriff employees having to make up the ever-increasing medical insurance cost difference for all qualified County retirees.

The Board of Supervisors' Agenda Staff Report for its July 15, 2014 meeting (County, 2014c) acknowledged that the County would ultimately have to "pick-up the cost of the reduction of these amounts" and estimated the cost impact of this proposal to be \$1.7 million in Fiscal Year 2014-2015 and \$3.5 million in Fiscal Year 2015-2016. County of Orange (2014c). Of course, the long-term implications would be even more daunting for the County. If approved, the County would have to indefinitely continue to make up for what Sheriffs employees would no longer be contributing toward the ever-increasing costs of retiree medical insurance.

One observer of this closed session indicated that as soon as the proposal was made, two other Board members almost immediately concurred with the proposal that would place on the County significant additional long-term financial responsibilities for retired health care coverage for Sheriff employees. It was further reported to the Grand Jury that the ensuing discussion of the matter was “brief” and no further study of the potential implications of the new proposal was considered by the Board before a vote was held on an MOU containing the new proposal. Had the County just decided to negotiate against itself? After all, had not all five Supervisors agreed in April to go to mediation to avoid this exact outcome? What had happened in the intervening two months?

It was reported to the Grand Jury, based on the dialogue observed between the five Supervisors, that the manner in which the new provisions were proposed resulted in two Supervisors opposing final approval of the MOU. The MOU, containing these terms, was ultimately approved by a 3-2 vote of the Supervisors at the regularly scheduled Board of Supervisors meeting on July 15, 2014. Therefore, based on the information provided to the Grand Jury, the Grand Jury has concluded that greater transparency is called for in the MOU negotiation process.

### **An Opportunity for Transparency – “COIN”**

Something positive may actually have come as a result of all of this. Following Costa Mesa’s lead, one of the two Supervisors who had opposed the new AOCDS MOU proposed adoption of a County ordinance that would require transparency for employee contract negotiations. The ordinance (Sec. 1-3-12.), titled “Civic Openness in Negotiations” (COIN), was adopted by a 5-0 vote in August 2014.

County union leaders criticized the ordinance as singling out public employees, and pointed out that the ordinance does nothing to require transparency in the County’s negotiation of contractual agreements with private companies who might have contributed to Supervisors’ political campaigns. In an attempt to address those concerns, the Orange County Employees Association (OCEA) endorsed State legislation (SB 331), titled “Civic Reporting Openness in Negotiations Efficiency Act” (CRONEY). CRONEY would impose similar transparency requirements as those contained in COIN ordinances for employee contract negotiations for virtually all third party contracts the County pursues.

Regarding COIN, the OCEA filed an unfair labor practice charge with the Public Employees Relation Board (PERB), claiming that the County did not abide by the “meet and confer” requirements of the Meyers-Milias-Brown Act prior to adopting COIN. As of June 2015, PERB had not yet issued a ruling on PERB’s unfair labor practice charge.

The COIN ordinance requires that the County retain the services of a principal negotiator (not a County employee) with demonstrated expertise in negotiating labor and employment agreements on behalf of public entities. COIN requires “reporting out” formal offers and counteroffers from closed sessions. It has already been claimed, with respect to other public agencies, that some COIN ordinances have been circumvented by characterizing what would normally be considered formal offers and counteroffers as

“supposals” that are not reported out. This practice defeats the letter and the spirit of the COIN ordinance and should not be tolerated in Orange County.

Also, per COIN, the County Auditor-Controller is required to prepare and regularly update an “Independent Economic Analysis.” That analysis is required to describe and summarize the fiscal costs to the County and assess how the proposed contract would differ from the current contract.

Everything associated with COIN compliance is required to be made available on the County’s website. Adoption of any future MOUs will first require that the matter be heard at a minimum of two Board meetings wherein the public would have adequate opportunity to review and comment on the matter.

Adoption of the COIN ordinance appears to be a very positive development. However, COIN is only an ordinance, which is always subject to repeal or sunset by a majority of the Supervisors. As a matter of fact, during the debate on whether to first adopt the COIN ordinance, one of the Supervisors proposed that the ordinance sunset in 2016, the year the current AOCDS MOU will expire. The proposed sunset provision was rejected.

If COIN remains intact, the Supervisors and the public will certainly have an opportunity, in the next year, to assess whether the ordinance is having its intended effect, as the current County-AOCDS MOU expires on June 30, 2016.

## **FINDINGS**

In accordance with California Penal Code sections 933 and 933.05, the 2014-2015 Grand Jury requires (or, as noted, requests) responses from each agency affected by the findings presented in this section. The responses are to be submitted to the Presiding Judge of the Superior Court.

Based on its investigation titled “Orange County Sheriff Medical Insurance: Transparency Problems Abound,” the 2014-2015 Orange County Grand Jury has arrived at nine principal findings, as follows:

- F.1.** Numerous provisions contained in the Memorandum of Understanding are ambiguous as they relate to medical insurance coverage for Association of Orange County Deputy Sheriffs active and retiree members.
- F.2.** There are no limitations in the Memorandum of Understanding on how the Association of Orange County Deputy Sheriffs Trust’s reserves are to be used, what should be done if the reserve is over-funded, or what would happen to the funds in the Blue Cross Stabilization Fund when the agreement between the Association of Orange County Deputy Sheriffs Trust and Blue Cross is terminated.
- F.3.** The County has not insisted that the Association of Orange County Deputy Sheriffs Trust have a formal anti-fraud program, accounting policy and procedure manuals, or disaster recovery plan.

- F.4.** The jointly retained auditor selection process does not guarantee that the three auditor candidates are qualified, willing to do the work if selected, and will actually do the work if selected.
- F.5.** The Association of Orange County Deputy Sheriffs Trust has subsidized retirees' health benefits.
- F.6.** Contrary to the terms of the Memorandum of Understanding, Association of Orange County Deputy Sheriffs employees are receiving health care coverage from the Association of Orange County Deputy Sheriffs Trust.
- F.7.** Auditors have noted a number of internal control deficiencies related to the Association of Orange County Deputy Sheriffs Trust.
- F.8.** Allowing only one Reserve study and one Administrative fee study during the entire term of the Memorandum of Understanding is inadequate.
- F.9.** There is a general lack of transparency in the Memorandum of Understanding negotiation and approval process.

### **RECOMMENDATIONS**

In accordance with California Penal Code sections 933 and 933.05, the 2014-2015 Grand Jury requires (or, as noted, requests) responses from each agency affected by the recommendations presented in this section. The responses are to be submitted to the Presiding Judge of the Superior Court.

Based on its investigation titled "Orange County Sheriff Medical Insurance: Transparency Problems Abound," the 2014-2015 Orange County Grand Jury makes the following ten recommendations:

- R.1.** The County should retain a qualified, experienced, and independent negotiator to assist in the next negotiations between Orange County and the Association of Orange County Deputy Sheriffs and require that entity to prepare an internally consistent Memorandum of Understanding that, for example, makes it clear whether the Orange County contributions are to be used only for active employees. (F.1.)
- R.2.** The County should retain a qualified, experienced, and independent negotiator to incorporate clear terms in the Memorandum Of Understanding that define limitations on the use of Orange County contributions that become reserve funds, specify how to deal with over-funding, and resolve what is to become of the funds in the Premium Stabilization Fund if the Trust's agreement with Blue Cross is terminated. (F.2.)
- R.3.** The County should ensure that an anti-fraud program, accounting policies and procedures manuals, and a disaster recovery plan are developed, implemented, and maintained by the Association of Orange County Deputy Sheriffs Trust. (F.3.)

- R.4.** The County should require the County and the Association of Orange County Deputy Sheriffs Trust to have each of the three-candidate auditor firms sign a firm commitment that the nominees meet specified qualifications, want the business, and will do the business, if selected. (F.4.)
- R.5.** If the County is convinced that Sheriff retirees should not be benefiting from monthly County contributions to the Trust, the County should seek reimbursement from the Association of Orange County Deputy Sheriffs Trust for funds that the County believes are inappropriately used, e.g., Trust funds used to subsidize retirees medical insurance premiums. (F.5)
- R.6.** The County should seek reimbursement from the Association of Orange County Deputy Sheriffs Trust for funds that the County believes are inappropriately used, e.g., Trust funds used to pay for Association of Orange County Deputy Sheriffs employees' medical insurance. (F.6)
- R.7.** The County should seek to include terms in the next Orange County and Association of Orange County Deputy Sheriffs Memorandum of Understanding that require that the Association of Orange County Deputy Sheriffs Trust have specific additional appropriate and necessary controls in place, and require that the Trust fully implement and maintain the Memorandum of Understanding controls the Trust currently has. (F.7.)
- R.8.** The County should seek to include provisions in the next Orange County and Association of Orange County Deputy Sheriffs Memorandum of Understanding, requiring that Administrative Fees Assessments and Reserve Studies be performed more often than once a term and contain specifications and guarantees of active, equal control/access/involvement by Orange County. (F.8.)
- R.9.** The County should support and take full advantage of Orange County's Civic Openness in Negotiations - "COIN" ordinance in future Orange County and Association of Orange County Deputy Sheriff's Memorandum of Understanding negotiations and approval processes. (F.9.)
- R.10.** The County, at the conclusion of the term of the current Memorandum of Understanding, should seriously consider discontinuing its agreement with the Association of Orange County Deputy Sheriffs and instead take back its rightful responsibility for administering the medical insurance program(s) for all qualified County of Orange employees. (F.1. through F.9.)

### **REQUIRED RESPONSES**

The California Penal Code section 933 requires the governing body of any public agency which the Grand Jury has reviewed, and about which it has issued a final report, to comment to the Presiding Judge of the Superior Court on the findings and recommendations pertaining to matters under the control of the governing body. Such comment shall be made no later than 90 days after the Grand Jury publishes its report (filed with the Clerk of the Court). Additionally, in the case of a report containing findings and recommendations pertaining to a department or agency headed by an elected

County official (e.g. District Attorney, Sheriff, etc.), such elected official shall comment on the findings and recommendations pertaining to the matters under that elected official's control within 60 days to the Presiding Judge with an information copy sent to the Board of Supervisors.

Furthermore, California Penal Code section 933.05, subdivisions (a), (b), and (c), provides as follows, the manner in which such comment(s) are to be made:

(a) As to each Grand Jury finding, the responding person or entity shall indicate one of the following:

(1) The respondent agrees with the finding

(2) The respondent disagrees wholly or partially with the finding, in which case the response shall specify the portion of the finding that is disputed and shall include an explanation of the reasons therefore.

(b) As to each Grand Jury recommendation, the responding person or entity shall report one of the following actions:

(1) The recommendation has been implemented, with a summary regarding the implemented action.

(2) The recommendation has not yet been implemented, but will be implemented in the future, with a time frame for implementation.

(3) The recommendation requires further analysis, with an explanation and the scope and parameters of an analysis or study, and a time frame for the matter to be prepared for discussion by the officer or head of the agency or department being investigated or reviewed, including the governing body of the public agency when applicable. This time frame shall not exceed six months from the date of publication of the Grand Jury report.

(4) The recommendation will not be implemented because it is not warranted or is not reasonable, with an explanation therefore.

(c) If a finding or recommendation of the Grand Jury addresses budgetary or personnel matters of a county agency or department headed by an elected officer, both the agency or department head and the Board of Supervisors shall respond if requested by the Grand Jury, but the response of the Board of Supervisors shall address only those budgetary or personnel matters over which it has some decision making authority. The response of the elected agency or department head shall address all aspects of the findings or recommendations affecting his or her agency or department.

Comments to the Presiding Judge of the Superior Court in compliance with Penal Code section 933.05 are required from:

**Responses Required:**

Orange County Sheriff Medical Insurance:  
County Failures in Negotiation, Documentation, Oversight, and Transparency

Responses to Findings F.1. through F.9. and to Recommendations R.1. through R.10. are required from the Orange County Board of Supervisors.

**Responses Requested:**

Responses to Findings F.1. through F.9. and to Recommendations R.1. through R.10. are requested from the County Executive Officer of Orange County.

## ENDNOTES

### **Auditor Identified Deficiency and Recommendations**

#### **<sup>1</sup>Develop and Document an Anti-Fraud Program – 2008 Significant Deficiency (Lindquist LLP, 2008b)**

The June 30, 2008 audit report concluded that the Trust not having an anti-fraud program was a “significant deficiency” in internal control. The auditor cited Statement on Auditing Standards (SAS) No. 112 as requiring “an entity to have implemented a risk assessment process whereby appropriate individuals are charged with the responsibility to identify and evaluate the risk of a misstatement occurring in their financial reporting process.”

The auditor recognized that the Trust has certain procedures and controls to prevent, deter, and detect fraud; however, noted that the Trust does not have a formal written antifraud program in place. The auditor recommended that the program be developed and implemented.

The auditor mentioned that they have discussed this topic with “various personnel” and offered to assist in the implementation of the recommendations. They also committed to review the status of this item during their next audit engagement. However, the Grand Jury could not find any further reference to the status of this significant deficiency in any future audit report. AOCDS representatives mentioned they thought they had an anti-fraud policy in place. However, the Grand Jury could find no evidence that an anti-fraud program (i.e., something much more comprehensive than a policy), as prescribed by the auditor, has been developed or implemented by AOCDS.

#### **<sup>2</sup>Accounting Policy and Procedure Manuals – 2008, 2011, 2012, 2013 Comments and Recommendations (Lindquist LLP, 2008b, 2011d, 2012a, 2013d)**

The auditor noted that the Trust does not have administrative and accounting policies and procedures manuals in place. The auditor recommended that the Trust continue working on developing the manual “in order to help ensure consistent application of the Plan’s policies and procedures.”

The Grand Jury could find no evidence that policies and procedures manuals have ever been developed, adopted, or implemented. Representatives from AOCDS mentioned they are waiting to do this until their “new system” is in place. The new system is expected to be in place following the “open-enrollment” period that will conclude at the end of May 2015. In fact, since at least 2008, AOCDS has had no accounting policies and procedures manuals.

#### **<sup>3</sup>Disaster Recovery Plan – 2008, 2014 Comments and Recommendations (Lindquist LLP, 2008b, 2014a)**

The auditor recommended that a formal disaster recovery plan be developed in the event there is an interruption of the Trust’s operation. The plan should address the following:

Orange County Sheriff Medical Insurance:  
County Failures in Negotiation, Documentation, Oversight, and Transparency

- Restoration of essential business systems
- Relocation if the Trust's premises are damaged or destroyed
- Restoration of interrupted communications services
- Re-creation of electronic or other files and records
- Assessment of insurance coverage

Additional material misstatements identified by the auditor, further supporting the need for improved controls, include:

- Restatement of net assets (Lindquist LLP, 2013a) – The Trust's 2012 financial statements pertaining to the funds contained in the Blue Cross Premium Stabilization Fund (reserves) were under-reported by \$1.03 million.
- Accounting records (Lindquist LLP, 2012b) – The Trust continues to maintain its accounting records on the cash basis of accounting. Because the financial statements are prepared on the accrual basis of accounting, the auditor has repeatedly recommended that the Trust calculate receivables and payables at year-end using the accrual basis.

Other relevant opportunities for strengthening internal controls include:

- Investment Advisor report (Lindquist LLP, 2015b) – The investment advisor prepares a report based on the combined portfolio of the AOCDS and the Trust. Because these two entities are separate and distinct organizations, the auditor recommended that, unlike in the past, two separate reports should be prepared.

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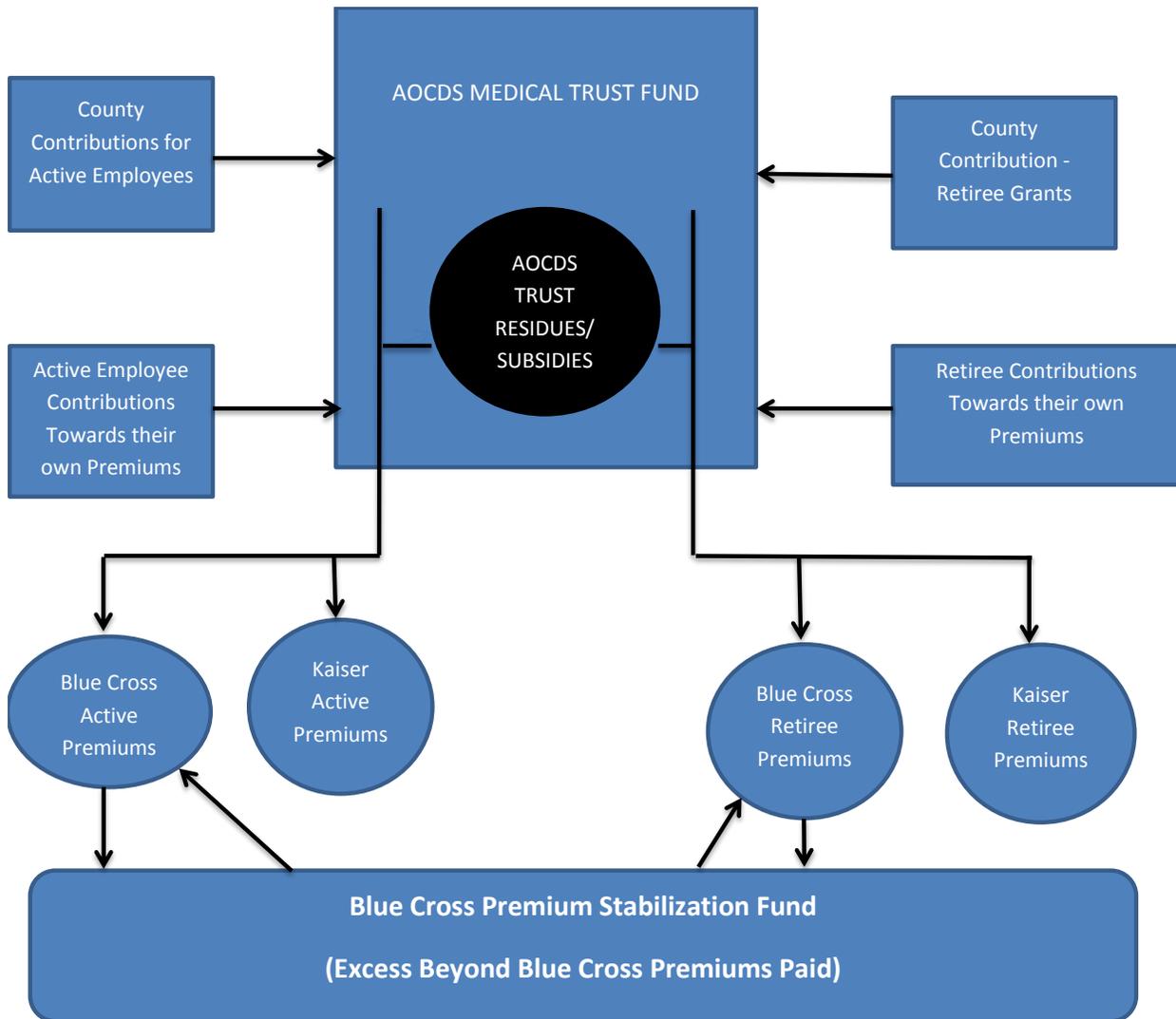
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- Lindquist LLP (2014b). Association of Orange County Deputy Sheriffs Medical Benefits Trust and County of Orange Independent Accountants' Report on Applying Agreed-Upon Procedures as of June 30, 2014 (January 27, 2015)
- Lindquist LLP (2015a). Significant Audit Findings for the year ended June 30, 2014, To the Board of Trustees of AOCDS Medical Benefits Trust (January 27, 2015)
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- Miller, Kaplan, Arase & Co., LLP (2007). Group Medical and Hospital Services Trust for Orange County Deputy Sheriffs Financial Statements as of June 30, 2007 and 2006 (September 27, 2007)
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**APPENDIX 1 - GLOSSARY**

<b>Term</b>	<b>Description</b>
ACLEM	Association of County Law Enforcement Managers
AOCDS	Association of Orange County Deputy Sheriffs
ARC	Annual Required Contribution
ASR	Orange County Board of Supervisors Agenda Staff Report
CAFR	Comprehensive Annual Financial Report
COIN	Civic Openness in Negotiations
County	Orange County
CPA	Certified Public Accountant
CRONEY	Civic Reporting Openness in Negotiations Efficiency Act
HMO	Health Maintenance Organization
MOU	Memorandum of Understanding, Article XII "On-The-Job Injuries, Workers' Compensation and Medical Insurance"
Peace Officer	Deputy Sheriffs I, II & Trainee; Investigator & Investigator I; District Attorney Investigator; Investigator-Polygraph Operator
POS	Point of Service
PPO	Preferred Provider Organization
PSF	Blue Cross Premium Stabilization Fund
SOW	Statement of Work
Supervising Peace Officer	Supervising Attorney's Investigator; Sergeant
Trust	Association of Orange County Deputy Sheriffs Medical Insurance Trust

**APPENDIX 2 - AOCDS MEDICAL INSURANCE TRUST**



### APPENDIX 3 - COUNTY & AOCDS HEALTH CARE ANALYSIS

The Grand Jury performed some analyses on the data obtained from the financial statements provided by the external auditor of the Association of Orange County Deputy Sheriffs (AOCDS) Trust and the County Employee Benefits staff. The data was reviewed to compare the costs, coverages, and reserves of the medical coverage accounts of the two populations, the AOCDS members versus the County employees. The Grand Jury determined that there were some interesting findings from the analyses that might be of help to County decision makers when negotiating the next Memorandum of Understanding with the AOCDS.

First, the Grand Jury decided to test whether the MOU requirement (Section 4.E.2) that monthly retiree premiums are at least 10% higher than the active employee premiums, was being done. The Grand Jury obtained the cost of premiums from the Independent Accountants' Report on Applying Agreed-Upon Procedures report prepared by Lindquist LLP (2014), dated January 27, 2015. Exhibit A, below, is a comparison of the Blue Cross HMO and PPO (BCHMO and BCPPO) premiums charged to County and AOCDS active and retiree participants.

**Exhibit A: Blue Cross HMO and PPO Comparison**

AOCDS Active Employees		AOCDS Retired under 65		Comparison	
BCHMO	Premium	BCHMO	Premium	Variance	%
Single	\$567.00	Single	\$624.00	\$57.00	10.05%
2-Party	\$1,062.00	2-Party	\$1,165.00	\$103.00	9.70%
Family	\$1,475.00	Family	\$1,618.00	\$143.00	9.69%
BCPPO	Premium	BCPPO	Premium	Variance	%
Single	\$808.00	Single	\$887.00	\$79.00	9.78%
2-Party	\$1,615.00	2-Party	\$1,773.00	\$158.00	9.78%
Family	\$2,120.00	Family	\$2,324.00	\$204.00	9.62%

(Lindquist LLP, 2014b)

It appears that retiree premium rates for the year starting July 1, 2013 were less than 10% higher than active members in almost every category of coverage in both HMO and PPO plans. Although the percentage differences were not significant, from the data available for review, it is not possible to determine whether the dollar value of the variance was significant.

The Grand Jury also decided to extend the analysis to determine the premium differential between the County's active employees and its retirees. The results indicated that, for comparable coverages, County retirees generally paid a significantly higher rate than County active employees (35-50% higher) did and also as compared to AOCDS active and retiree members. That is, AOCDS retirees only pay slightly more than 9% more than their active AOCDS counterparts for comparable coverage.

**Exhibit B: County HMO Comparison**

AOCDS Active Employees		AOCDS Retired under 65		Comparison	
County HMO	Premium	County HMO	Premium	Variance	%
Single	\$467.90	Single	\$932.25	\$464.35	99.24%
2-Party	\$935.80	2-Party	\$1,864.52	\$928.72	99.24%
Family	\$1,324.15	Family	\$2,703.53	\$1,379.38	104.17%

**Exhibit C: County PPO Comparison**

AOCDS Active Employees		AOCDS Retired under 65		Comparison	
County PPO	Premium	County PPO	Premium	Variance	%
Single	\$759.65	Single	\$1,174.35	\$414.70	54.59%
2-Party	\$1,405.38	2-Party	\$2,172.52	\$767.14	54.59%
Family	\$1,899.16	Family	\$2,935.86	\$1,036.70	54.59%

This premium data was obtained from the County Employee Benefits Division for FY 2013-2014

The Grand Jury next decided to test the clause in the MOU at Section 4.A. that states the following: *“The AOCDS shall provide medical benefits similar to those offered by the County. The plans should include one PPO or POS and one HMO option.”* The Grand Jury obtained data from the County Employee Benefits organization and comparable data from the AOCDS audited financial reports prepared by Lindquist for FY 2014. The results were interesting.

	COUNTY	AOCDS	VARIANCE
MEMBERS COVERED	22,636	2,934	19,702
ANNUAL COST OF PREMIUMS	\$213,290,589	\$40,906,171	\$172,384,418
<b>COST PER MEMBER</b>	<b>\$9,423</b>	<b>\$13,942</b>	<b>(\$4,519)</b>
<b>VARIANCE PER MEMBER PER MONTH</b>			<b>(\$377)</b>

It appears that premiums charged to active and retired County members are \$377 per month less than those charged to active and retired AOCDS members, which again raises the question of whether the medical benefits provided are, in fact, “similar.”

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The Grand Jury also looked at the level of reserves held by the County health plan and the AOCDS Trust reserve (numbers were derived from the FY2014 County Comprehensive Annual Financial Report - CAFR, Internal Service Funds, and from the audited financial statements for the AOCDS Trust). The level of reserves held by the two organizations were significantly different. The Grand Jury compared the reserve levels to the annual premiums paid and the variance was large.

ASSETS	COUNTY PLAN	AOCDS PLAN
HELD IN CASH, INVESTMENTS		\$7,173,204
POOLED CASH ETC PPO PLAN	\$25,510,000	
HMO CASH & INVESTMENTS	\$4,715,000	
BLUE CROSS PREMIUM STABILIZATION FUND		\$8,461,855
<b>TOTAL RESERVES HELD</b>	<b>\$30,225,000</b>	<b>\$15,635,059</b>
<b>PREMIUMS PAID</b>	<b>\$217,156,000</b>	<b>\$40,423,811</b>
<b>RESERVES AS % OF PREMIUM</b>	<b>13.92%</b>	<b>38.68%</b>

So, given this variance, what should be considered to be an acceptable level of reserve for medical insurance? The issue is further complicated by the fact that the County health insurance is self-funded and, therefore, necessitates a higher level of reserves to fund both the Incurred but Not Reported - IBNR and the PSF that protects the fund from catastrophic events that would require payments higher than the annual premiums collected from participants.

However, the AOCDS plan is not self-insured. As a result, the responsibility for covering higher losses than premiums collected falls on the insurance carrier, Blue Cross. The County should obtain an explanation from its own actuary as to why the County's self-insured fund is carrying a lower percentage of reserves as compared to the AOCDS fund that is fully insured by an outside vendor. (Lindquist LLP, 2014b)