COUNTY OF ORANGE
INTERNAL AUDIT DEPARTMENT

OFFICE OF THE DIRECTOR

Integrity
Objectivity
Independence

PETER HUGHES
Ph.D. MBA, CPA, CIA, CFE, CITP
DIRECTOR

MAILING ADDRESS:
400 CIVIC CENTER DRIVE WEST
BUILDING 12, ROOM 232
SANTA ANA, CA 92701

TELEPHONE: (714) 834-5475
FAX: (714) 834-2880
EMAIL: peter.hughes@ocgov.com
WEBSITE: www.oc.ca.gov/audit/

July 22, 2004

TO: John M. W. Moorlach, Treasurer-Tax Collector

SUBJECT: Management Letter on Audit of the Statement of Assets Held by the County Treasury at December 31, 2003 (Audit No. 2308)

Attached is our Management Letter on Audit of Statement of Assets Held by County Treasury for the period as of December 31, 2003 (Audit No. 2308).

The management letter contains audit recommendations. Your responses to our recommendations have been included in the management letter and the complete text of the responses is attached as Appendix.

Should you have any questions or desire additional information, please contact Alan Marcum, Audit Manager, at 834-4119 or Camille Gackstetter, Senior Auditor, at 834-4088.

Thank you for your courtesy and cooperation.

Respectfully submitted,

Peter Hughes

Peter Hughes, Ph.D., CPA
Director

/PH:cg

Attachment

Other recipients of this report:
- Members, Board of Supervisors
- Members, Audit Oversight Committee
- James D. Ruth, County Executive Officer
- Foreman, Grand Jury
- Darlene J. Bloom, Clerk of the Board of Supervisors
- David E. Sundstrom, Auditor-Controller
- Jim McConnell, Assistant Auditor-Controller, Central Operations
- Paul Gorman, Treasurer Accounting/Compliance Manager

ORANGE COUNTY TREASURER
MANAGEMENT LETTER
ON AUDIT OF STATEMENT OF ASSETS
HELD BY COUNTY TREASURY

AS OF DECEMBER 31, 2003

Issued: July 22, 2004

Audit Number 2308

Director:	Dr. Peter Hughes, CPA, CIA
Deputy Director:	Eli Littner, CPA, CIA
Audit Manager:	Alan Marcum, CPA, CIA
In-charge Auditor:	Camille Gackstetter, CPA
Sr. Staff Auditor:	Michael Dean, CIA
Sr. Staff Auditor:	Sonia Maceranka
Sr. Staff Auditor:	Dan Melton, CPA
Sr. Staff Auditor:	Scott Suzuki, CPA, CISA

COUNTY OF ORANGE

INTERNAL AUDIT DEPARTMENT

"The Internal Audit Department is an independent audit function reporting directly to the Orange County Board of Supervisors."

ORANGE COUNTY TREASURER

MANAGEMENT LETTER

ON AUDIT OF

STATEMENT OF ASSETS HELD BY COUNTY TREASURY

AS OF DECEMBER 31, 2003

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APPENDIX: Treasurer-Tax Collector Management Response (Full Text)

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PETER HUGHES
Ph.D. MBA, CPA, CIA, CFE, CITP
DIRECTOR

MAILING ADDRESS:
400 CIVIC CENTER DRIVE WEST
BUILDING 12, ROOM 232
SANTA ANA, CA 92701

TELEPHONE: (714) 834-5475
FAX: (714) 834-2880
EMAIL: peter.hughes@ocgov.com
WEBSITE: www.oc.ca.gov/audit/

Audit No. 2308

July 22, 2004

MANAGEMENT LETTER

John M. W. Moorlach
Treasurer-Tax Collector
12 Civic Center Plaza, Room G-76
Santa Ana, CA 92701-4521

Pursuant to Government Code 26920(b) and 26922, we have audited the Statement of Assets Held by the County Treasury as of December 31, 2003 and have issued our report dated May 7, 2004.

In planning and performing our audit, we considered the Treasury's internal controls in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statement and not to provide overall assurance on the internal controls in place. However, we noted certain matters involving the internal controls and its operations that we consider being reportable conditions under the standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that in our judgment, could adversely affect the organization's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statement.

The significant deficiencies we observed are discussed in the Findings, Recommendations, and Responses section of this report and should be corrected to strengthen the internal controls and enhance assurance that internal control procedures are adequate to achieve reliability of financial reporting.

The Treasurer is responsible for establishing and maintaining the internal controls framework for his Department. In fulfilling this responsibility, judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures. The objectives of internal controls over financial reporting are to provide management with reasonable, but not absolute, assurance that reliability of financial reporting is achieved with established criteria and management's policies.

John M. W. Moorlach
July 22, 2004

This report was discussed with representatives of the Treasury management; their responses have been incorporated in the report. This report is intended solely for the use of the Treasury management and should not be used for any other purpose. However, this report is a matter of public record and its distribution is not limited.

We appreciate the cooperation and assistance extended to us by the personnel of the Treasury during our examination.

Respectfully submitted,

Peter Hughes

Peter Hughes, Ph.D., CPA
Director

Distribution:
Members, Board of Supervisors
Members, Audit Oversight Committee
James D. Ruth, County Executive Officer
Foreman, Grand Jury
Darlene J. Bloom, Clerk of the Board of Supervisors
David Sundstrom, Auditor-Controller
Jim McConnell, Assistant Auditor-Controller, Central Operations
Paul Gorman, Treasurer Accounting/Compliance Manager

FINDINGS, RECOMMENDATIONS, AND RESPONSES

The American Institute of Certified Public Accountants Statement on Auditing Standards, Section AU 319—Consideration of Internal Control in a Financial Statement Audit requires auditors to obtain an understanding of the entity's internal controls over relevant processes, as well as, consider the entity's use of their information technology (IT) and its relevance to the audit of financial statements. During the audit period, the Treasurer's Office relied on information systems as their general ledger (Quantum System) and to record their cash (Cashiering and Back Office Systems), demand accounts and investments (Quantum System). Since the Treasurer's Office relied on these information systems to provide the information on the financial statement, we reviewed the general and application controls of the systems and identified the following weaknesses.

1. Training on Systems Development Life Cycle

Recently, the Treasurer Information Systems Unit documented a Systems Development Life Cycle (SDLC) methodology; however, the program staff and other employees involved in developing and testing software have not been trained on how to use the SDLC.

The SDLC provides a systematic approach for the development process that avoids shortsighted planning and provides for interim reviews and a final acceptance point. Without proper training on SDLC, critical steps could be omitted in the development process.

Recommendation No. 1
We recommend the Treasurer's Information Systems Unit train their program staff and all employees involved in developing and testing software on the utilization of the Systems Development Life Cycle (SDLC).

Treasurer Response:
Concur. The Treasurer-Tax Collector Information Systems Unit will train their program staff and all employees involved in developing and testing software on the utilization of the Systems Development Life Cycle (SDLC) by December 31, 2004.

2. Review of Security Reports

We found that the Treasurer's Office was not reviewing the following security reports generated by the Quantum System:

A. The "Master File Audit Report" reflects password changes, unauthorized log on attempts, changes to general ledger accounts, changes to counterparties, and user profile changes, additions, and deletions. A lack of review increases the risk that a breach of IT security or improper changes could occur and not be detected timely.

B. A report on user account rights and privileges. Failure to properly control user accounts could result in unauthorized access to the Treasurer's IT resources.

Recommendation No. 2
We recommend that the Treasurer's Information Systems Staff review the Master File Audit Report, and Accounting Management review the audit reports pertaining to user account rights, user privileges, and requested changes processed by the Treasurer's Information Systems Unit. The reviewers should document their review with their initials and date of review.

Treasurer Response:
Concur. By August 31, 2004 the Treasurer will implement a documented periodic review by Treasurer's Information System Staff of the Master File Audit report, and Accounting Management will implement a documented periodic review of the audit reports pertaining to user account rights, user privileges, and requested changes processed by the Treasurer's Information System's Unit.

3. Audit Report Retention Policy

The Treasurer has not developed an audit log retention methodology for Quantum transactions.

A "Message Log Listing" can be created by Crystal Reports and generated off Quantum by the Treasurer's Information Systems Staff on demand. This Listing shows employees who performed actions in a file, which provides a transaction history audit trail. Since this Listing is not automatically generated by Quantum, there is the risk that this audit trail may not be available for review in the future. The Treasurer's Information Systems Staff is not sure how long Quantum retains the transactions audit trail information and if it will be accessible in the future.

Recommendation No. 3
We recommend the Treasurer Information System Staff develop a methodology to ensure the transaction history is retained.

Treasurer Response:
Concur. The Treasurer's Information Systems Staff will develop a methodology to backup and retain transaction history audit trail logs by December 31, 2004.

4. Access to Back Office System

Treasurer's accounting employees have write access to the Back Office system when only read access is required. (Repeat finding from December 31, 2002 Management Letter, Finding B.2)

Inadequate access controls and privileges could allow unauthorized access to the department's information resources.

Recommendation No. 4
We recommend the Treasurer review all Back Office user accounts and apply the "least privileged" principal in determining appropriate access rights and privileges.

Treasurer Response:
Concur. Since the Treasurer's staff no longer uses the Back Office system, and does not require write access, it has been removed.

5. Segregation of Duties

Duties for reviewing the logs on unauthorized log-on attempts for both the Back Office and Cashiering Systems are not adequately segregated.

We noted that the end users of the Cashiering and Back Office Systems are also reviewing the logs for unauthorized log-on attempts for the same Systems. Failure to have appropriate personnel review the logs increases the risk that irregular activity could occur and not be detected.

Recommendation No. 5
We recommend the Treasurer require the Information Systems Staff to perform the review of unauthorized log-on attempts for both the Back Office and Cashiering Systems and document their review.

Treasurer Response:
Concur. The Treasurer's Information Systems Staff will implement a documented periodic review of unauthorized log-on attempts for both the Back Office and Cashiering Systems.

APPENDIX
TREASURER-TAX COLLECTOR MANAGEMENT RESPONSE

COUNTY OF ORANGE

OFFICE OF THE TREASURER-TAX COLLECTOR

HALL OF FINANCE & RECORDS
12 CIVIC CENTER PLAZA, ROOM G76
P. O. BOX 4515
SANTA ANA, CA 92701

JOHN M. W. MOORLACH, C.P.A., CFP®
TREASURER-TAX COLLECTOR
(714) 834-7625

GARY J. COWAN
ASSISTANT TAX COLLECTOR
(714) 834-3545

FAX (714) 834-2912

July 20, 2004

Dr. Peter Hughes, CPA
Director, Internal Audit
County of Orange
400 Civic Center Drive West
Building 12, Room 232
Santa Ana, CA 92701-4521

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Dear Dr Hughes:

Pursuant to Audit Oversight Committee Administrative Procedure No. 1, we have prepared our response to the draft results of your Management Letter on Audit of Statement of Assets held by County Treasury as of December 31, 2003. The recommendation numbers used in your report reference our response.

Recommendation No. 1
We recommend the Treasurer's Information Systems Unit train their program staff and all employees involved in developing and testing software on the utilization of the Systems Development Life Cycle (SDLC).

Treasurer-Tax Collector response:
Concur. The Treasurer Tax-Collector Information Systems Unit will train their program staff and all employees involved in developing and testing software on the utilization of the Systems Development Life Cycle (SDLC) by December 31, 2004.

Recommendation No. 2
We recommend the Treasurer's Information System Staff review the Master File Audit report, and Accounting Management review the audit reports pertaining to user account rights, user privileges, and requested changes, processed by the Treasurer's Information System's Unit. The reviewers should document their review with their initials and date of review.

Treasurer-Tax Collector response:
Concur. By August 31, 2004 the Treasurer will implement a documented periodic review by Treasurer's Information System Staff of the Master File Audit report, and Accounting Management will implement a documented periodic review of the audit reports pertaining to user account rights, user privileges, and requested changes processed by the Treasurer's Information System's Unit.

Dr. Peter Hughes, CPA
Page 2

Recommendation No. 3
We recommend the Treasurer Information Systems Staff develop a methodology to ensure the transaction history is retained.

Treasurer-Tax Collector response:
Concur. The Treasurer's Information Systems Staff will develop a methodology to backup and retain transaction history audit trail logs by December 31, 2004.

Recommendation No. 4
We recommend the Treasurer review all Back Office user accounts and apply the "least privileged" principal in determining appropriate access rights and privileges.

Treasurer-Tax Collector response:
Concur. Since the Treasurer's staff no longer uses the Back Office system, and does not require write access, it has been removed.

Recommendation No. 5
We recommend the Treasurer require the Information Systems Staff to perform the review of unauthorized log-on attempts for both the Back Office and Cashiering Systems and document their review.

Treasurer-Tax Collector response:
Concur. The Treasurer's Information Systems Staff will implement a documented periodic review of unauthorized log-on attempts for both the Back Office and Cashiering Systems.

If you have additional questions or follow-up comments, please contact Paul Gorman, Treasury Accounting/Compliance Manager at 834-2288.

Very truly yours,

John M. W. Moorlach, C.P.A., CFP®
Orange County Treasurer-Tax Collector