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INTERNAL AUDIT DEPARTMENT

File No. 2309

March 2, 2004

TO: The Honorable Frederick P. Horn
Presiding Judge of the Superior Court

SUBJECT: Report on Audit of Probation Department Internal Controls Over Juvenile Records and Accounts

Attached is a copy of the report on our Audit of the Probation Department Internal Controls Over Juvenile Records and Accounts for the Fiscal Years Ending June 30, 2002 and June 30, 2003 as required by Chapter 2, Section 275 of the Welfare and Institutions Code. If you have any questions, please call me at 834-5475 or Eli Littner, Deputy Director, at 834-5899.

Sincerely,

Dr. Peter Hughes, CPA
Director, Internal Audit

/PH:wk

Attachment

cc: Distribution Per Audit Oversight Committee
Administrative Procedure No. 1
Members, Board of Supervisors
Members, Audit Oversight Committee
James Ruth, County Executive Officer
Foreman, Grand Jury
David E. Sundstrom, Auditor-Controller
Darlene J. Bloom, Clerk of the Board of Supervisors
Stephanie W. Lewis, Chief Probation Officer
Colleene Preciado, Chief Deputy Probation Officer
Walter W. Watanabe, Director, Administrative and Fiscal Div., Probation
Jim McConnell, Assistant Auditor-Controller, Central Operations
Lorna Winterrowd, Administrative Manager, Probation Admin. and Fiscal Division

AUDIT OF
PROBATION DEPARTMENT
INTERNAL CONTROLS OVER
JUVENILE RECORDS AND ACCOUNTS
FOR THE FISCAL YEARS ENDING
JUNE 30, 2002 AND JUNE 30, 2003

REPORT DATE: March 2, 2004

File Number 2309

Audit Director:	Dr. Peter Hughes, CPA
Deputy Director:	Eli Littner, CPA
Audit Manager:	Alan Marcum, CPA
Auditor In-Charge:	Winnie Keung, CPA
Senior Auditor:	Lily Chin, CPA

INTERNAL AUDIT DEPARTMENT

COUNTY OF ORANGE

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INTERNAL AUDIT DEPARTMENT

File No. 2309

March 2, 2004

INTERNAL AUDITOR'S REPORT

The Honorable Frederick P. Horn
Presiding Judge of the Superior Court
County of Orange

Dear Judge Horn:

We have completed an audit of the Juvenile Division's books and accounts for the Orange County Probation Department (Probation) for the fiscal years ending June 30, 2002 and June 30, 2003 as required by Chapter 2, Section 275(b) of the Welfare and Institutions Code. Our audit included an evaluation of Probation's internal controls and processes relating to cash receipts, disbursements and case file management of juvenile probation cases. Our audit was performed in accordance with professional standards established by the Institute of Internal Auditors for the purpose of evaluating the adequacy and effectiveness of internal controls. We believe that our audit provides a reasonable basis for our opinion.

Probation's management is responsible for establishing and maintaining a system of prudent internal controls. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable but not absolute assurance that assets are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly. County Accounting Procedure S-2 – *Internal Control Systems* - prescribes the policies and standards to be followed by departments/agencies in establishing and maintaining internal control systems in their operations and administrative activities. This audit enhances but does not substitute for Probation's continuing emphasis on control activities and self-assessment of control risks.

Because of inherent limitations in any system of internal control, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate. Our audit, made for the limited purpose described above, would not necessarily disclose all material weaknesses in Probation's operating procedures, accounting practices, and compliance with County policy as they relate to the internal controls over Probation's books and accounts.

We have completed a follow-up examination of the actions taken by Probation to implement our recommendations made in our audit report dated May 1, 2002 and the management letter dated July 10, 2002. The prior audit report and management letter contained a total of thirteen recommendations and an overall conclusion that the processes and procedures pertaining to billing of fees and record maintenance were inadequate. We are pleased to report that actions taken by Probation have significantly enhanced internal controls over billings and record maintenance. Nine recommendations have been fully implemented and one is in progress. Two recommendations have not been fully implemented and have been readdressed in Findings Number 3 and 4C. One recommendation has not been implemented and has been repeated in Finding 6.

Based on our audit and follow-up, Probation's internal controls over its books and accounts relating to cash receipts, disbursements and cash file management of juvenile case are adequate and effective to ensure management's goals and objectives are accomplished in accordance with Chapter 2, Section 275(b) of the Welfare and Institutions Code. We did note opportunities where management can further enhance internal controls, which are discussed in the Findings, Recommendations, and Management Responses section of this report. Responses from Probation have been included for each recommendation, and the complete text of their responses has been appended to the report.

We appreciate the courtesy and cooperation extended to us by the personnel of the Probation Department during our review. If we can be of further assistance, please contact me at (714) 834-5475 or Eli Littner, Deputy Director at (714) 834-5899, or Alan Marcum, Audit Manager at (714) 834-4119.

Respectfully submitted,

Peter Hughes

Dr. Peter Hughes, CPA
Director, Internal Audit

Attachment

Judge Frederick C. Horn
March 2, 2004

Distribution: Pursuant to Audit Oversight Committee Procedure No. 1
Members, Board of Supervisors
Members, Audit Oversight Committee
James D. Ruth, County Executive Officer
Foreman, Grand Jury
David E. Sundstrom, Auditor-Controller
Darlene J. Bloom, Clerk of the Board of Supervisors
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Walter W. Watanabe, Director, Administrative and Fiscal Div., Probation
Lorna Winterrowd, Administrative Manager, Probation Admin. and Fiscal Div.
Jim McConnell, Assistant Auditor-Controller, Central Operations

OVERVIEW

OBJECTIVE

The Internal Audit Department conducted an audit of the Probation Department's (Probation's) books and accounts relating to cash receipts, disbursements, and case file management of juvenile cases for the purpose of evaluating the adequacy and effectiveness of internal controls and processes to ensure management is accomplishing its business goals and objectives in accordance with Chapter 2, Section 275(b) of the Welfare and Institutions Code.

SCOPE

Our audit focused on Probation's internal controls and processes over cash receipts and disbursements and was limited to the fiscal years ending June 30, 2002 and June 30, 2003. Chapter 2, Section 275(b) of the Welfare and Institutions Code requires an audit of the books and accounts relating to juvenile cases only; therefore, we limited our audit to include juvenile cases and related issues. Also, we reviewed actions taken by Probation to implement the twelve recommendations made in our audit report dated May 1, 2002 and the recommendation made in our management letter dated July 10, 2002. Our review methodology included inquiry, auditor observation, and testing of pertinent documentation for the purpose of assessing the adequacy and effectiveness of Probation's internal controls and processes. Our audit did not include a review of information systems or system controls used in the process.

BACKGROUND

Probation protects the community by conducting investigations for the court, enforcing court orders, assisting victims and facilitating the resocialization of offenders. Probation is headed by the Chief Probation Officer and employs 1,557 regular employees and 122 extra help employees. The department also utilizes the services of about 553 Volunteers in Probation, 25 Volunteer Probation Officers, 17 college interns, and the 100-member Probation Community Action Association. Probation Officers supervise approximately 15,000 adult and 7,500 juvenile offenders.

Probation has the fiduciary responsibility for a variety of monies, including monies for fines, fees, penalty assessments, restitution to victims, and charges for services provided. Probation maintains a trust fund that is used for the collection and disbursement of monies. Probation also administers a number of federal and state grant programs.

The major field offices are located in Anaheim, Westminster, Laguna Hills and Santa Ana. The department also operates five juvenile institutions, which collectively house about 800 youths daily. The Probation juvenile institutions are: Juvenile Hall, the Youth Guidance Center, the Joplin Youth Center, the Los Pinos Conservation Camp and the Lacy Juvenile Annex.

FINDINGS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

1. Review of PFS Error File

We found that the PFS Error File is not properly reviewed, which resulted in fees for Institutional Care and Support (ICS) not being completely billed.

The PFS Error File is created to record any records that do not conform to the business rules, which are defined in the system, when uploading data from other systems for billing. The system performs data validation and edit checks during the upload. When errors are encountered, the records are rejected and are added to the Error File.

In our testwork of parental obligation fees we found one instance where fees for ICS were not properly billed. A juvenile attended the Juvenile Hall from December 30, 2002 thru January 31, 2003, totaling thirty-three days. However, only the two days from December were billed to the parents; the thirty-one days in January, totaling $585.90 was not billed. We were informed that when the information was extracted from the Institution Management System (IMS) into PFS, only the December record was properly uploaded; the January record was rejected and appeared on the PFS Error File pending further research. We were informed that the PFS Error File is supposed to be reviewed by Manchester Office Building (MOB) Accounting Unit. However, the MOB Accounting Unit informed us that they are only responsible for reviewing the PFS Error File for errors related to bar panel fees.

Recommendation:

We recommend Probation assign responsibilities to ensure that PFS Error File is properly reviewed, and the errors corrected.

Probation Response:

Concur. The bulk of these errors are caused by inaccurate billing information provided by the firms generating bar panel fees. Probation will ensure appropriate PFS Error File review and correction of errors.

2. Segregation of Duties

The Collection Officer (CO) in the Parental Investigation & Enforcement Unit is responsible for monitoring parental obligations to ensure they are paid. Also, the CO has access in PFS to adjust the obligation amount for errors made before supervisor approval is obtained. In addition, the CO corresponds with parents and evaluates their financial ability when parents contest the obligations. After Supervising Collection Officer (SCO) reviews and approves the request; the CO sends an 'Unable to Pay' notification informing parents of the decision and an Account Modification Request (AMR) informing Probation Accounting to write off the obligations. Since the CO monitors the accounts, has access to the records, and notifies the parent of the waiver, the duties are not adequately segregated and an offsetting compensating control is not in place to migrate the risk.

Segregation of duties is a critical element to effective internal control; it reduces the risk of both erroneous and inappropriate actions. In general, the approval function, the recording function, reconciling function, and the asset custody function should be separated amid employees. When these functions cannot be separated, a detailed supervisory review of related activities is required as a compensating control activity. Segregation of duties is a deterrent to fraud because collusion with another person is required to perpetrate a fraudulent act.

Recommendation:

We recommend Probation establish procedure to assign the duty of notifying the parents declared as "unable to pay" to an independent source, and supervisor approval should be obtained before the Collection Officers adjust the obligation amounts.

Probation Response:

Concur. Probation will adopt the recommendation of assigning the duty of notifying the parents declared as "unable to pay" to the Accounting unit. Probation currently documents supervisory review in the PFS chronology for adjustments recommended by Parental Investigation and Enforcement unit Collection Officers. In addition, Probation will require supervisor approval prior to Collection Officers making any such adjustments.

3. Manual Check Payments (Prior year audit finding, No. 7A)

PFS is not programmed to record manual check payments. This program limitation causes discrepancy every time a manual check is issued by the Auditor-Controller's Office for Probation. This program deficiency results in a continuous reconciling item on the reconciliation of PFS to the A-C general ledger.

Currently, there are four reconciling items from four reporting categories (0555, 0777, 9999, 1111) of the Probation's main trust fund account number 300-347-9200. These reconciling items range from $10.00 to $490.00 totaling of $639.99, and the oldest one is dated December 2002. Remedy tickets were created requesting Probation Data System to correct this issue; however, due to materiality and other priorities; these items have not been cleared and remain unaddressed.

Recommendation:

We recommend that Probation work with its Data System Unit and Auditor-Controller's Office to clear the reconciling items. Also, we recommend that Probation continue its monitoring and limit the number of manual check payments.

Probation Response:

Concur. Probation's Administrative and Fiscal Division is working with Data Systems Division staff toward a resolution to clearing reconciling items within PFS, or via the Auditor-Controller when appropriate. Manual check payments are extremely limited, restricted to only a few each year, and are expected to remain that way.

4. Controls Over Data Input

We found that controls (reviews) are not in place to ensure the accuracy of the following manually input information:

A. Bar panel fees entered into PFS.
B. Testing for drug and substance abuse into the URI database.
C. Closing and vacating parental obligations in PFS. (**Prior year audit finding, No. 2B**)

Reviews are an important detective control activity. Lack of a review by a secondary set of eyes increases the risk that errors occur and are not detected. Probation agreed that this information should be reviewed, however, this is not possible at this time due to limited resources.

Recommendation:

We recommend Probation establish periodic review of data input to ensure accuracy.

Probation Response:

Concur. Probation will implement appropriate quality control measures to ensure accuracy of data input.

5. Controls Over Account Modification Requests (AMR)

We found that controls over AMR are not adequate to ensure that all AMR are received and processed.

AMR are forms that Collection Officers generate at the Manchester Office Building (MOB) requesting Grand Avenue Accounting Office (GAO) to modify juvenile probationers' account information or to clear suspense items. We found that not all AMRs are being received for processing.

Recommendation:

We recommend Probation establish controls (procedures) to ensure all Account Modification Requests are received at GAO for processing.

Probation Response:

Concur. This initiative is already underway and will be fully implemented with our electronic business initiatives, e.g., protocol associated with document imaging.

6. General Ledger Accrual (Prior year management letter audit finding)

During our last audit, we noted that legislatively authorized fees billed to clients to recover County service costs are not recorded on the County general ledger until the time client payments are received by Probation. We recommended that Probation work with the Auditor-Controller's Office in establishing the correct accounting entries for these types of financial transactions and in determining the proper timing for the recordation of these transactions.

During current year audit, we noted that Probation is still using cash basis of accounting to record these types of transactions. Probation informed us that due to system limitations and technical difficulties, they were unable to convert its accounting method to accrual. However, Probation informed us that they are developing a method for recording the receivable on their books, which includes a process to write off uncollectible accounts. Currently, the Collection Unit monitors

the amounts due from clients, and management is planning to partner with the State of California – Franchise Tax Board to recover the old balances due from former clients and if this process is unsuccessful, write off these old uncollectible accounts.

Recommendation:

We recommended that Probation account for fees due from clients for County services, such as those for legal defense and institutional care and support on the accrual basis.

Probation Response:

Do not concur. Probation has surveyed twenty-two other counties in California, and of the sixteen which have replied, including nine of the top ten most populated (one has not replied), none uses an accrual method to post revenues, based on client receivables. Article 25 of the Welfare and Institutions Code, which covers the support of wards and dependent children, including fiscal provisions, does not mandate an accrual accounting system. Ability to pay as well as financial evaluation and approvals by the Court are integral parts of our operation, and carry no pre-set predictive value of a client receivable. Each case is evaluated on its own merits. Due to the judicial and financial instability of the probation client population, it would be irresponsible of Probation to institute an accrual system that would artificially represent revenues at full value of what is initially charged to our clients. To implement an accrual system, Probation would also need to concurrently implement an aggressive write-off policy, which in turn would cause the Department to request of the Board of Supervisors a prohibitively high bad debt allowance. This possibility has been discussed with the Auditor-Controller's office and deemed inappropriate to Orange County's financial profile. Management will continue to strongly pursue fiscally appropriate collections policy for funds due from clients, involving partners and write-offs for uncollectible accounts. Further, management will continue to annually measure receivables to actual collected moneys, and manage its receivables in such a fashion so as to minimize receivables while maximizing actual revenue.

Internal Audit Response:

We discussed this issue with the County's external auditor, Macias, Gini & Company. We were informed that due to materiality, the affect is insignificant if Probation continues using the cash basis for financial reporting. However, for internal control prospective, Probation should have a system to keep track of fees due (receivables) from clients. During our review, we concluded that Probation's internal controls over its books and accounts are adequate and effective; therefore, we consider this issue closed.

COUNTY OF ORANGE

MEMORANDUM

RECEIVED
FEB 19 2004
COUNTY EXECUTIVE OFFICE

RECEIVED
INTERNAL AUDIT DEPARTMENT
2004 MAR -2 PM 2:14

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

via James Ruth
County Executive Officer

FROM: Stephanie Lewis
Chief Probation Officer

DATE: February 18, 2004

SUBJECT: **RESPONSES TO INTERNAL AUDIT FINDINGS**

Attached are the Probation Department's responses to your draft report (also attached). This document is being routed to you through the County Executive Officer for his review and comment. Per discussion between our respective staffs, finding number six will be set aside in the final report issued by your Department, pursuant to your team's meeting with the accounting firm Macias and Gini.

If you have any questions, please contact Walter Watanabe at 714.937.4728.
Thank you.

SL: lw
Attachments

Frederick A. Brown 3/1/04
Ltd Concurrence

Stephanie Lewis, Chief Probation Officer
Orange County Probation Department
Santa Ana, California

Management responses to:
Internal Audit of Probation Juvenile Accounts

1. **Review of PFS Error File**

Recommendation:

We recommend Probation assign responsibilities to ensure that PFS Error File is properly reviewed, and the errors corrected.

Probation Response:

Concur. The bulk of these errors are caused by inaccurate billing information provided by the firms generating bar panel fees. Probation will ensure appropriate PFS Error File review and correction of errors.

2. **Segregation of Duties**

Recommendation:

We recommend Probation establish procedure to assign the duty of notifying the parents declared as "unable to pay" to an independent source, and supervisor approval should be obtained before the Collection Officer adjust the obligation amounts.

Probation Response:

Concur. Probation will adopt the recommendation of assigning the duty of notifying the parents declared as "unable to pay" to the Accounting unit. Probation currently documents supervisory review in the PFS chronology for adjustments recommended by Parental Investigation and Enforcement unit Collection Officers. In addition, Probation will require supervisor approval prior to Collection Officers making any such adjustments.

3. **Manual Check Payments**

Recommendation:

We recommend that Probation work with its Data Systems Unit and Auditor-Controller's Office to clear the reconciling items. Also, we recommend that Probation continue its monitoring and limit the number of manual check payments.

Probation Response:

Concur. Probation's Administrative and Fiscal Division is working with Data Systems Division staff toward a resolution to clearing reconciling items within PFS, or via the Auditor-Controller when appropriate. Manual check payments are extremely limited, restricted to only a few each year, and are expected to remain that way.

4. **Controls over Data Input**

Recommendation:

We recommend Probation establish periodic review of data input to ensure accuracy.

Probation Response:

Concur. Probation will implement appropriate quality control measures to ensure accuracy of data input.

5. **Controls over Account Modification Requests (AMR)**

Recommendation:

We recommend Probation establish controls (procedures) to ensure all Account Modification Requests are received at GAO for processing.

Probation Response:

Concur. This initiative is already underway and will be fully implemented with our electronic business initiatives, e.g., protocol associated with document imaging.

6. **General Ledger Accrual**

Recommendation

We recommend that Probation account for fees due from clients for County services, such as those for legal defense and institutional care and support, on the accrual basis.

Probation Response:

Do not concur. Probation has surveyed twenty-two other counties in California, and of the sixteen which have replied, including nine of the top ten most populated (one has not replied), none uses an accrual method to post revenues, based on client receivables. Article 25 of the Welfare and Institutions Code, which covers the support of wards and dependent children, including fiscal provisions, does not mandate an accrual accounting system. Ability to pay as well as financial evaluation and approvals by the Court are integral parts of our operation, and carry no pre-set predictive value of a client receivable. Each case is evaluated on its own merits. Due to the judicial and financial instability of the probation client population, it would be irresponsible of Probation to institute an accrual system that would artificially represent revenues at full value of what is initially charged to our clients. To implement an accrual system, Probation would also need to concurrently implement an aggressive write-off policy, which in turn would cause the Department to request of the Board of Supervisors a prohibitively high bad debt allowance. This possibility has been discussed with the Auditor-Controller's office and deemed inappropriate to Orange County's financial profile. Management will continue to strongly pursue fiscally appropriate collections policy for funds due from clients, involving partners and write-offs for uncollectible accounts. Further, management will continue to annually measure receivables to actual collected moneys, and manage its receivables in such a fashion so as to minimize receivables while maximizing actual revenue.