DEPARTMENT CONTROL REVIEW
AUDITOR-CONTROLLER
TRUST AND AGENCY FUND DISBURSEMENTS

FOR THE PERIOD FROM JANUARY 1, 2003 THROUGH DECEMBER 31, 2003

REPORT DATE:
June 24, 2004

Audit Number #2429

Audit Director:	**Dr. Peter Hughes, CPA, CIA, CFE, CITP**
Deputy Director:	**Eli Littner, CPA, CIA, CISA**
Audit Manager:	**Michael Goodwin, CPA, CIA**
Senior Auditor:	**Lily Chin, CPA**

INTERNAL AUDIT DEPARTMENT

COUNTY OF ORANGE

DEPARTMENT CONTROL REVIEW
AUDITOR-CONTROLLER
TRUST AND AGENCY FUND DISBURSEMENTS

For the Period From January 1, 2003 Through December 31, 2003

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Transmittal Letter

Audit No. 2429

June 24, 2004

TO: David Sundstrom
Auditor-Controller

FROM: Peter Hughes, Ph.D., Director
FOR Internal Audit Department

SUBJECT: Department Control Review of Auditor-Controller
Trust and Agency Fund Disbursements

We have completed our review of internal controls over trust and agency fund disbursements processed by the Auditor-Controller's Office for the period from January 1, 2003 to December 31, 2003. The final report is attached along with your responses to our recommendations. We also attached a Customer Survey of Audit Services. Please complete the survey and return it to Eli Littner, Deputy Director of Internal Audit.

We appreciate the courtesy and cooperation of your staff during our review.

Attachment

Other recipients of this audit report:
Members, Board of Supervisors
Members, Audit Oversight Committee
Foreman, Grand Jury
Clerk of the Board of Supervisors
James D. Ruth, County Executive Officer
Jim McConnell, Assistant Auditor-Controller, A-C/Central Operations
Jan Grimes, Manager, A-C/Central Operations/General Accounting
Bob Leblow, Manager, A-C/Central Operations/Claims & Disbursing

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INTERNAL AUDITOR'S REPORT

Audit No. 2429

June 24, 2004

David Sundstrom
Auditor-Controller
12 Civic Center Plaza
Santa Ana, CA 92701

We have completed a review of internal controls and processes over trust and agency fund disbursements of the Auditor-Controller/Central Operations Division (Auditor-Controller) for the period from January 1, 2003 through December 31, 2003. Our review was made in accordance with professional standards established by the Institute of Internal Auditors for the purpose of evaluating the adequacy of internal controls in the areas noted above. We believe our review provides a reasonable basis for our opinion.

Management of the Auditor-Controller is responsible for establishing and maintaining a system of internal controls. The objectives of an internal control 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 (CAP) No. S-2 – *Internal Control Systems* prescribes the policies and standards to be followed by departments/agencies in establishing and maintaining internal control systems. Our review enhances and complements, but does not substitute for the Auditor-Controller's continuing emphasis on control activities and self-assessment of control risks.

Because of inherent limitations in any system of internal controls, 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. Accordingly, our review made for the limited purpose described above would not necessarily disclose all weaknesses in the Auditor-Controller's operating procedures, accounting practices and compliance with County policy.

Based upon our review, internal controls are effective to ensure trust and agency fund disbursements are properly authorized, accurate and supported in accordance with management's authorization and direction. Controls were generally effective over the monitoring of trust and agency funds and reconciling the accounts to the General Ledger, except for certain reporting categories that had not been reconciled for a period of time.

Our substantive testing did not disclose any instances of monetary loss or misappropriation; however, we did observe opportunities where internal controls over trust fund reconciliations could further be enhanced as detailed in the Observations, Recommendations, and Management Responses section of this report. Responses from the Auditor-Controller have been included for each recommendation and the complete text of responses has been appended to the report.

We appreciate the courtesy and cooperation extended to us by the personnel of the Auditor-Controller during our review. If we can be of further assistance, please contact me directly or Eli Littner, Deputy Director at (714) 834-5899 or Michael Goodwin, Audit Manager at (714) 834-6066.

Respectfully submitted,

FOR

Dr. Peter Hughes, CPA
Director, Internal Audit

Attachment

Distribution: Pursuant to Audit Oversight Committee Procedure No. 1
Members, Board of Supervisors
Members, Audit Oversight Committee
Foreman, Grand Jury
Clerk of the Board of Supervisors
James. D. Ruth, County Executive Officer
Jim McConnell, Assistant Auditor-Controller, Central Operations Division
Jan Grimes, Manager, A-C/Central Operations/General Accounting
Bob Leblow, Manager, A-C/Central Operations/Claims & Disbursing

OVERVIEW

OBJECTIVES

The Internal Audit Department conducted a review of the Auditor-Controller's Central Operations Division for the purpose of evaluating internal controls and whether they are operating effectively in the area of trust and agency funds to ensure:

- Trust and agency fund disbursements are authorized, accurate, supported and processed timely in accordance with management's authorization.
- Trust and agency funds are adequately monitored, properly reconciled to the County General Ledger, and old and/or unidentified reconciling items are researched and resolved timely.

BACKGROUND

The Auditor-Controller's mission is "to promote public oversight, provide accountability, and support financial decision-making for the County." The Auditor-Controller (A-C) provides professional accounting services that are mandated by the California Statutory Code Sections, along with other essential accounting services required for the County to receive and utilize more than $4.5 billion of Federal, State, and other County agency funds. To achieve this, the Auditor-Controller has 403 employees and is organized into three divisions, one of which is the Central Operations.

The Central Operations provides centralized accounting and financial reporting activities for all County agencies and departments. The Central Operations is responsible for six trust and agency funds. These funds are established to receive and disburse payroll withholdings, vehicle equipment violation fines, state and federal funding for law enforcement services, unclaimed properties belonging to the County, or overages exceeding $10 resulting from A/C Collections. The total disbursements for FY 2002-2003 were approximately $533 million with the number of transactions mostly comprised of payroll withholdings.

SCOPE

Our review was limited to internal controls over trust and agency funds and related disbursements for the period from January 1, 2003 to December 31, 2003. Our review included inquiry, auditor observation and limited testing of relevant documentation for the purpose of assessing the adequacy of internal controls over these processes in the Auditor-Controller's Office. We reviewed the establishment and purpose of the trust and agency funds, disbursements from various sub-accounts (herein referred to as reporting categories), and the reconciliations of these accounts. Our review excluded the reporting categories that the A-C/Collections Section administers, which will be addressed in a separate review. We also excluded controls over cash receipts, information systems and controls used in the trust and agency fund process and compliance with laws and regulations governing the trust and agency funds.

CONCLUSION

It is our opinion that internal controls over trust and agency fund disbursements are effective to ensure disbursements are properly authorized, accurate, supported and processed timely in accordance with management's authorization. We commend Auditor-Controller management in their attentiveness to internal controls, such as segregation of duties and supervisory/management reviews and approvals, over trust and agency fund disbursements. However, we did note where internal controls should be enhanced in the area of trust fund reconciliation, and are discussed in the Observations, Recommendations and Management Responses section of this report.

We appreciate the courtesy and cooperation that have been extended to us by the personnel of the Auditor-Controller during our review.

OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

I. Trust Fund Reconciliation

Reconciliation is a comparison of one set of data to another, identifying and investigating differences, and taking corrective action when necessary to resolve those differences. This internal control activity helps ensure the accuracy and completeness of transactions that have been charged to a department's accounts.

Our review of the monthly reconciliation of Trust Fund 300-309 (Attached Salary), established to process disbursements related to payroll withholdings, noted the following areas where controls over reconciliation should further be enhanced:

A. Outstanding Reconciling Items

We noted the following reconciling items that were unresolved as of our audit period and that require additional research and resolution:

1. **Account #300-309-9200-0200 – Medicare.** Four items totaling $912.26 remain unresolved, with one item outstanding from June 2002.

2. **Account #300-309-9200-0300 – FICA.** Six items totaling $2,863.72 remain unresolved since January 2003.

3. **Account #300-309-9200-0500 – Miscellaneous.** One item for $164 remains unresolved since July 2003.

We were informed that the A-C/ Claims & Disbursing Unit is currently investigating the resolution of these items.

Recommendation No. 1:
The Auditor-Controller research and resolve the above outstanding reconciling items.

Auditor-Controller Response:
Concur. The new accountant assigned to the reconciliation desk will research these items, and appropriate action will be taken to resolve them by the reconciliation for the month ending September 30, 2004.

B. Unreconciled Difference

Reporting categories within the Trust Fund 300-309 were established to process payroll withholdings for employees' purchase of US Savings Bond. Reporting categories 9200-0150 and 9200-0175 are designated to record active and inactive employees' contributions, respectively. We noted an unreconciled difference of $909.50 as of December 31, 2003. A-C/Claims & Disbursing informed us that the difference probably pertained to old monies, and they were in the process of clearing the inactive account.

Recommendation No. 2:
Auditor-Controller Claims & Disbursing ensure the unreconciled difference is identified and resolved.

Auditor-Controller Response:
Concur. This item has been resolved and cleared.

C. Reconciliation Procedure

In identifying the various reporting categories in Fund 300-309, we noted that management could not provide descriptions for several of the existing reporting categories, which had also not been reconciled. A/C Claims & Disbursing management informed us that all reporting categories are not reviewed because responsibility and accountability for the reporting categories may not always be clearly defined. Other units within the A-C/Central Operations Division also use the same trust fund by setting up their own reporting categories. The reconciliations in A/C Claims & Disbursing are limited to the reporting categories that are typically used for payroll.

We reviewed the General Ledger Report as of 12/31/2003 and noted the following accounts with outstanding, unreconciled balances:

1. **Account #300-309-8210**: Five reporting categories, some existing since December 1999, with debit balances ranging from $320.94 to $16,815.62.

2. **Account #300-309-9000**: Three reporting categories, some existing since December 1999, with credit balances ranging from $49.95 to $597.48.

3. **Account #300-309-9200-0152**: A credit balance of $1,591.41 existed since November 2003.

4. **Account #300-309-9200**: A credit balance of $99.54 existed, which was caused from date entry errors. It should be noted that this account balance has been researched and cleared since our fieldwork.

Responsibility for the above reporting categories needs to be established. One option management presented is to establish a separate fund for each Auditor-Controller unit to ensure clear responsibility and accountability of the funds.

Recommendation No. 3:
The Auditor-Controller take measures to ensure responsibility and accountability of the funds are clearly communicated to appropriate personnel, trust funds are reconciled completely, and differences are identified and resolved timely.

Auditor-Controller Response:
Concur. The format of the reconciliation has been changed to include all balance sheet accounts and reporting categories. Additionally, all payroll related trust fund activity will be consolidated into a single trust fund (Fund/Agency No. 300/309) that will be used only for Claims & Disbursing activity. This will eliminate any confusion over which reporting categories are the responsibility of the Claims accountant.

AUDITOR-CONTROLLER
COUNTY OF ORANGE

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DAVID E. SUNDSTROM, CPA
AUDITOR-CONTROLLER

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INTERNAL AUDIT DEPARTMENT
2004 JUN 17 AM 11:56

June 15, 2004

TO: Dr. Peter Hughes, Director, Internal Audit

SUBJECT: Response to Draft Audit Report: Department Control Review- Auditor-Controller Trust and Agency Fund Disbursements

The following are our responses to the recommendations contained in the *Draft Report on Department Control Review of Auditor-Controller Trust and Agency Fund Disbursements* (Audit Report No. 2429):

Recommendation No. 1
The Auditor-Controller research and resolve the above outstanding reconciling items.

Auditor-Controller Response
Concur. The new accountant assigned to the reconciliation desk will research these items, and appropriate action will be taken to resolve them by the reconciliation for the month ending September 30, 2004.

Recommendation No. 2
Auditor-Controller Claims & Disbursing ensure the unreconciled difference is identified and resolved.

Auditor-Controller Response
Concur. This item has been resolved and cleared.

Recommendation No. 3
The Auditor-Controller take measures to ensure responsibility and accountability of the funds are clearly communicated to appropriate personnel, trust funds are reconciled completely, and differences are identified and resolved timely.

Auditor-Controller Response
Concur. The format of the reconciliation has been changed to include all balance sheet accounts and reporting categories. Additionally, all payroll related trust fund activity will be consolidated into a single trust fund (Fund/Agency No. 300/309) that will be used only for Claims & Disbursing activity. This will eliminate any confusion over which reporting categories are the responsibility of the Claims accountant.

Thank you for the opportunity to respond to the draft report. Please contact Bob Leblow at 834-2466 if you have any questions on our responses.

David E. Sundstrom
Auditor-Controller

RL:lr (Audit Response-Trust Fund Audit/ops)

cc: Eli Littner, Internal Audit
Michael Goodwin, Internal Audit
John Nakane, Auditor-Controller
Jim McConnell, Auditor-Controller
Bob Leblow, Auditor-Controller