DEPARTMENT CONTROL REVIEW
HEALTH CARE AGENCY
TRUST AND AGENCY FUND DISBURSEMENTS

For the Period from
May 1, 2003 through April 30, 2004

REPORT DATE: November 2, 2004

Audit Number #2436

Audit Director:	**Peter Hughes, Ph.D., CPA**
Deputy Director:	**Eli Littner, CPA, CIA**
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Senior Auditor:	**Lily Chin, CPA**

INTERNAL AUDIT DEPARTMENT

COUNTY OF ORANGE

DEPARTMENT CONTROL REVIEW
HEALTH CARE AGENCY
TRUST AND AGENCY FUND DISBURSEMENTS

For the Period from May 1, 2003 through April 30, 2004

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COUNTY OF ORANGE
INTERNAL AUDIT DEPARTMENT

OFFICE OF THE DIRECTOR

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Transmittal Letter

Audit No. 2436

November 2, 2004

TO: Juliette A. Poulson, Director
Health Care Agency

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

SUBJECT: Department Control Review of Health Care Agency
Trust and Agency Fund Disbursements

We have completed a review of internal controls over trust and agency fund disbursements of the Health Care Agency for the period from May 1, 2003 through April 30, 2004. The final report is attached along with the responses to our recommendations. We have also attached a Customer Survey of Audit Services. Please ensure the appropriate staff completes the survey and return it to Renee Aragon, Executive Secretary, Internal Audit Department. We appreciate the courtesy and cooperation of your staff during our review.

Attachment

Other recipients of this report:
- Members, Board of Supervisors
- Members, Audit Oversight Committee
- Thomas G. Mauk, County Executive Officer
- David Sundstrom, Auditor-Controller
- Shaun Skelly, Assistant Auditor-Controller/Agency Accounting
- Alice Manning, Deputy Agency Director, HCA/Financial & Administrative Services
- Alice Sworder, Manager, HCA/Accounting Services
- Darlene J. Bloom, Clerk of the Board of Supervisors
- Foreman, Grand Jury

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

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INTERNAL AUDITOR'S REPORT

Audit No. 2436

November 2, 2004

Juliette A. Poulson
Health Care Agency
405 W. 5th Street
Santa Ana, CA 92701

We have completed a review of internal controls over trust and agency fund disbursements of the Health Care Agency (HCA) for the period from May 1, 2003 through April 30, 2004, which are administered by the Auditor-Controller employees in HCA/Accounting Services (HCA Accounting). 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 HCA is responsible for establishing and maintaining a system of internal controls for program operations, while the County's Auditor-Controller (A-C) is responsible for establishing and maintaining an appropriate system of internal controls for the accounting functions. 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 the departments/agencies should follow in establishing and maintaining internal control systems. Our review enhances and complements, but does not substitute for, HCA's and A-C's continuing emphasis on control activities, self-assessment of control risks and correction or mitigation of control risks identified.

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 HCA's or the A-C'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 except for certain reconciliation processes that need to be enhanced.

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. Although we reviewed a sample of trust and agency funds, our recommendations should be considered for all HCA's trust and agency funds where applicable. Responses from HCA and A-C have been included for each recommendation and the complete text of responses has been appended to the report.

We want to express our appreciation for the level of courtesy and cooperation extended to us by the personnel of HCA and HCA Accounting 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,

Peter Hughes, Ph.D., CPA
Director, Internal Audit

Distribution: Pursuant to Audit Oversight Committee Procedure No. 1
Members, Board of Supervisors
Members, Audit Oversight Committee
Thomas G. Mauk, County Executive Officer
David Sundstrom, Auditor-Controller
Shaun Skelly, Assistant Auditor-Controller/Agency Accounting
Alice Manning, Deputy Agency Director, HCA/Financial & Administrative Svcs.
Alice Sworder, Manager, HCA/Accounting Svcs.
Darlene J. Bloom, Clerk of the Board of Supervisors
Foreman, Grand Jury

OVERVIEW

OBJECTIVES

The Internal Audit Department conducted a review of Health Care Agency/Accounting Services to evaluate the effectiveness of internal controls 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 and direction.
- 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 mission of Health Care Agency is to protect the optimal health of individuals, families, and diverse communities through partnerships, community leadership, assessment of community needs, planning and policy development, and public services for prevention and education. Examples of these services include food protection, hazardous waste regulation, coordination of emergency medical care, and contracting essential medical services. The Auditor-Controller's Office (referred to in this report as HCA Accounting) performs the accounting functions for HCA. This includes administering the trust and agency funds used to support the programs and services described above.

HCA Accounting provides accounting functions for nine active trust and agency funds that include processing cash receipts, cash disbursements, and journal vouchers to transfer monies in and out of the funds. Within trust or agency funds, sub-accounts (reporting categories) are used to maintain separate accounting for specific components of the funds. Trust and agency fund receipts consist of cash and journal voucher transactions, and include fees, grant revenues, State program funding and interest earnings. Disbursements consist of cash and journal voucher transactions to reimburse other HCA funds for program expenditures, contracted medical services and payments to other governmental agencies. During FY 2003-04, HCA Accounting processed in excess of $200 million cash and non-cash disbursement transactions, while receipts exceeded $212 million.

SCOPE

Our review was limited to internal controls over trust and agency fund disbursements for the period from May 1, 2003 to April 30, 2004. Our review included inquiry, auditor observation and limited testing for assessing the effectiveness of internal controls over trust and agency funds. We selected four trust and agency funds and reviewed the establishment and purpose of these funds, disbursements from various reporting categories and the fund reconciliation process. Our review excluded controls over cash receipts, information systems and system controls used in the trust and agency fund process, compliance with laws and regulations governing the program expenditures, and HCA's monitoring of contract compliance related to trust and agency fund disbursements.

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 and direction. We commend HCA and HCA Accounting in their attentiveness to internal controls, such as with segregation of duties and supervisory/management reviews and approvals over trust and agency fund disbursements. We did note where internal controls should be further enhanced in the area of fund reconciliations, which are discussed in the Observations, Recommendations and Management Responses section of this report. HCA Accounting informed us that they either have begun or have implemented our recommendations.

OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

I. Trust and Agency Fund Reconciliations

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 recorded in trust and agency fund accounts. We noted the following areas where controls over reconciliations should be enhanced:

A. Timely Reconciliation

Reconciliation of County General Ledger accounts should be performed timely (within 30 days of month-end) to provide useful information to management and mitigate the risk of loss. HCA Accounting is responsible for performing the monthly reconciliations. During our review, we found that reconciliations were not prepared timely for the Certified Unified Program Agency (CUPA) program at Environmental Health that regulates hazardous materials and waste. HCA receives and disburses CUPA monies to local fire agencies and to the State. There were 13 reporting categories for CUPA in Fund 300-332 where the reconciliations were not completed for February 2004 through April 2004. HCA Accounting's procedure is to reconcile the collections prior to disbursing the monies, and disbursements are delayed if the fund is not reconciled timely.

Recommendation No I.A

HCA Accounting take measures to ensure the reconciliation is performed timely to ensure timely disbursements.

HCA Accounting Response:

Concur. All reconciliations for the 13 CUPA reporting categories in Fund 300-322 are now current. The unit manager completed the reconciliations for the months of February, March, and April 2004 by May 31, 2004. Since that time, the reconciliations have been completed within 30 days of month end. These are also monitored periodically in our status reports.

B. Review of General Ledger Report

In identifying all HCA trust and agency funds, we reviewed the General Ledger for our audit period and noted there were accounts not identified on HCA Accounting's schedule of active trust and agency funds. Those accounts we identified along with the outstanding unreconciled balances are as follows:

- **Account #300-394-various reporting categories**: 13 reporting categories existed since September 2003, with credit balances ranging from $.76 to $810.80.
- **Account #300-332-8590**: A debit balance of $50.00 existed for over 20 months.
- **Account #300-332-8590-0045**: A credit balance of $50.00 existed for over 20 months.
- **Account #300-332-9340-0019**: A credit balance of $50 existed for over 20 months.

Recommendation No I.B
HCA Accounting establish a procedure to review the monthly General Ledger to ensure all account balances are reconciled and differences are researched and resolved.

HCA Accounting Response:
Concur. The unreconciled balances in the inactive accounts noted on the audit report were the result of coding errors and have been transferred to the appropriate deferred revenue accounts. HCA Accounting has also assigned responsibility for reviewing the General Ledger each month to ensure all non-active account balances are identified and reconciled promptly.

C. Reconciliation Procedures and Documentation

During our reconciliation testing of Agency Fund 235 (CA Health Care for Indigents), Fund 237 (Medical Services for Indigents) and Fund 238 (Emergency Medical Services), we found that reconciliations were performed monthly; however, the reconciliation procedures need to be further enhanced. The following were noted:

1. The Statement of Fund Activity document that is prepared for the purpose of reconciliation was not a proper format to accomplish a formal reconciliation. Although this document listed all transactions in detail and month-end balances, its source of information is the same source used for the General Ledger – the County financial system. There was a documented supervisory review that compared the ending balance on the Statement of Fund Activity to the General Ledger; however, reconciliation should be a comparison between two sets of records.

   We noted that the Statement of Fund Activity could serve as a subsidiary ledger to the General Ledger if the transactions were obtained from other sources. We were informed that accounting staff does not always receive copies of transactions that were processed. HCA Accounting should take measures to obtain this information as transactions are processed to continuously maintain a subsidiary ledger. The subsidiary ledger should be reconciled monthly to the General Ledger.

   Recommendation No. I.C.1:
   HCA Accounting establish procedures to maintain a subsidiary ledger for trust and agency funds on an ongoing basis.

   HCA Accounting Response:
   Concur. A written procedure for performing reconciliations was established in April 2004, and staff has been trained on this procedure. It requires HCA Accounting staff to maintain subsidiary ledgers and reconcile these to the General Ledger on a monthly basis. The reconciliations are then reviewed and signed by unit managers.

   Recommendation No. I.C.2:
   HCA Accounting establish a reconciliation format that compares trust and agency fund activity between the subsidiary ledger to the General Ledger.

HCA Accounting Response:
Concur. The written procedure, discussed in I.C.1, requires that staff use a standardized reconciliation format which compares the activity of the subsidiary ledger to the General Ledger. The reconciliations are then reviewed and signed by unit managers.

2. For two funds tested (Fund 237 and Fund 238), reporting categories were used to designate various components of the funds. Our testing revealed that the reconciliation was performed at the fund level rather than at the reporting category level. The reconciliation agreed the total fund balance shown on the Statement of Fund Activity to the General Ledger ending fund balance, but we noted variances existed at the reporting category levels that did not agree to the General Ledger.

Recommendation No. I.C.3:
HCA Accounting establish procedures to perform reconciliations for each reporting category to ensure accounts are accurate.

HCA Accounting Response:
Concur. Written procedures have been prepared that require subsidiary ledgers be reconciled to the General Ledger, at the reporting category level, on a monthly basis. These reconciliations are all current.

COUNTY OF ORANGE
HEALTH CARE AGENCY
OFFICE OF THE DIRECTOR

Excellence
Integrity
Service

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October 8, 2004

TO: Peter Hughes, Director
Internal Audit Department

SUBJECT: **Response to HCA Trust and Agency Fund Disbursements Audit Report**
Audit Number 2436

We have reviewed the draft audit report prepared by the Internal Audit Department covering HCA trust and agency fund disbursements, which are administered by the Auditor-Controller's HCA Accounting Section. Both the Health Care Agency and the Auditor-Controller concur with the recommendations made in the audit, as stated in the attached response, and HCA Accounting has implemented each of these recommendations.

In accordance with County procedure, we have submitted the response to the County Executive Office and received their approval to submit it to Internal Audit.

Also attached is the letter from the Auditor-Controller, stating their concurrence.

Please call me at 834-6254, or Alice Sworder at 834-5264, if you have any questions concerning this report.

Juliette A. Poulson, RN, MN
Director

Concurrence:
James D. Ruth
County Executive Officer

JAP:as

Attachments

cc: James D. Ruth, County Executive Officer
William D. Mahoney, Deputy CEO
David E. Sundstrom, Auditor-Controller
Alice Manning, HCA/Financial & Administrative Services
Alice Sworder, HCA Accounting

RECEIVED
OCT 29 2004
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INFORMATION TECHNOLOGY

DAVID E. SUNDSTROM, CPA
AUDITOR-CONTROLLER

September 29, 2004

TO: Juliette A. Poulson, Director
Health Care Agency

SUBJECT: Response to HCA Trust and Agency Fund Disbursements Audit Report
Audit Number 2436

We reviewed the draft audit report prepared by the Internal Audit Department covering HCA trust and agency fund disbursements, which are administered by the Auditor-Controller's HCA Accounting Section.

We are pleased that the audit report concludes that internal controls over these operations "... are effective to ensure disbursements are properly authorized, accurate, supported and processed timely in accordance with management's authorization and direction." However, the report identifies some areas where internal controls over reconciliations should be enhanced. We concur with the findings and have implemented all of the recommendations. Our responses are attached.

Please contact Alice Sworder at 834-5264 if you have any questions regarding this report.

David E. Sundstrom
Auditor-Controller

SS:wg(AgyActg/HCA covr ltr)

Attachment

cc: Peter Hughes, Director, Internal Audit Department
Shaun M. Skelly, Assistant Auditor-Controller, Agency Accounting
Alice Sworder, Manager, HCA Accounting Services

DRAFT REPORT
DEPARTMENTAL CONTROL REVIEW
HEALTH CARE AGENCY
TRUST AND AGENCY FUND DISBURSEMENTS

I.A. Timely Reconciliation

Recommendation
HCA Accounting take measures to ensure the reconciliation is performed timely to ensure timely disbursements.

HCA Accounting Response:
Concur. All reconciliations for the 13 CUPA reporting categories in Fund 300-332 are now current. The unit manager completed the reconciliations for the months of February, March, and April 2004 by May 31, 2004. Since that time, the reconciliations have been completed within 30 days of month end. These are also monitored periodically in our status reports.

I.B. Review of General Ledger Report

Recommendation
HCA Accounting establish a procedure to review the monthly General Ledger to ensure all account balances are reconciled and differences are researched and resolved.

HCA Accounting Response:
Concur. The unreconciled balances in the inactive accounts noted on the audit report were the result of coding errors and have been transferred to the appropriate deferred revenue accounts. HCA Accounting has also assigned responsibility for reviewing the General Ledger each month to ensure all non-active account balances are identified and reconciled promptly.

I.C. Reconciliation Procedures and Documentation

Recommendation No. I.C.1:
HCA Accounting establish procedures to maintain a subsidiary ledger for trust and agency funds on an ongoing basis.

HCA Accounting Response:
Concur. A written procedure for performing reconciliations was established in April 2004, and staff has been trained on this procedure. It requires HCA Accounting staff to maintain subsidiary ledgers and reconcile these to the General Ledger on a monthly basis. The reconciliations are then reviewed and signed by unit managers.

Recommendation No. I.C.2:
HCA Accounting establish a reconciliation format that compares trust and agency fund activity between the subsidiary ledger to the General Ledger.

HCA Accounting Response:
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Recommendation No. I.C.3:
HCA Accounting establish procedures to perform reconciliations for each reporting category to ensure accounts are accurate.

HCA Accounting Response:
Concur. Written procedures have been prepared that require subsidiary ledgers be reconciled to the General Ledger, at the reporting category level, on a monthly basis. These reconciliations are all current.