INTERNAL AUDIT DEPARTMENT
COUNTY OF ORANGE

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DEPARTMENT CONTROL REVIEW RESOURCES & DEVELOPMENT MANAGEMENT DEPARTMENT TRUST AND AGENCY FUND DISBURSEMENTS

AUDIT NUMBER: 2432 **REPORT DATE: MARCH 30, 2005**

Audit Director: Peter Hughes, Ph.D., CPA
Deputy Director: Eli Littner, CPA, CIA
Audit Manager: Michael Goodwin, CPA, CIA
In-Charge Auditor: Winnie Keung, CPA

Department Control Review
Resources & Development Management Department
Trust and Agency Fund Disbursements

For the Year Ended June 30, 2004

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COUNTY OF ORANGE
INTERNAL AUDIT DEPARTMENT

OFFICE OF THE DIRECTOR

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Transmittal Letter

Audit No. 2432

March 30, 2005

TO: Bryan Speegle, Director
Resources & Development Management Department

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

SUBJECT: Department Control Review of Resources & Development Management Department Trust and Agency Fund Disbursements

We have completed a Department Control Review of Resources & Development Management Department Trust and Agency Fund Disbursements for the year ended June 30, 2004. The final **Internal Auditor's Report** is attached following this transmittal letter.

Please note, beginning in January 2005, we implemented a more structured and rigorous follow-up audit process in response to recommendations and suggestions made by the Audit Oversight Committee (AOC) and the Board of Supervisors (BOS). As a matter of policy, our first follow-up audit will now begin no later than six months upon the official release of the report. The AOC and BOS expect that audit recommendations will typically be implemented within six months and often sooner for significant and higher risk issues. Our second follow-up review will now begin at 12 months from the release of the original report, by which time all audit recommendations are expected to be addressed and implemented.

At the request of the AOC, we are to bring to their attention any audit recommendations we find still not implemented or mitigated after the second follow-up audit. The AOC requests that such open issues appear on the agenda at their next scheduled meeting for discussion.

In addition, as the Director of the Internal Audit Department, effective December 14, 2004, I now make a monthly audit status presentation to the BOS where I detail any material and significant audit findings released in reports during the prior month, the implementation status of audit recommendations as disclosed by our follow-up audits, any pressing audit or resource issues; as well as, respond to inquiries from the BOS. Therefore, the results of this audit will be included in a future summary to the Board.

For purposes of reporting our audit observations and recommendations, we will classify audit report items into three distinct categories:

- **Material Weaknesses:** Audit findings that can result in significant financial liability and exposure to a department/agency and to the County as a whole. Management is expected to immediately address "Material Weaknesses" brought to their attention.

- **Significant Issues:** Audit findings that represent a significant deficiency in the design or operation of processes or internal controls.

- **Reportable Conditions:** Audit findings that require management's corrective action to implement or enhance processes and internal controls.

Our review identified four audit observations containing seven recommendations. Of the four observations, we consider **Item I** as a "**Significant Issue**" and **Items II through IV** as "**Reportable Conditions**."

As always, the Internal Audit Department is available to partner with you so that you can successfully implement or mitigate difficult audit recommendations. Please feel free to call me should you wish to discuss any aspect of our audit report or recommendations.

We have attached a Follow-Up Audit Report Form. Your department should complete this template as our audit recommendations are implemented. When we perform our follow-up audit approximately six months from the date of this report, we will need to obtain the completed document to facilitate our review.

We have also attached a Customer Survey of Audit Services. Please complete the survey and return it to Renee Aragon, Executive Secretary, Internal Audit Department.

Attachment

Other recipients of this report:
Members, Board of Supervisors
Members, Audit Oversight Committee
Foreman, Grand Jury
David E. Sundstrom, Auditor-Controller
Thomas G. Mauk, County Executive Officer
Vicki Wilson, Deputy CEO/Infrastructure & Environmental Resources
Steve Danley, Director, RDMD/Administration
Mary Fitzgerald, Chief, RDMD/Accounting Services
Michael McMillan, Chief, RDMD/Purchasing & Contract Services
Brian Murphy, Chief, RDMD/Central Quality Assurance
Shaun Skelly, Assistant Auditor Controller/Agency Accounting
Bill Rawlings, Director, CEO/Purchasing & Real Estate
Shirley Charity, Manager/CEO/Administration
Darlene J. Bloom, Clerk of the Board of Supervisors

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INTERNAL AUDITOR'S REPORT

Audit No. 2432

March 30, 2005

Bryan Speegle, Director
Resources & Development Management Department
300 N. Flower Street
Santa Ana, CA 92703

We have completed an audit of internal controls over trust and agency fund disbursements of the Resources & Development Management Department (RDMD) for the year ended June 30, 2004. Our audit was made in accordance with professional standards established by the Institute of Internal Auditors.

Management of RDMD is responsible for establishing and maintaining a system of internal controls for program operations, while the Auditor-Controller is responsible for establishing and maintaining an appropriate system of internal controls for 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, RDMD's and 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 RDMD's or the Auditor-Controller's operating procedures, accounting practices, and compliance with County policy.

Our review identified four audit observations containing seven recommendations. Of the four observations, we consider **Item I** as a "**Significant Issue**" and **Items II through IV** as "**Reportable Conditions**."

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

Based on our review, internal controls are in place to ensure trust fund disbursements are properly authorized and recorded completely, accurately, and timely in accordance with agreements/contracts, County Accounting Procedures, and statutory requirements. In regards to monitoring and reconciling trust and agency funds, our review disclosed a significant issue involving Trust Fund 300-367 - Real Property Services where RDMD's records showed $833,770 in negotiable instruments that were no longer in RDMD's possession. These negotiable instruments were physically transferred to CEO/Real Estate in June 1997, yet they remained recorded under RDMD. This issue is discussed in detail under Item I in the Detailed Observations, Recommendations and Management Responses section of this report. In that section, we also discuss where other internal controls for monitoring trust and agency funds and fund disbursements should be enhanced. Responses from RDMD, the Auditor-Controller and the CEO are included for each recommendation and the complete text of responses is appended to the report.

While in our report we indicate the specific funds audited and where our observations are directly applicable, **RDMD and the Auditor-Controller should implement the recommendations in other funds they find as applicable to them.** An expectation of the Board of Supervisors is that departments and agencies will view this report as a "lessons learned" opportunity to guide them in proactively self-assessing other similar operations.

We appreciate the courtesy and cooperation extended to us by the personnel of RDMD, the Auditor-Controller and the County Executive Office during our review. As we identified issues during the review, personnel were responsive in taking corrective actions. 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: Members, Board of Supervisors
Members, Audit Oversight Committee
Foreman, Grand Jury
David E. Sundstrom, Auditor-Controller
Thomas G. Mauk, County Executive Officer
Vicki Wilson, Deputy CEO/Infrastructure & Environmental Resources
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Bill Rawlings, Director, CEO/Purchasing & Real Estate
Shirley Charity, Manager/CEO/Administration
Darlene J. Bloom, Clerk of the Board of Supervisors

OVERVIEW

OBJECTIVES

The Internal Audit Department conducted a review of the Resources & Development Management Department (RDMD) to ensure:

1. Trust fund disbursements are properly authorized and recorded completely, accurately, and timely in accordance with agreements/contracts, County's Accounting Procedures, or statutory requirements.
2. Trust and agency funds are adequately monitored and properly reconciled, and old and/or unidentified reconciling items are researched and resolved timely.

BACKGROUND

In January 2004, the former Public Facilities & Resources Department (PFRD) and Planning & Development Services Department (PDSD) merged to create RDMD. The mission of RDMD is to provide, operate, and maintain quality public facilities and regional resources for the enjoyment, mobility, protection, and business of the people of Orange County. RDMD has seven divisions to provide services such as flood protection, recreational facilities and maintaining road systems in unincorporated Orange County and cities. The Auditor-Controller performs accounting functions for RDMD and is referred to in this report as Auditor-Controller Accounting.

RDMD has ten trust and agency funds. These funds consist of various items, such as collections for road improvements and drainage facilities, refundable cash and non-cash security deposits, and donations. Within each trust and agency fund, sub-accounts (reporting categories) are used to maintain separate accounting for specific components of the fund (e.g., various road projects in different zone areas). Trust and agency fund receipts consist of cash and journal voucher transactions, and include fees, refundable surety and security deposits, donations and interest earnings. Fund disbursements consist of cash and journal voucher transactions to recognize revenue, reimbursement of RDMD operating accounts, refunds of deposits and payments to other agencies. During FY 2003-04, there were approximately $10 million cash and non-cash disbursement transactions and over $11 million cash receipts processed for the trust and agency funds formerly administered under PFRD.

SCOPE

Our review methodology included inquiry, auditor observation and testing of documentation over trust and agency fund disbursements and reconciliation processes. Our review was limited to the trust and agency funds under the former PFRD administration, and did not include funds under the former PDSD. We selected two trust and agency funds to perform tests of internal controls and processes: the Major Thoroughfare & Bridge Fee Program (Agency Fund 158-158) and Refundable Deposits (Trust Fund 300-328). For these funds, we reviewed disbursements on a sample basis from various reporting categories and the reconciliations of these accounts. We also reviewed limited aspects of Real Property Services (Trust Fund 300-367). As of June 30, 2004, Agency Fund 158-158 had a balance of $28.8 million, Trust Fund 300-328 had $10.4 million, and Trust Fund 300-367 had approximately $1 million. Our review excluded controls over cash receipts, information systems and system controls used in the trust and agency fund process.

CONCLUSION

1. Trust and agency fund disbursements we reviewed were properly authorized and recorded completely, accurately, and timely in accordance with agreements/contracts, County Accounting Procedures, and statutory requirements. We note in our report where enhancements should be made in the Auditor-Controller Accounting's deposit refund review process.

2. Trust and agency funds we reviewed were adequately monitored and properly reconciled, and old and/or unidentified reconciling items are researched and resolved timely, except for Trust Fund 300-367 – Real Property Services where negotiable instruments in the fund were transferred to the County Executive Office in 1997 and remain recorded under RDMD. We discuss this issue in detail under Item I in the Detailed Observations, Recommendations and Management Responses section of this report. We also note where RDMD and Auditor-Controller Accounting should enhance its controls over negotiable instruments maintained in Trust Fund 300-328, and in supervisory reviews of the monthly reconciliations prepared for Agency Fund 158-158.

DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

I. Real Property Services Trust Fund 300-367

Trust Fund 300-367 was established under the former General Services Agency to hold refundable security deposits from outside entities for leasing County owned property. Security deposits can be in the form of cash or non-cash, and are held in the event contractual obligations are not met. Non-cash security deposits are negotiable instruments that become due and payable to the County upon contractual non-performance or default. As of 6/30/04, the fund contained cash and non-cash security deposits, totaling $189,693 and $833,770, respectively. These security deposits are for older projects initiated between 1980 and 1996 and several of the negotiable instruments are still active. Our review disclosed the following:

- RDMD is shown as the controlling agency of this trust fund and has the security deposits currently recorded in the County General Ledger as belonging to RDMD. However, RDMD does not possess any of the non-cash security deposits as they were reported to us as physically transferred by Auditor-Controller Accounting to County Executive Office/Purchasing & Real Estate (CEO/Real Estate) in June 1997.

- When the negotiable instruments were transferred to CEO/Real Estate in 1997, there was no documentation of the transfer of accountability of the assets between the two departments. The negotiable instruments totaled $834,400 when transferred and are currently shown in the General Ledger for RDMD as $833,770, a difference of $630.

- Since the transfer in 1997, Auditor-Controller Accounting stopped monitoring the negotiable instruments in Trust Fund 300-367 because they no longer had possession of the negotiable instruments and it was believed that the remaining cash security deposits belonged to leases being managed by CEO. Between 1997 and 2004, there was very little activity in the trust fund.

- Accounting informed us they contacted CEO/Administration and CEO/Real Estate a few times to complete the transfer of this Trust Fund to CEO by completing a Statement of Assets Transferred form. We observed evidence of these discussions occurring in early 2003, and reportedly, earlier attempts were made. However, this was never finalized and the assets remain on RDMD's books. CEO/Administration informed us that the fund was not transferred to CEO/Real Estate because of insufficient information to show the deposits belonged to CEO/Real Estate.

Because the amounts are recorded in RDMD and it does not possess the negotiable instruments, this fund appears to be overstated by $833,770 in RDMD's records.

We verified the $834,440 in negotiable instruments that were physically transferred to CEO/Real estate in 1997, with the exception of two items: Instant Storage for $10,000 and Community Redevelopment Agency - City of Santa Ana for $120,000, where supporting documentation was not available to show the disposition of the negotiable instruments. All other negotiable instruments either were in CEO/Real Estate's possession or there was supporting documentation to account for their disposition.

We were told CEO/Real Estate would continue to research these items. (**Note:** Our review did not include CEO/Real Estate's processes and controls for safeguarding and monitoring its negotiable instruments.)

For the cash security deposits in this fund, Auditor-Controller Accounting maintains a subsidiary ledger; however, at the time of our review, they were unable to determine if any of these deposits pertained to current leases, or could be refunded and/or escheated. Auditor-Controller Accounting has been working with CEO/Real Estate to locate source documents to determine if these deposits are to be retained or should be returned to depositors due to a termination of the lease. Auditor-Controller Accounting recently informed us that some information has been located that will help expedite its efforts.

Recommendation No. I.A
RDMD, the Auditor-Controller, and the County Executive Office coordinate efforts to ensure the records and accounts for non-cash security deposits in Trust Fund 300-367 are accurately recorded under the appropriate controlling department. This should include an accounting for the remaining two negotiable instruments for Instant Storage and the Community Redevelopment Agency - City of Santa Ana.

RDMD Management Response: Concur with above recommendation. See Auditor-Controller response.

Auditor-Controller Management Response: Concur. Corrective actions are underway and the bulk of this account has been transferred to the CEO's Trust Fund 300-320. Of the original $833,770 in negotiable instruments recorded in Trust Fund 300-367, only $130,000 remains. This is being researched by the CEO and RDMD Accounting and is expected to be cleared shortly.

County Executive Office Management Response:
Concur with your recommendation and will work with CEO/Real Estate, RDMD, and Auditor-Controller to ensure an accurate recording and/or transfer of assets to the appropriate controlling department by June 30, 2005. The two negotiable instruments for Instant Storage and Community Redevelopment Agency – City of Santa Ana have been located and have been accurately recorded as of February 18, 2005.

Recommendation No. I.B
RDMD and Auditor-Controller Accounting continue its efforts to identify the status of the cash security deposits held in Trust Fund 300-367 to determine their proper resolution and disposition.

RDMD Management Response: Concur with above recommendation. See Auditor-Controller response.

Auditor-Controller Management Response: Concur. Corrective actions are underway and, of the original $189,693 in cash security deposits, only $22,446 remains. Of that amount, $17,000 is being researched or refunded. The remaining $5,446 will be escheated as the deposits date back to the early 90's and the records have been destroyed.

II. Refundable Deposits Trust Fund 300-328

Trust Fund 300-328 holds cash and non-cash security deposits for various RDMD operations (e.g., road surety deposits, flood surety deposits, real estate security deposits). Reporting category #0006 – Negotiable Instruments, holds non-cash deposits to ensure the second party will perform as contractually agreed, and/or for the purpose of offsetting any financial loss due to noncompliance with a contractual agreement. RDMD/Purchasing & Contract Services (RDMD/Purchasing) has responsibility for custodianship of these negotiable instruments. As of July 2004, the Active Negotiable Instruments list contained 58 instruments totaling $8,497,743.

In reviewing the list of Active Negotiable Instruments, we were informed that RDMD/Purchasing was unable to validate the current status of some instruments. Because some instruments were received under the former General Services Agency and Environmental Management Agency, some of the supporting documents cannot be located. In addition, some of the issuing financial institutions are no longer in business and information is not available. RDMD/Purchasing retains these instruments on the active list to protect the County's interest against financial losses in the event the negotiable instruments are still in effect.

Our testing of five negotiable instruments selected from RDMD/Purchasing's active inventory list found the two following negotiable instruments where RDMD was unable to determine if the instruments are currently in effect although the project/agreement that they are associated with appear to be completed or expired:

Item No.	Negotiable Instruments	Amount ($)	Issued Date	Expiration Date	Reason for Security Deposit
1	Performance & Payment Bond	559,152.00	1/13/95	None	Performance and payment guarantee for a construction project.
2	Deed of Trust	483,000.00	3/25/96	None	To secure a 5-year Promissory Note.

In addition, we were unable to verify the existence of a $2,500 certificate of deposit payable to the County from the Bank of Irvine, as the bank is no longer in existence.

We noted that RDMD/Purchasing properly safeguards the negotiable instruments in its possession by having a designated custodian responsible for the instruments, limiting access, and performing monthly physical inventories. However, the process does not include a verification of the current status of the instruments. RDMD/Purchasing should develop a process by which they can determine if the instruments are active, need renewal, or should be returned to the appropriate parties.

Recommendation No. II .A

RDMD/Purchasing coordinate their efforts with RDMD project/contract administrators to determine the status of instruments currently shown on the Active Negotiable Instrument list.

RDMD Management Response: Concur with above recommendation. Active negotiable instruments will continue to be monitored and the project/contract administrators are contacted on instruments about to expire for current status.

Recommendation No. II .B
RDMD/Purchasing establish a process to monitor, on a go-forward basis, all active negotiable instruments to ensure the dollar value and effective date requirements are proper and current according to contractual requirements. This also should be a joint effort between RDMD/Purchasing and the project/contract administrators.

RDMD Management Response: Concur with above recommendation. When a new negotiable instrument is submitted, a form has been developed for completion by the project/contract administrator with all the pertinent information regarding bank, contact person, etc. This coupled with the RDMD response to recommendation No. II. A, should resolve this issue.

III. Deposit Refund Review Process

Auditor-Controller Accounting is responsible for processing refunds of security and surety deposits after receiving authorization from other RDMD divisions. We noted the following areas where Auditor-Controller Accounting can enhance its existing controls for processing refundable deposits:

A. Authorized Signature List - County Property Permits Division

There was no authorized signature list established and maintained in Auditor-Controller Accounting for the County Property Permits Division showing the individuals who can authorize the refunds. Although there are a limited number of authorized signers in the division, Auditor-Controller Accounting should have a list for verification of signatures to ensure that the authorization is genuine and to reduce the probability of paying based upon unauthorized signatures.

Recommendation No. III.A
RDMD and Auditor-Controller Accounting establish and maintain an authorized signature list from County Property Permits Division for Auditor-Controller Accounting to use when processing deposit refunds.

RDMD Management Response: Concur with above recommendation. See Auditor-Controller response.

Auditor-Controller Management Response: Concur. RDMD Accounting is working with the County Property Permits Division to establish and maintain an authorized signature list.

B. Surety Deposit Subsidiary Ledger

The County Property Permits Division obtains surety deposits for permits that are issued. In many instances, the person or entity that pays the surety deposit is different from the permittee. A subsidiary ledger in Excel is maintained to track the surety deposits and is used in Auditor-Controller Accounting to process any refunds. RDMD Departmental Procedure of Surety Deposit Refund dated 2/10/04, requires that "*To Process Refund: Make sure all information from Permit and Receipt on the Sub ledger in Excel is matched on another.*"

Our review noted two instances where the subsidiary ledger contained the names of the permittees instead of the payors that were to receive the refunds. In addition, one of the permit receipts did not contain the name of the payor. Although in both instances Auditor-Controller Accounting properly refunded the surety deposits, not having the payor name on the subsidiary ledger and permit receipts could result in a refund going to wrong individual. A supervisory review of payor information recorded to the subsidiary ledger and permit receipt would help detect any discrepancies. (Note: Our review did not include controls over the receipt and recording of surety deposits).

Recommendation No. III.B
RDMD ensure the accuracy and completeness of surety deposit payor information recorded in the subsidiary ledger and on the permit receipts.

RDMD Management Response: Concur with above recommendation.

IV. Agency Fund 158-158 Reconciliation - Supervisory Reviews

Supervisory reviews help to ensure propriety, consistency, and reasonableness of work performed. The review should be documented as well as the resolution of items noted for follow-up. Auditor-Controller Accounting prepares monthly reconciliations for Agency Fund 158-158, the Major Thoroughfare & Bridge Fee Program; however, supervisory reviews of the reconciliations are performed quarterly due to workload and staffing issues. Because the fund contains approximately $29 million and has significant activity, we believe supervisory reviews of the reconciliations should be done monthly.

Recommendation No. IV.B
Auditor-Controller Accounting ensure that supervisory reviews of the Agency Fund 158-158 reconciliations are done on a monthly basis.

Auditor-Controller Management Response: Concur. While the reconciliations were prepared by staff on a monthly basis, the supervisory reviews were done quarterly. RDMD Accounting will ensure supervisory reviews of these reconciliations are done monthly.

ATTACHMENT A: RDMD Management Responses:

COUNTY OF ORANGE

RESOURCES & DEVELOPMENT MANAGEMENT DEPARTMENT

Bryan Speegle, Director
300 N. Flower Street
Santa Ana, CA

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Telephone: (714) 834-2300
Fax: (714) 834-5188

RECEIVED
INTERNAL AUDIT DEPARTMENT
2005 MAR 29 PM 12: 55

DATE: March 28, 2005

TO: Peter Hughes, Audit Director

FROM: Bryan Speegle, Director
Resources & Development Management Department

SUBJECT: RDMD Response to Internal Audit Department Letter
Audit Report No. 2432 Departmental Control Review – RDMD Trust Funds

Attached is a copy of Internal Audit's report on your review of Departmental Controls of RDMD Trust Funds. Also attached are RDMD's responses to the report.

If you require additional information on RDMD's response to the issues raised by IAD, please contact Brian Murphy at 714/834-6798, or Mary Fitzgerald at 714/834-5338.

Thank you for your assistance in this process.

Bryan Speegle, Director
Resources & Development Management Department

Attachments:
RDMD Response to Audit #2432

REVISED DRAFT REPORT

OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

I. Real Property Services Trust Fund 300-367

Trust Fund 300-367 was established under the former General Services Agency to hold refundable security deposits from outside entities for leasing County owned property. Security deposits can be in the form of cash or non-cash, and are held in the event contractual obligations are not met. Non-cash security deposits are negotiable instruments that become due and payable to the County upon contractual non-performance or default. As of 6/30/04, the fund contained cash and non-cash security deposits, totaling $189,693 and $833,770 respectively. These security deposits are for older projects initiated between 1980 – 1996 and several of the negotiable instruments are still active. Our review disclosed the following:

- RDMD is shown as the controlling agency of this trust fund and has the security deposits currently recorded in the County General Ledger as belonging to RDMD. However, RDMD does not possess any of the non-cash security deposits as they were reported to us as physically transferred by Auditor-Controller Accounting to County Executive Office/Purchasing & Real Estate (CEO/Real Estate) in June 1997.

- When the negotiable instruments were transferred to CEO/Real Estate in 1997, there was no documentation of the transfer of accountability of the assets between the two departments. The negotiable instruments totaled $834,400 when transferred and are currently shown in the General Ledger for RDMD as $833,770, a difference of $630.

- Since the transfer in 1997, Auditor-Controller Accounting stopped monitoring the negotiable instruments in Trust Fund 300-367 because they no longer had possession of the negotiable instruments and it was believed that the remaining cash security deposits belonged to leases being managed by CEO. Between 1997 and 2004, there was very little activity in the trust fund.

- Auditor-Controller Accounting informed us they contacted CEO/Administration and CEO/Real Estate a few times in attempt to complete the transfer of this Trust Fund to CEO by completing a Statement of Assets Transferred form. We observed evidence of these discussions occurring in early 2003, and reportedly, earlier attempts were made. However, this was never finalized and the assets remain on RDMD's books. CEO/Administration informed us that the fund was not transferred to CEO/Real Estate because of insufficient information to show the deposits belonged to CEO/Real Estate.

Because the amounts are recorded in RDMD and it does not possess the negotiable instruments, this fund appears to be overstated by $833,770 in RDMD's records. CEO's Trust Fund 300-320 is understated by the same amount.

We verified the $834,440 in negotiable instruments that were physically transferred to CEO/Real estate in 1997, with the exception of two items: Instant Storage for $10,000 and Community Redevelopment Agency - City of Santa Ana for $120,000, where

REVISED DRAFT REPORT

supporting documentation was not available to show the disposition of the negotiable instruments. All other negotiable instruments either were in CEO/Real Estate's possession or there was supporting documentation to account for their disposition. We were told CEO/Real Estate would continue to research these items. (**Note:** Our review did not include CEO/Real Estate's processes and controls for safeguarding and monitoring its negotiable instruments.)

For the cash security deposits in this fund, Auditor-Controller Accounting maintains a subsidiary ledger; however, at the time of our review, they were unable to determine if any of these deposits pertained to current leases, or could be refunded and/or escheated. Auditor-Controller Accounting has been working with CEO/Real Estate to locate source documents to determine if these deposits are to be retained or should be returned to depositors due to a termination of the lease. However, information was not available for research as a majority of the deposits was received under the former General Services Agency and Environmental Management Agency (which merged to become PFRD in 1996). (Previous statement not totally true—only records dated prior to 1992 are unavailable.) Auditor-Controller Accounting recently informed us that some information has been located that will help expedite its efforts.

Recommendation No. I.A
RDMD, the Auditor-Controller, and the County Executive Office coordinate efforts to ensure the records and accounts for non-cash security deposits in Trust Fund 300-367 are accurately recorded under the appropriate controlling department. This should include an accounting for the remaining two negotiable instruments for Instant Storage and the Community Redevelopment Agency - City of Santa Ana.

RDMD Management Response: Concur with above recommendation. See Auditor-Controller response.

Auditor-Controller Management Response: Concur. Corrective actions are underway and the bulk of this account has been transferred to the CEO's Trust Fund 300-320. Of the original $833,770 in negotiable instruments recorded in Trust Fund 300-367, only $130,000 remains. This is being researched by the CEO and RDMD Accounting, and is expected to be cleared shortly.

County Executive Office Management Response:

Recommendation No. I.B
RDMD and Auditor-Controller Accounting continue its efforts to identify the status of the cash security deposits held in Trust Fund 300-367 to determine their proper resolution and disposition.

RDMD Management Response: Concur with above recommendation. See Auditor-Controller response.

REVISED DRAFT REPORT

Auditor-Controller Management Response: Concur. Corrective actions are underway and, of the original $189,693 in cash security deposits, only $22,446 remains. Of that amount, $17,000 is being researched or refunded. The remaining $5,446 will be escheated as the deposits date back to the early 90's and the records have been destroyed.

II. Refundable Deposits Trust Fund 300-328

Trust Fund 300-328 holds cash and non-cash security deposits for various RDMD operations (e.g. road surety deposits, flood surety deposits, real estate security deposits). Reporting category #0006 – Negotiable Instruments, holds non-cash deposits to ensure the second party will perform as contractually agreed, and/or for the purpose of offsetting any financial loss due to noncompliance with a contractual agreement. RDMD/Purchasing & Contract Services (RDMD/Purchasing) has responsibility for custodianship of these negotiable instruments. As of July 2004, the Active Negotiable Instruments list contained 58 instruments totaling $8,497,743.

In reviewing the list of Active Negotiable Instruments, we were informed that RDMD/Purchasing was unable to validate the current status of some instruments. Because some instruments were received under the former General Services Agency and Environmental Management Agency, some of the supporting documents cannot be located. In addition, some of the issuing financial institutions are no longer in business and information is not available. RDMD/Purchasing retains these instruments on the active list to protect the County's interest against financial losses in the event the negotiable instruments are still in effect.

Our testing of five negotiable instruments selected from RDMD/Purchasing's active inventory list found the two following negotiable instruments where RDMD was unable to determine if the instruments are currently in effect although the project/agreement that they are associated with appear to be completed or expired:

Item No.	Negotiable Instruments	Amount ($)	Issued Date	Expiration Date	Reason for Security Deposit
1	Performance & Payment Bond	559,152.00	1/13/95	None	Performance and payment guarantee for a construction project.
2	Deed of Trust	483,000.00	3/25/96	None	To secure a 5-year Promissory Note

In addition, we were unable to verify the existence of a $2,500 certificate of deposit payable to the County from the Bank of Irvine, as the bank is no longer in existence.

We noted that RDMD/Purchasing properly safeguards the negotiable instruments in its possession by having a designated custodian responsible for the instruments, limiting access, and performing monthly physical inventories. However, the process does not include a verification of the current status of the instruments. RDMD/Purchasing should develop a process by which they can determine if the instruments are active, need renewal, or should be returned to the appropriate parties.

REVISED DRAFT REPORT

Recommendation No. II .A

RDMD/Purchasing coordinate their efforts with RDMD project/contract administrators to determine the status of instruments currently shown on the Active Negotiable Instrument list.

RDMD Management Response: Concur with above recommendation. Active negotiable instruments will continue to be monitored and the project/contract administrators are contacted on instruments about to expire for current status.

Recommendation No. II .B
RDMD/Purchasing establish a process to monitor, on a go-forward basis, all active negotiable instruments to ensure the dollar value and effective date requirements are proper and current according to contractual requirements. This also should be a joint effort between RDMD/Purchasing and the project/contract administrators.

RDMD Management Response: Concur with above recommendation. When a new negotiable instrument is submitted, a form has been developed for completion by the project/contract administrator with all the pertinent information regarding bank, contact person, etc. This coupled with the RDMD response to recommendation No. II. A, should resolve this issue.

III. Deposit Refund Review Process
Auditor-Controller Accounting is responsible for processing refunds of security and surety deposits after receiving authorization from other RDMD divisions. We noted the following areas where Auditor-Controller Accounting can enhance its existing controls for processing refundable deposits:

A. Authorized Signature List - County Property Permits Division
There was no authorized signature list established and maintained in Auditor-Controller Accounting for the County Property Permits Division showing the individuals who can authorize the refunds. Although there are a limited number of authorized signers in the division, Auditor-Controller Accounting should have a list for verification of signatures to ensure that the authorization is genuine and to reduce the probability of paying based upon unauthorized signatures.

Recommendation No. III.A
RDMD and Auditor-Controller Accounting establish and maintain an authorized signature list from County Property Permits Division for Auditor-Controller Accounting to use when processing deposit refunds.

RDMD Management Response: Concur with above recommendation. See Auditor-Controller response.

Auditor-Controller Management Response: Concur. RDMD Accounting is working with the County Property Permits Division to establish and maintain an

authorized signature list.

B. Surety Deposit Subsidiary Ledger

The County Property Permits Division obtains surety deposits for permits that are issued. In many instances, the person or entity that pays the surety deposit is different from the permittee. A subsidiary ledger in Excel is maintained to track the surety deposits and is used in Auditor-Controller Accounting to process any refunds. RDMD Departmental Procedure of Surety Deposit Refund dated 2/10/04, requires that "*To Process Refund: Make sure all information from Permit and Receipt on the Sub ledger in Excel is matched on another.*"

Our review noted two instances where the subsidiary ledger contained the names of the permittees instead of the payors that were to receive the refunds. In addition, one of the permit receipts did not contain the name of the payor. Although in both instances Auditor-Controller Accounting properly refunded the surety deposits, not having the payor name on the subsidiary ledger and permit receipts could result in a refund going to wrong individual. A supervisory review of payor information recorded to the subsidiary ledger and permit receipt would help detect any discrepancies. (Note: Our review did not include controls over the receipt and recording of surety deposits.)

Recommendation No. III.B

RDMD ensure the accuracy and completeness of surety deposit payor information recorded in the subsidiary ledger and on the permit receipts.

RDMD Management Response: Concur with above recommendation.

IV. Agency Fund 158-158 Reconciliation - Supervisory Reviews

Supervisory reviews help to ensure propriety, consistency, and reasonableness of work performed. The review should be documented as well as the resolution of items noted for follow-up. Auditor-Controller Accounting prepares monthly reconciliations for Agency Fund 158-158, the Major Thoroughfare & Bridge Fee Program; however, supervisory reviews of the reconciliations are performed quarterly due to workload and staffing issues. Because the fund contains approximately $29 million and has significant activity, we believe supervisory reviews of the reconciliations should be done monthly.

Recommendation No. IV.B

Auditor-Controller Accounting ensure that supervisory reviews of the Agency Fund 158-158 reconciliations are done on a monthly basis.

Auditor-Controller Management Response: Concur. While the reconciliations were prepared by staff on a monthly basis, the supervisory reviews were done quarterly. RDMD Accounting will ensure supervisory reviews of these reconciliations are done monthly.

ATTACHMENT B: Auditor-Controller Management Responses:

AUDITOR-CONTROLLER
COUNTY OF ORANGE

HALL OF FINANCE AND RECORDS
12 CIVIC CENTER PLAZA, ROOM 202
POST OFFICE BOX 567
SANTA ANA, CALIFORNIA 92702-0567

(714) 834-2450 FAX: (714) 834-2569

www.oc.ca.gov/ac

JOHN H. NAKANE
CHIEF ASSISTANT AUDITOR-CONTROLLER

JAMES M. McCONNELL
ASSISTANT AUDITOR-CONTROLLER
CENTRAL OPERATIONS

SHAUN M. SKELLY
ASSISTANT AUDITOR-CONTROLLER
AGENCY ACCOUNTING

MAHESH N. PATEL
ASSISTANT AUDITOR-CONTROLLER
INFORMATION TECHNOLOGY

DAVID E. SUNDSTROM, CPA
AUDITOR-CONTROLLER

RECEIVED
INTERNAL AUDIT DEPARTMENT
2005 MAR -7 PM 2:19

March 3, 2005

TO: Bryan Speegle, Director
Resources & Development Management Department

SUBJECT: Response to RDMD Trust and Agency Fund Disbursements Audit

We reviewed the draft audit report prepared by the Internal Audit Department covering the review of internal controls over trust and agency fund disbursements of the Resources & Development Management Department for the year ended June 30, 2004.

We concur with the recommendations made in the draft audit report that relate to processes that were under the control of RDMD Accounting operations. Our response is attached.

Please call Mary Fitzgerald at 834-5338 if you have any questions regarding this letter.

David E. Sundstrom
Auditor Controller

DES:lr (RDMD Fund Audit Response/agency)
Attachment

cc: Peter Hughes, Director, Internal Audit Department
Steve Danley, Director, RDMD Administration
Shaun Skelly, Assistant Auditor Controller, Agency Accounting
Mary Fitzgerald, Manager, RDMD Accounting

Internal Audit Report
Review of Internal Controls of
RDMD Trust and Agency Disbursements

I. Real Property Services Trust Fund 300-367

Recommendation No. I.A
RDMD, the Auditor Controller, and the County Executive Office coordinate efforts to ensure the records and accounts for non-cash security deposits in Trust Fund 300-367 are accurately recorded under the appropriate controlling department. This should include an accounting for the remaining two negotiable instruments for Instant Storage and the Community Redevelopment Agency – City of Santa Ana.

Auditor Controller Response:
Concur. Corrective actions are underway and the bulk of this account as been transferred to the CEO's Trust Fund 300-320. Of the original $833,770 in negotiable instruments recorded in Trust Fund 300-367, only $130,000 remains. This is being researched by the CEO and RDMD Accounting and is expected to be cleared shortly.

Recommendation No. I.B
RDMD and Auditor Controller RDMD Accounting continue its efforts to identify the status of the cash security deposits held in Trust Fund 300-367 to determine their proper resolution and disposition.

Auditor Controller Response:
Concur. Corrective actions are underway and, of the original $189,693 in cash security deposits, only $22,446 remains. Of that amount, $17,000 is being researched or refunded. The remaining $5,446 will be escheated as the deposits date back to the early 90's and the records have been destroyed.

III. Deposit Refund Review Process

Recommendation No. III.A
RDMD and Auditor Controller RDMD Accounting establish and maintain an authorized signature list from County Property Permits Division for Auditor Controller RDMD Accounting to use when processing deposit refunds.

Auditor Controller Response:
Concur. RDMD Accounting is working with the County Property Permits Division to establish and maintain an authorized signature list.

Internal Audit Report-Review of Internal Controls of
RDMD Trust and Agency Disbursements
Page 2

IV. Agency Fund 158-158 Reconciliation – Supervisory Review

Recommendation No. IV.
Auditor Controller RDMD Accounting ensure that supervisory reviews of the Agency Fund 158-158 reconciliations are done on a monthly basis.

Auditor Controller Response:
Concur. While the reconciliations were prepared by staff on a monthly basis, the supervisory reviews were done quarterly. RDMD Accounting will ensure supervisory reviews of these reconciliations are done monthly.

ATTACHMENT C: County Executive Office Management Response:

County of Orange MEMO

RECEIVED
INTERNAL AUDIT DEPARTMENT
2005 FEB 24 PM 2:22

February 22, 2005

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

FROM: Thomas G. Mauk, County Executive Officer

SUBJECT: Draft Report on Department Control Review of Resources and Development Management Department Trust and Agency Fund Disbursements

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I am in receipt of the subject report and would like first to thank you for bringing these issues to our attention and secondly to respond to your Recommendation No. 1A:

RDMD, the Auditor-Controller and the County Executive Office coordinate efforts to ensure the records and accounts for non-cash security deposits in Trust fund 300-367 are accurately recorded under the appropriate controlling department. This should include an accounting for the remaining two negotiable instruments for Instant Storage and the Community Redevelopment Agency – City of Santa Ana; these remaining two negotiable instruments have been located and have been accurately recorded as of February 18, 2005.

I concur with your recommendation and will work with CEO/Real Estate, RDMD, and Auditor-Controller to ensure an accurate recording and/or transfer of assets to the appropriate controlling department by June 30, 2005.

I thank you again for your recommendations and should you have any questions or comments regarding our response, please feel free to contact me at 834-6200.

cc: Ed Corser, Deputy/CEO-CFO
William A. Rawlings, Manager, CEO/Real Estate
Shirley Charity, CEO/Administration
Rob Richardson, Assistant to the CEO