INTERNAL AUDIT DEPARTMENT

COUNTY OF ORANGE

2005 Recipient of the Institute of Internal Auditors Award for Recognition of Commitment to Professional Excellence, Quality and Outreach

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INTERNAL CONTROL REVIEW
OF
JOHN WAYNE AIRPORT

CASH DISBURSEMENTS

For the Period
November 1, 2005 through October 31, 2006

AUDIT NUMBER: 2629 **REPORT DATE: APRIL 24, 2007**

Audit Director:	**Peter Hughes, Ph.D., CPA**
Deputy Director:	**Eli Littner, CPA, CIA**
Senior Audit Manager:	**Michael Goodwin, CPA, CIA**
Audit Manager:	**Michael Dean, CPA, CIA**

Internal Control Review of John Wayne Airport
Cash Disbursements

For the Period
November 1, 2005 through October 31, 2006

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AUTUMN MCKINNEY, CPA, CIA, CGFM, SENIOR AUDIT MANAGER

Transmittal Letter

Audit No. 2629

April 24, 2007

TO: Alan L. Murphy, Director
John Wayne Airport

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

SUBJECT: Internal Control Review of John Wayne Airport Cash Disbursements

We have completed our Internal Control Review of John Wayne Airport cash disbursements for the period November 1, 2005 through October 31, 2006. The final report is attached along with your responses to our recommendations.

Please note, we have a 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 at six months from the official release of the report. A copy of all our Follow-Up Audit reports is provided to the BOS as well as to all those individuals indicated on our standard routing distribution list.

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 Audit** 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.

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 first Follow-Up Audit approximately six months from the date of this report, we will need to obtain the completed document to facilitate our review.

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

Each month I submit an **Audit Status Report** to the BOS where I detail any material and significant audit findings released in reports during the prior month and the implementation status of audit recommendations as disclosed by our Follow-Up Audits. Accordingly, the results of this audit will be included in a future status report to the BOS.

As always, the Internal Audit Department is available to partner with you so that JWA 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.

Additionally, we will request your department complete a Customer Survey of Audit Services. You will receive the survey shortly after the distribution of our final report.

Attachments

Other recipients of this report:
Members, Board of Supervisors
Members, Audit Oversight Committee
Thomas G. Mauk, County Executive Officer
David E. Sundstrom, Auditor-Controller
Loan Leblow, Assistant Airport Director, JWA
Don Arthur, Deputy Airport Director, JWA/Finance and Administration
Scott Suzuki, Quality Assurance & Compliance Manager, JWA
Bill Castro, Assistant Auditor-Controller, Satellite Accounting Operations
Sharon Tabata, Manager, JWA Accounting
Foreperson, Grand Jury
Darlene J. Bloom, Clerk of the Board of Supervisors

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MBA, CPA, CIA, CFE
SENIOR AUDIT MANAGER

AUTUMN MCKINNEY
CPA, CIA, CGFM
SENIOR AUDIT MANAGER

INTERNAL AUDITOR'S REPORT

Audit No. 2629

April 24, 2007

TO: Alan L. Murphy, Director
John Wayne Airport

SUBJECT: Internal Control Review of John Wayne Airport
Cash Disbursements

Scope of Review

We have completed our Internal Control Review of John Wayne Airport (JWA) cash disbursements for the period from November 1, 2005 through October 31, 2006. Our audit was conducted in accordance with professional standards established by the Institute of Internal Auditors.

Results

Based on our audit, **no material weaknesses or significant issues were identified.** However, we did identify **three Control Findings** with corresponding recommendations to enhance controls and processes as discussed in the Detailed Observations, Recommendations and Management Responses section of this report. See *Attachment A* for a description of Report Item Classifications.

Management's Responsibilities for Internal Controls

In accordance with the Auditor-Controller's County Accounting Manual section S-2 - *Internal Control Systems*, "All County departments/agencies shall maintain effective internal control systems as an integral part of their management practices. This is because *management has primary responsibility* for establishing and maintaining the internal control system. All levels of management must be involved in assessing and strengthening internal controls. Control systems shall be continuously evaluated and weaknesses, when detected, must be promptly corrected." The criteria for evaluating an entity's internal control structure is the Committee of Sponsoring Organizations (COSO) control framework. Internal Audit's review enhances and complements, but does not substitute for JWA's continuing emphasis on control activities and self-assessment of control risks.

While our report indicates the specific areas where our observations are directly applicable, **JWA should implement the recommendations in other processes they find applicable.** 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 or processes.

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

Inherent Limitations in Any System of Internal Control
Because of inherent limitations in any system of internal controls, errors or irregularities may nevertheless occur and not be detected. Specific examples of limitations include, but are not limited to, resource constraints, unintentional errors, management override, circumvention by collusion, and poor judgment. 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 the degree of compliance with the procedures may deteriorate. Accordingly, our review made for the purpose described above *would not necessarily disclose all weaknesses* in JWA's operating procedures, accounting practices and compliance with County policy.

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

Respectfully Submitted,

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

Attachments

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:
Members, Board of Supervisors
Members, Audit Oversight Committee
Thomas G. Mauk, County Executive Officer
David E. Sundstrom, Auditor-Controller
Loan Leblow, Assistant Airport Director, JWA
Don Arthur, Deputy Airport Director, JWA Finance and Administration
Scott Suzuki, Quality Assurance & Compliance Manager, JWA
Bill Castro, Assistant Auditor-Controller, Satellite Accounting Operations
Sharon Tabata, Manager, JWA Accounting
Foreperson, Grand Jury
Darlene J. Bloom, Clerk of the Board of Supervisors

EXECUTIVE SUMMARY

OBJECTIVES

The Internal Audit Department conducted an Internal Control Review of cash disbursements at John Wayne Airport (JWA) that included in its scope a limited review of the accuracy of the financial and accounting records; the adequacy and integrity of internal controls; compliance with applicable rules, regulations and department policies; evidence of process efficiencies and effectiveness; and proper safeguarding of County assets.

The objectives of our audit were to determine whether internal controls at both the departmental and the Auditor-Controller's core business system levels are in place and operating to ensure:

- Cash disbursements are accurate, valid (adequately supported), processed timely, and properly recorded in both the JWA and the County accounting records.

- Cash disbursements are properly authorized and processed in compliance with JWA management's directives and with County accounting procedures.

- Auditor-Controller core business processes are effective through accurate recording, reporting, and system output for cash disbursement transactions initiated by JWA as determined through our testing of transactions.

- Business processes are efficient and effective as related to JWA cash disbursements.

BACKGROUND

The mission of JWA is to plan, direct, and provide high quality aviation services and facilities for Orange County in a safe, secure, and efficient manner. JWA is owned and operated by the County of Orange and is a self-supporting enterprise fund. JWA derives revenues primarily from nonaeronautical and aeronautical users, represented by landing fees, terminal space rental, parking, concessions, and tiedown fees. The revenues are utilized to operate JWA, provide for repayment of revenue bonds, fund facility capital improvement or maintenance projects, and support aviation planning. JWA's major expenses include operating costs, capital projects and debt services. Shown below are JWA's budget units (funds) and the expenditures made by JWA from each of the funds during the audit period:

Fund/Agency 280/280 – Airport Operating Enterprise	$73,985,454
Fund/Agency 281/281 – John Wayne Airport Construction	$ 2,755,210
Fund/Agency 283/283 – John Wayne Airport Debt Service	$18,444,361
Total Expenditures for Period	$95,185,025

SCOPE

Our audit was limited to evaluating controls and processes over cash disbursements for the period November 1, 2005 through October 31, 2006. Our methodology included inquiry, auditor observation and examination and testing of relevant documentation.

RESULTS

No material weaknesses or significant issues were noted. Based upon the objectives of our audit, we noted the following:

Objective: *Cash disbursements are accurate, valid (adequately supported), processed timely, and properly recorded in both the JWA and the County accounting records.*

Results: Controls and processes are in place to ensure cash disbursements are recorded accurately, are valid (adequately supported) and are properly recorded. Appropriate management tools (invoice logs) are in use to monitor invoice processing. We note in our audit report where JWA should evaluate and document its policy on invoice processing and enhance its completion of invoice logs. These are considered **Control Findings** and are discussed in the Detailed Observations, Recommendations and Management Reponses section of this report.

Objective: *Cash disbursements are properly authorized and processed in compliance with JWA management's directives and with County accounting procedures.*

Results: Controls and processes are in place to ensure cash disbursements are properly authorized and processed in compliance with management's directives. We note in our audit report where enhancement is needed in documenting approval of new vendor additions into the Auditor-Controller's Countywide Accounting and Personnel System (CAPS). This is considered a **Control Finding**.

Objective: *Auditor-Controller core business systems are effective through accurate recording, reporting, and system output for cash disbursement transactions initiated by JWA as determined through our testing of transactions.*

Results: We performed testing of cash disbursement transactions originating at JWA through the following Auditor-Controller core business systems without noting any exceptions:

- Verified disbursement documents were accurately reflected in the ERMI system, the Auditor-Controller's electronic report management and imaging system that stores and retrieves reports generated by CAPS.
- Agreed disbursement information from JWA source documents to the information recorded in the County General Ledger.
- Agreed payment voucher and manual warrant information from JWA internal records to Auditor-Controller's "Voucher Payment Check Register."
- Verified payment vouchers were properly authorized by Auditor-Controller Claims & Disbursing staff prior to disbursement.

Objective: *Business processes are efficient and effective as related to JWA cash disbursements.*

Results: No inefficient or ineffective procedures were noted or came to our attention during fieldwork in JWA Accounting related to cash disbursements.

DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

Invoice Processing Time and Invoice Logs

JWA Accounting utilizes invoice logs to track the status of invoices received and monitor invoice processing times. One log is for invoices related to "Purchase Orders" and another log for "Non-Purchase Order" invoices. The logs show the vendor, invoice number, amount, date received, date routed to the applicable JWA division, date sent to the Auditor-Controller, and date paid. Invoice logs enable JWA Accounting to track invoice processing time from the point of receipt through the point of submission to the Auditor-Controller/Claims for payment. The logs are regularly reviewed by a supervisor to ensure they are properly completed. We commend JWA Accounting for establishing and maintaining such logs as they are a valuable tool for monitoring invoice processing times.

JWA has two practices with respect to the timely processing of invoices, neither of which have been formalized in a documented procedure. First, invoices should be processed for payment within 30 days of receipt by JWA Accounting (not the invoice date), unless there are valid circumstances requiring an extension of this timeframe, e.g., invoiced goods have not been received, invoiced services have not been performed, etc. Second, JWA Accounting should route invoices to the applicable JWA division for approval within 15 days of receipt, unless there are valid circumstances requiring JWA Accounting to hold the invoice, e.g., additional documentation or information is required from vendor, invoice contains complex referencing or calculation errors that must be resolved, etc.

We obtained electronic versions of JWA Accounting's invoice logs for our audit period that were used in testing cash disbursement transactions. The invoice logs contain columns that calculate the number of days it takes to route the invoice to the applicable JWA division for approval and the number of days it takes to process the invoice for payment.

We reviewed the invoice logs and noted instances where invoices were not processed within 30 days of receipt. JWA Accounting management informed us that for these invoices, either additional supporting documentation was required from the vendor or additional time was spent awaiting approval from other divisions within JWA. As JWA Accounting staff did not consistently document either the justification for the increased processing time or the disposition for invoices that were ultimately not paid, it is unknown if there were valid explanations for the extended processing times.

Our review of the Purchase Order invoice log noted several dated invoices that did not have a date sent to Auditor-Controller/Claims indicated or a written explanation of the respective invoice's current status. JWA Accounting determined these invoices were either already sent or did not need to be sent to Auditor-Controller/Claims (e.g, duplicate invoices or erroneous invoices were received). In these instances, the invoice log should have been updated to reflect the final disposition of each invoice.

Recommendation No. 1

We recommend JWA and JWA Accounting evaluate the 30-day practice for processing invoices and develop a written procedure for invoice processing. JWA management should communicate this policy to all divisions to ensure they are aware of the required timeframes.

JWA Management Response:

Concur. JWA management and JWA Accounting have evaluated the 30-day practice for processing invoices and will continue with that timeframe. JWA is in the process of documenting the administrative procedures to ensure that invoices continue to be processed in a timely manner. Once completed, the written procedures will be distributed to all JWA divisions, and meetings will be held with the appropriate division personnel to ensure that the divisions are aware of the timeframe requirements. JWA management estimates that the written procedures will be completed by September 30, 2007.

Auditor-Controller Management Response:
Concur. JWA Management and JWA Accounting have evaluated the 30-day practice for processing invoices and will continue with that timeframe. JWA Accounting estimates that the accounting invoice processing procedure will be completed by June 1, 2007.

Recommendation No. 2
We recommend JWA Accounting ensure the invoice logs contain written explanations for invoices not processed within JWA's acceptable timeframes and in other situations where invoices received do not require submission to Auditor-Controller/Claims.

Auditor-Controller Management Response:
Concur. Daily Invoice Log Book (DILB) procedures have been documented and training has been provided to JWA Accounting staff wherein invoice log completion requirements were reiterated. The JWA Accounting Accounts Payable Supervisor will review the DILB twice a month to ensure its completeness. JWA Accounting will contact divisions for invoices not returned within JWA's acceptable timeframes and request feedback on the status of the invoices (i.e. goods/services have not yet been received). Those explanations will then be documented in the DILB. JWA Accounting estimates that the recommendation will be implemented by May 1, 2007.

Documented Approval of Vendor Additions
JWA Accounting assigns and inputs new vendor information directly into the Auditor-Controller's CAPS system vendor table. Documented approval of vendor additions helps ensure only valid vendors are input into the system. We noted there was no process in place requiring documented approval for the addition of new vendors into the CAPS system.

Recommendation No. 3
We recommend JWA Accounting ensure approval of new vendors into the Auditor-Controller's CAPS system is documented.

Auditor-Controller Management Response:
Concur. JWA Accounting created a Vendor Table Update form to be completed when vendor additions or changes to vendor information in CAPS are required. Each form is reviewed by a supervisor and approval is documented. This recommendation has already been implemented.

ATTACHMENT A: Report Item Classifications

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

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

- **Significant Issues:**
  Audit findings or a combination of Control Findings that represent a significant deficiency in the design or operation of processes or internal controls. Significant Issues do not present a material exposure throughout the County. They generally will require prompt corrective actions.

- **Control Findings:**
  Audit findings that require management's corrective action to implement or enhance processes and internal controls. Control Findings are expected to be addressed within our follow-up process of six months, but no later than twelve months.

JOHN WAYNE AIRPORT

RECEIVED
INTERNAL AUDIT DEPARTMENT
2007 APR 19 PM 3:57

MEMO

April 18, 2007

TO: Dr. Peter Hughes, Director
Internal Audit Department

FROM: Alan L. Murphy, Airport Director
John Wayne Airport

SUBJECT: Response to the Internal Audit Department's Internal Control Review of John Wayne Airport Cash Disbursements

This memo is in response to the Internal Audit Department's internal control review of John Wayne Airport (JWA) cash disbursements for the period of November 1, 2005 *through October 31, 2006.*

The review determined that no material weaknesses or significant issues were identified. However, Internal Audit did identify three control findings with corresponding recommendations. Two of the recommendations apply to JWA Accounting and one recommendation applies to JWA management.

JWA management's response has been reviewed and approved by the County Executive Office on April 18, 2007.

Attachment

cc: Loan Leblow, Assistant Airport Director
Don Arthur, Deputy Airport Director, Finance & Administration
Scott Suzuki, Quality Assurance & Compliance Manager
Sharon Tabata, Accounting Manager

JOHN WAYNE AIRPORT
Response to the Internal Audit Department's Report on
Internal Control Review of John Wayne Airport Cash Disbursements
Audit No. 2629

Recommendation No. 1:
We recommend JWA and JWA Accounting evaluate the 30-day practice for processing invoices and develop a written procedure for invoice processing. JWA management should communicate this policy to all divisions to ensure they are aware of the required timeframes.

JWA Management Response:
Concur. JWA management and JWA Accounting have evaluated the 30-day practice for processing invoices and will continue with that timeframe. JWA is in the process of documenting the administrative procedures to ensure that invoices continue to be processed in a timely manner. Once completed, the written procedures will be distributed to all JWA divisions, and meetings will be held with the appropriate division personnel to ensure that the divisions are aware of the timeframe requirements. JWA management estimates that the written procedures will be completed by September 30, 2007.

AUDITOR-CONTROLLER
COUNTY OF ORANGE

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WILLIAM A. CASTRO
ASSISTANT AUDITOR-CONTROLLER
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PHILLIP T. DAIGNEAU
ASSISTANT AUDITOR-CONTROLLER
INFORMATION TECHNOLOGY

RECEIVED
INTERNAL AUDIT DEPARTMENT
2007 APR 12 AM 7: 59

April 10, 2007

TO: Alan L. Murphy, Director, John Wayne Airport

SUBJECT: Response to Internal Control Review of John Wayne Airport Cash Disbursements

We reviewed the draft audit report prepared by the Internal Audit Department covering the review of internal controls of the cash disbursements process at John Wayne Airport (JWA) for the period November 1, 2005 through October 31, 2006.

We concur with the recommendations made in the draft audit report that relate to processes that were under the control of JWA Accounting operations. Our responses are attached.

Please call Sharon Tabata at (949) 252-5218 if you have any questions regarding this letter.

David E. Sundstrom
Auditor-Controller

WAC:lr
Attachment

cc: Peter Hughes, Director, Internal Audit Department
Bill Castro, Assistant Auditor-Controller, Satellite Accounting Operations
Sharon Tabata, Manager, JWA Accounting
Don Arthur, Deputy Airport Director, JWA Finance and Administration

Internal Audit Report
Internal Control Review of
John Wayne Airport Cash Disbursements

Findings No. 1 & 2

Invoice Processing Time and Invoice Logs

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invoices were received). In these instances, the invoice log should have been updated to reflect the final disposition of each invoice.

Recommendation No. 1
We recommend JWA and JWA Accounting evaluate the 30-day practice for processing invoices and develop a written procedure for invoice processing. JWA management should communicate this policy to all divisions to ensure they are aware of the required timeframes.

Auditor-Controller Management Response:
Concur. JWA Management and JWA Accounting have evaluated the 30-day practice for processing invoices and will continue with that timeframe. JWA Accounting estimates that the accounting invoice processing procedure will be completed by June 1, 2007.

Recommendation No. 2
We recommend JWA Accounting ensure the invoice logs contain written explanations for invoices not processed within JWA's acceptable timeframes and in other situations where invoices received do not require submission to Auditor-Controller/Claims.

Auditor-Controller Management Response:
Concur. Daily Invoice Log Book (DILB) procedures have been documented and training has been provided to JWA Accounting staff wherein invoice log completion requirements were reiterated. The JWA Accounting Accounts Payable Supervisor will review the DILB twice a month to ensure its completeness. JWA Accounting will contact divisions for invoices not returned within JWA's acceptable timeframes and request feedback on the status of the invoices (i.e. goods/services have not yet been received). Those explanations will then be documented in the DILB. JWA Accounting estimates that the recommendation will be implemented by May 1, 2007.

Finding No. 3

Documented Approval of Vendor Additions
JWA Accounting assigns and inputs new vendor information directly into the Auditor-Controller's CAPS system vendor table. Documented approval of vendor additions helps ensure only valid vendors are input into the system. We noted there was no process in place requiring documented approval for the addition of new vendors into the CAPS system.

Recommendation No. 3
We recommend JWA Accounting ensure approval of new vendors into the Auditor-Controller's CAPS system is documented.

Auditor-Controller Management Response:
Concur. JWA Accounting created a Vendor Table Update form to be completed when vendor additions or changes to vendor information in CAPS are required. Each form is reviewed by a supervisor and approval is documented. This recommendation has already been implemented.