

Internal Audit Department

O R A N G E C O U N T Y
6th Largest County in the USA

Internal Control Audit: COUNTY COUNSEL REVOLVING FUND PROCESS

For the Period March 1, 2010
through February 28, 2011

County Counsel has an authorized revolving fund amount of \$8,000. During the period from March 1, 2010 through February 28, 2011, County Counsel requested 15 reimbursements, totaling about \$33,000.

We audited the County Counsel Revolving Fund Process and found that internal controls are in place to ensure that the revolving fund is adequately safeguarded; transactions are processed in accordance with County policy; and transactions are properly authorized and recorded completely, accurately and timely.

However, we did identify **three (3) Control Findings** regarding the resolution of long-outstanding reconciling items on bank reconciliations, fund reconciliations not being performed by an individual with no other revolving fund duties, and the efficiency of the bank reconciliation process. County Counsel agreed with all three (3) findings and recommendations and is working to implement corrective actions.

AUDIT NO: 1055

REPORT DATE: AUGUST 23, 2011

Director: Dr. Peter Hughes, MBA, CPA, CIA

Deputy Director: Eli Littner, CPA, CIA

Senior Audit Manager: Alan Marcum, CPA, CIA

Audit Manager: Winnie Keung, CPA, CIA

Audit Intern: Michael Steinhaus

RISK BASED AUDITING

GAO & IIA Peer Review Compliant – 2001, 2004, 2007, 2010



American Institute of Certified Public Accountants Award to Dr. Peter Hughes as 2010 Outstanding CPA of the Year for Local Government

GRC (Government, Risk & Compliance) Group 2010 Award to IAD as MVP in Risk Management



2009 Association of Certified Fraud Examiners' Hubbard Award to Dr. Peter Hughes for the Most Outstanding Article of the Year – Ethics Pays



2008 Association of Local Government Auditors' Bronze Website Award



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

 ORANGE COUNTY BOARD OF SUPERVISORS'
Internal Audit Department

GAO & IIA Peer Review Compliant - 2001, 2004, 2007, 2010

Providing Facts and Perspectives Countywide

RISK BASED AUDITING

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OC Fraud Hotline (714) 834-3608



Transmittal Letter



Audit No.1055 August 23, 2011

TO: Nicholas S. Chrisos
County Counsel

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

SUBJECT: Internal Control Audit: County Counsel
Revolving Fund Process

We have completed an Internal Control Audit of the County Counsel Revolving Fund Process for the period ending February 28, 2011. We performed this audit in accordance with our *FY 2010-11 Audit Plan and Risk Assessment* approved by the Audit Oversight Committee and the Board of Supervisors. Our final report is attached for your review.

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). Our **first Follow-Up Audit** will 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 begin at six months from the release of the first Follow-Up Audit 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.

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 your staff so that they 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 are listed on the **OC Internal Auditor's Report** on page 3.

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Revolving Fund Process
Audit No. 1055*

For the Period March 1, 2010 through February 28, 2011

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Audit No. 1055

August 23, 2011

TO: Nicholas S. Chrisos
County Counsel

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

SUBJECT: Internal Control Audit: County Counsel
Revolving Fund Process

Audit Highlight

The County Counsel maintains one revolving fund with an authorized amount of \$8,000, and for year-ending February 28, 2011 received replenishments of about \$33,000.

We audited the County Counsel Revolving Fund Process and found that internal controls are in place to ensure that revolving funds are adequately safeguarded; transactions are processed in accordance with County policy; and transactions are properly authorized and recorded completely, accurately and timely. However, we did identify **three (3) Control Findings** regarding long-outstanding reconciling items on bank reconciliations not being resolved timely, fund reconciliations not performed by an individual with no other revolving fund duties, and the efficiency of the bank reconciliation process.

OBJECTIVES

In accordance with our *FY 2010-11 Audit Plan and Risk Assessment* approved by the Audit Oversight Committee and the Board of Supervisors, the Internal Audit Department conducted an Internal Control Audit of the County Counsel revolving fund process. Our audit included an evaluation of the adequacy and integrity of internal controls, testing compliance with County Counsel and County policies, and evaluating process efficiency and effectiveness. Our audit was conducted in conformance with professional standards established by the Institute of Internal Auditors. The objectives of this audit were to ensure that:

1. Revolving funds are adequately safeguarded.
2. Revolving fund transactions are processed in accordance with applicable County Accounting Manual (CAM) procedures.
3. Revolving fund transactions are properly authorized and recorded completely, accurately and timely.

RESULTS

Objective #1: Revolving funds are adequately safeguarded. We found that controls and processes are in place to ensure that revolving funds are adequately safeguarded. However, we noted **one (1) Control Finding** regarding the long-outstanding reconciling items on bank reconciliations not being resolved timely.

Objective #2: Revolving fund transactions are processed in accordance with applicable County Accounting Manual (CAM) procedures. We found that controls and processes are in place to ensure that revolving fund transactions are processed in accordance with applicable County Accounting Manual (CAM) procedures. However, we noted **one (1) Control Finding** regarding fund reconciliations not being performed by an individual with no other revolving fund duties. In addition, we noted **one (1) Control Finding ~ Efficiency and Effectiveness**, where efficiency can be improved when preparing bank reconciliations.

OC Internal Auditor's Report



Objective #3: Revolving fund transactions are properly authorized and recorded completely, accurately and timely. We found that controls and processes are in place to ensure that revolving fund transactions are properly authorized and recorded completely, accurately and timely.

The following *Summary of Findings and Recommendations* shows our findings and recommendations for this audit. See further discussion in the *Detailed Results, Findings, Recommendations and Management Responses* section of this report. See *Attachment A* for a description of Report Item Classifications.

Finding No.	Finding Classification - See Attachment A	Finding Description	Recommendation	Agreement by Management?	Page No. in Audit Report
1.	Control Finding	Long outstanding checks not cleared timely.	County Counsel establishes a policy to define the time limit and responsibilities to follow-up long outstanding checks. Also, County Counsel considers including the check issuance date on the bank reconciliation to facilitate the process on following up on long outstanding checks.	Yes	4
2.	Control Finding	Revolving fund reconciliations were not performed by an individual with no other revolving fund duties.	County Counsel considers assigning the fund reconciliation duty to an individual with no other revolving fund duties or implementing detail supervisory review of the fund reconciliation to mitigate risks.	Yes	5
3.	Control Finding	Bank reconciliation process can be improved to increase efficiency.	County Counsel considers revising the current bank reconciliation process, i.e., use same date for bank balance and check register balance, to increase efficiency.	Yes	5

BACKGROUND

The mission of the Offices of the County Counsel is to provide the highest quality legal advice and representation to the Board of Supervisors, elected and appointed department heads, County agencies/departments and staff, and Board-governed special districts. The County Counsel acts as “in-house” council to all County agencies and departments; however, the Board of Supervisors is their primary client.

County Counsel consists of four divisions: Litigation & Material Heath/Probate Division; Child Protection, Public Services & Facilities Division; Law Enforcement, Public Finance & Government Services Division; and Department Administration Services.

The County Counsel has one revolving fund, which is maintained at the Department Administration Services. The authorized amount of the revolving fund is **\$8,000**, which includes \$142.50 in cash. This fund is used for the purposes of departmental petty cash expenditures, e.g., delivery fees.

OC Internal Auditor's Report



During the period from March 1, 2010 through February 28, 2011, County Counsel requested **15** reimbursements ranging from \$1,276 ~ \$3,160, totaling about **\$33,000**, and no travel/cash advances was made.

SCOPE AND METHODOLOGY

Our audit scope was limited to internal controls and processes over revolving funds for the period from March 1, 2010 through February 28, 2011. Our methodology included inquiry, auditor observation, and examination and testing of relevant documentation.

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 (by Management) and weaknesses, when detected, must be promptly corrected. The criterion for evaluating an entity's internal control structure is the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control – Integrated Framework. Our Internal Control Audit enhances and complements, but does not substitute for the County Counsel's continuing emphasis on control activities and self-assessment of control risks.

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 risks that procedures may become inadequate or the degree of compliance with the procedures may deteriorate because of changes in conditions. Accordingly, our audit would not necessarily disclose all weaknesses in County Counsel's operating procedures, accounting practices, and compliance with County policy.

Acknowledgment

We appreciate the courtesy extended to us by the County Counsel during our audit. If we can be of further assistance, please contact me directly; or Eli Littner, Deputy Director at 834-5899; or Alan Marcum, Senior Audit Manager at 834-4119.

Attachments

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

- Members, Board of Supervisors
- Members, Audit Oversight Committee
- Thomas G. Mauk, County Executive Officer
- Jack Golden, Chief Assistant County Counsel, County Counsel
- Mary Chin, Director of Administration, County Counsel
- Foreperson, Grand Jury
- Darlene J. Bloom, Clerk of the Board of Supervisors

Detailed Results, Findings, Recommendations and Management Responses



Finding 1 – Long Outstanding Checks Not Cleared Timely (Control Finding)

The June 2010 bank reconciliation contained five long outstanding checks, three were outstanding for over two years and two were outstanding approximately one year. These five checks were voided on September 2, 2010. See table below for detail:

Check #	Issue Date	Amount	Void Date
2538	01/25/2008	50.00	09/02/2010
2630	05/21/2008	25.00	09/02/2010
2662	06/23/2008	325.00	09/02/2010
2964	09/23/2009	14.00	09/02/2010
2969	10/02/2009	34.00	09/02/2010

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. Revolving fund bank reconciliations help ensure the accuracy and completeness of revolving fund transactions. Reconciling items, including long outstanding checks should be investigated and resolved in a timely manner.

To avoid unnecessary disputes over late payment, procedures should be in place to follow up with vendors if a check remains outstanding beyond a reasonable duration. Also, long outstanding checks not cleared timely affect the efficiency of preparing the reconciliations as the same items repeat on subsequent reconciliations.

Recommendation No. 1

We recommend County Counsel establish a policy to define the time limit and responsibilities to follow-up long outstanding checks. Also, we recommend County Counsel consider including the check issuance date on the bank reconciliation to facilitate the process on following up on long outstanding checks.

County Counsel Management Response:

Concur. As of the March 2011 reconciliation, we have implemented adding a column for the check issuance date. We have also implemented a new policy of following up on outstanding checks after six months. The reviewer of the bank reconciliations will inform the revolving fund custodian that a check has been outstanding more than six months. At that time, the custodian will cancel the check.

Detailed Results, Findings, Recommendations and Management Responses



Finding 2 – Revolving Fund Reconciliations were not Performed by an Individual with no Other Revolving Fund Duties (Control Finding)

The fund custodian prepares a fund reconciliation each time when preparing a reimbursement request package.

CAM C-7 *Revolving Cash Fund* Section 2.4.5 *Fund Reconciliations* states that, “A reconciliation of the revolving fund shall be performed once per month by a person with no other revolving fund duties.”

Reconciliations performed by the custodian increases the risk of fund misappropriation not being detected.

Recommendation No. 2

We recommend County Counsel consider assigning the fund reconciliation duty to an individual with no other revolving fund duties or implementing detail supervisory review of the fund reconciliation to mitigate risks.

County Counsel Management Response:

Concur. We have developed a new fund reconciliation form and have been using it since the March 2011 fund reconciliation. By September 30, 2011, the same person will perform both the bank reconciliation and fund reconciliation. This person will have no other revolving fund duties.

Finding 3 – Bank Reconciliation Process can be improved to Increase Efficiency (Control Finding ~ Efficiency & Effectiveness)

When preparing bank reconciliations, County Counsel compares the bank balance and check register balance from two different dates, e.g., the dates used for November bank reconciliation were November 30, 2010 and January 11, 2011, respectively.

Standard practice for bank reconciliations is to compare two ending balances of the same reference date; then identify and reconcile any differences.

Because reconciliations are a comparison of data between two sets of records, using data from two records of different dates will result in unnecessary discrepancies, which require resources to investigate and resolve. As a result, it affects efficiency.

Recommendation No. 3

We recommend County Counsel consider revising the current bank reconciliation process, i.e., use same date for bank balance and check register balance, to increase efficiency.

County Counsel Management Response:

Concur. We have implemented this process as of the March 2011 bank statement.



ATTACHMENT A: Report Item Classifications

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

- ▶ **Critical Control Weaknesses:**
Serious audit findings or a combination of Significant Control Weaknesses that represent critical exceptions to the audit objective(s) and/or business goals. Management is expected to address Critical Control Weaknesses brought to their attention immediately.
- ▶ **Significant Control Weaknesses:**
Audit findings or a combination of Control Findings that represent a significant deficiency in the design or operation of internal controls. Significant Control Weaknesses generally will require prompt corrective actions.
- ▶ **Control Findings:**
Audit findings concerning internal controls, compliance issues, or efficiency/effectiveness issues 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.

Detailed Results, Findings, Recommendations and Management Responses



ATTACHMENT B: County Counsel Management Responses



**OFFICE OF THE COUNTY COUNSEL
COUNTY OF ORANGE**

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Santa Ana, California 92701
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NICHOLAS S. CHRISOS
COUNTY COUNSEL

MEMORANDUM

July 28, 2011

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

FROM: Nicholas S. Chrisos, County Counsel
Office of the County Counsel

SUBJECT: Response to Draft Audit Report No. 1055

RECEIVED
INTERNAL AUDIT DEPARTMENT
2011 AUG -2 AM 9:44

Please see our management responses to the draft audit report recommendations below:

Recommendation No. 1

We recommend County Counsel establish a policy to define the time limit and responsibilities to follow-up long outstanding checks. Also, we recommend County Counsel consider including the check issuance date on the bank reconciliation to facilitate the process on following up on long outstanding checks.

County Counsel Management Response: Concur. As of the March 2011 reconciliation, we have implemented adding a column for the check issuance date. We have also implemented a new policy of following up on outstanding checks after six months. The reviewer of the bank reconciliations will inform the revolving fund custodian that a check has been outstanding more than six months. At that time, the custodian will cancel the check.

Recommendation No. 2

We recommend County Counsel consider assigning the fund reconciliation duty to an individual with no other revolving fund duties or implementing detail supervisory review of the fund reconciliation to mitigate risks.

County Counsel Management Response: Concur. We have developed a new fund reconciliation form and have been using it since the March 2011 fund reconciliation. By September 30, 2011 the same person will perform both the bank reconciliation and fund



ATTACHMENT B: County Counsel Management Responses (continued)

Response to Draft Audit Report 1055
July 28, 2011
Page 2

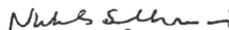
reconciliation. This person will have no other revolving fund duties.

Recommendation No. 3

We recommend County Counsel consider revising the current the bank reconciliation process, i.e., use same date for bank balance and check register balance, to increase efficiency.

County Counsel Management Response: Concur. We have implemented this process as of the March 2011 bank statement.

We want to thank Winnie Keung and Mike Steinhaus for their courteous interactions with our accounting staff. We appreciate the recommendations to help us strengthen our internal controls over County Counsel's Revolving Fund.



MC:mc