



2005 INTERNAL AUDIT REPORT TO THE OC BOARD OF SUPERVISORS

Orange County's Board of Supervisors



**Supervisor
Lou Correa
First District**



**Supervisor
James W. Silva
Second District**



**Board Chairman
Bill Campbell
Third District**



**Vice Chairman
Chris Norby
Fourth District**



**Supervisor
Thomas W. Wilson
Fifth District**

Internal Audit Receives International Award...



June 27, 2005

Dr. Peter Hughes, PhD
Director
Internal Audit Department
County of Orange
400 Civic Center Drive West, Build 12, Room 232
Santa Ana, CA 92701

Dear Dr. Hughes:

Congratulations! We are pleased to provide you formal notification that County of Orange, Internal Audit Department is a recipient of The Institute of Internal Auditors' Recognition of Commitment (ROC). As you know, this honor recognizes internal auditing departments committed to improving the quality of their internal auditing function in the areas of professional excellence, quality of service, and professional outreach. Your auditing function is one of only twelve in the world to receive the recognition in the first half of 2005.

Your local Institute of Internal Auditors (IIA) Chapter leadership will also be notified of the achievement, and in the near future, your organization should be recognized at a local chapter meeting. We hope that your auditing staff will be present during the meeting to receive this most deserving recognition.

The IIA will publicize your accomplishment in some of our publications. Enclosed are two copies of a press release, which you might want to distribute to local media. Letters will be sent to your organization's Chief Executive Officer and the Chairman of the Audit Committee notifying them about the award.

Again, please accept our sincere congratulations on your accomplishment.

Sincerely,

Brian E. Kruk, CIA, CISA, CCSA, CGAP
Director
Quality Audit Services



In this Issue:

- Page 2 - A Message from Orange County's Director of Internal Audit
- Page 3 - Actual and Potential Revenue Recoveries
- Page 6 - The OC Internal Audit Department Receives Award
- Page 7 - 2005 Detailed Achievements
- Page 14 - The Orange County Internal Audit Department



A Message from

**ORANGE COUNTY'S
DIRECTOR OF INTERNAL AUDIT**



**Internal Audit
Director**

**Peter Hughes, Ph.D., MBA,
CPA, CIA, CFE, CITP**

Find us at:

www.ocgov.com/audit

E-mail your comments to:

peter.hughes@ocgov.com

Transparency

The Internal Audit function reports directly to the Board of Supervisors on a monthly basis in a public forum. Additionally, the Internal Audit function reports quarterly to the Board appointed advisory group known as the Audit Oversight Committee.

IAD Mission Statement

The mission of the Internal Audit Department (IAD) is to provide reliable, independent and objective evaluations of business processes to the Board of Supervisors and County management in order to assist them in making business and financial decisions, and to protect and safeguard the County's resources and assets.

Greetings,

We had a very successful and productive year in 2005. We finished over 100 audit projects while providing audit coverage to an impressive eighteen (18) out of twenty-three (23) County departments and agencies.

Of particular noteworthiness is the fact that we are the first County Audit Department in California's history to receive the very prestigious Institute of Internal Auditors' award for excellence. This recognition is only given to the best governmental and corporate internal audit departments in the world.

In addition to this recognition as a "world class" internal audit department, we also achieved another first for the County by realizing for the fifth consecutive year revenue recoveries exceeding six million dollars which is three times our annual budget.

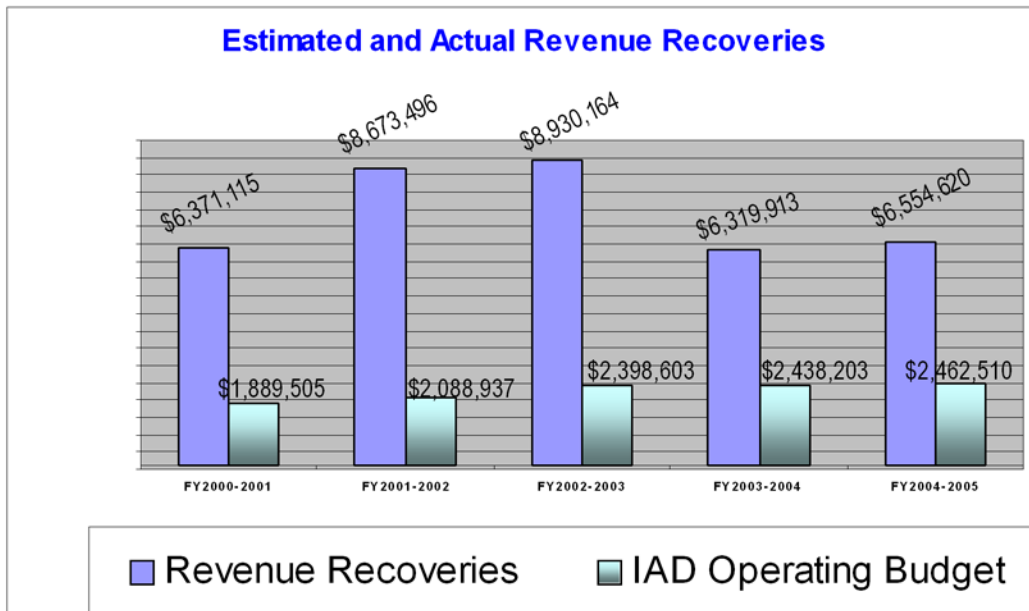
On a personal note, I want to thank my Deputy Director, Eli Littner, my three audit managers, Alan Marcum, Mike Goodwin and Autumn McKinney, my administrative staff and my auditors for their dedication, professionalism and support over the past seven years.

Sincerely

*Dr. Peter Hughes, Ph.D., MBA, CPA,
Director of Internal Audit*

ACTUAL AND POTENTIAL REVENUE RECOVERY

The OC Internal Audit Department aggressively audits and reviews for revenue recoveries whenever the opportunity presents itself. We look for under recovered revenues as a critical component of assisting management in safeguarding the County's assets. We conduct numerous audits of firms contracted by agencies such as John Wayne Airport, Resources Development and Management Department, and the Dana Point Harbor Department to ensure all revenues due to the County are properly calculated and received. In addition, we audit to determine if any double payments to vendors have been mistakenly made and we also look to see if account receivables are being properly recorded and collected.



POSITIVE RATE OF RETURN ON INTERNAL AUDIT

Although the amounts vary each year, the OC Internal Audit Department's economic impact (estimated savings and or actual revenue recoveries) continues to exceed the department's cost by a margin of 300%. This clearly demonstrates our budget is more of an investment that generates an impressive rate of return rather than just a County expense.

California Board of Accountancy



The OC Internal Audit Department has the privilege of staffing Fifteen (15) Certified Public Accountants (CPAs) under the State of California and follows the guidelines of the (AICPA) American Institute of Certified Public Accountants.



The Institute of Internal Auditors

The OC Internal Audit Department has an annual sustaining membership with the Institute of Internal Auditors and 11 of our staff are Certified Internal Auditors (CIA).

The Institute of Internal Auditors, Research Foundation

Dr. Peter Hughes, Ph.D., CPA, Director of Internal Audit, served another term on the IIAs Board of Research and Education for 2005.



NATIONAL ASSOCIATION OF LOCAL GOVERNMENT AUDITORS

National Association of Local Government Auditors (NALGA)

The OC Internal Audit Department also has an annual sustaining membership with NALGA. In 2005, the Department's Integrated Audit of the Auditor-Controller Collections and Accounts Receivable was listed in the Audit Abstracts Category: Integrated Internal Control Audits of the Local Government Auditing Quarterly, Volume 19, Number 1, September 2005 which is published by NALGA.



Association of Certified Fraud Examiners

Several OC Internal Audit Department staff are Certified Fraud Examiners or Specialists (CFE or CFS) and are members of the Association of Certified Fraud Examiners.

PROFESSIONAL ACKNOWLEDGEMENTS



I want to acknowledge the outstanding contributions of my audit professionals as follows: Principal Auditors, Scott Suzuki for designing and implementing a Countywide IT Risk Assessment model and contributions on all IT audits and Nancy Ishida, for her enhancements to the Control Self-Assessment process and assistance in conducting IT audits of the Treasury Office. Also, my appreciation is due to my Senior Auditors: Lily Chin and Winnie Keung for leading and supervising Audit Follow Ups throughout the County and Internal Control Reviews; Camille Gackstetter for her expertise on Treasury Audits and IT assistance: Michael Dean for his expertise and contributions in Control Self-Assessment, Treasury and Internal Control Reviews: Carol Swe for her expertise and contributions in the Computer Assisted Audit Technique Routines, Leasehold and Revenue Audits, Treasury Audits and Internal Control Reviews; Toni Smart for the design and implementation for the newly established Performance Measurement Validation Audits; and to Ken Wong, Susan Nestor, and Abul Khan, our newest auditors, for their expertise and contributions in IT audits and Internal Control Reviews. Next, I want to acknowledge the outstanding contributions of my administrative staff as follows: Vangie Ortiz for her efforts on our strategic business plan, office budget detail, human resource support and office management; Renee Aragon for the preparations and efforts in preparing the monthly reports to the Board, department management support and the quarterly AOC package coordination, assembly, and distribution; Maribel Garcia for the office administration, report distribution and coordination, and departmental support; and Jerry Causey for department IT maintenance and support.

PROFESSIONAL AUDIT STAFF

Director, **Dr. Peter Hughes**, Ph.D., MBA, **CPA**, CIA, CFE, CITP
Deputy Director, **Eli Littner**, **CPA**, CIA, CFE, CFS, CISA
Audit Manager, **Michael J. Goodwin**, **CPA**, CIA
Audit Manager, **Alan Marcum**, MBA, **CPA**, CIA, CFE
Audit Manager, **Autumn McKinney**, **CPA**, CIA, CGFM
Principal Auditor, **Nancy N. Ishida**, **CPA**, CIA, CCSA
Principal Auditor, **Scott M. Suzuki**, **CPA**, CISA, CIA, CFS
Senior Auditor, **Lily Chin**, **CPA**
Senior Auditor, **Michael Dean**, **CIA**, CCSA
Senior Auditor, **Camille A. Gackstetter**, **CPA**
Senior Auditor, **Abdul Khan**, **CPA**
Senior Auditor, **Winnie Y. Keung**, **CPA**
Senior Auditor, **Susan Nestor**, **CPA**, CIA
Senior Auditor, **Toni M. Smart**, **CPA**
Senior Auditor, **Carol L. Swe**, **CPA**, CIA, CCSA
Senior Auditor, **Kenneth Wong**, **CPA**, CIA

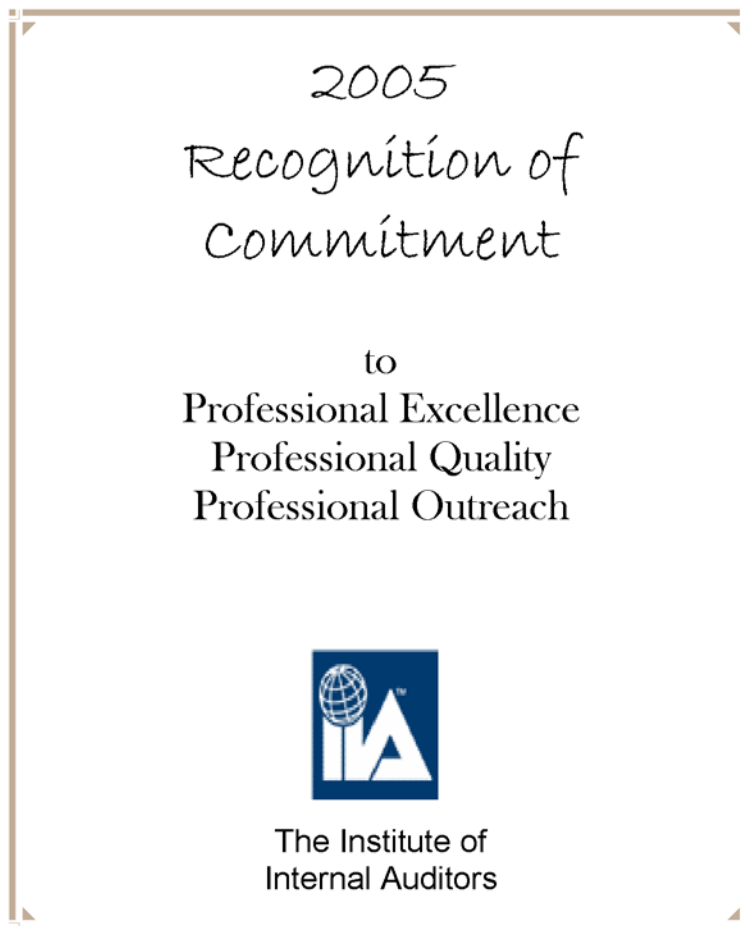
LEGEND

CCSA	Certification Control Self-Assessment
CFE	Certified Fraud Examiner
CFS	Certified Fraud Specialist
CGFM	Certified Government Financial Manager
CIA	Certified Internal Auditor
CISA	Certified Information Systems Auditor
CITP	Certified Information Tech. Professional
CPA	Certified Public Accountant

ADMINISTRATIVE STAFF

Administrative Manager, **Vangie Ortiz**
Systems Analyst, **Jerry Causey**
Executive Secretary, **Renee Aragon**
Secretary II, **Maribel Garcia**

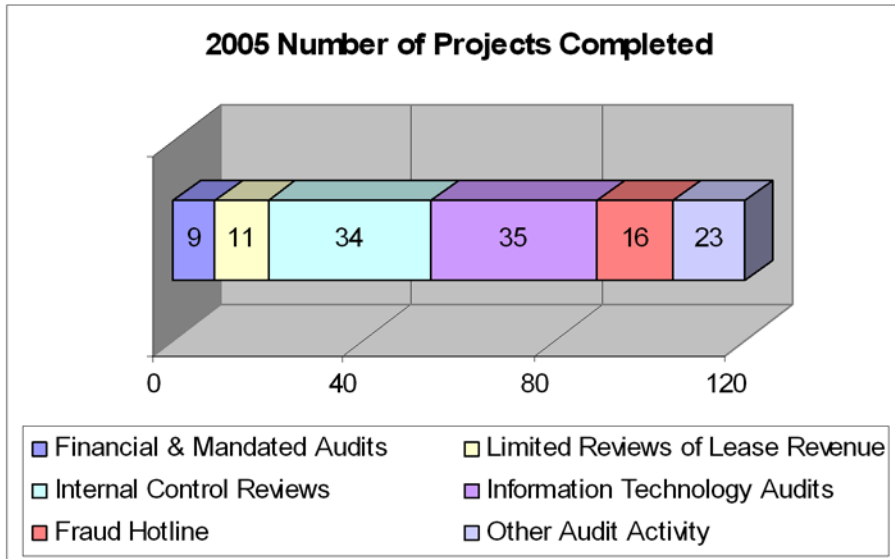
Internal Audit Receives Award



The Internal Audit Department has received the highly prestigious “Recognition of Commitment to Quality Award” from the Institute of Internal Auditors (IIA). On behalf of the OC Board of Supervisors and the Internal Audit Department, Dr. Hughes was presented with a plaque at the IIA’s International Conference on July 12, 2005 in Chicago.

According to the IIA, this award is designed to recognize internal audit departments worldwide that demonstrate excellence in management and performance. The OC Internal Audit Department is the first and only County Audit Department out of 58 counties in California to receive this honor.

2005 DETAILED ACCOMPLISHMENTS



FINANCIAL & MANDATED AUDITS

We completed 9 audits in this category. We audit financial reports for accuracy and completeness. We also conduct reviews to determine managements' compliance with rules and regulations. We completed all financial and mandated audits listed in the 2005 Audit Plan on schedule as follows:

- Treasury Fund Audits for quarters ending 12/31/04, 3/31/05, 6/30/05, and 9/30/05
- Probation Audit
- Tax Redemption Audit
- District Attorney Auto Insurance Fraud Grant Audit
- District Attorney Workers' Compensation Fraud Grant Audit
- District Attorney Spousal Abuser Prosecution Grant Audit

We followed-up on all audit recommendations to ensure they are implemented.



CONTROL SELF-ASSESSMENT (CSA)

We completed 1 in this category. In a CSA, we facilitate workshops in which management and staff target inefficiencies and obstacles in their business operations, as well as identify corrective remedies. We completed one CSA in the Housing and Community Services Department (HCSD) Office on Aging.



BOARD REQUESTED AUDITS OR SPECIAL REQUEST AUDITS

During 2005, Internal Audit performed **two** special request audits/reviews resulting from requests by the Board of Supervisors, the CEO, or Agency/Departments:

1. **Audit of Public Administrator/Public Guardian.** The Public Administrator/Public Guardian became a separate department in July 2005. At the request of the Board of Supervisors, we performed a management and procedural audit to ensure appropriate practices were in place. Processes reviewed were cash receipts and disbursements, trust and revolving funds, warehouse and property controls and the budget process.
2. **Audit of Community Service Programs, Inc.** At the request of the Board of Supervisors, we conducted an audit of the Victim/Witness Assistance program administered by the Community Services Programs, Inc., to analyze the possibility of using District Attorney staff to perform the program in-house.

MONTHLY PRESENTATIONS TO THE BOARD OF SUPERVISORS



Dr. Peter Hughes, CPA, Internal Audit Director, made monthly presentations on audit activity to the Board of Supervisors as part of their Discussion Calendar at their public meetings. These presentations included a summary page of all the audits performed during the month and summarized report findings in those audits. The official audit reports were also provided for public review. Highlights were given to identify material weakness, significant issues or control findings. These heightened presentations gave a level of exposure that provided transparency of the internal auditing process and invited the public to comment.

LIMITED REVIEWS OF LEASE REVENUE

We completed 11 audits in this category. In these reviews, we audit to determine if all revenues due the County are properly calculated, recorded, and received. These reviews are requested by the Resource Development and Management Department (RDMD) and John Wayne Airport (JWA) and are performed on a fiscal year basis.

INTERNAL CONTROL REVIEWS

We completed 34 audits in this category. Internal Control Reviews are audits that determine whether controls and processes are in place over critical business processes in order to accomplish department/agency objective and minimize risks in accomplishing the objectives. Most of our audits review multiple areas, issues, and activities. For example, one audit report may address cash receipts, cash disbursements, as well as selected trust funds. We performed internal control reviews in the following areas during 2005:

-Highlights-
During the course of the year, we audited controls over contract administration, cash receipts, disbursements, budget, trust/agency funds and lease agreements.

- 1) Cash Receipts and Cash Disbursements - **5 completed.** We performed a cash receipts review in the **Public Administrator/Public Guardian** and 4 cash disbursements reviews in the **Orange County Development Agency, the Health Care Agency, the Social Services Agency, and the Public Administrator/Public Guardian.**
- 2) Trust/Agency Funds and Revolving Funds – **2 completed.** We performed reviews of trust funds and special use revolving funds at the **Public Administrator/Public Guardian.**
- 3) Accounts Receivable and Collections— **1 completed.** We completed an Integrated ICR of the **Auditor-Controller** Accounts Receivable and Collections Section where we evaluated both IT and non-IT controls and processes. In 2005, we started a review of accounts receivable and collections in the **Social Services Agency** and expect to complete it in early 2006.
- 4) Procurement and Contract Administration - **2 completed.** We completed two audits of contract administration in the **Health Care Agency** and the **Social Services Agency.** In these audits, we reviewed controls and processes to ensure that contractor invoice payments were adequately supported either through reviews of contractor supporting documentation, contractor expenditure audits, or a combination of both. In 2005, we started an audit of **John Wayne Airport's** Public Works contract administration and expect to complete it in 2006.
- 5) Department/Agency Budget Process Reviews - **6 completed.** We performed reviews in the **Health Care Agency, Public Defender, Public Administrator/Public Guardian, Resources and Development Management Department/Planning and Development Services, Sheriff-Coroner, and the Social Services Agency.**
- 6) Other Internal Control Reviews - We periodically perform reviews of other areas based upon requests or input we received. In 2005, we started a review of the non-sufficient funds (NSF) check notification process to ensure the County and departments/agencies receive timely notice of NSF checks and take appropriate actions to prevent acceptance of subsequent NSF checks. We also started an audit of cash receipts and disbursements at the Orange County Zoo located in Irvine Park.

- 7) *Follow-Up Audits of Internal Control Reviews* - **14 Follow-Up Audits were completed.** Follow-Up Audits are necessary to ensure that audit recommendations from the ICRs are implemented satisfactorily. In 2005, we enhanced our Follow-Up Audit process to perform the First Follow-Up Audit six months from the date of the original audit report. If any items are not fully implemented, a Second Follow-Up Audit is conducted 12 months from the date of the original audit. In most instances, we only do two Follow-Up Audits, but occasionally have exceptions where an additional Follow-Up Audit is needed. In 2005, we conducted Follow-Up Audits in the following departments: **Auditor-Controller, Clerk-Recorder, Child Support Services, HR/Employee Benefits, Health Care Agency, Housing and Community Services Department, Resources and Development Management Department, Social Services Agency,** and the **Sheriff-Coroner.**

- 8) *Follow-Up Audits on Compliance & Other Audits* - **4 Follow-Up Audits were completed.** We performed Follow-Up Audits on audits other than the ICRs. In 2005, we completed Follow-Up Audits in **Resources and Development Management Department/Planning and Development Services, the County Executive Office (CEO)** and the **Auditor-Controller** Budget Process, the County Unemployment Insurance Compensation Reserve Fund #291 (**CEO & Human Resources**), and a HIPAA Compliance Review. A Follow-Up Audit of the **Human Resources** Management Reclassification Process was started in late 2005.

INFORMATION TECHNOLOGY (IT) AUDITS



We completed 35 projects in this category. In these audits, we review controls in a variety of information technology areas including general IT controls, application controls, and systems development. We performed work in the following IT audit areas during 2005:

- 1) *IT Component of a Financial Audit:* As part of the 12/31/04 Treasury Funds Audit, we completed documentation of IT related risks and controls in compliance with SAS 99, implemented a general IT controls rotation testing plan and performed related testing including a review of application controls for the wire transfer process, and a follow-up on IT related finding identified during the prior year (12/31/03) Treasury Funds Audit.
- 2) *IT Component of an Internal Control Review Audit:* We completed a review of application controls for the Auditor-Controller's collections and accounts receivable application (CUBS) and general IT controls for the Auditor-Controller's local area network (LAN).
- 3) *IT Self-Assessment Questionnaire:* We issued a final report for a validation audit performed based upon HCA's voluntary completion of IAD's information technology self-assessment questionnaire (based upon the COBIT model from the Information Systems Audit and Control Association.).

- 4) Follow-Up of IT Audit: We completed 2 First Follow-Up Audits of the Auditor-Controller's Laser Check Printing Application and the Clerk-Recorder's Cashiering System Upgrade. Two additional Follow-Up Audits were started of the Integrated Waste Management Department's LIST Implementation and the CAPS Readiness Assessment and expect to be completed in early 2006.
- 5) Computer Assisted Audit Techniques (CAATs): **We completed 26 projects in this category.** We use a proprietary, state-of-the-art/best practice software product to help us analyze data for payroll and vendor payments. The audit work is commonly known as Computer Assisted Audit Techniques (CAATs). We perform the following CAAT routines on a regular basis:
- Duplicate Vendor Payments: **We conducted 12 monthly computer routines** to identify potential duplicate vendor payments. Since the inception of this routine in May 2002, duplicate payments identified are \$296,511 and amounts recovered are \$233,353.
 - Deleted Vendors: We performed monthly routines to identify vendors deleted or removed from the Vendor Master List.
 - Direct Deposits: During 2005, we were unable to perform the monthly routine reviewing for employees paid twice in the same pay period (utilizing direct deposit data) due to the inaccessibility of certain necessary data. We are partnering with Auditor-Controller/Information Technology staff to determine an effective method of obtaining the required data and expect to resume this routine in early 2006.
 - Annual Risk Assessment: We performed several CAAT routines to obtain financial information (transaction amounts and activity) that we utilize in the annual risk assessment. For example, we compile cash receipt activity by the department that processed the cash receipt rather than by the department/fund where the money was deposited (some departments process monies for other departments).
 - Working Retirees/Extra Help Hours: We did not specifically perform a CAAT routine of working retiree activity during 2005. However, we did review the monitoring performed by the Human Resource Department and available working retiree reports to identify retirees who exceed hour limits for FY 04-05.
- 6) IT Component of a PA/PG Audit: We provided assistance to the Board of Supervisors requested audit of Public Administrator/Public Guardian to gain a high level understanding of their IT environment and mission critical application (ePAGES).

POSITIVE FEED BACK
ON AUDIT SERVICES
PROVIDED DURING
2005

"The auditor was professional courteous and knowledgeable."

"The auditor created a positive atmosphere and his recommendations assisted us in improving our IT operations."

"We look forward to future engagement with Internal Audit."

"The audit process was a very positive experience overall."

"We received valuable information that will assist (us)."

"The auditors more than pay for themselves with their helpful recommendations."

CASH LOSSES



During 2005, **17 cash losses were reported that were each less than \$1,000** and per County policy did not require an investigation by Internal Audit. For cash losses more than \$1,000, the Auditor-Controller requests the Internal Audit Department to review the circumstances surrounding the loss, and to evaluate the adequacy of corrective actions taken to prevent future losses. We continue to see a decrease in cash losses where our assistance is requested. Most cash losses result from counterfeit bills passed to the County.

FRAUD HOTLINE

We processed 16 Hotline incidents: 10 incidents were referred to County departments/agencies for investigation, 2 incidents were referred to the Welfare Fraud Hotline for investigations, 1 was referred to outside agencies, and 3 were information requests and “other” category. To date, 2 of the 10 incidents referred to County departments/agencies for investigation remain open. The enhanced Fraud Hotline process allows employees, vendors and the public to report fraud anonymously by telephone or on-line.

COUNTYWIDE RISK ASSESSMENT

The Internal Audit Department performed a risk assessment for purposes of preparing the 2005 Annual Audit Plan. In 2005, we converted our Annual Audit Plan from a calendar year basis to a fiscal year basis. To accommodate this transition, we expanded our 2005 Annual Audit Plan by six months (for a total of eighteen months) to cover the period 1/1/05-6/30/06. In December 2005, we began preparations for another risk assessment to be conducted in early 2006.



EXTERNAL AUDIT ACTIVITY

We compiled and presented **4 quarterly reports** of all external audits in process throughout the County to the Audit Oversight Committee highlighting material findings. For 2005, we created a summary page for the report to highlight material findings.

PERFORMANCE MEASURE VALIDATIONS

In 2005, we added a new audit area called Performance Measure Validation Audits (PMV) to our Audit Plan. These audits will validate the performance measure results included in the annual business plans produced by the County departments. Two PMV audits were started in 2005, one for the Auditor-Controller and one for John Wayne Airport. We estimate completion in the first quarter of 2006.

HIPAA COMPLIANCE REVIEW & ADMINISTRATION



The Health Insurance Portability and Accountability Act (HIPAA) is a Federal law that protects the privacy of an individual's medical information. Under the law, the Internal Audit Department is considered a designated "covered entity" within the County. The Internal Audit Department has a designated HIPAA Coordinator who attends monthly HIPAA meetings. In 2005, we performed a Follow-Up Audit on our compliance review on the HIPAA Privacy Rule. In April 2005, the HIPAA Security Rule went into effect, which expands the HIPAA requirements in the area of information technology. Internal Audit will continue its involvement in HIPAA and will periodically perform compliance reviews as part of our monitoring function.

CPA AND OTHER PROFESSIONAL CERTIFICATIONS.

During 2005, one employee was certified with the approved experience to be evaluated to receive the Certified Public Accountant (CPA) credential. The appropriate forms and information were sent to the California Board of Accountancy and anticipated approval is expected in early 2006. Three employees continued developing certifying work experience to acquire the Certified Information Systems Auditor (CISA) credential. With involvement and direct oversight in the development of staff, Mr. Eli Littner, Deputy Director, has certified several of our staff in the following designations: CISA, CPA, and CFE/CFS.

INTERNAL CONTROLS TRAINING

The Internal Audit Department is periodically asked by departments to conduct internal controls training for their managers. The presentations are conducted by Internal Audit Director, Dr. Peter Hughes, CPA, and are well received. Training material and information are available on the department website for reference.

STAFF TRAINING

Professional staff completed the minimum continuing professional education required for their professional licenses. Training was received in a variety of topics including government accounting and auditing standards updates, information technology auditing, and computer assisted audit techniques.



THE ORANGE COUNTY INTERNAL AUDIT DEPARTMENT AN INDEPENDENT AND TRANSPARENT DEPARTMENT

The **Internal Audit Department reports directly to the OC Board of Supervisors.**

This reporting structure is unique as Orange County is the only county in the State of California with this reporting relationship. This increased visibility and the Board's continuing support allowed the County of Orange Internal Audit Department to become a **model audit department** within just seven years of operation under the leadership of Dr. Peter Hughes and through the dedication of his staff.

The Board also created the Audit Oversight Committee (AOC).

The AOC is an advisory arm of the Board and is comprised of the Chairman and Vice Chairman of the Board of Supervisors, the County Executive Officer, the Auditor-Controller, and a Public Member. The AOC reviews and approves the Annual Audit Plan as well as selects the peer reviewer. The **OC Internal Audit Department meets quarterly with the AOC and reports on the status of its work.**



WHO AUDITS THE AUDITORS? Other Auditors in a Peer Review.

Have you ever wondered who audits the Orange County internal auditors? Government Code and the audit profession require that auditors be audited at least every three years. This audit is called a Peer Review or Quality Assessment. A Peer Review assesses an audit department's adherence to professional audit standards. The Department was given **the best rating possible** by its independent Peer Reviewers for all **three reviews** in the past five years. These audits were conducted by the internationally recognized firms of Thompson, Cobb, Bazilio and Associates and Jefferson Wells International.



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